NETSMART TECHNOLOGIES INC
Form 10-Q/A
November 13, 2002

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

Form 10-Q/A

Amendment No. 2

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

For Quarter Ended September 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 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__

Number of shares of common stock outstanding as of October 15, 2002: 3,755,665

Netsmart Technologies, Inc. and Subsidiaries

Index

Part I: - Financial Information:

Item 1. Financial Statements:	Page
Condensed Consolidated Balance Sheets - September 30, 2002 (Unaudited) and December 31, 2001	1-2
Condensed Consolidated Statements of Income - (Unaudited) Nine Months Ended September 30, 2002 and September 30, 2001 and Three Months Ended September 30, 2002 and 2001	3

Condensed Consolidated Statements of Cash Flows - (Unaudited)
Nine Months Ended September 30, 2002 and September 30, 2001 4-5

Condensed Consolidated Statement of Stockholders' Equity - (Unaudited)
Nine Months Ended September 30, 2002 6-7

Notes to Condensed Consolidated Financial Statements 8-11

Item 2. Management's Discussion and Analysis of
Financial Condition and Results of Operations 12-16

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2002 Unaudited	December 31, 2001
Assets:		
Current Assets:		
Cash and Cash Equivalents	$ 5,102,647	$ 3,837,226
Accounts Receivable - Net	5,989,472	5,876,970
Costs and Estimated Profits in Excess of Interim Billings	4,015,924	3,783,356
Deferred taxes	500,000	500,000
Other Current Assets	25,209	128,232
Total Current Assets	15,633,252	14,125,784
Property and Equipment - Net	346,813	366,356
Other Assets:		
Software Development Costs - Net	453,242	686,301
Customer Lists - Net	2,260,677	2,618,145
Other Assets	190,419	210,787
Total Other Assets	2,904,338	3,515,233
Total Assets	$18,884,403	$18,007,373

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30,	December 31,

	2002 Unaudited	2001
Liabilities and Stockholders' Equity:		
Current Liabilities:		
Current Portion - Long Term Debt	$ 500,000	$ 500,000
Current Portion Capital Lease Obligations	9,581	28,905
Accounts Payable	742,421	688,682
Accrued Expenses	819,538	359,908
Interim Billings in Excess of Costs and Estimated Profits	4,041,534	3,959,230
Deferred Revenue	880,431	685,569
Total Current Liabilities	6,993,505	6,222,294
Capital Lease Obligations - Less current portion	4,453	12,519
Long Term Debt - Less current portion	1,375,010	1,750,004
Interest Rate Swap at Fair Value	113,130	74,875
Total Non Current Liabilities	1,492,593	1,837,398
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 September 30, 2002, 3,719,247 shares at December 31, 2001	37,247	37,192
Additional Paid in Capital	20,897,734	20,856,166
Accumulated Comprehensive loss - Interest Rate Swap	(113,130)	(74,875)
Accumulated Deficit	(10,123,736)	(10,570,992)
	10,698,115	10,247,491
Less: Cost of shares of Common Stock held in treasury - 28,038 shares at September 30, 2002 and December 31, 2001	299,810	299,810
Total Stockholders' Equity	10,398,305	9,947,681
Total Liabilities and Stockholders' Equity	$ 18,884,403	$ 18,007,373

See Notes to Condensed Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Nine months ended September 30,		Three months ended September 30,	
	2002	2001	2002	2001
Revenues:				
Software and Related Systems and Services:				
General	$10,361,414	$ 8,493,803	$4,061,727	$2,660,7
Maintenance Contract Services	4,521,469	3,772,538	1,499,181	1,299,7
Total Software and Related Systems and Services	14,882,883	12,266,341	5,560,908	3,960,4
Data Center Services	1,438,254	1,548,640	482,859	615,0
Total Revenues	16,321,137	13,814,981	6,043,767	4,575,4
Cost of Revenues:				
Software and Related Systems and Services:				
General	7,457,227	5,899,287	3,006,903	1,837,1
Maintenance Contract Services	2,660,630	2,608,638	889,418	997,4
Total Software and Related Systems and Services	10,117,857	8,507,925	3,896,321	2,834,6
Data Center Services	794,327	761,339	267,382	254,7
Total Cost of Revenues	10,912,184	9,269,264	4,163,703	3,089,3
Gross Profit	5,408,953	4,545,717	1,880,064	1,486,1
Selling, General and Administrative Expenses	3,799,164	3,255,337	1,314,642	1,036,4
Research and Development	992,557	985,782	308,097	344,4
Total	4,791,721	4,241,119	1,622,739	1,380,8
Income from Operations before Interest	617,232	304,598	257,325	105,2
Interest Income	32,847	24,632	12,394	17,9
Interest Expense	158,823	129,794	50,162	68,9

Income before Income Tax Expense	491,256	199,436	219,557	54,2
Income Taxes Expense	44,000	15,000	18,000	4,0
Net Income	$ 447,256	$ 184,436	$ 201,557	$ 50,2
Earnings Per Share of Common Stock:				
Basic:				
Net Income	$ .12	$ .05	$ .05	$.
Weighted Average Number of Shares of Common Stock Outstanding	3,696,159	3,596,376	3,696,709	3,691,2
Diluted:				
Net Income	$ .11	$ .05	$ .05	$.
Weighted Average Number of Shares of Common Stock and Common Stock Equivalents Outstanding	4,062,130	3,844,476	4,070,466	3,937,4

See Notes to Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2002	2001
Operating Activities:		
Net Income	$ 447,256	$ 184,436
Adjustments to Reconcile Net Income to Net Cash Provided by (Used In) Operating Activities:		
Depreciation and Amortization	772,280	802,999
Issuance of Warrants and Options for Services	32,073	--
Changes in Assets and Liabilities:		
[Increase] Decrease in:		
Accounts Receivable	(112,502)	(686,690)
Costs and Estimated Profits in Excess of Interim Billings	(232,568)	(527,335)
Other Current Assets	103,023	64,240
Other Assets	20,368	(67,520)

Increase [Decrease] in		
Accounts Payable	53,739	266,176
Accrued Expenses	459,630	(540,488)
Interim Billings in Excess of Costs and Estimated Profits	82,304	(31,746)
Deferred Revenue	194,862	(103,286)
Total Adjustments	1,373,209	(823,650)
Net Cash Provided by (Used In) Operating Activities	1,820,465	(639,214)
Investing Activities:		
Net Cost of AIMS Acquisition	--	(779,700)
Acquisition of Property and Equipment	(162,210)	(99,639)
Net Cash Used In Investing Activities	(162,210)	(879,339)

See Notes to Condensed Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2002	2001
Financing Activities:		
Proceeds from Long Term Loan	$ --	$2,500,000
Payment of Capitalized Lease Obligations	(27,390)	(25,528)
Net Proceeds from Stock Options Exercised	9,550	21,834
Payments of Term Loan	(374,994)	(124,998)
Net Cash (Used in) Provided by Financing Activities	(392,834)	2,371,308
Net Increase in Cash and Cash Equivalents	1,265,421	852,755
Cash and Cash Equivalents - Beginning of Period	3,837,226	2,418,947
Cash and Cash Equivalents - End of Period	$5,102,647	$3,271,702

Supplemental Disclosure of Cash Flow Information:

Cash paid during the period for:		
Interest	$ 161,638	$ 90,997
Income Taxes	$ 23,992	$ 117,810

Non Cash Financing Activities:
The fair value of the interest rate swap calculated at September 30, 2002 was $113,130.

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 Nine Months Ended September 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 - September 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 Nine Months Ended September 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		32,073
Ending Balance - September 30, 2002		$ 20,897,734

Accumulated Deficit		
Beginning Balance - December 31, 2001		$(10,570,992)
Net Income		447,256
Ending Balance - September 30, 2002		$(10,123,736)
Accumulated Comprehensive Loss - Interest Rate Swap:		
Beginning Balance - December 31, 2001		$ (74,875)
Change in Fair Value of Interest Rate Swap		(38,255)
Ending Balance - September 30, 2002		$ (113,130)
Treasury Stock		
Beginning Balance - December 31, 2001	28,038	$ (299,810)
Ending Balance - September 30, 2002	28,038	$ (299,810)
Total Stockholders' Equity		$ 10,398,305

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 September 30, 2002 and the results of its operations for the nine and three months ended September 30, 2002 and 2001 and the changes in cash flows for the nine months ended September 30, 2002 and 2001. The results of operations for the periods ended September 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:

	Nine Months Ended September 30,		Three Months End
	2002	2001	2002

Numerator:			
Net income	$ 447,256	$ 184,436	$ 201,557
Denominator:			
Weighted average shares	3,696,159	3,596,376	3,696,709
Effect of dilutive securities:			
Employee stock options	364,176	248,100	371,140
Stock warrants	1,795	--	2,617
Dilutive potential common shares	365,971	248,100	373,757
Denominator for diluted earnings per share-adjusted weighted average shares after assumed conversions	4,062,130	3,844,476	4,070,466

(4) Income Taxes - The provision for income taxes for the period ended September 30, 2002, reflects a deferred tax provision of approximately $138,000 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 in 2002, 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. 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. On August 21, 2002, the United States District Court for the Eastern District of New York denied Richmond's motion to dismiss the Company's complaint for lack of personal jurisdiction in New York on the basis of improper venue. 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: (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:

Nine Months Ended September 30,	Software and Related Systems and Services	Data Center Services	Consol
2002			
Revenue	$14,882,883	$1,438,254	$16,32
Income before income taxes	254,815	236,441	49
Total identifiable assets at September 30, 2002	17,233,292	1,651,111	18,88
2001			
Revenue	$12,266,341	$1,548,640	$13,81
Income (loss) before income taxes	(201,416)	400,852	19
Total identifiable assets at September 30, 2001	16,024,759	1,798,554	17,82

Three Months Ended September 30,	Software and Related Systems and Services	Data Center Services	Consol
2002			
Revenue	$ 5,560,908	$ 482,859	$ 6,04
Income before income taxes	130,714	88,843	21
2001			
Revenue	$ 3,960,472	$ 615,020	$ 4,57
Income (loss) before income taxes	(162,405)	216,671	5

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

During the nine months ended September 30, 2002, the Company charged to operations $26,400 as costs related to the April 10, June 1, 2002 and September 1, 2002 warrants. The Company is scheduled to charge to future operations the amounts of $7,200 each for the November 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) In October 2002, stock options to purchase 88,333 shares were exercised and we received gross proceeds of $160,157. Pursuant to the option grants, employees had the right to pay for the exercise price of the option by delivering shares of common stock owned by them. During October, the Company received 29,377 shares, having a value of $146,582 and cash totaling $13,575, as the exercise price of the options.

(11) 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.

Effective July 30, 2002, the FASB issued SFAS No. 146, "Accounting for Cost

Associated with Exit or Disposal Activities." The main provisions of this statement address the recognition of liabilities associated with an exit or disposal activity. Implementation of this statement is not expected to have a material impact on our consolidated financial statements.

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 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.

Nine months ended September 30, 2002 and 2001

Our revenue for the nine months ended September 30, 2002 (the "September 2002 period") was $16,321,000, an increase of $2,506,000, or 18%, from our revenue for the nine months ended September 30, 2001, (the "September 2001 period") which was $13,815,000. The largest component of revenue was turnkey systems labor revenue, which increased by $314,000 to $5,357,000 in the September 2002 period, from $5,043,000 in September 2001 period, reflecting a 6% increase. This increase was substantially the result of an increase in spending for information systems in the behavioral health marketplace and our ability to provide the staff necessary to generate additional revenue. Revenue from third party hardware and software increased to $2,964,000 in the September 2002 period, from $1,868,000 in the September 2001 period, which represents an increase of 59%. This increase was attributable to an increase in spending for information systems in the behavioral health marketplace as well as a substantial sale of hardware to an existing customer. 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 decreased to $1,438,000 in the September 2002 period, from $1,549,000 in the September 2001 period, reflecting a decrease of 7%. This decrease was the result of work performed for one particular client during the September 2001 period. License revenue increased to $1,388,000 in the September 2002 period, from $623,000 in the September 2001 period, reflecting an increase of 123%. 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 substantially the result of an increase in spending for information systems in the behavioral health marketplace as well as a sale of our licensed programs to an existing customer. Maintenance revenue increased to $4,521,000 in the September 2002 period, from $3,772,000 in the September 2001 period, reflecting an increase of 20%. 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 $653,000 in the September 2002 period, from $960,000 in the September 2001 period, reflecting a decrease of 32%. We are experiencing a decline in small systems sales as a result of a redirection of our sales efforts to the larger turnkey sales.

Revenue from contracts from government agencies represented 53% of revenue in the September 2002 period and 39% of revenue in the September 2001 period. This reflects an increase in new government contracts.

Gross profit increased to $5,409,000 in September 2002 period from $4,546,000 in the September 2001 period, reflecting an increase of 19%. Our gross margin percentage remained constant at 33% in the September 2002 period and the September 2001 period. Although license and maintenance revenue, which are highly margined revenue components, increased in the September 2002 period, our gross margin percentage did not increase. This is because the mix of our revenue components for the September 2002 period included a larger amount of third party hardware and software revenue than the September 2001 period. Our third party

hardware and software revenue yields margins significantly less than our margin from behavioral health systems and services revenue.

Selling, general and administrative expenses were $3,799,000 in the September 2002 period, reflecting an increase of 17% from the $3,255,000 in the September 2001 period. This increase was substantially in the area of general insurance, investor relations and increase in the provision for bad debts and provision for bonuses.

We incurred product development expenses of $993,000 in the September 2002 period, an increase of 1% from the $986,000 in the September 2001 period. During the September 2002 period, we continued to invest in improved functionality and technology in our products.

Interest expense was $159,000 in the September 2002 period, an increase of $29,000, or 22%, from the $130,000 in the September 2001 period. 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 $32,000, for the September 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 $10 million. In the September 2002 period, a deferred tax provision in the amount of $138,000 was offset by a reduction in the deferred tax valuation allowance of the same amount. Therefore, in the September 2002 period we provided for taxes in the amount of $44,000. This provision was based upon certain state taxes and federal minimum alternative taxes. We made a similar provision in the September 2001 period in the amount of $15,000.

As a result of the foregoing factors, in the September 2002 period, we had a net income of $447,000, or $.12 per share basic and $.11 per share diluted. For the September 2001 period, we had net income of $184,000, or $.05 per share basic and diluted.

Three Months Ended September 30, 2002 and 2001

Our revenue for the three months ended September 30, 2002 (the "September 2002 quarter") was $6,044,000, an increase of $1,468,000, or 32%, from our revenue for the three months ended September 30, 2001, (the "September 2001 quarter") which was $4,575,000. The largest component of revenue was turnkey systems labor revenue, which increased by $150,000 to $1,808,000 in the September 2002 quarter, from $1,658,000 in September 2001 quarter, reflecting a 9% increase. This increase was substantially the result of an increase in spending for information systems in the behavioral health marketplace and our ability to provide the staff necessary to generate additional revenue. Revenue from third party hardware and software increased to $1,586,000 in the September 2002 quarter, from $515,000 in the September 2001 quarter, which represents an increase of 208%. This increase was attributable to an increase in spending for information systems in the behavioral health marketplace as well as a substantial sale of hardware to an existing customer. 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 decreased to $483,000 in the September 2002 quarter, from $615,000 in the September 2001 quarter, reflecting a decrease of 21%. This decrease was the result of work performed for one particular client during the September 2001 quarter. License revenue increased to $476,000 in the September 2002 quarter, from $140,000 in the September 2001 quarter, reflecting an increase of 241%. 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 substantially the result of an increase in spending for information systems in the behavioral health marketplace. Maintenance revenue increased to $1,499,000 in the September 2002 quarter, from

$1,300,000 in the September 2001 quarter, reflecting an increase of 15%. 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 $192,000 in the September 2002 quarter, from $348,000 in the September 2001 quarter, reflecting a decrease of 45%. We are experiencing a decline in small systems sales as a result of a redirection of our sales efforts to the larger turnkey sales.

Revenue from contracts from government agencies represented 53% of revenue in the September 2002 quarter and 35% of revenue in the September 2001 quarter. This reflects an increase in new government contracts.

Gross profit increased to $1,880,000 in September 2002 quarter from $1,486,000 in the September 2001 quarter, reflecting an increase of 27%. Our gross margin percentage decreased to 31% in the September 2002 quarter from 32% in the September 2001 quarter. Although license and maintenance revenue, which are highly margined revenue components, increased in the September 2002 quarter, our gross margin percentage decreased. This is because the mix of our revenue components for the September 2002 quarter included a larger amount of third party hardware and software revenue than the September 2001 quarter. Our third party hardware and software revenue yields margins significantly less than our margin from behavioral health systems and services revenue.

Selling, general and administrative expenses were $1,315,000 in the September 2002 quarter, reflecting an increase of 27% from the $1,036,000 in the September 2001 quarter. This increase was substantially in the area of general insurance, investor relations and increase in the provision for bad debts and provision for bonuses.

We incurred product development expenses of $308,000 in the September 2002 quarter, a decrease of 11% from the $344,000 in the September 2001 quarter. Although the percentage decrease was 11%, the absolute dollar decrease was $36,000. During the September 2002 quarter, we continued to invest in improved functionality and technology in our products.

Interest expense was $50,000 in the September 2002 quarter, a decrease of $19,000, or 28%, from the $69,000 in the September 2001 quarter. This decrease was substantially the result of lower borrowings associated with the $2,500,000 term loan, which we made in June 2001.

Interest income was $12,000 in the September 2002 quarter, a decrease of $6,000, or 33%, from the $18,000 in the September 2001 quarter. Interest income is generated from short-term investments made with a substantial portion of the proceeds received from the term loan arrangement and the decrease reflects the reduced interest rates for the September 2002 quarter.

We have a federal net operating loss tax carry forward of approximately $10 million. In the September 2002 quarter, a deferred tax provision in the amount of $61,000 was offset by a reduction in the deferred tax valuation allowance of the same amount. Therefore, in the September 2002 quarter we provided for taxes in the amount of $18,000. This provision was based upon certain state taxes and federal minimum alternative taxes. We made a similar provision in the September 2001 quarter in the amount of $4,000.

As a result of the foregoing factors, in the September 2002 quarter, we had a net income of $202,000, or $.05 per share basic and diluted. For the September 2001 quarter, we had net income of $50,000, or $.01 per share basic and diluted.

Liquidity and Capital Resources

We had working capital of $8.6 million at September 30, 2002 as compared to working capital of $7.9 million at December 31, 2001. The increase in working capital for September 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 September 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 September 30, 2002. We have made principal payments on the $2.5 million term loan and the amount outstanding at September 30, 2002 is $1,875,000.

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 material acquisitions, and we cannot give any assurance that we will be able to complete any material acquisitions.

Forward-Looking Statements

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 our Form 10-K for the year ended December 31, 2001 under "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and 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.

Item 4. Controls and Procedures

Our chief executive officer and chief financial officer have supervised and participated in an evaluation of the effectiveness of our disclosure controls and procedures as of a date within 90 days of the date of this report, and, based on their evaluations, they believe that our disclosure controls and procedures (as defined in Rule 13a-14(c) of the Securities Exchange Act of 1934, as amended) are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. As a result of the evaluation, there were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Part II

Item 1. Legal Proceedings

In the Company's form 10-K for the year ended December 31, 2001, the Company reported it 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 and a complaint filed by Richmond in the Circuit Court for the City of Richmond, Richmond, Virginia. On August 21, 2002, the United States District Court for the Eastern District of New York denied Richmond's motion to dismiss the Company's complaint for lack of personal jurisdiction in New York on the basis of improper venue.

Item 4. None.

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)	November 13, 2002
/s/Anthony F. Grisanti ---------------------- Anthony F. Grisanti	Chief Financial Officer (Principal Financial and Accounting Officer)	November 13, 2002

CERTIFICATIONS OF CHIEF EXECUTIVE AND FINANCIAL OFFICERS

The undersigned chief executive officer and chief financial officer of the Registrant do hereby certify that this Quarterly Report of Form 10-Q fully complies with the requirements of Section 13(a) or 15(d) of the Securities Act of 1934, as amended, and that the information contained in this report fairly presents, in all material respects, the financial condition and results of operations of the Registrant at the dates and for the periods shown in such report.

/s/James L. Conwy ------------------------ James L. Conway	Chief Executive Officer (Principal Executive Officer)	November 13, 2002
/s/Anthony F. Grisanti ------------------------ Anthony F. Grisanti	Chief Financial Officer (Principal Financial and Accounting Officer)	November 13, 2002

James L. Conway does hereby certify that he is the duly elected and incumbent chief executive officer and Anthony F. Grisanti does hereby certify that he is the duly elected and incumbent chief financial officer of Netsmart Technologies, Inc. (the "issuer") and each of them does hereby certify, with respect to the issuer's Form 10-Q for the quarter ended September 30, 2002 (the "report") as follows:

1. He or she has reviewed the report;

2. Based on his or her knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the report;

3. Based on his or her knowledge, the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in the report;

4. He or she and the other certifying officers are responsible for establishing and maintaining disclosure controls and procedures, as defined in Rule 13a-14(c) of the Securities Exchange Act of 1934, as amended, for the issuer and have:

   i. Designed such disclosure controls and procedures to ensure that material information relating to the issuer, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the periodic reports are being prepared;

   ii. Evaluated the effectiveness of the issuer's disclosure controls and procedures as of a date within 90 days prior to the filing date of the report (the "Evaluation Date"); and

   iii. Presented in the report their conclusions about the effectiveness of the disclosure controls and procedures based on the required evaluation as of the Evaluation Date

5. He or she and the other certifying officers have disclosed to the issuer's auditors and to the audit committee of the board of directors (or persons fulfilling the equivalent function):

   i. All significant deficiencies in the design or operation of internal controls which could adversely affect the issuer's ability to record, process, summarize and report financial data and have identified for the issuer's auditors any material weaknesses in internal controls; and

   ii. Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls; and

6. He or she and the other certifying officers have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/James L. Conway	/s/Anthony F. Grisanti
James L. Conway	Anthony F. Grisanti
Chief Executive Officer	Chief Financial Officer