NETSMART TECHNOLOGIES INC
Form 10-Q
October 29, 2003

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 September 30, 2003
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 X No__

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes __ No X

Number of shares of common stock outstanding as of October 24, 2003: 4,813,615

Netsmart Technologies, Inc. and Subsidiary

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NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2003 Unaudited	December 31, 2002
Assets:		
Current Assets:		
Cash and Cash Equivalents	$11,752,518	$ 7,251,740
Accounts Receivable - Net	6,241,107	7,058,855
Costs and Estimated Profits in Excess of Interim Billings	2,539,125	3,857,522
Deferred taxes	918,000	459,000
Other Current Assets	509,896	337,719
Total Current Assets	21,960,646	18,964,836
Property and Equipment - Net	697,028	364,306

Other Assets:		
Software Development Costs - Net	1,025,300	382,387
Customer Lists - Net	2,851,049	2,141,855
Deferred taxes less current portion	882,000	441,000
Other Assets	215,984	121,419
Total Other Assets	4,974,333	3,086,661
Total Assets	$27,632,007	$22,415,803

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2003 Unaudited	December 2002
Liabilities and Stockholders' Equity:		
Current Liabilities:		
Current Portion - Long Term Debt	$ 666,667	$ 500
Current Portion Capital Lease Obligations	62,840	9
Accounts Payable	849,042	1,166
Accrued Expenses	1,480,459	1,063
Interim Billings in Excess of Costs and Estimated Profits	6,577,025	5,914
Deferred Revenue	733,295	1,095
Total Current Liabilities	10,369,328	9,749
Capital Lease Obligations - Less current portion	101,314	1
Long Term Debt - Less current portion	1,166,684	1,250
Interest Rate Swap at Fair Value	75,082	107
Total Non Current Liabilities	1,343,080	1,359

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 5,001,505 shares at September 30, 2003 and 4,046,430 at December 31, 2002	50,015	40
Additional Paid in Capital	24,390,549	21,411
Unearned Compensation	--	(14
Accumulated Comprehensive loss - Interest Rate Swap	(75,082)	(107
Accumulated Deficit	(7,037,103)	(9,375
	17,328,379	11,954
Less: cost of shares of Common Stock held in treasury - 205,220 shares at September 30, 2003 and 89,797 at December 31, 2002	1,408,780	648
Total Stockholders' Equity	15,919,599	11,306
Total Liabilities and Stockholders' Equity	$ 27,632,007	$ 22,415

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME - (Unaudited)

	Nine Months ended September 30,		Three mont Septemb
	2003	2002	2003
Revenues:			
Software and Related Systems and Services:			
General	$ 13,060,682	$ 10,361,414	$ 4,799,001
Maintenance Contract Services	5,283,395	4,521,469	1,796,190
Total Software and Related Systems and Services	18,344,077	14,882,883	6,595,191
Data Center Services	1,471,785	1,438,254	512,482
Total Revenues	19,815,862	16,321,137	7,107,673
Cost of Revenues:			

Software and Related Systems and Services:			
General	8,165,333	7,457,227	2,833,193
Maintenance Contract Services	2,600,031	2,660,630	860,130
Total Software and Related Systems and Services	10,765,364	10,117,857	3,693,323
Data Center Services	793,741	794,327	262,065
Total Cost of Revenues	11,559,105	10,912,184	3,955,388
Gross Profit	8,256,757	5,408,953	3,152,285
Selling, General and Administrative Expenses	5,100,127	3,799,164	1,820,403
Research and Development	1,509,377	992,557	566,350
Total	6,609,504	4,791,721	2,386,753
Income from Operations before Interest	1,647,253	617,232	765,532
Interest Income	52,409	32,847	21,781
Interest and Other Expense	150,991	158,823	49,154
Income before Income Tax Expense (Benefit)	1,548,671	491,256	738,159
Income Tax Expense (Benefit)	(790,000)	44,000	(808,000)
Net Income	$ 2,338,671	$ 447,256	$ 1,546,159
Earnings Per Share of Common Stock:			
Basic:			
Net Income	$ .56	$ .12	$ .34
Weighted Average Number of Shares of Common Stock Outstanding	4,159,740	3,696,159	4,512,891
Diluted:			
Net Income	$ .52	$ .11	$ .33
Weighted Average Number of Shares of Common Stock and Common Stock Equivalents Outstanding	4,468,963	4,062,130	4,706,257

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)

	Nine Months ended September 30,	
	2003	2002
Operating Activities:		
Net Income	$ 2,338,671	$ 447,256
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	870,298	772,280
Bad Debt Expense	125,000	183,413
Amortization of Warrants Issued for Services and Costs Related to Warrant Extension	20,736	32,073
Deferred Taxes	(900,000)	--
Changes in Assets and Liabilities:		
[Increase] Decrease in:		
Accounts Receivable	692,748	(295,915)
Costs and Estimated Profits in Excess of Interim Billings	1,318,397	(232,568)
Other Current Assets	(313,319)	103,023
Other Assets	33,768	20,368
Increase [Decrease] in		
Accounts Payable	(317,103)	53,739
Accrued Expenses	551,234	459,630
Interim Billings in Excess of Costs and Estimated Profits	600,795	82,304
Deferred Revenue	(362,117)	194,862
Total Adjustments	2,320,437	1,373,209
Net Cash Provided by Operating Activities	4,659,108	1,820,465
Investing Activities:		
Acquisition of Property and Equipment	(356,221)	(162,210)
Net Cost of CareNet Acquisition	(1,047,845)	--
Net Cash Used In Investing Activities	(1,404,066)	(162,210)

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - (Unaudited)

	Nine Months ended September 30,	
	2003	2002
Financing Activities:		
Payments on Capitalized Lease Obligations	$ (30,922)	$ (27,390)
Net Proceeds from Stock Options and Warrants Exercised	2,134,766	9,550
Payments on Term Loans	(416,661)	(374,994)
Dividend Paid	(441,447)	--
Net Cash Provided By (Used in) Financing Activities	1,245,736	(392,834)
Net Increase in Cash and Cash Equivalents	4,500,778	1,265,421
Cash and Cash Equivalents - Beginning of Period	7,251,740	3,837,226
Cash and Cash Equivalents - End of Period	$ 11,752,518	$ 5,102,647
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest	$ 153,780	$ 161,638
Income Taxes	$ 99,587	$ 23,992

Non Cash Investing and Financing Activities:
The fair value of the interest rate swap decreased by $32,631 for the nine months ended September 30, 2003. The fair value of the interest rate swap increased by $38,255 for the nine months ended September 30, 2002.

The Company acquired equipment in the amount of $183,326 in connection with a capital lease during the nine months ended September 30, 2003.

During the nine months ended September 30, 2003, the Company received 115,423 shares of its common stock as consideration for the exercise of certain stock options. The value of the shares received was $760,668, which was the market value of the common stock on the date of exercise.

During the nine months ended September 30, 2003, the Company issued 100,000 shares of common stock in connection with its acquisition of CareNet acquisition. See Note 13. These shares were valued at $528,000, which was based upon the average stock price three days before and after the acquisition was agreed to and announced. The Company also issued a $500,000 three-year promissory note and assumed contract obligations and vacation liabilities totaling $68,068.

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - (UNAUDITED)

	Common Stock		Additional Paid-in Capital			Accumulated Comprehensive Loss	
	Shares	Amount	Common Stock	Unearned Compensation	Accumulated Deficit	Interest Rate Swap	Comprehensi Income
Balance - January 1, 2003	4,046,430	$40,464	$21,411,777	$(14,400)	$(9,375,774)	$(107,713)	
Common Stock Issued - Exercise of Options	565,075	5,651	1,403,953				
Common Stock Issued - Exercise of Warrants	290,000	2,900	1,482,930				
Common Stock Issued - Acquisition	100,000	1,000	527,000				
Cost Related to Warrant Extension			6,336				
Change in Fair Value of Interest Rate Swap						32,631	$ 32,631
Treasury Shares from Cashless Exercise of Stock Options							
Amortization of Warrants Issued for Services				14,400			

Dividends			(441,447)				
Net Income					2,338,671		2,338,671
							$2,371,302
Balance - September 30, 2003	5,001,505	$50,015	$24,390,549	$ --	$(7,037,103)	$ (75,082)	

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Financial Statements

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 September 30, 2003 and the results of its operations for the nine and three months ended September 30, 2003 and 2002 and the changes in cash flows for the nine months ended September 30, 2003 and 2002. The results of operations for the nine and three months ended September 30, 2003 are not necessarily indicative of the results to be expected for the full year.

(2) Accounting Policies

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/A for the year ended December 31, 2002.

(3) Earnings Per Share

The following table sets forth the components used in the computation of basic and diluted earnings per share:

	Nine Months Ended September 30,		Three M
	2003	2002	
Numerator:			
Net income	$ 2,338,671	$ 447,256	$

Denominator:			
Weighted average shares	4,159,740	3,696,159	
Effect of dilutive securities:			
Employee stock options	307,086	364,176	
Stock warrants	2,137	1,795	
Dilutive potential common shares	309,223	365,971	
Denominator for diluted earnings per share-adjusted weighted average shares after assumed conversions	4,468,963	4,062,130	

(4) Stock Options and Similar Equity Instruments

At September 30, 2003, the Company had three stock-based employee compensation plans. As permitted under SFAS No. 148, "Accounting for Stock-Based Compensation--Transition and Disclosure", which amended SFAS No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation", the Company has elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangements, as defined by Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees", and related interpretations including Financial Accounting Standards Board Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of APB No. 25. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the

date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation:

	Nine Months Ended September 30,		T
	2003	2002	
Net Income as Reported	$ 2,338,671	$ 447,256	
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of related tax effect	573,649	140,179	
Pro Forma Net Income	$ 1,765,022	$ 307,077	
Basic Net Income Per Share as Reported	$. 56	$ .12	

Basic Pro Forma Net Income Per Share	$ .42	$ .08
Diluted Net Income Per Share as Reported	$ .52	$ .11
Diluted Pro Forma Net Income Per Share	$ .39	$ .08

The fair value of options at date of grant was estimated using the Black-Scholes fair value based method with the following weighted average assumptions:

	Nine Months Ended	
	September 30,	September 30,
	2003	2002
Expected Life (Years)	5.04	5
Interest Rate	4%	4%
Annual Rate of Dividends	--%	--%
Volatility	66%	63%

The weighted average fair value of options at date of grant using the fair value based method during 2003 and 2002 is estimated at $2.38 and $1.41 respectively.

(5) Income Taxes

The provision for income taxes for the period ended September 30, 2003, consists of a current provision of $110,000. The current income tax provision was reduced by $780,000 as a result of the use of available net operating losses. The deferred tax asset and valuation allowance were reduced by the same amount. During the September 2003 period, the Company recognized an additional $900,000 benefit from a reduction in its deferred tax asset valuation allowance associated with its net operating loss carry forwards.

(6) Stockholders' Equity

On January 27, 2003, following stockholder approval of the amendment to its 2001 Plan to increase the number of shares of common stock available for issuance pursuant to the 2001 Plan, the Company granted to employees options to purchase

217,500 shares under the 2001 Plan at a price per share of $4.93, which was the fair market value at the date of grant. On May 22, 2003, the Company granted to employees additional options to purchase 152,500 shares under the 2001 Plan at a price per share of $4.37, which was the fair market value at the date of grant. On August 12, 2003, the Company granted to employees additional options to purchase 8,250 shares and 2,750 under the 1999 Plan and the 1998 Plan, respectively, at a price per share of $6.61, which was the fair market value at the date of grant. The majority of the options granted to date under the above Plans vest 50% after six months and 100% after one year.

On February 27, 2003, the Board of Directors authorized management to purchase up to $100,000 of the Company's common stock at any time the market price of the common stock is less than $3.50 per share. Purchases of stock will be made from time to time, depending on market conditions, in open market or in privately

negotiated transactions, at prices deemed appropriate by management. There is no set time limit on the purchases. The Company expects to fund any stock repurchases from its operating cash flow. As of September 30, 2003, the Company had not made any stock repurchases.

During the nine months ended September 30, 2003, warrants to purchase 290,000 shares were exercised and the Company received gross proceeds of $1,543,500. During the nine month ended September 30, 2003, options to purchase 565,075 shares were exercised and the Company received gross proceeds of $1,409,604. Included in the gross proceeds received from the exercise of options was the delivery of 115,423 shares of the Company's common stock, which were valued at $760,668, which was based upon the market price of the common stock on the date of the exercise in accordance with the cashless exercise provisions of the Company's stock option plans.

Included in the above options exercised were 320,000 options owned by certain of the Company's Officers and members of the Board of Directors. These options were exercised by delivery of 88,295 shares of the Company's common stock valued at $561,295, which was based upon the market price of the common stock on the date of exercise in accordance with the cashless exercise provisions of the Company's stock option plans.

In January 2003, the expiration date of the company's Series B warrants to purchase 448,535 shares of common stock at $12.00 per share were extended from January 31, 2003 to April 30, 2003. In April 2003, the Company agreed to extend the expiration date of these same warrants from April 30, 2003 to July 31, 2003. The Company re-measured the fair value of the warrants at the dates of extension. No financing costs were recorded associated with the warrant extensions made in January 2003, as there was no material change in their fair value. The Company charged $1,125 to operations related to the warrant extension made in April 2003. In July 2003, the Company agreed to extend the expiration date of these same warrants from July 31, 2003 to October 31, 2003. The Company re-measured the fair value of the warrants at the date of extension and charged $5,211 of financing costs to operations in July 2003.

(7) Operating Segments

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

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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:

Nine Months Ended September 30,	Software and Related Systems and Services	Data Center Services

2003		
Revenue	$ 18,344,077	$ 1,471,785
Income before income taxes	1,220,333	328,338
Total identifiable assets at September 30, 2003	25,324,692	2,307,315
Nine Months Ended September 30,		
2002		
Revenue	$ 14,882,883	$ 1,438,254
Income before income taxes	254,815	236,441
Total identifiable assets at September 30, 2002	17,233,292	1,651,111
Three Months Ended September 30,		
2003		
Revenue	$ 6,595,191	$ 512,482
Income before income taxes	595,906	142,253
Three Months Ended September 30,		
2002		
Revenue	$ 5,560,908	$ 482,859
Income before income taxes	130,714	88,843

(8) New Accounting Pronouncements

In April 2002, the FASB 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 requires that gains and losses from extinguishment of debt be classified as extraordinary items only if they meet the criteria in Accounting Principles Board Opinion No. 30 ("Opinion No. 30"). Applying the provisions of Opinion No. 30 will distinguish transactions that are part of an entity's recurring operations from those that are unusual and infrequent that meet the criteria for classification as an extraordinary item. The Company adopted SFAS No. 145 during the first quarter of fiscal 2003. The adoption of this standard did not have a material effect on the Company's consolidated financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)". SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value when the liability is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of this standard did not have a material effect on the Company's consolidated financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, ("FIN 45") "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect

Guarantees of Indebtedness of Others." FIN 45 requires a company, at the time it issues a guarantee, to recognize an initial liability for the fair value of obligations assumed under the guarantee and elaborates on existing disclosure requirements related to guarantees and warranties. The initial recognition requirements of FIN 45 are effective for guarantees issued or modified after December 31, 2002. The Company's adoption of the recognition requirements of FIN 45 did not have a material effect on its consolidated financial position or results of operations.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after December 15, 2003. The Company does not expect the adoption of FIN 46 to have a material effect on its consolidated financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This Statement amends and clarifies SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities." This statement clarifies the accounting guidance on (1) derivative instruments (including certain derivative instruments embedded in other contracts) and (2) hedging activities that fall within the scope of the SFAS 133. SFAS 149 also amends certain other existing pronouncements, which will result in more consistent reporting of contracts that are derivatives in their entirety or that contain embedded derivatives that warrant separate accounting. SFAS 149 is effective (1) for contracts entered into or modified after September 30, 2003, with certain exceptions, and (2) for hedging relationships designated after September 30, 2003. The guidance is to be applied prospectively. The Company does not expect the adoption of SFAS No. 149 to have a material impact on its consolidated financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 addresses certain financial instruments that, under previous guidance, could be accounted for as equity, but now must be classified as liabilities in statements of financial position. These financial instruments include: 1) mandatorily redeemable financial instruments, 2) obligations to repurchase the issuer's equity shares by transferring assets, and 3) obligations to issue a variable number of shares. SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The Company is evaluating the impact that the adoption of SFAS No. 150 will have on its consolidated financial position and results of operations.

(9) Reclassifications

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform to the presentation in the current year financial statements. These reclassifications have no effect on previously reported income.

(10) Acquisitions

On June 25, 2003, the Company acquired substantially all of the assets of the CareNet segment ("CareNet") of Shuttle Data Systems Corporation, d/b/a Adia Information Management Corp. ("Adia"), pursuant to an asset purchase agreement dated June 25, 2003, among the Company, Adia and Steven Heintz, Jr., the president and majority shareholder of Adia. The principal assets acquired were the intellectual property and customer contracts of CareNet. The total purchase

price, including acquisition costs, was $2,003,913 which consisted of 100,000 shares of common stock of the Company valued at $528,000, $838,740 in cash and a three-year promissory note in the principal amount of $500,000 payable in 36 equal monthly installments of principal plus interest at the average prime rate plus 1% as defined in the note agreement. Adia has received certain piggyback registration rights with respect to these 100,000 shares. The cash portion of the purchase price was paid out of existing working capital. The Company also assumed certain contractual obligations and liabilities totaling $68,068 and incurred $69,105 in legal and accounting costs which are included in the purchase price.

In addition, in connection with the acquisition, the Company entered into a non-compete and non-solicitation agreement with Steven Heintz, Jr. and Jennifer Lindbert for which they were paid a fee of an aggregate $140,000, which fee was paid in cash out of existing working capital and is included in "other assets" on the balance sheet.

The cost of the acquisition was allocated to purchased software in the amount of $883,075, customer lists in the amount of $1,097,138, covenant not to compete in the amount of $140,000 and computer hardware in the amount of $23,700. The Company is amortizing the purchased software over an eight-year life and the customer lists over a nine-year life. The covenant not to compete is currently being amortized over a three-year life.

The Company accounted for this acquisition pursuant to the purchase method of accounting. For accounting purposes the Company recorded the assets and related liabilities of CareNet effective as of June 30, 2003. The Company incorporated the operations of CareNet into its operations commencing July 1, 2003.

The following unaudited proforma condensed consolidated statements of operations assumes the CareNet acquisition occurred on January 1, 2002. In the opinion of management, all adjustments necessary to present fairly such unaudited proforma statements have been made.

	Nine months ended September 30, (in 000's except Per Share Data)	
	2003	2002
Revenue	$20,171	$16,776
Net Income	$ 2,349	$ 428
Net Income Per Share - Basic	$ .55	$ .11
Diluted	$ .51	$ .10

(11) Dividends

In July 2003, the Company's Board of Directors approved a cash dividend of $0.10 per share of common stock which was paid in September 2003 to all stockholders of record on August 20, 2003. The amount charged to surplus in August 2003, based upon the shares outstanding on August 20, 2003, the record date for the dividend, was $441,447.

(12) Legal Proceedings

In October 2002, the Company commenced an action against the City of Richmond, in 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. On July 29, 2003, this action was settled and the Company received an amount of $205,000. This settlement had no material adverse effect on the results of operations of the Company.

(13) Commitments and Contingencies

The Company plans to relocate its Islip, New York headquarters facility to a larger facility in Great River, New York. The Company is party to a lease agreement that was signed by the Company on September 25, 2003. The lease is for a ten year and ten month period and calls for fixed rent payments of $5.8 million over the ten year and ten month period. The actual commencement date of the lease is dependent upon the ability of the landlord to deliver possession of the property to the Company. Included in the terms and conditions of the lease is the requirement of the Company to provide to the Landlord a letter of credit in the amount of $292,980, which represents approximately six months rent. The letter of credit was provided to the landlord on October 31, 2003. The letter of credit is required for the first 22 months of the lease and will be reduced as follows:

$244,150 for months 23 through 34 of the lease.
$195,320 for months 35 through 46 of the lease.
$146,490 for months 47 through 58 of the lease.
$97,660 for months 59 to the expiration of the lease.

The letter of credit will expire in September 2004, at which time the Company is required to renew the letter of credit per the above terms.

(14) Major Customers

During the nine months ended September 30, 2003 and 2002, no one customer accounted for more than 10% of revenue. During the three months ended September 30, 2003, one customer accounted for approximately $890,000 or 13% of revenue. The account receivable from this customer at September 30, 2003 was $89,000 or 1% of the total accounts receivable. No one customer accounted for more than 10% of revenue for the three months ended September 30, 2002.

(15) Subsequent Event

On October 23, 2003, the Company reduced the exercise price of its Series B Common Stock Purchase Warrants from $12.00 per share to $10.00 per share. These warrants will not be extended beyond their maturity date of October 31, 2003. As of October 29, 2003, 8,500 warrants have been exercised and the Company has received gross proceeds in the amount of $85,000.

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

Overview

Our operations are grouped into two segments:

|*| Software and Related Systems and Services
|*| Data Center [service bureau services]

Results of Operations

Fixed price software development contracts and licenses accounted for 44% of consolidated revenue for both of the nine-month periods ended September 30, 2003 and 2002. We recognize revenue for fixed price contracts using the percentage of completion method. 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 costs and estimated profits. Revenue from fixed price software development contracts is determined using the percentage of completion method which 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. Our time spent on projects during the second half of the year generally ranges from 1% to 3% less than time spent on projects during the first half of the year.

Nine months ended September 30, 2003 and 2002

Our total revenue for the nine months ended September 30, 2003 (the "September 2003 period") was $19,816,000, an increase of $3,495,000, or 21%, from our revenue for the nine months ended September 30, 2002 (the "September 2002 period"), which was $16,321,000. Revenue from contracts from government agencies represented 59% of revenue in the September 2003 period and 53% of revenue in the September 2002 period. This reflects an increase in new government contracts, primarily relating to contracts with two new county agencies.

Software and Related Systems and Services

Our Software and Related Systems and Services revenue for the September 2003 period was $18,344,000, an increase of $3,461,000, or 23%, from our revenue for the September 2002 period, which was $14,883,000. Software and related systems and services revenue is comprised of turnkey systems labor revenue, revenue from sales of third party hardware and software, license revenue, maintenance revenue and revenue from small turnkey systems.

The largest component of revenue was turnkey systems labor revenue, which increased to $7,131,000 in the September 2003 period, from $5,357,000 in the September 2002 period, reflecting a 33% increase. Turnkey systems labor revenue refers to labor associated with turnkey installations and includes categories such as training, installation, project management and development. This increase was substantially the result of an increase in spending for information systems in the human services marketplace and our ability to provide the staff necessary to generate additional revenue. Labor rate price changes from September 2003 period to the September 2002 period resulted in a 13% increase in the average daily billing rate and accounted for approximately $441,000, or 25%,

of the total turnkey systems labor increase. The acquisition of the operations of CareNet accounted for $191,000 or 11% of the total turnkey systems labor increase. Revenue from third party hardware and software increased to $3,470,000 in the September 2003 period, from $2,964,000 in the September 2002 period, which represents an increase of 17%. 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 human services revenue. License revenue increased to $1,877,000 in the September 2003 period, from $1,388,000 in the September 2002 period, reflecting an increase of 35%. License revenue is generated as part of a sale of a human services information system pursuant to a contract or purchase order that includes delivery of the system and maintenance. This increase in license revenue was the result of an increase in spending for

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information systems in the human services marketplace. Maintenance revenue increased to $5,283,000 in the September 2003 period, from $4,521,000 in the September 2002 period, reflecting an increase of 17%. As turnkey systems are completed, they are transitioned to the maintenance division, thereby increasing our installed base. Revenue from the sales of our small turnkey division decreased to $583,000 in the September 2003 period, from $653,000 in the September 2002 period, reflecting a decrease of 11%. This decrease is the result a redirection of our sales efforts to larger turnkey sales. Small turnkey division sales relate to turnkey contracts that are less than $50,000 and are usually completed within one month.

Gross profit increased to $7,578,000 in the September 2003 period from $4,765,000 in the September 2002 period, reflecting an increase of 59%. Our gross margin percentage increased to 41% in the September 2003 period from 32% in the September 2002 period. Our gross margins have increased primarily as a result of increased maintenance and license revenue and, to a lesser extent, an increase in our labor revenue. Our infrastructure costs with respect to our maintenance division are substantially in place and as new maintenance revenue occurs, our gross profit margins are improved accordingly.

Data Center

Data center clients typically generate approximately the same amount of revenue each year. We bill on a transaction basis or on a fixed fee arrangement. Historically, each year, we increase the transaction or fixed fees by an amount that approximates the New York urban consumer price index increase. The data center revenue increased to $1,472,000 in the September 2003 period, from $1,438,000 in the September 2002 period, representing an increase of $34,000, or 2%. This increase was due to an increase in the client base.

Gross profit increased to $678,000 in the September 2003 period from $644,000 in the September 2002 period, reflecting an increase of 5%. Our gross margin percentage increased to 46% in the September 2003 period from 45% in the September 2002 period. This increase was the result of the increase in revenue with no additional increase in costs.

Operating Expenses

Selling, general and administrative expenses were $5,100,000 in the September 2003 period, reflecting an increase of $1,301,000, or 34%, from the $3,799,000 in the September 2002 period. This increase was in the area of sales and marketing salaries and commissions, which increased by $381,000; advertising and promotion, which increased by $145,000; an increase in general and administrative salaries, which increased by $237,000; and provisions for bonuses, which increased by $465,000.

We incurred product development expenses of $1,509,000 in the September 2003 period, an increase of 52% from the $993,000 in September 2002 period. The increase in product development expense is the result of continuing investment in product enhancement and extensions. These extensions include the development of new software modules including Minimum Data Set (MDS) reporting, which is designed to address Federal reporting requirements, and a Computerized Physician Order Entry (CPOE) module, as well as continued investment in core products including a new version of our addictions management software products. These amounts have been appropriately accounted for in accordance with SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed."

Interest and other expense was $151,000 in the September 2003 period, a decrease of $8,000, or 5%, from the $159,000 in the September 2002 period. This decrease is the result of reduced borrowing during the September 2003 period.

Interest income was $52,000 in the September 2003 period, an increase of $20,000, or 60%, from 33,000 in the September 2002 period. Interest income is generated from short-term investments made with a substantial portion of the proceeds received from the term loan, as well as cash generated from operations.

We have a net operating loss tax carry forward of approximately $6.95 million. In the September 2003 period, we recorded a current income tax expense of $110,000, which related to various state and local taxes, as well as a provision for the Federal alternative minimum tax. The current income tax provision was reduced by $780,000 as a result of the use of available net operating losses. The deferred tax asset and the valuation allowance were reduced by the same amount. We also re-evaluated the deferred tax asset valuation allowance and further reduced the allowance by $900,000, which was recorded as a tax benefit. In the September 2002 period we provided for taxes in the amount of $44,000. This provision was based upon certain state taxes.

As a result of the foregoing factors, in the September 2003 period, we had net income of $2,339,000, or $.56 per share (basic) and $.52 per share (diluted). For the September 2002 period, we had net income of $447,000, or $.12 per share (basic) and $.11 per share (diluted).

Three Months Ended September 30, 2003 and 2002

Results of Operations

Fixed price software development contracts and licenses accounted for 39% of consolidated revenue for the three months ended September 30, 2002 (the "September 2003 quarter") and 48% of consolidated revenue for the three months ended June 30, 2002 (the "September 2002 quarter"). We recognize revenue for fixed price contracts on the percentage of completion method. 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. Revenue from fixed price software development contracts is determined using the percentage of completion method which 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. Our time spent on projects during the second half of the year generally ranges from 1% to 3% less than time spent on projects during the first half of the year.

Our total revenue for the September 2003 quarter was $7,108,000, an increase of $1,064,000, or 18%, from our revenue for the September 2002 quarter, which was $6,044,000. Revenue from contracts from government agencies represented 54% of revenue in the September 2003 quarter and 53% of revenue in the September 2002 quarter. This reflects an increase in new government contracts, primarily relating to contracts with two new county agencies. Revenue from one client, Hennepin County, accounted for 12.5% of total consolidated revenue for the September 2003 quarter. No one client accounted for more than 10% of total consolidated revenue for the September 2002 quarter.

Software and Related Systems and Services

Our Software and Related Systems and Services revenue for the September 2003 quarter was $6,595,000, an increase of $1,034,000, or 19%, from our revenue for the September 2002 quarter, which was $5,561,000. Software and related systems and services revenue is comprised of turnkey systems labor revenue, revenue from sales of third party hardware and software, license revenue, maintenance revenue and revenue from small turnkey systems.

The largest component of revenue was turnkey systems labor revenue, which increased to $2,631,000 in the September 2003 quarter or 46%, from $1,808,000 in the September 2002 quarter. Turnkey systems labor revenue refers to labor associated with turnkey installations and includes categories such as training, installation, project management and development. This increase was substantially the result of an increase in spending for information systems in

the human services marketplace and our ability to provide the staff necessary to generate additional revenue. Labor rate price changes from September 2003 quarter to the September 2002 quarter resulted in an 11% increase in the average daily billing rate and accounted for approximately $114,000, or 14%, of the total turnkey systems labor increase. The acquisition of the operations CareNet accounted for $191,000 or 23% of the total turnkey systems labor increase. Revenue from third party hardware and software decreased to $1,324,000 in the September 2003 quarter, from $1,586,000 in the September 2002 quarter, which represents a decrease of 17%. This decrease was primarily the result of a large sale of computer hardware of approximately $686,000 made to a client in the September 2002 period. 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 human services revenue. License revenue increased to $632,000 in the September 2003 quarter, from $476,000 in the September 2002 quarter, reflecting an increase of 33%. License revenue is generated as part of a sale of a human services information system pursuant to a contract or purchase order that includes delivery of the system and maintenance. This increase in license revenue was the result of an increase in spending for information systems in the human services marketplace. Maintenance revenue increased to $1,796,000 in the September 2003 quarter, or 20%, from $1,499,000 in the September 2002 quarter. As turnkey systems are completed, they are transitioned to the maintenance division, thereby increasing our installed base. Revenue from the sales of our small turnkey division increased to $212,000 in the September 2003 quarter, from $192,000 in the September 2002 quarter, reflecting an increase of 10%. This increase is the result of sales of our new Avatar Addictions Management product introduced during the September 2003 quarter. Small turnkey division sales relate to turnkey contracts that are less than $50,000 and are usually completed within one month.

Gross profit increased to $2,902,000 in the September 2003 quarter from $1,665,000 in the September 2002 quarter, reflecting an increase of 74%. Our gross margin percentage increased to 44% in the September 2003 quarter from 30%

in the September 2002 quarter. Our gross margins have increased as a result of increased maintenance and license revenue and to a lesser extent, an increase in our labor revenue. Our infrastructure costs with respect to our maintenance division are substantially in place and as new maintenance revenue occurs, our gross profit margins are improved accordingly.

Data Center

Data center clients typically generate approximately the same amount of revenue each year. We bill on a transaction basis or on a fixed fee arrangement. Historically, each year, we increase the transaction or fixed fees by an amount that approximates the New York urban consumer price index increase. The data center revenue increased to $512,000 in the September 2003 quarter, from $483,000 in the September 2002 quarter, representing an increase of $30,000, or 6%. The increase in revenue was primarily due to an increase in the client base.

Gross profit increased to $250,000 in the September 2003 quarter from $215,000 in September 2002 quarter, reflecting an increase of 16%. Our gross margin percentage increased to 49% in the September 2003 quarter from 45% in the September 2002 quarter. This increase was the result of an increase in revenue with no corresponding increase in costs.

Operating Expenses

Selling, general and administrative expenses were $1,820,000 in the September 2003 quarter, reflecting an increase of $506,000, or 38%, from the $1,315,000 in the September 2002 quarter. This increase was in the area of sales and marketing salaries and commissions, which increased by $132,000; advertising and promotion, which increased by $62,000; an increase in general and administrative salaries, which increased by $75,000; an increase in the provisions for bonuses, which increased by $166,000 and the addition of the amortization of the CareNet acquisition which was $70,000 in the September 2003 quarter and was not present in the September 2002 quarter.

We incurred product development expenses of $566,000 in the September 2003 quarter, an increase of 84% from the $308,000 in September 2002 quarter. The increase in product development expense is the result of continuing investment in product enhancement and extensions. These extensions include the development of new software modules including Minimum Data Set (MDS) reporting, which is designed to address Federal reporting requirements and a Computerized Physician Order Entry (CPOE) module as well as continued investment in core products including a new version of our addictions management software products. These amounts have been appropriately accounted for in accordance with SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed."

Interest and other expense was $49,000 in the September 2003 quarter, a decrease of $1,000, or 2%, from the $50,000 in the September 2002 quarter. This decrease is the result of reduced borrowing during the September 2003 period and was partially offset by interest associated with a new capitalized lease arrangement.

Interest income was $22,000 in the September 2003 quarter, an increase of $9,000, or 76%, from $12,000 in the September 2002 quarter. Interest income is generated from short-term investments made with a substantial portion of the proceeds received from the term loan, as well as cash generated from operations.

We have a net operating loss tax carry forward of approximately $6.95 million.

In the September 2003 quarter, we recorded a current income tax credit of $8,000, which related to various state and local net operating loss tax benefits as well as a provision for the Federal alternative minimum tax. The current income tax credit was further reduced by $412,000 as a result of the use of available net operating losses. The deferred tax asset and the valuation allowance were reduced by the same amount. We also re-evaluated the deferred tax asset valuation allowance and further reduced the allowance by $800,000, which was recorded as a tax benefit. In the September 2002 quarter, we provided for taxes in the amount of $18,000. This provision was based upon certain state taxes.

As a result of the foregoing factors, in the September 2003 quarter, we had net income of $1,546,000, or $.34 per share (basic) and $.33 per share (diluted). For the September 2002 quarter, we had net income of $202,000, or $.05 per share basic and diluted.

Liquidity and Capital Resources

We had working capital of approximately $11.5 million at September 30, 2003 as compared to working capital of approximately $9.2 million at December 31, 2002. This increase of $2.3 million in working capital was the result of the following: our net income, after adding back depreciation and amortization and adjusting for the current portion of the deferred tax asset, increased working capital by $2.8 million. The increase in working capital also included $2.2 million in net proceeds from the exercise of our stock options and warrants. These increases were partially offset by the costs related to the CareNet acquisition, which utilized approximately $979,000 of our cash. Our working capital was further reduced by the CareNet acquisition because of the current portion of the long-term debt assumed, which we recorded in the amount of $166,000, and the assumption of certain other contract obligations totaling $68,000. We also reduced our working capital by $441,000 as a result of the payment of a dividend and by an additional $357,000 forthe acquisition of equipment. The remaining reduction in working capital of $689,000 was due to changes in other current assets and liabilities.

In June 2001, we entered into a revolving credit and term loan agreement with Fleet Bank ("Fleet"). 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 $1.5 million line of credit expired in June 2003. We did not utilize this line of credit during its duration. We are currently exploring our options with Fleet, relating to the possible increase in its term loan to be used for acquisitions, as well as an additional term loan to assist in financing costs associated with the relocation of our corporate headquarters. The current term loan bears interest at LIBOR plus 2.5%. We have entered into an interest rate swap agreement with Fleet for the amount outstanding under the term loan whereby

we converted our variable rate on the term loan to a fixed rate of 7.95% in order to reduce the interest rate risk associated with these borrowings. The proceeds of the term loan are designated for acquisitions as well as for product enhancements specific to California requirements. We have made principal payments on the $2.5 million term loan and the amount outstanding at September 30, 2003 is $1.4 million.

The terms of our term loan agreement require compliance with certain covenants, including maintaining a minimum net equity of $9 million, minimum cash reserves of $500,000, maintenance of certain financial ratios, limitations on capital expenditures and indebtedness and prohibition of the payment of cash dividends. We received Fleet's consent to the payment of the dividend declared in August 2003 and paid in September 2003. As of September 30, 2003, we were in compliance

with the financial covenants of this agreement.

On February 27, 2003, our Board of Directors authorized the purchase of up to $100,000 of our common stock at any time the market price is less than $3.50 per share. Purchases of stock will be made from time to time, depending on market conditions, in open market or in privately negotiated transactions, at prices deemed appropriate by management. There is no set time limit on the purchases. We expect to fund any stock repurchases from our operating cash flow. As of September 30, 2003, we have not made any stock repurchases.

On June 25, 2003, we acquired substantially all of the assets of the CareNet segment of Shuttle Data Systems Corporation, d/b/a Adia Information Management Corp., pursuant to an asset purchase agreement dated June 25, 2003, among the Netsmart, Adia and Steven Heintz, Jr., the president and majority shareholder of Adia. The principal assets acquired were the intellectual property and customer contracts of CareNet. The total purchase price, including acquisition costs, was $2,003,913 which consisted of 100,000 shares of common stock valued at $528,000, $838,740 in cash, and a three-year promissory note in the principal amount of $500,000 payable in 36 equal monthly installments of principal plus interest at the prime rate plus 1%. The cash portion of the purchase price was paid for out of existing working capital. We also assumed certain contractual obligations and liabilities totaling $68,068 and incurred $69,105 in legal and accounting costs which are included in the purchase price.

In addition, in connection with the acquisition, we entered into a non-compete and non-solicitation agreement with Steven Heintz, Jr. and Jennifer Lindbert for which they were paid a fee of an aggregate $140,000, which fee was paid in cash out of existing working capital and is included in "other assets" on the balance sheet.

The cost of the acquisition was allocated to purchased software in the amount of $883,075, customer lists in the amount of $1,097,138, the covenant not to compete in the amount of $140,000 and computer hardware in the amount of $23,700. We are amortizing the purchased software over an eight-year life and the customer lists over a nine-year life. The covenant not to compete is currently being amortized over a three-year life.

We accounted for this acquisition pursuant to the purchase method of accounting. For accounting purposes we recorded the assets and related liabilities of CareNet effective as of June 30, 2003. We incorporated the operations of CareNet into our operations commencing July 1, 2003.

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

Based on our outstanding contracts and our continuing business, we believe that our cash flow from operations, and our cash on hand will be sufficient to enable us to fund our operations for at least the next twelve months. It is possible that we may need additional funding if we go forward with certain acquisitions or 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.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. Among other things, estimates are used in accounting for allowances for bad debts, deferred income taxes, expected realizable values of assets (primarily capitalized software development costs and customer lists) and revenue recognition. To the extent there are material differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The significant accounting policies that we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition
Impairment of Capitalized Software Development Costs
Impairment of Customer Lists

Revenue Recognition: Revenue associated with fixed price turnkey sales consists of the following components: licensing of software, labor associated with the installation and implementation of the software; and maintenance services rendered in connection with such licensing activities. Revenue from fixed price software development contracts and revenue under license agreements, which require significant modification of the software package to the customer's specifications, are recognized on the estimated percentage-of-completion method. Using the units-of-work-performed method to measure progress towards completion, revisions in cost estimates and recognition of losses on these contracts are reflected in the accounting period in which the facts become known. The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent with the application of the percentage of completion method of accounting affect the amounts of revenue and related expenses reported in our Consolidated Financial Statements. A number of internal and external factors can affect our estimates, including labor rates, utilization and efficiency variances and specification and testing requirement changes. Maintenance contract revenue is recognized on a straight-line basis over the life of the respective contract. We also derive revenue from the sale of third party hardware and software which is recognized based upon the terms of each contract. Consulting revenue is recognized when the services are rendered. Data Center revenue is recognized in the period in which the service is provided. The above sources of revenue are recognized when, persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable and collectibility is probable.

Contract terms provide for billing schedules that differ from revenue recognition and give rise to costs and estimated profits in excess of billings, and billings in excess of costs and estimated profits.

Deferred revenue represents revenue billed and collected but not yet earned.

The cost of maintenance revenue, which consists solely of staff payroll and applicable overhead, is expensed as incurred.

Capitalized Software Development Costs - Capitalization of computer software development costs begins upon the establishment of technological feasibility. Technological feasibility for our computer software products is generally based

upon achievement of a detail program design free of high risk development issues. The establishment of technological feasibility and the ongoing

assessment of recoverability of capitalized computer software development costs requires considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology. Prior to reaching technological feasibility these costs are expensed as incurred and included in research and development. Amortization of capitalized computer software development costs commences when the related products become available for general release to customers. Amortization is provided on a product by product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product bear to the total of current and anticipated future gross revenue for that product or (b) the straight-line method over the remaining estimated economic life of the product. The estimated life of these products range from 3 to 8 years.

We periodically perform reviews of the recoverability of such capitalized software costs. At the time a determination is made that capitalized amounts are not recoverable based on the estimated cash flows to be generated from the applicable software, any remaining capitalized amounts are written off.

Pursuant to Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", we evaluate our long-lived assets for financial impairment, and continue to evaluate them as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable. We evaluate the recoverability of long-lived assets by measuring the carrying amount of the assets against the estimated undiscounted future cash flows associated with them. At the time such evaluations indicate that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their fair values.

Impairment of Customer Lists - Pursuant to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", we evaluate our long-lived assets for financial impairment, and continue to evaluate them as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable. We evaluate the recoverability of long-lived assets by measuring the carrying amount of the assets against the estimated undiscounted future cash flows associated with them. At the time such evaluations indicate that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the carrying amount of such assets, the assets are adjusted to their fair values.

The following table summarizes, as of September 30, 2003, our obligations and commitments to make future payments under debt, capital leases and operating leases:

Contractual Obligations	Payments Due by Period			
	Total	Less than 1 year	1 - 3 years	4 - 5 yea
Long Term Debt	1,833,351	666,667	1,166,684	--

Capital Lease Obligations	164,154	62,840	101,314	--
Operating Leases	286,360	227,054	59,306	--
Total Contractual Cash Obligations	2,283,865	956,561	1,327,304	--

We plan to relocate our Islip, New York headquarters facility to a larger facility located in Great River, New York. We are a party to a lease agreement that was signed by us on September 25, 2003. The lease is for a ten year and ten month period and calls for fixed rent payments of $5.8 million over the ten year and ten month period. The rental payments are excluded from the contractual

obligations chart because the commencement date of the rental payments is dependent upon the ability of the landlord to deliver possession of the property to us as per the specifications contained in the lease.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk related to changes in interest rates. Most of our debt is at fixed rates of interest after completing an interest rate swap agreement, which effectively converted our variable rate debt into a fixed rate debt of 7.95%. Therefore, if the LIBOR rate plus 2.5% increases above 7.95%, it may have a positive effect on our net income.

Most of our invested cash and cash equivalents, which are invested in money market accounts and commercial paper, are at variable rates of interest. If market interest rates decrease by 10 percent from levels at September 30, 2003, the effect on our net income would be a decrease of approximately $7,200 per year.

Item 4. Controls and Procedures

Evaluation and Disclosure Controls and Procedures

Based on their evaluation as of a date within 90 days of the filing of this Form 10-Q, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as required by Exchange Act Rule 13a-15. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported with the time periods specified by the SEC's rules and forms.

Changes in Internal Controls

There were no significant changes in our internal controls over financial reporting that occurred during the quarter ended September 30, 2003 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the Effectiveness of Controls

We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are

met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Part II OTHER INFORMATION

Item 1. Legal Proceedings

In October 2002, the Company commenced an action against the City of Richmond, in 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. On July 29, 2003, this action was settled and the Company received $205,000.

Item 2. Changes in Securities

On June 25, 2003, the Company issued 100,000 shares of common stock in connection with its acquisition of substantially all of the assets of the CareNet segment of Shuttle Data Systems Corporation, d/b/a Adia Information Management Corp., pursuant to an asset purchase agreement dated June 25, 2003, among the Company, Adia and Steven Heintz, Jr., the president and majority shareholder of Adia. The issuance of the foregoing securities was issued in reliance upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended, as a transaction not involving a public placement based on the fact that it was an issuance of securities to one person and the shares were legended to prevent their transfer.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 8 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

Report on Form 8-K dated June 25, 2003, as amended by Form 8-K/A filed September 2, 2003 - Items 2 and 7 containing the audited financial statements of the CareNet segment of Shuttle Data Systems for the year ended December 31, 2002 and the three month periods ended March 31, 2003 and 2002 and the pro forma financial statements of Netsmart and CareNet for the year ended December 31, 2002 and for the three months ended March 31, 2003.

Report on Form 8-K filed July 8, 2003 - Items 4 and 7.

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	Chief Executive Officer (Principal Executive Officer)	October 29, 2003
/s/* ------------------------ Anthony F. Grisanti	Chief Financial Officer (Principal Financial and Accounting Officer)	October 29, 2003

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Index of Exhibits

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 8 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.