SMART ONLINE INC
Form S-1
April 03, 2007

Registration No. __________

As filed with the Securities and Exchange Commission on April 3, 2007.

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

FORM S-1
REGISTRATION STATEMENT
Under
THE SECURITIES ACT OF 1933

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

Delaware	**7372**	**95-4439334**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code No.)**	**(I.R.S. Employer Identification No.)**

2530 Meridian Parkway, 2nd Floor
Durham, North Carolina 27713
(919) 765-5000
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Dennis Michael Nouri
Smart Online, Inc.
2530 Meridian Parkway, 2nd Floor
Durham, NC 27713
(919) 765-5000
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copy to:

James W. Gayton, Esq.
Smart Online, Inc.
2530 Meridian Parkway, 2nd Floor
Durham, NC 27713

(919) 765-5000

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of the registration statement until such time that all of the shares of common stock being offered hereunder have been sold.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

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If this Form is a post-effective amendment pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If the Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED (1)	PROPOSED MAXIMUM OFFERING PRICE PER SHARE	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE	AMOUNT OF REGISTRATION FEE
Common Stock, par value $0.001 per share	5,451,056	$ 2.70 (2)	$ 14,717,851.20 (2)	$ 451.84
Common Stock, par value $0.001 per share	479,444 (3)	$ 2.70 (4)	$ 1,294,498.80 (4)	$ 39.74
Common Stock, par value $0.001 per share	1,176,471 (3)	$ 3.00 (5)	$ 3,529,413.00 (5)	$108.35
TOTAL	7,106,971		$ 19,541,763.00	$ 599.93

(1) This prospectus relates to the resale of up to 7,106,971 shares, including (i) 2,352,941 shares of common stock and warrants to purchase 1,211,471 shares of common stock issued in a private placement transaction conducted in February 2007; (ii) a warrant to purchase 444,444 shares of common stock issued as consideration for an increase in an irrevocable standing letter of credit issued by a current stockholder; (iii) 1,000,000 shares of common stock issued in private placement transactions conducted during March 2006 through August 2006; (iv) 83,093 shares of common stock issued as a penalty for late registration of certain of the shares covered by the registration statement of which this prospectus forms a part; (v) 836,642 shares of common stock issued in private placement transactions conducted during February 2005 through September 2005, which number includes 50,000 shares of common stock issued upon exercise of a warrant issued in connection with this private placements; (vi) 145,000 shares of common stock issued upon exercise of warrants having an exercise price of $1.30 per share; (vii) 768,752 shares of common stock sold by our president and CEO under certain note cancellation agreements and stock purchase agreements; (viii) 241,628 shares of common stock issued upon exercise of warrants having an exercise price of $3.50 per share; (ix) 23,000 shares of common stock issued in exchange for investor relations services; and (x) pursuant to Rule 416 under the Securities Act, an indeterminate number of additional shares of common stock which may become issuable by reason of any stock dividend, stock split, recapitalization or other similar transaction effected without the receipt of consideration which results in an increase in the number of outstanding shares of common stock, by the selling security holders named in this prospectus and the person(s) to whom such security holders may transfer their shares.

(2) Estimated solely for the purpose of computing the registration fee required by Rule 457(c) under the Securities Act based on the average of the bid and ask prices of the registrant's common stock as reported on the Over-the-Counter Bulletin Board on March 30, 2007.

(3) Represents shares issuable upon exercise of an outstanding common stock purchase warrants of the registrant held by certain selling security holders.

(4) Estimated solely for the purpose of computing the registration fee required by Rule 457(g) under the Securities Act based on the average of the bid and ask prices of the registrant's common stock as reported on the Over-the-Counter Bulletin Board on March 30, 2007.

(5) Estimated solely for the purpose of computing the registration fee required by Rule 457(g) under the Securities Act based on the exercise price of the warrants to purchase the registrant's common stock at $3.00 per share.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. THESE SECURITIES MAY NOT BE SOLD UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IT IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

SUBJECT TO COMPLETION, DATED APRIL 3, 2007

PROSPECTUS

SMART ONLINE, INC.
7,106,971
SHARES OF COMMON STOCK

This prospectus relates to the resale of up to 7,106,971 shares, including (i) 2,352,941 shares of common stock and warrants to purchase 1,211,471 shares of common stock issued in a private placement transaction conducted in February 2007; (ii) a warrant to purchase 444,444 shares of common stock issued as consideration for an increase in an irrevocable standing letter of credit issued by a current stockholder; (iii) 1,000,000 shares of common stock issued in private placement transactions conducted during March 2006 through August 2006; (iv) 83,093 shares of common stock issued as a penalty for late registration of certain of the shares covered by the registration statement of which this prospectus forms a part; (v) 836,642 shares of common stock issued in private placement transactions conducted during February 2005 through September 2005, which number includes 50,000 shares of common stock issued upon exercise of a warrant issued in connection with this private placements; (vi) 145,000 shares of common stock issued upon exercise of warrants having an exercise price of $1.30 per share; (vii) 768,752 shares of common stock sold by our president and CEO under certain note cancellation agreements and stock purchase agreements; (viii) 241,628 shares of common stock issued upon exercise of warrants having an exercise price of $3.50 per share; (ix) 23,000 shares of common stock issued in exchange for investor relations services; and (x) pursuant to Rule 416 under the Securities Act, an indeterminate number of additional shares of common stock which may become issuable by reason of any stock dividend, stock split, recapitalization or other similar transaction effected without the receipt of consideration which results in an increase in the number of outstanding shares of common stock, by the selling security holders named in this prospectus and the person(s) to whom such security holders may transfer their shares. The selling security holders named in this prospectus are offering all of the shares of common stock offered through this prospectus. No shares are being offered by us.

We will not receive proceeds from the resale of the shares by selling security holders. We will bear substantially all expenses of registration of the shares. The selling security holders will pay any underwriting fees, discounts or commissions and transfer taxes in connection with the sale of the shares. The selling security holders and any broker-dealer who may participate in sales of the shares may use this prospectus. See “Plan of Distribution.”

Our common stock is quoted on the Over-the-Counter Bulletin Board, or the OTC-BB, under the symbol “SOLN.” On March 30, 2007, the last reported sale price for our common stock as reported on the OTC-BB was $2.80 per share.

The selling security holders will sell shares of our common stock at prevailing market prices or at privately negotiated prices.

INVESTING IN OUR COMMON STOCK INVOLVES RISKS THAT ARE DESCRIBED IN THE “RISK FACTORS” SECTION BEGINNING ON PAGE 2 OF THIS PROSPECTUS.

Our principal executive offices are located at 2530 Meridian Parkway, 2nd Floor, Durham, North Carolina 27713. Our telephone number is 919-765-5000.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is
April 3, 2007.

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No person is authorized to give any information or to make any representation other than those contained in this prospectus, and if made, such information or representation must not be relied upon as having been given or authorized. This prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities other than the securities offered by this prospectus or an offer to sell or a solicitation of an offer to buy the securities in any jurisdiction to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction.

The delivery of this prospectus shall not, under any circumstances, create any implication that there have been no changes in our affairs since the date of this prospectus. However, in the event of a material change, this prospectus will be amended or supplemented accordingly.

PROSPECTUS SUMMARY

This summary highlights important information about our company and business. Because it is a summary, it may not contain all of the information that is important to you. To understand this offering fully, you should read this entire prospectus and the financial statements and related notes included in this prospectus carefully, including the "Risk Factors" section. The terms "we," "us," "our," and "our company" refer to Smart Online, Inc., a company incorporated in Delaware, and its consolidated subsidiaries, unless the context otherwise requires.

Company Overview

Smart Online, Inc. was incorporated under the laws of Delaware on August 10, 1993.

We develop and market products and services targeted towards small businesses (less than 50 employees) that are delivered via a Software-as-a-Service, or SaaS, model. Our goal is to be the leading provider of on-demand SaaS applications for small businesses, which according to International Data Corporation, is a potential market of $3 billion. We sell our products and services primarily through private label syndication and OEM distribution channels, although small businesses may purchase products and services directly through our main portal located at www.smartonline.com.

Our primary source of revenue currently comes from sales of our SaaS applications for business management, web marketing, and e-commerce, which represented 63%, 77%, and 54% of our revenue from continuing operations for the fiscal years ended December 31, 2006, 2005, and 2004, respectively. We derive revenue from sales of services that are designed to complement our product offerings and allow us to create custom business solutions that fit our end-users' and our channel partners' needs, which represented 35%, 19%, and 0% of our revenue from continuing operations for the fiscal years ended December 31, 2006, 2005, and 2004, respectively.

We have designed two technology platforms to serve as the foundation for delivery of our business solutions: OneBiz^{SM} and iDirect Architecture^{TM}, or iDA. OneBiz^{SM} is our business management platform offered though our main portal and through the sites of our private-label partners. iDA is our web marketing and web selling platform offered through our wholly owned subsidiary, Smart Commerce, Inc. (d/b/a iMart), or Smart Commerce. Both platforms are designed to allow integrated applications to share data with the rest of the products and/or services running on our platforms. Virtually all of our products and services are offered on a subscription basis using the on-demand SaaS model.

Our principal executive offices are located at 2530 Meridian Parkway, 2nd Floor, Durham, North Carolina 27713, and our telephone number is (919) 765-5000.

Offering Summary

This prospectus relates to the resale of up to 7,106,971 shares, including (i) 2,352,941 shares of common stock and warrants to purchase 1,211,471 shares of common stock issued in a private placement transaction conducted in February 2007; (ii) a warrant to purchase 444,444 shares of common stock issued as consideration for an increase in an irrevocable standing letter of credit issued by a current stockholder; (iii) 1,000,000 shares of common stock issued in private placement transactions conducted during March 2006 through August 2006; (iv) 83,093 shares of common stock issued as a penalty for late registration of certain of the shares covered by the registration statement of which this prospectus forms a part; (v) 836,642 shares of common stock issued in private placement transactions conducted during February 2005 through September 2005, which number includes 50,000 shares of common stock issued upon exercise of a warrant issued in connection with this private placements; (vi) 145,000 shares of common stock issued upon exercise of warrants having an exercise price of $1.30 per share; (vii) 768,752 shares of common stock sold by our president and CEO under certain note cancellation agreements and stock purchase agreements; (viii) 241,628

shares of common stock issued upon exercise of warrants having an exercise price of $3.50 per share; (ix) 23,000 shares of common stock issued in exchange for investor relations services; and (x) pursuant to Rule 416 under the Securities Act, an indeterminate number of additional shares of common stock which may become issuable by reason of any stock dividend, stock split, recapitalization or other similar transaction effected without the receipt of consideration which results in an increase in the number of outstanding shares of common stock, by the selling security holders named in this prospectus and the person(s) to whom such security holders may transfer their shares. The selling security holders named in this prospectus are offering all of the shares of common stock offered through this prospectus. No shares are being offered by us.

Securities Being Offered	Up to 7,106,971 shares of common stock
Offering Price	The selling security holders can sell our shares at prevailing market prices, or at privately negotiated prices.
Terms of the Offering	The selling security holders will determine when and how they will sell the common stock offered in this prospectus. See "Plan of Distribution."
Securities Issued and to be Issued	17,822,637 shares of our common stock are issued and outstanding as of March 31, 2007. Options to issue 2,340,100 shares of our common stock are also outstanding as of March 15, 2007, subject to adjustment pursuant to antidilution provisions contained in the options.
Use of Proceeds	All of the common stock to be sold under this prospectus will be sold by existing stockholders and we will not receive any proceeds from the sale of the common stock by the selling security holders.

RISK FACTORS

An investment in Smart Online involves significant risks. You should read the risks described below very carefully before deciding whether to invest in Smart Online. The following is a description of what we consider our key challenges and risks.

We operate in a dynamic and rapidly changing business environment that involves substantial risk and uncertainty and these risks may change over time. The following discussion addresses some of the risks and uncertainties that could cause, or contribute to causing, actual results to differ materially from expectations. In evaluating our business, you should pay particular attention to the descriptions of risks and uncertainties described below and in other sections of this document and our other filings. These risks and uncertainties are not the only ones we face. Additional risks and uncertainties not presently known to us that we currently deem immaterial, or that are similar to those faced by other companies in our industry or business in general may also affect our business. If any of the risks described below actually occurs, our business, financial condition, or results of operations could be materially and adversely affected.

We have organized these factors into the following categories below:

- Our Financial Condition
- Our Products and Operations
- Our Market, Customers and Partners
- Our Officers, Directors, Employees and Stockholders
- Regulatory Matters that Affect Our Business
- Matters Related to the Market For Our Securities

Risks Associated with Our Financial Condition

(1) We have had recurring losses from operations since inception, and have deficiencies in working capital and equity capital. If we do not rectify these deficiencies through additional financing or growth, we may have to cease operations and liquidate our business. Because we have only nominal tangible assets, you may lose your entire investment.

Through December 31, 2006, we have lost an aggregate of approximately $57 million since inception on August 10, 1993. During the years ended December 31, 2006 and 2005, we incurred a net loss of approximately $5.0 million and

$15.6 million, respectively. Losses do not include the pre-acquisition losses, or profit, of the two companies we acquired during the fourth quarter of 2005. At December 31, 2006, we had a $3.8 million working capital deficit. Our working capital, including our line of credit and recent financing transaction for $6 million, is not sufficient to fund our operations beyond July 2008, unless we substantially increase our revenue, limit expenses or raise substantial additional financing. Factors such as the suspension of trading of shares of our common stock by the SEC, and the resulting drop in share price, trading volume and liquidity; the commercial success of our existing services and products; the timing and success of any new services and products; the progress of our research and development efforts; our results of operations; the status of competitive services and products; and the timing and success of potential strategic alliances or potential opportunities to acquire technologies or assets may require us to seek additional funding sooner than we expect. If we fail to raise sufficient financing, we will not be able to implement our business plan, we may have to liquidate our business and you may lose your investment.

(2) Any issuance of shares of our common stock in the future could have a dilutive effect on your investment.

We may issue shares of our common stock in the future for a variety of reasons. For example, under the terms of the stock purchase warrant and agreement we recently entered into with Atlas Capital, S.A., or Atlas, Atlas may elect to purchase up to 444,444 shares of our common stock at $2.70 per share upon termination of, or if we are in breach under the terms of our line of credit with Wachovia Bank, NA, or Wachovia. In connection with our recent private financing, we issued warrants to the investors to purchase an additional 1,176,471 shares of our common stock at $3.00 per share, and warrants to our placement agent in that transaction to purchase 35,000 shares of our common stock at $2.55 per share. In addition, we may raise funds in the future by issuing additional shares of common stock or other securities.

If we raise additional funds through the issuance of equity securities or debt convertible into equity securities, the percentage of stock ownership by our existing stockholders would be reduced. In addition, such securities could have rights, preferences, and privileges senior to those of our current stockholders, which could substantially decrease the value of our securities owned by them. For example, from March through August 2006, we sold an aggregate of 1,000,000 shares of common stock to investors for a price of $2.50 per share for total aggregate proceeds of $2.5 million. Similarly, in February 2007, we sold an aggregate of 2,352,941 shares of common stock to investors for a price of $2.55 per share, and issued the investors warrants for the purchase of an aggregate of 1,176,471 shares of common stock at an exercise price of $3.00 per share, for total aggregate proceeds of $6 million. Because of the share price, we had to sell a significant number of shares to raise the necessary amount of capital. You may experience dilution in the value of your shares as a result.

(3) In the future, we may enter into certain debt financing transactions with third parties that could adversely affect our financial health.

We currently have a secured loan arrangement from Fifth Third Bank. Under the terms of this agreement, Smart Commerce borrowed $1.8 million to be repaid in twenty-four (24) monthly installments of $75,000 plus interest beginning in December 2006. The interest rate is prime plus 1.5% as periodically determined by Fifth Third. The loan is secured by all of the assets of Smart Commerce and all of Smart Commerce’s intellectual property. The loan is guaranteed by us and such guaranty is secured by all the common stock of Smart Commerce.

We also have a revolving line of credit from Wachovia. The line of credit advanced by Wachovia is $2.5 million, and as of March 14, 2007, we have drawn down approximately $2.1 million. Any advances made on the line of credit must be repaid no later than August 1, 2008, with monthly payments of accrued interest only commencing on December 1, 2006 on any outstanding balance. The interest shall accrue on the unpaid principal balance at the LIBOR Market Index Rate plus 0.9%. The line of credit is secured by Smart Online’s deposit account at Wachovia and an irrevocable standby letter of credit in the amount of $2.5 million issued by HSBC Private Bank (Suisse) S.A. with Atlas Capital, S.A. as account party.

We are evaluating various equity and debt financing options and in the future may incur indebtedness that could adversely affect our financial health. For example, indebtedness could:

- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- result in the loss of a significant amount of our assets or the assets of our subsidiary if we are unable to meet the obligations of these arrangements;
-

place us at a competitive disadvantage compared to our competitors that have less indebtedness or better access to capital by, for example, limiting our ability to enter into new markets; and

· limit our ability to borrow additional funds in the future.

Risks Associated with Our Products and Operations

(4) Our business is dependent upon the development and market acceptance of our applications, including the acceptance of using some of our applications to conduct business. Our business models and operating plans have changed as a result of forces beyond our control. Consequently, we have not yet demonstrated that we have a successful business model or operating plan.

We continually revise our business models and operating plans as a result of changes in our market, the expectations of customers and the behavior of competitors. Today, we anticipate that our future financial performance and revenue growth will depend, in large part, upon our Internet-based SaaS business model and the results of our sales efforts to reach agreements with syndication partners with small business customer bases, but these business models may become ineffective due to forces beyond our control that we do not currently anticipate. We recently entered into agreements with two new syndication partners, but we have not yet derived any revenue under these agreements. Consequently, we have not yet demonstrated that we have a successful business model or operating plan. Our evolving business model makes our business operations and prospects difficult to evaluate. There can be no assurance that our revised business model will allow us to capture significant future market potential. Investors in our securities should consider all the risks and uncertainties that are commonly encountered by companies in this stage of operations under our current business model, particularly companies, such as ours, that are in emerging and rapidly evolving markets.

Our future financial performance and revenue growth will depend, in part, upon the successful development, integration, introduction, and customer acceptance of our software applications. Thereafter, other new products either developed or acquired and enhanced versions of our existing applications will be critically important to our business. Our business could be harmed if we fail to deliver timely enhancements to our current and future solutions that our customers desire. We also must continually modify and enhance our services and products to keep pace with market demands regarding hardware and software platforms, database technology, information security, and electronic commerce technical standards. There can be no assurance that we will be able to successfully develop new services or products, or to introduce in a timely manner and gain acceptance of our new services or products in the marketplace.

Our business could be harmed if we fail to achieve the improved performance that customers want with respect to our current and future offerings. We cannot assure you that our products will achieve widespread market penetration or that we will derive significant revenues from the sale of our applications.

Certain of our services involve the storage and transmission of customers' proprietary information (such as credit card, employee, purchasing, supplier, and other financial and accounting data). If customers determine that our services do not provide adequate security for the dissemination of information over the Internet or corporate extranets, or are otherwise inadequate for Internet or extranet use, or if, for any other reason, customers fail to accept our products for use, our business will be harmed. Our failure to prevent security breaches, or well-publicized security breaches affecting the Internet in general, could significantly harm our business, operating results, and financial condition.

(5) We may consider strategic divestiture, acquisition or investment opportunities in the future.

We face risks associated with any such opportunity. From time to time we evaluate strategic opportunities available to us for product, technology or business acquisitions, investments and divestitures. In the future, we may divest ourselves of products or technologies that are not within our continually evolving business strategy or acquire other products or technologies. We may not realize the anticipated benefits of any such current or future opportunity to the extent that we anticipate, or at all. We may have to issue debt or equity securities to pay for future acquisitions or investments, the issuance of which could be dilutive to our existing stockholders. If any opportunity is not perceived as improving our earnings per share, our stock price may decline. In addition, we may incur non-cash amortization charges from acquisitions, which could harm our operating results. Any completed acquisitions or divestitures would also require significant integration or separation efforts, diverting our attention from our business operations and strategy. Our limited acquisition experience is from 2005, and therefore our ability as an organization to integrate any acquired companies into our business is unproven. Acquisitions and investments involve numerous risks, including:

- difficulties in integrating operations, technologies, services and personnel;
- diversion of financial and managerial resources from existing operations;
- reduction of available cash;
- risk of entering new markets;
- potential write-offs of acquired assets;
- potential loss of key employees;
- inability to generate sufficient revenue to offset acquisition or investment costs; and
- delays in customer purchases due to uncertainty.

If we fail to properly evaluate and execute acquisitions, divestitures or investments, our business and prospects may be seriously harmed.

(6) We entered into a debt financing transaction in order to make certain installment payments under our agreement in the iMart acquisition. Failure to comply with the provisions of this loan agreement could have a material adverse effect on us.

When we purchased iMart in October 2005, we committed to make installment payments of approximately $3,462,000 and non-competition payments to two key employees of $780,000. Prior to the loan agreement described below, the cash flow we received from the business we purchased from iMart has been insufficient to cover any of the installment payments we have been required to make, and we have had to fund the difference. We recently amended the lock box agreement, terminating the iMart shareholders' security interest in the amounts in the lock box account, and agreed to pay the installment payments and noncompetition payments in three non-equal installments by February 2007, which have been paid in full.

In order to make these payments, we entered into a loan agreement with Fifth Third Bank in order to finance a portion of the payments to the iMart shareholders. Under the terms of this agreement, Smart Commerce borrowed $1.8 million to be repaid in twenty-four (24) monthly installments of $75,000 plus interest. The interest rate is prime plus 1.5% as periodically determined by Fifth Third Bank. Currently and at closing, the prime rate was 8.25%. The loan is secured by all of the assets of Smart Commerce, including a security account of $250,000 and all of Smart Commerce's intellectual property. The loan is guaranteed by us and such guaranty is secured by all the common stock of Smart Commerce. If an event of default occurs and remains uncured, then the lender could foreclose on the assets securing the loan. If that were to occur, it would have a substantial adverse effect on our business. Making the payments on the loan used to finance part of these payments may drain our financial resources or cause other material harm to our business if the lender forecloses on the secured assets.

(7) We rely on third-party software that may be difficult to repair should errors or failures occur. Such an error or failure, or the process undertaken by us to correct such an error or failure, could disrupt our services and harm our business.

We rely on software licensed from third parties in order to offer our services. We use key systems software from commercial vendors. The software we use may not continue to be available on commercially reasonable terms, or at all, or upgrades may not be available when we need them. We currently do not have support contracts or upgrade subscriptions with some of our key vendors. We are not currently aware of any immediate issues, but any loss of the right to use any of this software could result in delays in providing our services until equivalent technology is either developed by us, or, if available, is identified, obtained and integrated, which could harm our business. Any errors or defects in, or unavailability of, third-party software could result in errors or a failure of our services, which could harm our business.

We also use key systems software from leading open source communities that are free and available in the public domain. Our products will use additional public domain software, if needed for successful implementation and deployment. We currently do not have support contracts for the open source software that we use. We rely on our own research and development personnel and the open source community to discover and fix any errors and bugs that may exist in the software we use. As a result, if there are errors in such software of which we are unaware or are unable to repair in a timely manner, there could be a disruption in our services if certain critical defects are discovered in the software at a future date.

Risks Associated with Our Markets, Customers and Partners

(8) The structure of our subscription model makes it difficult to predict the rate of customer subscription renewals or the impact non-renewals will have on our revenue or operating results.

Our small business customers do not sign long-term contracts. Our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period and in fact, customers have often elected not to do so. In addition, our customers may renew for a lower-priced edition of our services or for fewer users. Many of our customers utilize our services without charge. These factors make it difficult to accurately predict customer renewal rates. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including when we begin charging for our services, their dissatisfaction with our services and their capability to continue their operations and spending levels. The number of current subscribers is less than the number of subscribers in mid-January 2006, but has been relatively constant since September 2006. If our customers do not renew their subscriptions for our services, or we are not able to increase the number of subscribers, our revenue may decline and our business will suffer.

(9) We depend on corporate partners to market our products through their web sites under relatively short-term agreements in order to increase subscription fees and grow revenue. Failure of our partners'

marketing efforts or termination of these agreements could harm our business.

Subscription fees represented approximately 52%, 22% and 0% of total revenues for 2006, 2005 and 2004, respectively. With the launch of our new applications and the acquisition of iMart, subscription fees represent a significant percentage of our total revenues and our future financial performance and revenue growth depends, in large part, upon the growth in customer demand for our outsourced services delivery models. We depend on our syndication partners and referral relationships to offer our core products and services to a larger customer base than we can reach through direct sales or other marketing efforts. Although we recently entered into agreements with two new syndication partners and a marketing referral agreement, we have not yet derived any revenue under these agreements. Our success depends in part on the ultimate success of our syndication partners and referral partners and their ability to market our products and services successfully. Our partners are not obligated to provide potential customers to us. In addition, some of these third parties have entered, and may continue to enter into, strategic relationships with our competitors. Further, many of our strategic partners have multiple strategic relationships, and they may not regard us as significant for their businesses. Our strategic partners may terminate their respective relationships with us, pursue other partnerships or relationships, or attempt to develop or acquire products or services that compete with our products or services. Our strategic partners also may interfere with our ability to enter into other desirable strategic relationships. If we are unable to maintain our existing strategic relationships or enter into additional strategic relationships, we will have to devote substantially more resources to the distribution, sales, and marketing of our products and services.

(10) Our future growth is substantially dependent on customer demand for our subscription services delivery models. Failure to increase this revenue could harm our business.

We have invested significantly in infrastructure, operations, and strategic relationships to support our SaaS delivery model, which represents a significant departure from the delivery strategies that other software vendors and we have traditionally employed. To maintain positive margins for our small business services, our revenues will need to continue to grow more rapidly than the cost of such revenues. There can be no assurance that we will be able to maintain positive gross margins in our subscription services delivery models in future periods. If our subscription services business does not grow sufficiently, we could fail to meet expectations for our results of operations, which could harm our business.

Any delays in implementation may prevent us from recognizing subscription revenue for periods of time, even when we have already incurred costs relating to the implementation of our subscription services. Additionally, subscribers can cancel their subscriptions to our services at any time and, as a result, we may recognize substantially less revenue than we expect. If large numbers of customers cancel or otherwise seek to terminate subscription agreements more quickly than we expect, our operating results could be substantially harmed. To become successful, we must cause subscribers who do not pay fees to begin paying fees and increase the length of time subscribers pay subscription fees.

(11) There are risks associated with international operations, which may become a bigger part of our business in the future.

We currently do not generate revenue from international operations. Although we have recently signed an agreement with a company to market our products and services in a foreign country, this agreement has not yet generated any revenue for us. We are currently evaluating whether and how to expand into additional international markets. If we continue to develop our international operations, these operations will be subject to risks associated with operating abroad. These international operations are subject to a number of difficulties and special costs, including:

- costs of customization and localization of products for foreign countries;
- laws and business practices favoring local competitors;
- uncertain regulation of electronic commerce;
- compliance with multiple, conflicting, and changing governmental laws and regulations;
- longer sales cycles; greater difficulty in collecting accounts receivable;
- import and export restrictions and tariffs;
- potentially weaker protection for our intellectual property than in the United States, and practical difficulties in enforcing such rights abroad;
- difficulties staffing and managing foreign operations;
- multiple conflicting tax laws and regulations; and
- political and economic instability.

Our international operations may also face foreign currency-related risks. To date, all of our revenues have been denominated in United States Dollars, but an increasing portion of our revenues may be denominated in foreign currencies. We do not engage in foreign exchange hedging activities, and therefore our international revenues and expenses may be subject to the risks of foreign currency fluctuations.

We must also customize our services and products for international markets. This process is much more complex than merely translating languages. For example, our ability to expand into international markets will depend on our ability to develop and support services and products that incorporate the tax laws, accounting practices, and currencies of particular countries. Since a large part of our value proposition to customers is tied to developing products with the peculiar needs of small businesses in mind, any variation in business practice from one country to another may

substantially decrease the value of our products in that country unless we identify the important differences and customize our product to address the differences.

Our international operations may also increase our exposure to international laws and regulations. If we cannot comply with domestic or foreign laws and regulations, which are often complex and subject to variation and unexpected changes, we could incur unexpected costs and potential litigation. For example, the governments of foreign countries might attempt to regulate our services and products or levy sales or other taxes relating to our activities. In addition, foreign countries may impose tariffs, duties, price controls or other restrictions on foreign currencies or trade barriers, any of which could make it more difficult for us to conduct our business in international markets.

Risks Associated with Our Officers, Directors, Employees and Stockholders

(12) Our executive management team is critical to the execution of our business plan and the loss of their services could severely impact negatively on our business.

Our success depends significantly on the continued services of our executive management personnel. Losing any of our officers could seriously harm our business. Competition for executives is intense. If we had to replace any of our officers, we would not be able to replace the significant amount of knowledge that they have about our operations. All of our executive team work at the same location, which could make us vulnerable to loss of our entire management team in the event of a natural or other disaster. We do not maintain key man insurance policies on any of our employees.

(13) Officers, directors and principal stockholders control us. This might lead them to make decisions that do not benefit the interests of minority stockholders.

Our officers, directors and principal stockholders beneficially own or control approximately 51% of our outstanding common stock. As a result, these persons, acting together, will have the ability to control substantially all matters submitted to our stockholders for approval (including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets) and to control our management and affairs. Accordingly, this concentration of ownership may have the effect of delaying, deferring or preventing a change in control of us, impeding a merger, consolidation, takeover or other business combination involving us or discouraging a potential acquiror from making a tender offer or otherwise attempting to obtain control of us, which in turn could materially and adversely affect the market price of our common stock.

Regulatory Risks

(14) Compliance with new regulations governing public company corporate governance and reporting is uncertain and expensive.

As a public company, we have incurred and will incur significant legal, accounting and other expenses that we did not incur as a private company. We will incur costs associated with our public company reporting requirements. We also anticipate that we will incur costs associated with recently adopted corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002, or Sarbanes-Oxley, the changes in our internal controls and procedures, as well as new rules implemented by the SEC and the NASD. We expect these rules and regulations to increase our legal and financial compliance costs and to make some activities more time consuming and costly. Any unanticipated difficulties in preparing for and implementing these reforms could result in material delays in complying with these new laws and regulations or significantly increase our costs. Our ability to fully comply with these new laws and regulations is also uncertain. Our failure to prepare timely for and implement the reforms required by these new laws and regulations could significantly harm our business, operating results, and financial condition. We also expect that these new rules and regulations may make it more difficult and more expensive for us to obtain director and officer liability insurance and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. We have also incurred substantial additional professional fees and expenses associated with the SEC's suspension of trading of our securities in January 2006, and with the internal investigation authorized by our Board of Directors in March 2006. Although our insurance carrier has paid a portion of these fees, not all such fees and expenses will be covered by our insurance.

By the end of fiscal 2007, we are required to comply with Sarbanes-Oxley requirements involving management's assessment of our internal control over financial reporting and our independent accountants' audit of that assessment is required for fiscal 2008. In March 2006, we retained a new Chief Financial Officer. His review of our internal control

over financial reporting to date and the final findings of our Audit Committee investigation have identified several deficiencies in our internal control over financial reporting. While we have made some progress on this remediation effort, we continue to work on addressing all the issues raised in these findings. Although we believe our on-going review and testing of our internal control over financial reporting will enable us to be compliant with these requirements, we have identified some deficiencies and may identify others that we may not be able to remediate and test by the end of fiscal 2007.

If we cannot assess our internal controls over financial reporting as effective, it may affect our management's assessment of our internal control environment as it will be disclosed in our Annual Report on Form 10-K for fiscal year 2007 and our stock price could decline.

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(15) The SEC suspension of trading of our securities has damaged our business, and it could damage our business in the future.

The suspension of trading by the SEC has harmed our business in many ways, and may cause further harm in the future. Prior to our re-entry onto the Over the Counter Bulletin Board, or the OTC-BB, for quotation, our ability to raise financing on favorable terms to us and our existing stockholders suffered due to the lack of liquidity of our stock, the questions raised by the SEC's action, and the resulting drop in the price of our common stock. As a result, we did not raise sufficient financing to make the sales and marketing investments we felt were needed in 2006 to substantially increase revenue. Legal and other fees related to the SEC's action also reduced our cash flow which jeopardized our ability to make the installment payments required by the agreements to acquire iMart. We recently completed a private placement financing for $6 million, however we make no assurance that we will not continue to experience additional harm as a result of the SEC matter. The time spent by our management team and directors dealing with issues related to the SEC action also detracted from the time they spent on our operations, including strategy development and implementation. Finally, an important part of our business plan is to enter into private label syndication agreements with large companies. The SEC's action and related matters have caused us to be a less attractive partner for large companies and to lose important opportunities. The SEC's action and related matters may cause other problems in our operations.

Risks Associated with the Market for Our Securities

(16) If securities analysts do not publish research or reports about our business or if they downgrade our stock, the price of our stock could decline.

The trading market for our common stock relies in part on the research and reports that industry or financial analysts publish about us or our business. Because our stock is currently quoted on the OTC-BB rather than traded on a national exchange, analysts may not be interested in conducting research or publishing reports on us. If we do not succeed in attracting analysts to report about our company, most investors will not know about us even if we are successful in implementing our business plan. We do not control these analysts. There are many large, well established publicly traded companies active in our industry and market, which may mean it will be less likely that we receive widespread analyst coverage. Furthermore, if one or more of the analysts who do cover us downgrade our stock, our stock price would likely decline rapidly. If one or more of these analysts cease coverage of our company, we could lose visibility in the market, which in turn could cause our stock price to decline. Lower trading volume may also mean that you could not resell your shares.

(17) Our revenues and operating results may fluctuate in future periods and we may fail to meet expectations of investors and public market analysts, which could cause the price of our common stock to decline.

Our revenues and operating results may fluctuate significantly from quarter to quarter. If quarterly revenues or operating results fall below the expectations of investors or public market analysts, the price of our common stock could decline substantially. Factors that might cause quarterly fluctuations in our operating results include:

- the evolving demand for our services and software;
- spending decisions by our customers and prospective customers;
- our ability to manage expenses;
- the timing of product releases;
- changes in our pricing policies or those of our competitors;
- the timing of execution of contracts;
- changes in the mix of our services and software offerings;
- the mix of sales channels through which our services and software are sold;
- costs of developing product enhancements;

- global economic and political conditions;
- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' requirements;
- the renewal rates for our service;
- the rate of expansion and effectiveness of our sales force;
- the length of the sales cycle for our service;
- new product and service introductions by our competitors;
- technical difficulties or interruptions in our service;
- regulatory compliance costs;
- integration of acquisitions; and
- extraordinary expenses such as litigation or other dispute-related settlement payments.

In addition, due to a slowdown in the general economy and general uncertainty of the current geopolitical environment, an existing or potential customer may reassess or reduce its planned technology and Internet-related investments and defer purchasing decisions. Further delays or reductions in business spending for technology could have a material adverse effect on our revenues and operating results.

(18) Our stock price is likely to be highly volatile and may decline.

The trading prices of the securities of technology companies have been highly volatile. Accordingly, the trading price of our common stock has been and is likely to continue to be subject to wide fluctuations. Further, our common stock has a limited trading history. Factors affecting the trading price of our common stock include:

- variations in our actual and anticipated operating results;
- the volatility inherent in stock prices within the emerging sector in which we conduct business;
- announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;
- recruitment or departure of key personnel;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- market conditions in our industry, the industries of our customers and the economy as a whole; and
- the volume of trading in our common stock, including sales of substantial amounts of common stock issued upon the exercise of outstanding options and warrants.

In addition, the stock market from time to time has experienced extreme price and volume fluctuations that have affected the trading prices of many emerging growth companies. Such fluctuations have often been unrelated or disproportionate to the operating performance of these companies. These broad trading fluctuations could adversely affect the trading price of our common stock.

Further, securities class action litigation has often been brought against companies that experience periods of volatility in the market prices of their securities. Securities class action litigation could result in substantial costs and a diversion of our management’s attention and resources. If such a suit is brought against us, we may determine, like many defendants in such lawsuits, that it is in our best interests to settle such a lawsuit, even if we believe that the plaintiffs’ claims have no merit, to avoid the cost and distraction of continued litigation. Any liability we incur in connection with any potential lawsuit could materially harm our business and financial position and, even if we defend ourselves successfully, there is a risk that management’s distraction in dealing with this type of lawsuit could harm our results.

(19) Shares eligible for public sale could adversely affect our stock price.

Certain holders of shares of our common stock signed agreements that prohibit resales of our common stock. If substantial numbers of shares are resold as lock-up periods expire, the market price of our common stock is likely to decrease substantially.

At March 31, 2007, 17,822,637 shares of our common stock were issued and outstanding and 3,996,015 shares may be issued pursuant to the exercise of warrants and options. During May 2005, we registered on Form S-8 5,000,000 shares of our common stock for issuance to our officers, directors and consultants under our 2004 Equity Compensation Plan, of which at March 15, 2007, 51,500 shares were outstanding and 2,340,100 shares are subject to outstanding stock options of the 5,000,000 shares reserved for issuance under such plan. The remaining outstanding shares of our common stock are restricted and may be sold in the public market only if they qualify for an exemption from registration under Rules 144 or 701 promulgated under the Securities Act.

We entered into agreements that limit the number of shares that may be sold during specific time periods, or Dribble Out Agreements, with all of the investors who purchased shares of our stock from us in private placements during 2005 and 2006, a total of approximately 2,497,000 shares. Under these Dribble Out Agreements, sales of shares are limited to 25% during a rolling 30-day period. Such limitations terminate six months after the effective date of the registration statement registering these shares.

Our stock is very thinly traded. The average daily trading volume for our common stock between October 2006 and January 2007 was approximately 18,000 shares per day. The number of shares that could be sold during this period was restrained by Dribble Out Agreements and other contractual limitations imposed on some of our shares, while there was no similar contractual restraint on the number of buyers of our common stock. This means that market supply may increase more than market demand for our shares when lock-up and dribble-out periods expire. Many companies experience a decrease in the market price of their shares when such events occur.

We cannot predict if future sales of our common stock, or the availability of our common stock held for sale, will materially and adversely affect the market price for our common stock or our ability to raise capital by offering equity securities. Our stock price may decline if the resale of shares under Rule 144, in addition to the resale of registered shares, at any time in the future exceeds the market demand for our stock.

Market conditions and market makers may cause your investment in our common stock to significantly diminish and become very illiquid.

We can offer no assurance that the volume of trading of our shares in the public markets will be sufficient to allow all sellers to sell at the times or prices sellers desire. Future sales of substantial amounts of our shares in the public market could adversely affect market prices prevailing from time to time and could impair our ability to raise capital through the sale of our equity securities.

(20) Our securities may be subject to "penny stock" rules, which could adversely affect our stock price and make it more difficult for you to resell our stock.

The SEC has adopted rules that regulate broker-dealer practices in connection with transactions in penny stocks. Penny stocks are generally equity securities with a price of less than $4.00 per share(other than securities registered on certain national securities exchanges or quotation systems, provided that reports with respect to transactions in such securities are provided by the exchange or quotation system pursuant to an effective transaction reporting plan approved by the SEC).

The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from those rules, to deliver a standardized risk disclosure document prescribed by the SEC, which:

- contains a description of the nature and level of risk in the market for penny stocks in both public offerings and secondary trading;

- contains a description of the broker's or dealer's duties to the customer and of the rights and remedies available to the customer with respect to a violation of such duties or other requirements;

- contains a brief, clear, narrative description of a dealer market, including "bid" and "ask" prices for penny stocks and the significance of the spread between the bid and ask price;

- contains a toll-free telephone number for inquiries on disciplinary actions;

- defines significant terms in the disclosure document or in the conduct of trading penny stocks; and

- contains such other information and is in such form (including language, type, size, and format) as the SEC requires.

The broker-dealer also must provide the customer, prior to effecting any transaction in a penny stock, with:

- bid and ask quotations for the penny stock;
- the compensation of the broker-dealer and its salesperson in the transaction;
- the number of shares to which such bid and ask prices apply, or other comparable information relating to the depth and liquidity of the market for such stock; and
- monthly account statements showing the market value of each penny stock held in the customer's account.

In addition, the penny stock rules require that, prior to a transaction in a penny stock not otherwise exempt from those rules, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written acknowledgment of the receipt of a risk disclosure statement, a written agreement related to transactions involving penny stocks, and a signed and dated copy of a written suitability statement. These disclosure requirements could have the effect of reducing the trading activity in the secondary market for our stock because it will be subject to these penny stock rules. Therefore, stockholders may have difficulty selling those securities.

FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements regarding our plans, objectives, expectations, intentions, future financial performance, future financial condition, and other statements that are not historical facts. You can identify these statements by our use of the future tense, or by forward-looking words such as “may,” “will,” “expect,” “anticipate,” “believe,” “intend,” ”estimate,” “continue,” and other similar words and phrases. Examples of sections containing forward-looking statements include “Description of Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” These forward-looking statements involve many risks and uncertainties. Examples of such risks and uncertainties are described under “Risk Factors” and elsewhere in this prospectus, as well as in other filings we may make from time to time with the SEC. You should be aware that the occurrence of any of these risks and uncertainties may cause our actual results to differ materially from those anticipated in our forward-looking statements, which could have a material adverse effect on our business, results of operations, and financial condition. All forward-looking statements included in this prospectus are based on information available to us as of the date of this prospectus. We assume no obligation or duty to update any such forward-looking statements.

USE OF PROCEEDS

We will receive none of the proceeds of resales of common stock by selling security holders in this offering.

DETERMINATION OF OFFERING PRICE

The selling stockholders will offer shares from time to time at prevailing market prices or privately negotiated prices. Our common stock became eligible to be quoted on the OTC-BB on April 15, 2005, and, following a suspension in trading issued by the SEC, returned to being quoted on the OTC-BB on September 11, 2006. Our trading symbol is “SOLN.” The high and low prices of our common stock on March 30, 2007 were $2.60 and $2.80, respectively. These prices may or may not be similar to the price or prices at which the selling stockholders offer shares in this offering.

DILUTION

Dilution represents the difference between the amount per share paid by purchasers of our common stock from the selling security holders identified in this prospectus and the net tangible book value per share of our common stock at the time of purchase. Since we will not receive any of the proceeds from the sale of common stock sold under this prospectus, the net tangible book value of our common stock will not be increased as a result of such sales, nor will the number of shares outstanding be affected by such sales. Consequently, there will be no change in the net tangible book value per share of our common stock as a result of any sales under this prospectus.

The net tangible book value per share represents stockholders’ equity less the estimated costs of this offering (which are $650,000), divided by the number of shares outstanding. As of December 31, 2006, we had 15,379,030 shares outstanding. These shares, as of December 31, 2006, had a net tangible book value of $(4,488,121) or $(0.29) per share. The current market price per share of our common stock substantially exceeds the net tangible book value per share of our outstanding common stock. Therefore, purchasers of our common stock in this offering will suffer immediate and substantial dilution.

We completed a private placement in February 2007 in which we sold an aggregate of 2,352,941 shares of common stock for $2.55 per share and issued warrants to purchase an additional 1,176,471 shares of common stock at an exercise price of $3.00 per share. We also issued a warrant to purchase 444,444 shares of common stock at $2.70 per share in connection with an increase in an irrevocable standby letter of credit, and a warrant to purchase 35,000 shares of common stock at $2.55 per share to our agent in the February 2007 private placement. Our consolidated financial statements as of and for the year ended December 31, 2006 do not reflect the completion of these transactions or their effect on our net tangible book value.

The following table illustrates the pro forma effect of the February 2007 private placement on the net tangible book value per share as of December 31, 2006. The table does not take into account any other changes in the net tangible book value of our shares occurring after December 31, 2006 or offering expenses related to the private placement:

Net tangible book value per share at December 31, 2006	$	(4,488,121)
Increase in net tangible book value per share attributable to the sale of 2,352,941 shares at $2.55 per share	$	0.34
Net tangible book value per share at December 31, 2006, as adjusted for the February 2007 private placement	$	861,879
Dilution per share to investors in the February 2007 private placement	$	2.50

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The number of shares of our common stock outstanding may be increased by shares issued upon exercise of outstanding options and warrants, and to the extent they are exercised for cash, the net tangible book value of our common stock may increase. We also may seek additional equity financing in the future, which may cause additional dilution to purchasers of our common stock in this offering, and a reduction in their equity interest. The holders of the shares purchased in this offering will have no preemptive rights on any shares of common stock to be issued by us in the future in connection with any such additional equity financing. If we sell additional shares or warrants to purchase additional shares, the sale or exercise price could be higher or lower than what purchasers are paying in this offering. If we sell additional shares at a lower price, it could lower the value of an existing stockholder's shares.

SELLING SECURITY HOLDERS

An aggregate of 7,106,971 shares of our common stock may be offered for sale and sold pursuant to this prospectus by the selling security holders. These shares consist of:

· 5,451,056 currently outstanding shares; and
· 1,655,915 shares issuable upon exercise of outstanding warrants.

These aggregate shares are to be offered by and for the respective accounts of the selling security holders and any pledgees, donees, assignees and transferees or successors-in-interest of the respective selling security holders. We have agreed to register all of such securities under the Securities Act and to pay all of the expenses in connection with such registration and sale of the shares (other than underwriting discounts and selling commissions and the fees and expenses of counsel and other advisors to the selling security holders).

The following table and notes to the table sets forth, with respect to each selling securityholder:

· the name of the selling security holder and any material relationship the selling security holder has had with us over the past three years;
· the number of shares of our common stock beneficially owned by the selling security holder as of March 31, 2007;

· the number of shares being offered for sale by the selling security holder pursuant to this prospectus; and
· the number of shares of our common stock and percentage that will be beneficially owned by the selling security holder assuming the selling security holder disposes of all of the shares being offered pursuant to this prospectus.

Name and Material Relationships	Beneficial Ownership Prior to Sale of the Shares	Number of Shares Being Offered for Sale	Beneficial Ownership After the Sale of the Shares Number	Percentage
John Smith [4]	70,553	2,929	67,624	*
Juliani Ltd. [4]	217,030	7,030	210,000	1.2%
Chiche Yael [4]	22,343	2,343	20,000	*
The Blueline Fund [2][3][4][13]	718,750	218,750	500,000	2.8%
Atlas Capital, SA[1][3][4][5][6][9][14]	2,773,600	1,760,619	1,012,981	5.6%
HSBC Private Bank (Suisse) SA[1][4]	37,453	37,453	0	0
Gilbert H. Burnett[1][4][5]	20,135	13,479	6,656	*
Sandra Burnett [5]	6,656	600	6,056	*
Edward S. Finley, Jr. [1][4]	16,356	10,600	5,756	*
Lawrence Zirbel [1][4]	30,566	30,566	0	0
Credite Suisse Zurich[1][4]	187,274	187,274	0	0
Eddie G. Hatch, III[1][4]	7,056	4,240	2,816	*
Candis Boyer Trust[1][4]	10,916	10,916	0	0
David P. Nichols[1][4]	23,826	9,540	14,286	*
Judy M. Nichols[1][4]	23,826	9,540	14,286	*
C. Richard Vaughn, Jr. [1][4]	46,500	26,500	20,000	*
William M. Rhyne[1][4]	9,236	3,180	6,056	*
Horace T. Bone [1][4][12]	2,800	2,800	0	0
Ursula Main[1][4][12]	2,800	2,800	0	0
Edgar L. Blackley[1][4]	27,291	27,291	0	0
Martin L. Wachtel, III[1][4]	2,120	2,120	0	0
Rodney Cantrell[1][4]	31,800	31,800	0	0
Michael Hensley[1][4][5]	22,058	15,900	6,158	*
Steven Andreus[1][4]	31,200	21,200	10,000	*
William L. Daniels, Jr. [1][4]	39,805	8,480	31,325	*
Michael Olander[1][4]	59,550	59,550	0	0
Andrew Tyson[1][4]	13,100	10,600	2,500	*
C. Richard Vaughn, Sr. [1][4]	10,600	10,600	0	0
Jeffrey C. Davis[1][4]	33,347	27,291	6,056	*
Monty K. Venable[1][4]	13,600	10,600	3,000	*
David Young[1][4]	16,972	10,916	6,056	*
Charles Hoffman[1][4]	5,300	5,300	0	0
Danny Eason[1][4]	22,096	14,840	7,256	*
Carolyn Polston[1][4]	10,916	10,916	0	0
Philippe Pouponnot – member of Board of Directors [3][4][13]	50,750	50,750	0	0
Berkley Financial Services, Ltd.[6]	216,175	216,175	0	0
Leon Sokolic [6][7]	389,965	320,000	85,065	*
Pete Coker[6]	57,328	57,328	0	0
Doron Roethler[6]	2,001,778	247,043	1,754,735	9.7%
Daniel Flebotte[5]	29,232	3,000	26,232	*
Richmond Bernhardt, III[7]	16,815	5,015	11,800	*
J. Fielding Miller[7]	16,815	5,015	11,800	*
Perkins Holdings, LLC[7]	16,815	5,015	11,800	*
Wilson Hoyle, III[7]	6,555	1,955	4,600	*

Ruben Serrano [8]	2,000	2,000	0	0
Mistere, LLC [8]	16,000	16,000	0	0
David Gardner [8]	5,000	5,000	0	0
Hare & Co.[10]	1,176,471	1,176,471	0	0
Magnetar Capital Master Fund, Ltd.[10]	2,352,941	2,352,941	0	0
Canaccord Adams, Inc.[11]	35,000	35,000	0	0

This table was prepared based solely upon our stock transfer records as of March 31, 2007, and information furnished to us by the selling security holders listed above. The selling security holders identified above may have sold, transferred or otherwise disposed of, in transactions exempt from the registration requirements of the Securities Act, all or a portion of their shares since the date on which the information in the preceding table was provided. The number and percentage of shares beneficially owned before and after the sales was determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934, or the Exchange Act, and based on 17,822,637 shares outstanding as of March 31, 2007, and the percentage of outstanding shares of any person as shown in this table does not necessarily reflect the person's actual ownership or voting power with respect to the number of shares of common stock actually outstanding on March 31, 2007.

(1) Acquired these shares being offered pursuant to this prospectus in a private placement conducted during February 2005 through September 2005. Under the terms of registration rights agreements with investors in this transaction, we have filed with the SEC, under the Securities Act, the registration statement of which this prospectus forms a part, with respect to the resales of the shares from time to time in the markets in which shares of our common stock may be traded from time to time, in privately-negotiated transactions, or otherwise, and have agreed to prepare and file such amendments and supplements to the registration statement as may be necessary to keep such registration statement effective until the earlier of (i) 270 days after the effective date of this registration statement, (ii) the date on which all the registered securities have been sold by the selling security holders, and (iii) all the shares registered hereunder can be immediately resold by the selling security holders without a registration statement being in effect.

(2) Acquired these shares being offered pursuant to this prospectus upon the exercise of common stock purchase warrants having an exercise price of $5.00 per share.

(3) Acquired these shares being offered pursuant to this prospectus in a private placement conducted in July 2006 through August 2006. Under the terms of registration rights agreements with investors in this transaction, we have filed with the SEC, under the Securities Act, the registration statement of which this prospectus forms a part, with respect to the resales of the shares from time to time in the markets in which shares of our common stock may be traded from time to time, in privately-negotiated transactions, or otherwise, and have agreed to prepare and file such amendments and supplements to the registration statement as may be necessary to keep such registration statement effective until the earlier of (i) 270 days after the effective date of this registration statement, (ii) the date on which all the registered securities have been sold by the selling security holders, and (iii) all the shares registered hereunder can be immediately resold by the selling security holders without a registration statement being in effect.

(4) Acquired these shares being offered pursuant to this prospectus as a penalty for late registration of other shares issued in private placements.

(5) Acquired these shares being offered pursuant to this prospectus upon the exercise of common stock purchase warrants having an exercise price of $3.50 per share.

(6) Acquired these shares being offered pursuant to this prospectus upon transfer from the registrant's president and CEO pursuant to a note cancellation agreement or stock purchase agreement. Under the terms of registration rights agreements with investors in this transaction, each party receiving shares of our common stock from our president and CEO's personal holdings under these agreements shall be given notice when the Company files a registration statement under the Securities Act of 1933. Each party is then permitted to include the shares received in such registration statement.

(7) Acquired these shares being offered pursuant to this prospectus upon the exercise of common stock purchase warrants having an exercise price of $1.30 per share.

(8) Acquired these shares being offered pursuant to this prospectus as compensation for investor relations services in 2005.

(9) Includes 444,444 shares issuable upon the exercise of a common stock purchase warrant waving an exercise price of $2.70 per share.

(10) Acquired these shares being offered pursuant to this prospectus in a private placement conducted in February 2007, and an aggregate of 1,176,471 shares issuable upon the exercise of a common stock purchase warrant waving an exercise price of $3.00 per share. Under the terms of registration rights agreements with investors in this transaction, we have an obligation to register the shares sold for resale by the investors by filing a registration statement within 30 days of the closing of the private placement, and to have the registration statement declared effective 60 days after actual filing, or 90 days after actual filing if the SEC reviews the registration statement. If a registration statement is not timely filed or declared effective by the SEC by the date set forth in this agreement, we are obligated to pay a cash penalty of 1% of the purchase price on the day after the filing or declaration of effectiveness is due, and 0.5% of the purchase price per every 30 day period thereafter, to be prorated for partial periods, until we fulfills these obligations. Under no circumstances can the aggregate penalty for late registration or effectiveness exceed 10% of the aggregate purchase price. Under the terms of these agreements, we cannot offer for sale or sell any securities until May 22, 2007, subject to certain limited exceptions, unless, in the opinion of our counsel, such offer or sale does not jeopardize the availability of exemptions from the registration and qualification requirements under applicable securities laws with respect to this placement.

(11) Includes 35,000 shares issuable upon the exercise of a common stock purchase warrant having an exercise price of $2.55 per share.

(12) Includes 300 shares issued as a penalty for late registration of other shares issued in a private placement that are jointly held by Horace T. Bone and Ursula Main.

(13) Philippe Pouponnot, a member of our Board of Directors, was originally recommended for appointment to the Board by the Blueline Fund.

(14) One of the members of our Board was originally recommended for appointment to the Board by Atlas Capital, S.A.

PLAN OF DISTRIBUTION

The shares of common stock may be sold from time to time by the selling security holders through customary brokerage channels, either through broker-dealers acting as broker or agent, or through broker-dealers acting as principals, in one or more transactions at fixed prices, at market prices at the time of sale, at varying prices determined at the time of sale or at negotiated prices. The selling security holders may offer their shares of common stock in one or more of the following transactions, including block transactions:

- on any national securities exchange or quotation service on which the common stock may be listed or quoted at the time of sale;
- in the over-the-counter market;
- in private transactions;
- through writing options on common stock;
- in short sales;
- by pledge to secure debts and other obligations;
- in any combination of one or more of these methods of distribution; or
- any other method permitted pursuant to applicable law.

When we use the term "selling security holder" in this prospectus, it includes donees, pledgees and other transferees who are selling shares received after the date of this prospectus from a selling security holder whose name appears in the "Selling Security Holders" table above. If a selling security holder pledges the shares of our common stock owned by him and defaults in the performance of his secured obligations, then the secured parties or pledgees may, from time to time, offer and sell such shares under this prospectus after we amend as appropriate the list of selling security holders pursuant to Rule 424(b)(3) or other applicable rules of the Securities Act. If we are notified by a selling security holder that a donee, pledgee or other transferee intends to sell more than 25,000 shares, we will file a prospectus supplement if required by law. In addition, if required, we will distribute a supplement to this prospectus to describe any material changes in the terms of the offering.

The selling security holders and any underwriters, broker-dealers or agents that participate in the distribution of the shares of common stock may be deemed to be "underwriters" within the meaning of the Securities Act and will be subject to the prospectus delivery requirements of the Securities Act. Any profits on the resale of shares of common stock by selling security holders and any compensation received by any underwriter, broker-dealer or agent from a selling security holder may be deemed to be underwriting discounts and commissions under the Securities Act.

Any shares covered by this prospectus which qualify for sale pursuant to Rule 144 under the Securities Act may, in the discretion of each selling security holder, be sold under Rule 144 rather than under the terms of this prospectus. The selling security holders may decide not to sell all of the shares offered pursuant to this prospectus. The selling security holders may transfer such shares by will, gift or other means not described in this prospectus.

To comply with the securities laws of certain jurisdictions, the common stock must be offered or sold only through registered or licensed brokers or dealers. In addition, in certain jurisdictions, the common stock may not be offered or sold unless it has been registered or qualified for sale or an exemption is available in that jurisdiction and complied with. We plan to register our securities in each jurisdiction in which such registration is required for the resale of our securities. We are included in the Standard and Poor's Corporation Record. Inclusion in that publication can provide an exemption for resale of our common stock in approximately 39 jurisdictions. We believe resales will qualify for this exemption in most of the jurisdictions which afford this form of exemption.

The selling security holders may also sell their shares directly to market makers acting as principals or brokers or dealers, who may act as agent or acquire the common stock as a principal. Any broker or dealer participating in such transactions as agent may receive a commission from the selling security holders, or, if it acts as agent for the

purchaser of such common stock, from such purchaser. The selling security holders will likely pay the usual and customary brokerage fees for such services. Brokers or dealers may agree with the selling security holders to sell a specified number of shares at a stipulated price per share and, to the extent such broker or dealer is unable to do so acting as agent for the selling security holders, to purchase, as principal, any unsold shares at the price required to fulfill the respective broker's or dealer's commitment to the selling security holders. Brokers or dealers who acquire shares as principals may thereafter resell such shares from time to time in transactions in a market or on an exchange, in negotiated transactions or otherwise, at market prices prevailing at the time of sale or at negotiated prices, and in connection with such resales may pay or receive commissions to or from the purchasers of such shares. These transactions may involve cross and block transactions that may involve sales to and through other brokers or dealers. If applicable, the selling security holders may distribute shares to one or more of their partners who are unaffiliated with us. Such partners may, in turn, distribute such shares as described above. We can provide no assurance that all or any of the common stock offered will be sold by the selling security holders.

Under the applicable rules and regulations of the Exchange Act, any person engaged in the distribution of the common stock may not bid for or purchase shares of common stock during a period which commences one business day (five business days if our public float is less that $25 million or the average daily trading volume of our stock is less than $100,000) prior to such person's participation in the distribution, subject to exceptions for certain passive market making activities. In addition and without limiting the foregoing, each selling security holder will be subject to the applicable provisions of the Exchange Act and the rules and regulations thereunder, including, without limitation, Regulation M, which provisions may limit the timing of purchases and sales of shares of our common stock by such selling security holder or any such other person. These factors may affect the marketability of the common stock and the ability of brokers or dealers to engage in market-making activities.

We agreed to register the shares under the Securities Act and to indemnify and hold the selling security holders harmless against certain liabilities under the Securities Act that could arise in connection with the sale of the shares by the selling security holders. We have agreed to pay all reasonable fees and expenses incident to the filing of this registration statement. The selling security holders will pay all brokerage commissions and similar selling expenses, if any, attributable to their sales of shares. Refer to “Selling Security Holders” for a description of the registration rights of the selling security holders.

Resale of the shares registered by this registration statement is subject to restriction by our contractual agreements with the selling security holders. Refer to “Shares Eligible for Future Sale - Lock-up Agreements” for a description of these contractual restrictions.

Any dealer or broker participating in any distribution of the common stock may be required to deliver a copy of this prospectus, including a prospectus supplement, if any, to any person who purchases any of the shares from or through the dealer or broker.

SELECTED FINANCIAL DATA

The following table sets forth selected consolidated financial data that has been derived from our audited financial statements for the years ended December 31, 2006, 2005, 2004, 2003, and 2002. The following selected financial data should be read in conjunction with our financial statements and related notes thereto, and with " MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS."

Income Statement Data

INCOME STATEMENT DATA	Fiscal Year Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Revenues	$ 3,644,890	$ 2,155,425	$ 1,002,970	$ 1,261,223	$ 1,391,645
Loss from Continuing Operations	$ (2,498,144)	$ (15,554,874)	$ (2,671,929)	$ (1,558,773)	$ (805,406)
Loss per Share from Continuing Operations	$ (0.17)	$ (1.20)	$ (0.26)	$ (0.61)	$ (0.25)
Net Loss Attributable to Common Stockholders	$ (5,023,707)	$ (15,590,609)	$ (8,319,049)	$ (4,375,836)	$ (1,766,606)
Net Loss per Share - Basic and Diluted	$ (0.33)	$ (1.20)	$ (0.82)	$ (0.61)	$ (0.25)
Number of Shares Used in Per Share Calculation	15,011,830	12,960,006	10,197,334	7,145,047	7,181,759

BALANCE SHEET DATA	As of December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Total Assets	$ 7,433,009	$ 14,558,079	$ 773,701	$ 306,072	$ 252,579
Long-term Obligations	$ 836,252	$ 2,963,289	$ 1,091,814	$ 1,193,211	$ 958,925
Redeemable Preferred Stock	$ —	$ —	$ —	$ 17,509,214	$ 14,692,150
Stockholders' Equity (Deficit)	$ 1,825,998	$ 6,672,631	$ (1,911,090)	$ (22,014,156)	$ (19,268,323)

During October 2005, we acquired substantially all of the assets of Computility, a privately held developer and distributor of SFA/CRM software applications, based in Des Moines, Iowa. We operated this SFA/CRM business under the name Smart CRM. In September 2006, we sold substantially all of the assets of Smart CRM to Alliance Technologies, Inc. We retained rights to the SFA/CRM application that we developed and added to our OneBizSM platform.

Also during October 2005, we acquired all the stock of iMart Incorporated, a privately held developer and distributor of multi-channel e-commerce systems based in Grand Rapids, Michigan. We operate this e-commerce business under the name Smart Commerce, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We develop and market Internet-delivered SaaS applications and data resources for small businesses. We reach small businesses through syndication arrangements with large corporations that private-label our software applications through their corporate websites and through our own website, www.smartonline.com. We believe our syndication relationships provide a cost and time efficient way to market to the extremely diverse and large, yet fragmented small business sector.

Consistent with SFAS No. 131, we have defined two reportable segments based on factors such as geography, products, customers, how operations are managed, and how the chief operating decision-maker views results. Those segments are our core operations, or the Smart Online segment, and the operations of our wholly-owned subsidiary, or the Smart Commerce segment. Substantially all of our revenues are generated by the Smart Commerce segment as the resources of our Smart Online segment were focused primarily on research and development efforts from 2000 to late 2006, and in 2006, on the SEC suspension and resulting investigations.

The Smart Commerce segment's revenues are derived primarily from the development and distribution of multi-channel e-commerce systems including domain name registration and e-mail solutions, e-commerce solutions, website design and website hosting. In 2006, our Smart Commerce segment generated 86% of our total consolidated revenue and 96% and 100% of our subscription and professional services revenue, respectively.

The Smart Online segment generates revenues from the development and distribution of internet-delivered SaaS small business applications through a variety of subscription, integration and syndication channels. In 2006, our Smart Online segment generated 14% of our total consolidated revenue and 100% of our integration and syndication revenue, and 4% of our subscription revenue.

The Company includes costs such as corporate general and administrative expenses and share-based compensation expenses that are not allocated to specific segments in the Smart Online segment, which includes the parent or corporate segment.

Except as noted below, all financial information for periods prior to our acquisition of Computility and iMart contained in this prospectus refers to the financial performance of Smart Online only, and does not include the financial performance of either Computility or iMart before the acquisitions occurred in October of 2005. All financial information for periods after these acquisitions contained in this prospectus includes the financial performance of the businesses we acquired, unless otherwise noted. Due to the sale of substantially all of the assets of Smart CRM on September 29, 2006, Smart CRM is classified throughout this prospectus as discontinued operations and the assets and liabilities related to Smart CRM are classified as available for sale.

During 2006, we made significant improvements to our applications and platforms, including enhancements to the OneBizSM dashboard, the iDA marketing features and adding additional software applications to OneBizSM such as our SFA/CRM and Accounting applications. We recently redesigned our website to provide greater ease-of-use. We began offering our primary products as part of the second version of our new applications in November 2005. As of December 31, 2006, certain bundles of our applications are offered on our website and the websites of three private label partners. In May of 2006, we integrated a simplified version of the SFA/CRM software applications that we acquired in October of 2005 into our OneBizSM application suite, and we will integrate applications from one platform into the other as requested by our customers. We have not yet received any request to do so.

We derive subscription revenue primarily from our stand alone e-commerce application, which is offered through our subsidiary, Smart Commerce. We generate a small amount of revenue from subscriptions through our Smart Online segment. In the first half of 2006, the number of subscribers to our software products had declined. We are not certain what caused this decline. Some customers had indicated they had difficulty accessing our software applications on our website. Consequently, we redesigned our website and product bundling to address this problem. As of March 2007, the decline in the number of subscribers has ceased, but the level of subscribers is still significantly lower than the number from January 2006. It is critical that we grow our subscriber base, which we expect will be done primarily through our private-label partners. Failure to do so will negatively affect our business.

On January 17, 2006, the SEC temporarily suspended the trading of our securities. By its terms, that suspension ended on January 30, 2006. Simultaneously with the suspension, the SEC advised us that it would be conducting a non-public investigation. In March 2006, our Board of Directors authorized its Audit Committee to conduct an internal investigation of matters relating to the SEC suspension and investigation. The Audit Committee did not conclude that any of our officers or directors have engaged in fraudulent
or criminal activity. However, it did conclude that we lacked an adequate control environment, and has taken action to address certain conduct of management that was revealed as a result of the investigation. As a result of the SEC matter and the Audit Committee investigation, our management was distracted from our daily operations and obtaining adequate sources of financing to sustain our operations, and the uncertainty surrounding the situation caused us to be a less attractive partner for businesses with whom we were looking to affiliate. As of March 26, 2007, the SEC has not

provided us with any communication indicating that its investigation has concluded or that we or any of our officers or directors have engaged in any criminal or fraudulent conduct with respect to Smart Online.

During October 2005, we acquired substantially all of the assets of Computility. We operated this SFA/CRM business under the name Smart CRM. During 2006, we integrated a simplified version of the SFA/CRM product we acquired from Computility into our OneBizSM platform. Following this successful integration, in September 2006 we sold to a strategic buyer the remaining assets of Computility, which primarily related to computer networking and software businesses. These businesses were not strategic to our long-term business model. Also during October 2005, we acquired all the stock of iMart. We operate this e-commerce business under the name Smart Commerce.

The initial effect of these acquisitions on our working capital has been negative with approximately $200,000 negative cash flow through December 31, 2005 and approximately $1,100,000 cumulative, net negative cash flow through December 31, 2006. Approximately $800,000 of the negative cash flow has been principal payments of purchase price towards the iMart acquisition. As of February 2007, the previous owners of iMart have been paid all installment payments required under the purchase agreement, including non-compete payments. We were able to make these payments by conducting a refinancing of the payments with a loan of approximately $1.8 million from Fifth Third Bank, as well as through a drawdown of approximately $1.0 million from our revolving line of credit with Wachovia, described below. The loan from Fifth Third Bank is to be paid back in 24 monthly installments. The loan is secured by all of the assets of Smart Commerce and all of Smart Commerce's intellectual property and is guaranteed by us and such guaranty is secured by all the common stock of Smart Commerce.

In November 2006, we established a$1.3 million revolving line of credit with Wachovia, which we subsequently increased to $2.5 million. Any advances made on the line of credit are to be paid off no later than August 1, 2008, with monthly payments of accrued interest on any outstanding balance commencing on December 1, 2006. The line of credit is secured by the Company's deposit account at Wachovia and an irrevocable standby letter of credit in the amount of $2.5 million issued by HSBC Private Bank (Suisse) S.A. with Atlas, a current stockholder, as account party. As of March 14, 2007, we have drawn down $2.1 million of the $2.5 million Wachovia line of credit.

In connection with the increase in the letter of credit to obtain the increase of the Wachovia line of credit, we entered into a warrant purchase agreement with Atlas. Under the terms of this agreement, we issued a warrant to Atlas to purchase up to 444,444 shares of common stock at a price of $2.70 per share at the termination of the line of credit or if we are in default under the terms of the line of credit.

In January 2007, several of our executive officers entered into new compensation arrangements with us. Under the terms of these new agreements, these executive officers agreed to a reduction in their base salaries to $100,000 per year. In exchange for this reduction, these executive officers will be paid an equal amount from a bonus pool of 10% of our "Free Cash Flow," defined as our total revenue, less operating expenses (with non-cash items added back), less principal debt payments.

In February 2007, we completed a private placement with two new investors. We sold an aggregate of 2,352,941 shares of common stock for $2.55 per share, issued warrants to purchase 1,176,471 shares of common stock with an exercise price of $3.00 per share, and received $6 million in gross proceeds from the sale. In connection with this transaction, we paid our placement agent 7% of the gross proceeds and issued the agent warrants to purchase 35,000 shares of our common stock at an exercise price of $2.55.

Fiscal Year

Our fiscal year ends on December 31. References to fiscal 2006, for example, refer to the calendar year ended December 31, 2006.

Sources of Revenue

We derive revenues from the following sources:

- Subscription fees - monthly fees charged to customers for access to our SaaS applications.
- Integration fees - fees charged to partners to integrate their products into our syndication platform.
- Syndication fees - fees consisting of:

fees charged to syndication partners to create a customized private-label site.

- barter revenue derived from syndication agreements with media companies.
- Professional service fees - fees related to consulting services which complement our other products and applications.
- Other revenues - revenues generated from non-core activities such as sales of shrink-wrapped products, OEM contracts and miscellaneous other revenues.

Our current primary focus is to target those established companies that have both a substantial base of small business customers as well as a recognizable and trusted brand name. Our goal is to enter into partnerships with these established companies whereby they private label our products and offer them to their base of small business customers. We believe the combination of the magnitude of their customer bases and their trusted brand names and recognition will help drive our subscription volume.

Subscription revenues consist of sales of subscriptions directly to end-users, or to others for distribution to end-users, hosting and maintenance fees, and e-commerce website design fees. Subscription sales are made either on a subscription or on a "for fee" basis. Subscriptions, which include access to most of our offerings are payable in advance on a monthly basis and are typically paid via credit card of the individual end-user or their aggregating entity. During past years, most of our OneBizSM users have been given free use of our products for extended time periods. During the fourth quarter of 2005, we changed that policy to a limited 30-day free use period, after which we terminate access for users who fail to become paid subscribers. We have delayed the termination of access for those subscribers as we were not yet able to offer the complete suite of applications which we deemed as necessary in order to convince free customers to convert to paying customers. However, we do not expect to convert a significant number of these free users into paying subscribers as we have shifted our focus to forging strategic partnerships with other companies that have small business customer bases. We expect lower net fees from subscribers at the private label syndication websites of our partners than from our main portal since our agreements call for us to share revenue generated on each respective site. In 2006, 96% of our subscription revenue was generated by our Smart Commerce segment, and the remaining 4% by our Smart Online segment.

When appropriate, we charge our partners a fee for private-labeling our website in their own customized interface (i.e., in the "look and feel" of our partners' sites). This fee is based on the extent of the modifications required as well as the revenue sharing ratio that has been negotiated between us and our partner. If a fee is charged for the production of the website and the modifications, it is recorded as Syndication Revenue.

In certain instances, we have integrated products offered by other companies into our products or websites. This is a means for the partner to generate additional traffic to their own website or revenue for their own product. Such revenue is recorded as integration revenue. Our integration contracts also provide for us to receive a percentage of revenue generated by our partner. Such revenues to date have been immaterial.

Both syndication and integration fees are recognized on a monthly basis over the life of the contract, although a significant portion of integration fees is received upfront. Our contracts and support contracts are non-cancelable, though customers typically have the right to terminate their contracts for cause if we fail to perform. We generally invoice our paying syndication or integration customers in annual or monthly installments and typical payment terms provide that our customers pay us within 30 days of invoice. Amounts that have been invoiced are recorded as accounts receivable and in deferred revenue or revenue depending on whether the revenue recognition criteria have been met. In general, we collect our billings in advance of the service period. As we have shifted our focus toward driving subscription revenue, which we deem to have the greatest potential for future revenue growth, we have seen a decrease in syndication and integration revenue through 2006 and we expect to this decrease to continue through 2007. In 2006, 100% of our syndication and integration revenue was generated by our Smart Online segment.

Professional service fees are fees generated from consulting services often directly associated with other projects which will generate subscription revenue. For example, a partner may request that we re-design its website to better accommodate our products or to improve its own website traffic. Such fees are typically billed on a time and material basis and are recognized as revenue when these services are performed and the customer is invoiced. In 2006, 100% of our professional services revenue was generated by our Smart Commerce segment.

Other revenues consist primarily of non-core revenue sources such as traditional shrink-wrap software sales and miscellaneous web services. It also includes OEM revenue generated through sales of our applications bundled with products offered by manufacturers such as Dell, Gateway and CompUSA. Revenues from OEM arrangements are reported and paid to us on a quarterly basis and are subject to certain contractual minimum volumes.

Revenue From Related Parties

In the past, we entered into a number of business transactions with related parties (as described below). Although we have little intention of entering into new related party transactions, we might do so if the transaction was for the benefit of our stockholders.

Approximately 0%, 0%, and 32.9% of total revenues for the years ended December 31, 2006, 2005, and 2004, respectively, were from a single customer, Smart IL Ltd., or SIL, formerly known as Smart Revenue Europe Ltd., an Israel based software company that specialized in secured instant messaging products. During March 2004, SIL ceased further development of its technology and laid-off all employees after SIL delivered to us a version of its instant messenger product. SIL is currently seeking to license or sell its technology. If our private label partners require that this instant messenger to be bundled with our platform, then certain revenue must be shared with SIL. SIL is owned by Doron Roethler, one of our stockholders.

We paid $221,517 to the Small Business Lending Institute, Inc. , or SBLI, during the first three months of 2004, because SBLI paid our employees during the first quarter of 2004 while we were dealing with a tax matter with the Internal Revenue Service. The temporary transfer of our employees to SBLI allowed us to obtain a clean cut off to determine the extent of our tax liability. Tamir Sagie, an officer of Smart Online at the time, was an officer of SBLI.

Michael Nouri, our Chief Executive Officer, is a shareholder in SBLI.

The following is a summary of related party revenues for years ended December 31, 2006, 2005 and 2004.

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
SIL Integration fees	$ —	$ —	$ 330,050
SBLI Consulting Services	—	—	—
Total Related Party Revenues	$ —	$ —	$ 330,050

Cost of Revenues

Cost of revenues consists primarily of salaries and related employee expenses associated with employees who provide maintenance and support services. Additionally, during 2005, a portion of cost of revenues included third-party fees.

During 2005, we acquired rights to an accounting software engine from a software development company and co-developed our accounting software with that developer. We have exclusive rights to the accounting application and non-exclusive rights to the software engine included in the application. During the third quarter of 2005, we capitalized $105,000 of costs associated with this acquired software. During the fourth quarter of 2005, management changed its estimate as to the realizability of the value of this asset and determined that the full value of the asset capitalized to date should be written off and all future costs incurred related to this same software should be expensed in the period incurred until the criteria of SFAS No. 86, Accounting for the Costs of Software to be Sold, Leased, or Otherwise Marketed, or SFAS No. 86, for capitalizing software costs are met. No amounts were capitalized in 2006.

Operating Expenses

During 2006, 2005, and 2004 our efforts were primarily focused on product development and integration. We employed approximately 18 full-time development employees during 2004. During 2005, we completed two acquisitions and hired additional development and sales staff bringing the total to 72 full-time employees at December 31, 2005. As of March 15, 2007, we had 56 employees. Most employees perform multiple functions.

Research and Development. Historically, we have not capitalized any costs associated with the development of our products and platform. SFAS No. 86 requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. Because any such costs that would be capitalized following the establishment of technological feasibility would immediately be written off due to uncertain realizability, all such costs have been recorded as research and development costs and expensed as incurred. Because of our proprietary, scalable and secure multi-user architecture, we are able to provide all customers with a service based on a single version of our application. As a result, we do not have to maintain multiple versions, which enables us to have relatively low research and development expenses as compared to traditional enterprise software business models. We expect that in the future, research and development expenses will increase substantially in absolute dollars but decrease as a percentage of total revenue as we upgrade and extend our service offerings, develop new technologies and transition from development stage to revenue generation.

Marketing and Sales. During 2006, 2005, and 2004, we spent limited funds on marketing, advertising, and public relations. Our business model of partnering with established companies with extensive small business customer bases allows us to leverage the marketing dollars spent by our partners rather than requiring us to incur such costs. We do not conduct any significant direct marketing or advertising programs. Our sales and marketing costs are expected to increase significantly in 2007 due to the addition of several sales persons, including a Vice President of Sales and Marketing. As we begin to grow the number of subscribers to our products, sales and marketing expense will increase

due to the various percentages of revenue we may be required to pay to partners.

General and Administrative. General and administrative expenses consist of salaries and related expenses for executive, finance and accounting, legal, human resources, and information technology personnel, professional fees, and other corporate expenses, including facilities costs. General and administrative expenses have increased and will continue to increase as we add personnel and incur additional professional fees and insurance costs related to the growth of our business and to our operations as a public company. Non-recurring general and administrative expenses increased in 2006 as a result of the SEC's suspension of trading of our securities, the continuing SEC action, and the internal investigation of matters relating to that suspension. Our expenses related to these matters have continued to decrease to an immaterial amount in the fourth quarter of 2006. We expect to incur additional material costs in 2007 as we take the necessary steps to comply with Section 404 of the Sarbanes-Oxley Act.

Stock-Based Expenses. Our operating expenses include stock-based expenses related to options and warrants issued to employees and non-employees. These charges have been significant and are reflected in our historical financial results. Effective January 1, 2006, we adopted SFAS No. 123 (revised 2004), Share-Based Payment, or SFAS No. 123R, which has resulted and will continue to result in material costs on a prospective basis. See Note 11, "Stockholders' Deficit," of the Consolidated Financial Statements in this report. In addition, in connection with the issuance of 1,273,000 shares of our common stock issued pursuant to investor relations services contracts, including 1,250,000 of which were issued in the fourth quarter of 2005, we have incurred non-cash expenses equal to the market value of the shares of approximately $9.9 million. In 2006, the 1,250,000 shares issued in the fourth quarter of 2005 were redeemed by Smart Online, resulting in other income of $3,125,000. This was done in connection with the settlement agreements between the parties issued these shares and us. Under these agreements, these parties retained the cash fee paid to them, totaling $500,000, for their services.

Critical Accounting Policies and Estimates

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. "Critical accounting policies and estimates" are defined as those most important to the financial statement presentation and that require the most difficult, subjective, or complex judgments. We base our estimates on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Under different assumptions and/or conditions, actual results of operations may materially differ. We periodically re-evaluate our critical accounting policies and estimates, including those related to revenue recognition, provision for doubtful accounts, expected lives of customer relationships, useful lives of intangible assets and property and equipment, provision for income taxes, valuation of deferred tax assets and liabilities, and contingencies and litigation reserves. We presently believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition- We recognize revenue in accordance with accounting standards for software and service companies including the SEC's Staff Accounting Bulletin 104, Revenue Recognition, or SAB 104,, Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, or EITF 00-21, Emerging Issues Task Force Issue No. 99-19, Reporting Revenue Gross as a Principal or Net as an Agent, or EITF 99-19,and related interpretations including American Institute of Certified Public Accountants, or AICPA, Technical Practice Aids. We also utilize interpretative guidance from regulatory and accounting bodies, which include, but are not limited to, the SEC, the AICPA, the Financial Accounting Standards Board, or FASB, and various professional organizations.

We recognize revenue when all of the following conditions are satisfied: (1) there is persuasive evidence of an arrangement; (2) the service has been provided to the customer; (3) the collection of our fees is probable; and (4) the amount of fees to be paid by the customer is fixed or determinable. EITF 00-21 states that revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables in the arrangement meet the following criteria: (1) the delivered item has value to the customer on a stand-alone basis; (2) there is objective and reliable evidence of the fair value of the undelivered item; and (3) if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially in control of the vendor. Our syndication and integration agreements typically include multiple deliverables including the grant of a non-exclusive license to distribute, use and access to our platform, fees for the integration of content into our platform, maintenance and hosting fees, documentation and training, and technical support and customer support fees. We cannot establish fair value of the individual revenue deliverables based on objective and reliable evidence because we do not have a long, consistent history of standard syndication and integration contractual arrangements, there have only been a few contracts that have continued past the initial contractual term, we do not have any contracts in which these elements have been sold as stand-alone items, and there is no third-party evidence of fair value for products or services that are interchangeable and comparable to our products and services. As such, we cannot allocate revenue to the individual deliverables and must record all revenues received as a single unit of accounting as further described below. Additionally, we have evaluated the timing and substantive nature of the performance obligations associated with the multiple deliverables noted above, including the determination that the remaining obligations are essential to the ongoing usability and functionality of the delivered products, and determined that revenue should be recognized over the life of the contracts, commencing on the date the site goes on-line.

Syndication fees consist primarily of fees charged to syndication partners to create and maintain a customized private-label site and ongoing support, maintenance and customer service. Syndication agreements typically include an advance fee and monthly hosting fees. Integration fees consist primarily of fees charged to integration partners to

integrate their products into our syndication platform. Amounts that have been invoiced are recorded as accounts receivable and in deferred revenue and the revenue is recognized ratably over the specified lives of the contracts, commencing on the date the site goes on-line. Syndication, integration and support contracts typically provide for early termination only upon a material breach by either party that is not cured in a timely manner. If a contract terminates earlier than its term, the remaining deferred revenue is recognized upon termination. It is possible that the estimates of expected duration of customer contract lives may change and the period over which such syndication revenues are amortized could be adjusted. Any such change in specified contract lives could affect future results of operations.

Both syndication and integration fees are recognized on a monthly basis over the life of the contract, although a significant portion of the fee from integration agreements is received upfront. Customers are generally invoiced in annual or monthly installments and typical payment terms provide that customers pay within 30 days of invoice. In general, billings are collected in advance of the service period.

Other revenues, which include traditional shrink-wrap sales and OEM arrangements, are recorded based on the greater of actual sales or contractual minimum guaranteed royalty payments. For OEM contracts, we record the minimum guaranteed royalties monthly and receive payment of the royalties on a quarterly basis, thirty (30) days in arrears. To the extent actual royalties exceed the minimum guaranteed royalties, the excess is recorded in the quarter we receive notification of such additional royalties.

Subscription revenues consist of subscription sales directly to end-users, or to others for distribution to end-users, hosting and maintenance fees, e-commerce website design fees and online loan origination fees. Subscription sales are made either on a monthly subscription or a one-time for fee basis. Subscriptions, which include access to most of our offerings, are payable in advance on a monthly basis. Currently, most of our syndication agreements call for us to receive a percentage of revenue generated. Depending on the criteria of each individual contract and in accordance with EITF 99-19, a determination is made as to whether we should recognize the gross revenue with a corresponding expense for the portion paid to or retained by the partner or recognize only our net portion as revenue. At this time, we are still selling certain products and services on a “for fee” basis. We also recently began to offer to our potential syndication partners volume discounts for pre-paid subscriptions, which they can either resell or contribute to their small business customers, but no volume sales have occurred. E-Commerce website design fees, which are charged for building and maintaining corporate websites or to add the capability for e-commerce transactions, are recognized over the life of the project. Domain name registration fees are recognized over the term of the registration period. Online loan origination fees are charged to provide users online financing options. We receive payments for loans or credit provided.

Professional service fees are recognized over the term of the consulting engagement as services are performed, which is typically one to three months. Advance payments for consulting services, if billed and paid prior to completion of the project, are recorded as deferred revenue when received. If the fees are not fixed or determinable, revenue is recognized as work is performed and billed. In determining whether the professional service fees can be accounted for separately from subscription and support revenues, we consider the following factors for each consulting agreement: availability of the consulting services from other vendors, whether objective and reliable evidence for fair value exists of the undelivered elements, the nature of the consulting services, the timing of when the consulting contract was signed in comparison to the subscription service start date, and the contractual dependence of the subscription service on the customer’s satisfaction with the consulting work.

Barter Transactions - Barter revenue relates to syndication and integration services provided by us to business customers in exchange for advertising in the customers’ trade magazines and on their websites. Barter expenses reflect the expense offset to barter revenue. The amount of barter revenue and expense is recorded at the estimated fair value of the services received or the services provided, whichever is more objectively determinable, in the month the services and advertising are exchanged. We apply APB 29, Accounting for Non-Monetary Transactions, the provisions of EITF 93-11, Accounting for Barter Transactions Involving Barter Credits and EITF 99-17, Accounting for Advertising and Barter Transactions and, accordingly, recognize barter revenues only to the extent that we have similar cash transactions within a period not to exceed six months prior to the date of the barter transaction. To date the amount of barter revenue to be recognized has been more objectively determinable based on integration and syndication services provided. For revenue from integration and syndication services provided for cash to be considered similar to the integration and syndication services provided in barter transactions, the services rendered must have been in the same media and similar term as the barter transaction. Once the value of the barter revenue has been determined, we follow the same revenue recognition principles as we apply to cash transactions with unearned revenues being deferred as described more fully under the caption “Revenue Recognition” above. Barter revenues totaled approximately $103,000, $424,000 and $113,000, for the years ended December 31, 2006, 2005 and 2004, respectively.

Impairment of Long Lived Assets - Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Income Taxes. We are required to estimate our income taxes in each of the jurisdictions in which we operate. This involves estimating our current tax liabilities in each jurisdiction, including the impact, if any, of additional taxes resulting from tax examinations as well as making judgments regarding our ability to realize our deferred tax assets. Such judgments can involve complex issues and may require an extended period to resolve. In the event we determine that we will not be able to realize all or part of our net deferred tax assets, an adjustment would be made in the period such determination is made. We recorded no income tax expense in any of the periods presented, as we have experienced significant operating losses to date. If utilized, the benefit of our total net operating loss carryforwards may be applied to reduce future tax expense. Since our utilization of these deferred tax assets is dependent on future profits, which are not assured, we have recorded a valuation allowance equal to the net deferred tax assets. These carryforwards would also be subject to limitations, as prescribed by applicable tax laws. As a result of prior equity financings and the equity issued in conjunction with certain acquisitions, we have incurred ownership changes, as defined by applicable tax laws. Accordingly, our use of the acquired net operating loss carryforwards may be limited. Further, to the extent that any single year loss is not utilized to the full amount of the limitation, such unused loss is carried over to subsequent years until the earlier of its utilization or the expiration of the relevant carryforward period.

Results of Operations

The following tables set forth selected consolidated statements of operations data for each of the periods indicated.

	Year Ended December 31, 2006	Year Ended December 31, 2005	Year Ended December 31, 2004
REVENUES:			
Integration Fees	$ 182,660	$ 798,178	$ 374,055
Syndication Fees	218,386	402,847	176,471
Subscription Fees	1,904,192	468,621	—
Professional Services Fees	1,269,300	401,677	—
Other Revenue	70,352	84,102	122,394
Related Party Revenues	—	—	330,050
Total Revenues	3,644,890	2,155,425	1,002,970
COST OF REVENUES	329,511	154,892	211,616
GROSS PROFIT	3,315,379	2,000,533	791,354
OPERATING EXPENSES:			
General and Administrative	5,648,377	15,038,563	2,432,928
Sales and Marketing	1,016,107	1,386,019	596,989
Research and Development	2,016,507	1,649,956	563,372
Total Operating Expenses	8,680,991	18,074,538	3,593,289
LOSS FROM CONTINUING OPERATIONS	(5,365,612)	(16,074,005)	(2,801,935)
OTHER INCOME (EXPENSE):			
Interest Expense, Net	(254,381)	(37,502)	(119,389)
Gain on Debt Forgiveness	144,351	556,215	249,395
Redemption of Investor Relations Shares	3,125,000	—	—
Writeoff of Investment	(25,000)	—	—
Other Income (Expense)	(122,502)	418	—
Total Other Income	2,867,468	519,131	130,006
NET LOSS FROM CONTINUING OPERATIONS	(2,498,144)	(15,554,874)	(2,671,929)
DISCONTINUED OPERATIONS			
Loss of Operations of Smart CRM (2006 includes gain on sale of assets of $563,835, write-off of goodwill of $2,793,321 and loss on operations of $296,077), net of tax ($0)	(2,525,563)		—
Loss on Discontinued Operations	(2,525,563)	(35,735)	
Preferred stock dividends and accretion of discount on preferred stock	—	—	(2,215,625)
Accretive dividend issued in connection with registration rights agreement	—	—	(206,085)
Converted preferred stock inducement cost	—	—	(3,225,410)
NET LOSS			

Net loss attributed to common stockholders	$	(5,023,707)	$	(15,590,609)	$	(8,319,049)

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The following tables set forth selected consolidated statements of operations data for each of the periods indicated as a percentage of total revenues.

	Year Ended December 31,		
REVENUES:	**2006**	**2005**	**2004**
Integration Fees	5%	37%	37%
Syndication Fees	6%	19%	18%
Subscription Fees	52%	22%	—
Professional Services Fees	35%	19%	—
Other Revenue	2%	3%	12%
Related Party Revenues	—	—	33%
Total Revenues	100%	100%	100%
COST OF REVENUES	9%	7%	21%
GROSS PROFIT	91%	93%	79%
OPERATING EXPENSES:			
G&A	155%	698%	243%
Sales & Marketing	28%	64%	60%
Development	55%	77%	56%
Total Operating Expenses	238%	839%	359%
Net Income (Loss) from Operations	-147%	-746%	-279%
OTHER INCOME (EXPENSES):			
Interest Income (Expense), net	-7%	-2%	-12%
Gain / Loss on Legal Settlements	4%	26%	25%
Other Income	82%	—	—
Writeoff of Investment	-1%	—	—
Gain on Sale of Assets	—	—	—
DISCONTINUED OPERATIONS			
Gain from Operations of Smart CRM (including Loss on Sale of $2,140,054)	-69%	-2%	—
Income Tax	—	—	—
Income from Discontinued Operations	-69%	-2%	—
NET INCOME (LOSS)	-138%	-723%	-266%
Preferred Stock Dividends and Accretion of Discount on Preferred Stock	—	—	-221%
Accretive dividend issued in connection with Reg Rights Statement	—	—	-21%
Converted Preferred Stock Inducement Cost	—	—	-322%
Net Loss Attributed to Common Stockholders	-138%	-723%	-830%

Overview of Results of Operations for the Fiscal Year Ended December 31, 2006

Total revenues for the year ended December 31, 2006 were $3.6 million, an increase of $1.4 million or 69% over 2005. Subscription revenue for 2006 was $1.9 million, an increase of $1.4 million or 305% over 2005. For 2006, we reported in two segments for the first time and derived $513,000 and $3.1 million of our consolidated revenue from our Smart Online segment and Smart Commerce segment, respectively.

Our net loss for 2006 was $5.0 million, a decrease of $10.6 million from a net loss of $15.6 million in 2005. Net loss for 2006 included a loss from discontinued operations of $2.5 million, and $3,125,000 of other income from the redemption of investor relations shares. For 2005, the loss from discontinued operations was approximately $36,000. Net loss for 2006 also included non-cash charges of $782,000 related to amortization and depreciation and $780,000 related to compensation costs for stock options as accounted for under SFAS No. 123R. During 2005, we incurred depreciation and amortization expense of $217,000 and no stock option expense as SFAS No. 123R was not yet adopted. 2005 included a non-cash charge of $9.7 million related to investor relations contracts that we cancelled during 2006.

During 2006, substantial costs were incurred related to the SEC’s suspension of the trading of our common stock and the resulting SEC and internal investigation. Legal expense related to the SEC and internal investigations was approximately $1.0 million for 2006.

In the first quarter of 2006, we learned that one of our major customers for the Smart Commerce segment underwent a restructuring. During 2006, this restructuring resulted in a loss of approximately 45% of the revenue generated by this customer. Revenue from this customer decreased in the months following the restructuring, then leveled off for the last three months of 2006.

As of January 1, 2006, we offered our OneBizSM and iDA platforms to small businesses through four total syndication partners. During 2006, one of these partners, Union Bank of California, N.A., renewed its contract for a one year term. As of December 31, 2006, our OneBizSM and iDA platforms were available through four syndication partners and our main portal.

In September 2006, we sold substantially all of the assets of Smart CRM to Alliance. This sale resulted in $600,000 cash proceeds and the elimination of approximately $1.7 million in liabilities. We recorded an impairment of goodwill of approximately $2.8 million resulting in a net loss on sale of approximately $2.1 million. As a result, we reported results of operations for Smart CRM prior to the sale of assets as discontinued operations.

During the first half of 2006, the number of subscribers to our products and services through our main portal and the web sites of our partners declined. Over the second half of 2006 and into 2007, the number of subscribers has been relatively constant. We are not aware of all the factors that led to the decrease in the number of subscribers, but we are aware that some complained about the ease of use of our website. We subsequently redesigned our main portal to address these concerns. Also, in the fourth quarter of 2006, we began focusing on increasing these subscription numbers by contracting with new partners to market our applications to their small business customers.

At December 31, 2006, we had $577,000 in cash of which $250,000 was restricted as compared to cash of $1.7 million at December 31, 2005, of which $230,000 was restricted. Accounts receivable at December 31, 2006 was $248,000 as compared to $505,000 at December 31, 2005. Deferred revenue at December 31, 2006 was $325,000 as compared to $766,000 at December 31, 2005.

Comparison of the Results of Operations for the Years Ended December 31, 2006 and 2005

Revenues - Total revenues were $3.6 million in 2006 as compared to $2.2 million in 2005, an increase of $1.4 million or 69%. Subscription revenue for 2006 was $1.9 million, an increase of $1.4 million or 305% over 2005. This increase was primarily attributable to the subscription revenue of Smart Commerce, which was operational as our subsidiary for the full twelve months of 2006 as compared to only two and one half months during 2005 (October 18, 2005 to December 31, 2005). In the first quarter of 2006, we learned that one customer of Smart Commerce, constituting approximately 40% of iMart's 2005 revenue, underwent a restructuring that resulted in a decrease of approximately 45% in its business with Smart Commerce between April 2006 and December 2006. Although this customer restructuring has had a negative effect on Smart Commerce, we are targeting to offset this loss by securing new customers in 2007. As of March 15, 2007, we have secured one new customer for Smart Commerce. Integration revenue decreased $615,000, or 77%, to $183,000 in 2006. Syndication revenue decreased $185,000, or 46%, to $218,000 in 2006 compared to 2005. This decrease was primarily attributable to our shift away from integration and syndication revenue as we began focusing on building subscription revenue. Accordingly, we have let the majority of our integration and syndication contracts expire in 2006. We expect our integration and syndication revenue to continue to decline as we work to increase our subscription revenue. Professional services fees increased $867,000 or 216% to $1,269,000 in 2006 compared to 2005. This increase was primarily attributable to the professional service fees of Smart Commerce, which was operational as our subsidiary for the full twelve months of 2006 as compared to only two and one half months during 2005 (October 18, 2005 to December 31, 2005), and revenue for a perpetual license of approximately $500,000. We did not derive any material revenue from related parties during 2005.

Cost of Revenues - Cost of revenues were $330,000 in 2006 as compared to $155,000 in 2005, an increase of $175,000 or 113%. The Smart Commerce segment contributed $271,000 to cost of revenues in 2006 as compared to $56,000 in 2005, an increase of $215,000. This increase was offset by a decrease in cost of revenues of $43,000 in the Smart Online segment over 2005, which was the result of headcount reductions in personnel directly responsible for integration and syndication contract maintenance.

General and Administrative - General and administrative expenses were $5.6 million in 2006 as compared to $15 million in 2005, a decrease of $9.4 million or 62%. This decrease was primarily due to decreases in investor relations, management consultant, travel, meal and entertainment and bonus expenses, which was offset by increases in total compensation expense, legal and professional fees and expenses related to Smart Commerce.

Our investor relations expenses decreased by $10,285,000, from $10,318,000 in 2005 to $33,000 in 2006. The expenses for 2005 were extraordinarily high as a result of shares that we issued to investor relations firms. Pursuant to settlement agreements with these investor relations firms in 2006, we redeemed these shares in 2006, resulting in a $3.125 million increase in our other income. Our management consulting expenses decreased by $1,295,000, from $1,320,000 in 2005 to $25,000 in 2006. This decrease resulted from our termination or non-renewal of contracts with a substantial number of management consulting firms. Travel expenses decreased by $146,000, from $220,000 in 2005 to $74,000 in 2006. This decrease was the combined result of higher than normal expense in 2005 when our executives were traveling frequently related to financing and investing activity, specifically with Atlas and the Blueline Fund, combined with lower than normal expense in 2006 when travel was greatly curtailed as management focused on the SEC and internal investigation. For those same reasons, our meals and entertainment expenses decreased by $44,000, from $60,000 in 2005 to $16,000 in 2006. Our bonus expenses also decreased by $51,000, from $52,000 in 2005 to $1,000 in 2006 as we curtailed our cash incentive programs due to, in part, the following factors (1) the suspension in the trading of our securities by the SEC and the related investigation, (2) the repeated need to enter into various financing transactions in order to continue operations, (3) we had immaterial revenues other than those generated by Smart Commerce and Smart CRM, and (4) we have only experienced net losses to date.

The decreases in our general and administrative expenses were offset by a $1,022,000 increase in total compensation expense, from $645,000 in 2005 to $1,667,000 in 2006. Of this increase, $794,000 is attributable to the non-cash stock option expense now required by our adoption of SFAS No. 123R and the remaining $228,000 of the increase is attributable to salaries paid to our CFO, COO and Corporate Counsel. As a result of hiring a full-time CFO, third party accounting and bookkeeping fees decreased by $405,000, from $669,000 in 2005 to $264,000 in 2006.

The decreases in our general and administrative expenses also were offset by a $827,000 increase in legal and professional fees, from $421,000 in 2005 to $1,248,000 in 2006. This increase was primarily attributable to the legal costs related to the SEC and internal investigations. Management anticipates an increase in legal and professional fees in 2007 for non-recurring expenses related to the costs of compliance with the Sarbanes-Oxley Act and other public company-related expenses. The increased expenses associated with the SEC's suspension of trading of our securities, the continuing SEC action, and the internal investigation of matters relating thereto are all non-recurring expenses, but may continue to be significant expenses in 2007. To date, our insurers have only agreed to cover a portion of the fees and expenses related to the SEC action and the internal investigation.

Finally, our Smart Commerce segment contributed an additional $237,000 of general and administrative expense in 2006 as compared to 2005, because Smart Commerce was operational as our subsidiary for the full twelve months of 2006 as compared to only two and one half months during 2005 (October 18, 2005 to December 31, 2005).

Sales and Marketing - Sales and marketing expense decreased by $370,000, from $1,386,000 in 2005 to $1,016,000 in 2006. This decrease was primarily attributable to decreases in our advertising, sales and marketing wages, management consulting, commission, marketing and public relations expenses, which were offset by increased expenses related to our Smart Commerce segment.

Advertising expense decreased by $289,000, from $290,000 in 2005 to $1,000 in 2006 primarily due to reduced barter advertising expense. Sales and marketing wages decreased by $263,000, from $402,000 in 2005 to $139,000 in 2005, primarily due to the promotion to Chief Operating Officer of an individual whose salary has now been re-allocated to general and administrative expenses as well as the elimination of several sales positions. Management consulting expense decreased by $73,000, from $79,000 in 2005 to $6,000 in 2006, as we relied less on outside consultants. Commission expense decreased by $46,000, from $52,000 in 2005 to $6,000 in 2006, as we reduced our sales staff due to workforce reductions. We expect commission expense to increase in 2007 as we anticipate hiring additional sales staff as we renew our focus on revenue generation. Marketing expense decreased by $90,000, from $96,000 in 2005 to $6,000 in 2006, as we reduced our direct marketing efforts in 2006 and shifted to leveraging the marketing power of our partners. Public relations expense decreased by $90,000, from $103,000 in 2005 to $12,000 in 2006, as we greatly reduced our utilization of third party public relations firms and focused our expenditures on our core operations.

These decreases in our sales and marketing expenses in 2006 were offset by the contribution of an additional $492,000 by our Smart Commerce segment to sales and marketing expense in 2006 as compared to 2005, because Smart Commerce was operational as our subsidiary for the full twelve months of 2006 as compared to only two and one half months during 2005 (October 18, 2005 to December 31, 2005).

Development Expense - Development expense increased by $367,000, from $1,650,000 in 2005 to $2,017,000 in 2006. This increase was primarily attributable to an additional $706,000 in development expense from our Smart Commerce segment in 2006 as compared to $116,000 in 2005, because Smart Commerce was operational as our subsidiary for the full twelve months of 2006 as compared to only two and one half months during 2005 (October 18, 2005 to December 31, 2005). This increase was offset by a $185,000 decrease in accounting application development expense, from $293,000 in 2005 to $108,000 in 2006. This decrease was the result of a reevaluation of our efforts regarding the accounting application in 2006. During the second half of 2006 when our needs pertaining to the accounting application were being re-evaluated and re-designed, no significant development expense related to the accounting application was incurred as no significant designing or programming was taking place.

Development bonus expense decreased by $150,000 from $150,000 in 2005 as bonuses were suspended in 2006.

Other Income (Expense) - In 2005, we paid an aggregate $500,000 in cash and issued an aggregate of 1,250,000 shares of our common stock to two investor relations consultants pursuant to consulting agreements with each. At the time of issuance, the aggregate value of the shares of common stock was approximately $9,738,000. In 2006, we entered into settlement agreements with each of these investors relations consultants. Under the terms of the settlement agreements, the consultants retained all of the cash fees paid to them, but released any interest in the shares that were issued. These shares were redeemed by us in 2006, resulting in other income of $3,125,000.

We incurred net interest expense of $254,000, net of interest income of $11,000, in 2006 as compared to net interest expense of $38,000, net of $33,000 of interest income in 2005. This increase in net interest expense of $174,000, or 218%, is primarily attributable to the carrying cost for a full year of the debt associated with the iMart and Computility acquisitions. The decrease in interest income is primarily the result of reduced cash balances in interest-earning accounts.

Due to our financing activities related to the iMart purchase price as well as the establishment and use of our Wachovia line of credit, we anticipate that interest expense will be significantly higher in 2007.

Comparison of the Results of Operations for the Years Ended December 31, 2005 and 2004

Revenues - Total revenues were $2.2 million in 2005 as compared to $1.0 million in 2004, an increase of $1.2 million, or 115%. Our subscription revenue increased from zero in 2004 to $469,000 in 2005. Revenues from professional services increased from zero in 2004 to $402,000 in 2005. These increases were primarily attributable to our acquisition of all of the stock of iMart, which became our subsidiary, Smart Commerce, in October 2005.

Integration revenues in 2005 totaled $798,000 as compared to $374,000 in 2004, representing an increase of $424,000, or 113%. This increase was primarily due to two new integration contracts that accounted for approximately 43% of the 2005 integration revenues. Syndication revenues in 2005 totaled $403,000, as compared to $176,000 in 2004, representing an increase of $227,000, or 128%, due primarily to our entering into new syndication agreements. All of the 2005 syndication revenues were from three agreements. The 2005 and 2004 integration and syndication revenues also included $424,000 and $113,000, respectively, of revenue derived from barter transactions.

We did not derive any material revenue from related parties during 2005. In 2004, revenues from related parties accounted for $330,050, or 33%, of total revenue. Management does not expect related party revenues to be a significant source of income going forward.

Cost of Revenues - Cost of revenues was $155,000 in 2005 as compared to $212,000 in 2004, a decrease of $57,000, or 27%. This decrease was primarily a result of a decrease in the costs of wages associated with maintaining and supporting integration and syndication partners due to a reduction in the number of active contracts. These wages decreased by $96,000, from $129,000 in 2004 to $33,000 in 2005. In addition, stock-based consulting expense decreased by $22,000, from $22,000 in 2004 to zero in 2005 because we no longer used these consultants. However, these decreases were offset due to the acquisition of iMart, which increased the cost of revenues by $56,000 for 2005 primarily due to third-party domain registration fees and personnel costs associated with supporting subscription services. This increase in costs of revenues for the Smart Commerce segment represented 7% of Smart Commerce’s revenue for 2005.

General and Administrative - General and administrative expenses increased by approximately $12.6 million, from $2.4 million in 2004 to $15 million in 2005. Approximately $10.2 million of this increase is attributable to two investor relations contracts of which $9.7 million was paid in stock and $500,000 was paid in cash. As described above, we subsequently entered into settlement agreement with these parties and redeemed the shares. Additionally, in 2005 we paid a total of $499,000 in cash and issued 23,000 shares of common stock valued at a total of $216,000 to other investor relations consultants. Approximately $159,000 of the increase in general and administration expense is attributable to amortization expense related to intangible assets acquired from iMart. 2004 included $350,000 of general and administrative expense associated with the conversion of certain warrants to common stock and $66,000 of stock-based compensation expense. Finally, general and administrative expense increased due to a $319, 000 increase in legal and professional fees, from $770,000 in 2004 to $1,089,000 in 2005, which was primarily due to costs associated with conducting financial statements audits for 2002 and 2003 and one-time expenses associated with preparing to become a public company.

Sales and Marketing - Sales and marketing increased by $789,000, from $597,000 in 2004 to $1,386,000 in 2005, as we increased our sales and marketing staff and activities. 2004 included approximately $206,000 of barter advertising expense as compared to $274,000 for 2005.

Development - Development expense increased by $1,087,000, from $563,000 in 2004 to $1,650,000 in 2005. This increase is primarily the result of our adding additional programming, database management, quality assurance, and project management resources to support the on-going development of the applications.

Other Income (Expense) - We incurred net interest expense of $38,000, net of $33,000 of interest income, in 2005 and $119,000 of interest expense in 2004. The 2005 interest expense of approximately $71,000 was primarily the result of interest expense on the non-compete and purchase price notes related to our acquisitions of iMart and Computility. We earned approximately $33,000 of interest income related to bank deposits during 2005, compared to zero in 2004. 2004 interest expense included $75,000 of interest related to the issuance of 150,000 shares of common stock to a relative of one of our officers in consideration for extending the term of a loan and loaning additional funds to us as described in Note 8, Loans, to the accompanying audited financial statements. The remainder of the 2004 interest expense was primarily attributable to interest due on deferred compensation owed to certain of our officers and interest related to unpaid payroll tax obligations. There was no interest income in 2004. Both the deferred compensation and income tax obligations were relieved during the first quarter of 2005.

During 2005 and 2004, we realized gains totaling $556,000 and $249,000, respectively, from negotiated and contractual releases of outstanding liabilities. The gains from debt forgiveness resulted from unrelated third parties, primarily trade creditors who had performed services for us, agreeing to accept as payment in full a lesser amount than the stated liability in consideration for timely payment of the negotiated settlement.

Provision for Income Taxes —We did record a provision for income tax expense in 2006, 2005 or 2004 because we have been generating net losses. Furthermore, we have not recorded an income tax benefit for 2006, 2005, and 2004, primarily due to continued substantial uncertainty regarding our ability to realize our deferred tax assets. Based upon available objective evidence, there has been sufficient uncertainty regarding the ability to realize our deferred tax assets, which warrants a full valuation allowance in our financial statements. As of December 31, 2006, we had approximately $42 million in net operating loss carryforwards, which may utilized to offset future taxable income.

Utilization of our net operating loss carryforwards may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization.

Liquidity and Capital Resources

As of December 31, 2006, our principal sources of liquidity were cash and cash equivalents totaling $577,000 and accounts receivable of $248,000. As of March 15, 2007, our principal sources of liquidity were cash and cash equivalents totaling approximately $5,114,000 and accounts receivable of approximately $209,000. This increase in cash and cash equivalents from December 31, 2006 to March 15, 2007 is primarily due to total aggregate proceeds of $6,000,000 from our sale of 2,352,941 shares of common stock to investors for a price of $2.55 per share, which included warrants for the purchase of an aggregate of 1,176,471 shares of common stock at an exercise price of $3.00 per share. Of this, $250,000 of our cash is restricted in accordance with our promissory note with Fifth Third Bank, or Fifth Third, described below. As of March 15, 2007, we have drawn approximately $2.1 million of our $2.5 million line of credit, leaving approximately $400,000 available for our operations.

Cash Flow from Operations. Cash flows used in operations in 2006 totaled $3.25 million, down from $6.35 million in 2005 and $3.69 million in 2004. This decrease was primarily attributable to cash flows from the two companies we acquired in October 2005.

Cash Flow from Financing Activity. In 2006, we generated a total of $1.72 million net cash from our financing activities. This net cash was generated through both equity and debt financing, as described below.

Equity Financing. Our primary source of cash during 2006, 2005 and 2004, as well as prior years, was from the sale of our securities. Between March 2006 and August 2006, we sold an aggregate of 1 million shares of our common stock to four investors, three of whom were current stockholders, for a price of $2.50 per share resulting in gross proceeds of $2,500,000. We incurred immaterial issuance costs related to these stock sales. During 2005, we generated net cash from financing activities, including the sales of shares of our common stock, of approximately $7.7 million. During the first half of 2004, we sold shares of common stock to new and existing shareholders resulting in net proceeds of $3.33 million. During the second half of 2004, we sold shares of common stock to new and existing investors in a private placement resulting in net proceeds of $1.4 million.

Debt Financing. In 2006, we entered into two debt financing transactions. On November 9, 2006, Smart Commerce entered into a loan agreement with Fifth Third Bank. Under the terms of this agreement, Smart Commerce borrowed $1.8 million to be repaid in 24 monthly installments of $75,000 plus interest beginning in December 2006. The interest rate is prime plus 1.5% as periodically determined by Fifth Third. Currently and at closing, the prime rate was 8.25%. The loan is secured by all of the assets of Smart Commerce, including a security account of $250,000 with Fifth Third, and all of Smart Commerce’s intellectual property. The loan is guaranteed by us and such guaranty is secured by all the common stock of Smart Commerce. Under the terms of the loan agreement, Smart Commerce has established a lock box account with Fifth Third, but has the right to use the amounts deposited therein for any purpose not inconsistent with the loan agreement and related documents so long as no event of default exists and is continuing. Further, the $250,000 in the security account will be released in 3 installments of approximately $83,000 if on June 30, 2007, December 31, 2007, and June 30, 2008 Smart Commerce meets certain debt covenants regarding operating metrics for Smart Commerce.

On November 14, 2006, we entered into a revolving credit arrangement with Wachovia. The line of credit advanced by Wachovia was $1.3 million, and can be used for general working capital. This was increased to $2.5 million in January 2007. Any advances made on the line of credit must be paid off no later than August 1, 2008, with monthly payments of accrued interest commencing on December 1, 2006 on any outstanding balance. The interest shall accrue on the unpaid principal balance at the LIBOR Market Index Rate plus 0.9%. The line of credit is secured by our deposit account at Wachovia and an irrevocable standby letter of credit in the amount of $2.5 million issued by HSBC Private Bank (Suisse) S.A. with Atlas as account party. We have separately agreed with Atlas that in the event of a default by us in the repayment of the line of credit that results in the letter of credit being drawn, we shall reimburse Atlas any sums that Atlas is required to pay under such letter of credit. At our sole discretion, these payments may be made in cash or by issuing shares of our common stock at a set per share price of $2.50.

Deferred Revenue. At December 31, 2006, we had deferred revenue totaling $325,000, net of offsetting amounts receivable. Deferred revenue represents amounts collected in advance of the revenue being recognized. Based upon current conditions, we expect that approximately 96% of this amount will be recognized during 2007.

We have not yet achieved positive cash flows from operations, and our main sources of funds for our operations have been the sale of securities in private placements and the Wachovia line of credit. We must continue to rely on these sources until we are able to generate sufficient revenue to fund our operations. We believe that anticipated cash flows from operations, funds available from our existing line of credit, together with cash on hand, will provide sufficient funds to finance our operations at least for the next 12 months. Changes in our operating plans, lower than anticipated sales, increased expenses, or other events may cause us to need to seek additional equity or debt financing in future

periods. There can be no guarantee that financing will be available on acceptable terms or at all. Additional equity financing could be dilutive to the holders of our common stock, and additional debt financing, if available, could impose greater cash payment obligations and more covenants and operating restrictions. We have no current plans to seek any such additional financing.

Recent Developments

New Contracts. During the first quarter of 2007, we entered into the following new contracts:

- Two syndication agreements, one through our Smart Online segment which will offer a private label suite of branded food safety compliance applications for industry associations. The partnership will incorporate our partner's food industry traceability and compliance functionality into our business application suite. The other through our Smart Commerce segment with a leading direct selling organization.

- Marketing referral agreement through our Smart Online segment with a firm that provides IT services to financial service companies in Caribbean countries. We entered into this partnership to offer a Spanish version of our applications to financial service companies, which will be offered as a private labeled site to the partner's small business customers.

Sales of Securities. On February 21, 2007, we sold an aggregate of 2,352,941 shares of our common stock at $2.55 per share to two new investors for aggregate gross proceeds of $6,000,000. Under the purchase agreement, we issued the investors warrants for the purchase of an aggregate of 1,176,471 shares of common stock at an exercise price of $3.00 per share. We also entered into registration rights agreements with the investors that obligate us to register the shares sold for resale by the investors by a certain date. If a registration statement is not timely made, we are obligated to pay a cash penalty up to 10% of the aggregate purchase price. Under the terms of the registration rights agreement, we cannot offer for sale or sell any securities until May 22, 2007, subject to certain limited exceptions, unless, in the opinion of our outside counsel, such offer or sale would not jeopardize the availability of exemptions from the registration and qualification requirements under applicable securities laws with respect to this placement. We incurred issuance costs of approximately $500,000 related to this private placement, excluding warrants issued to our private placement agent.

As part of the issuance costs of this transaction, we issued our placement agent a warrant to purchase 35,000 shares of our common stock at an exercise price of $2.55 per share. We also entered into a registration rights agreement with the agent. Under this agreement, the shares issuable upon exercise of the warrant must be included on the same registration statement we are obligated to file as described above, but with no provisions for the payment of any penalties for late registration or effectiveness.

On January 15, 2007, we entered into a "Stock Purchase Warrant and Agreement" with Atlas as incentive to modify an irrevocable standby letter of credit underlying our revolving line of credit arrangement with Wachovia. Under the terms of this agreement, Atlas receives a warrant to purchase up to 444,444 shares of our common stock at $2.70 per share at the termination of the Wachovia line of credit or if we are in default under the terms of the Wachovia line of credit. If the warrant is exercised in full, it will result in gross proceeds to the Company of approximately $1,200,000.

On March 29, 2007, we issued 55,666 shares of our common stock to certain investors as registration penalties for our failure to timely file a registration statement covering shares owned by those investors as required pursuant to registration rights agreements between such investors and us.

Wachovia Revolving Line of Credit. As of March 14, 2007, we have drawn down $2.1 million of the $2.5 million Wachovia line of credit.

Outlook for 2007

With the release of our new applications and the expenses associated with becoming a public company, we believe our capital requirements in 2007 and beyond will be greater than in past years. Although we do not anticipate these needs to be substantial, the non-recurring costs associated with the SEC's suspension of trading of our securities and related investigation, and the internal investigation of matters relating thereto, may increase our capital requirements in 2007. As such, our historical cash flows may not be indicative of future cash flows. The following is a discussion of factors that we consider important to our future capital requirements and which will affect the amount of additional capital we need to raise. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our marketing and sales activities, the timing and extent of spending to support product development efforts and expansion into new territories, the timing of introductions of new services and enhancements to existing services, and the market acceptance of our services.

Primary drivers for future operating cash flows include the commercial success of our existing services and products and the timing and success of any new services and products and our ability to maintain and grow the revenues from the companies we acquired. We will continue to seek additional integration and syndication customers who typically pay an upfront fee and to increase revenues generated from small business end users, and increase our effort in regard to direct sales and cross selling of pre-paid subscriptions.

Generally, we expect we will need to increase marketing and sales expenses before we can substantially increase our revenue from sales of subscriptions. We have increased our sales and marketing department as of December 2006 and added personnel in January 2007. We also expect increased expenses from the revenue share component of our recently executed contracts.

As a public company, we will incur significant legal, accounting and other expenses that we did not incur as a private company. We will incur costs associated with our public company reporting requirements. We incurred costs in excess of $1 million associated with the SEC suspension of trading described above; recently adopted corporate governance requirements, including requirements under the Sarbanes-Oxley Act of 2002; as well as new rules implemented by the SEC, the NASD, and national securities exchanges. We expect these rules and regulations to increase our legal and financial compliance costs and to make some activities more time-consuming and costly. Any unanticipated difficulties in preparing for and implementing these reforms could result in material delays in complying with these new laws and regulations or significantly increase our costs. Historically, we have failed to file our SEC periodic reports on time and our ability to fully comply with these new laws and regulations is also uncertain. Our failure to timely prepare for and implement the reforms required by these new laws and regulations could significantly harm our business, operating results, and financial condition. We are currently evaluating and monitoring developments with respect to these new rules, and we cannot predict or estimate the amount of additional costs we may incur or the timing of such costs.

In accordance with the provisions of SFAS No. 131, as we continue to integrate the operations and management of our subsidiaries, we may periodically re-assess the manner in which we report our segment data. Changes in our internal organization or the manner in which we monitor and manage our business and the business of our subsidiaries may result in the identification of different segments that provide more meaningful data than our current segment presentation.

Contractual Obligations. The following table lists certain of our contractual obligations as of December 31, 2006:

	Payments Due By Period				
	Total	**Less than 1 year**	**1 - 3 years**	**3 - 5 years**	**More than 5 years**
Long-Term Debt Obligations	$ 3,062,631	$ 2,237,631	$ 825,000	—	—
Capital Lease Obligations	—	—	—	—	—
Operating Lease Obligations	33,000	18,000	15,000	—	—
Purchase Obligations	250,000	250,000	—	—	—
Other Long-Term Liabilities	—	—	—	—	—
TOTAL	$ 3,345,631	$ 2,505,631	$ 840,000	—	—

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest rate sensitivity

We had unrestricted cash and cash equivalents totaling $327,000, $1,435,000, and $173,000 at December 31, 2006, 2005, and 2004, respectively. These amounts were invested primarily in demand deposit accounts and money market funds. The cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income.

Two debt instruments have variable interest rates; one is prime + 1.5% and the other is LIBOR + .9% (See Note 9 - “Notes Payable,” to the Consolidated Financial Statements). At December 31, 2006, the outstanding principal balance on these loans was $1,725,000 and $602,000, respectively. Due to the relatively short term of these debt instruments combined with the relative stability of interest rates, we do not expect interest rate or market volatility will have a material effect on our cash flows.

DESCRIPTION OF BUSINESS

OVERVIEW

Smart Online, Inc. develops and markets products and services targeted to small businesses (less than 50 employees) that are delivered via a Software-as-a-Service, or SaaS, model. Our goal is to be the leading provider of on-demand SaaS applications for small businesses. We sell our products and services primarily through private label syndication and original equipment manufacturer, or OEM, distribution channels, although small businesses may purchase products and services directly through our main portal located at www.smartonline.com.

Our primary source of revenue currently comes from sales of our SaaS applications for business management, web marketing, and e-commerce, which represented 63%, 77%, and 55% of our revenue from continuing operations for the fiscal years ended December 31, 2006, 2005, and 2004, respectively. We derive revenue from sales of services that are designed to complement our product offerings and allow us to create custom business solutions that fit our end-users’

and our channel partners' needs, which represented 35%, 19%, and 0% of our revenue from continuing operations for the fiscal years ended December 31, 2006, 2005, and 2004, respectively.

We offer two technology platforms that communicate via web service and serve as the foundation for delivery of our business solutions: OneBizSM and iDirect ArchitectureTM, or iDA. Each is described more fully below. Both platforms allow integrated applications to share data with the other products and/or services running on our platforms. Our products and services are primarily offered on a subscription basis using the on-demand SaaS model.

HISTORY

We were incorporated in Delaware in 1993 and initially offered our software applications using traditional distribution methods of diskettes and later CD-ROMs. In 2000, we moved away from the traditional distribution model and began primarily offering on-demand SaaS applications over the Internet. Unlike the traditional distribution method that requires a customer to install, configure, and maintain hardware, software, and network services internally to support the software applications, our proprietary SaaS applications allow small businesses to subscribe to a wide variety of applications that have been developed specifically for delivery over the Internet on an on-demand basis with very little or no installation or maintenance required.

During October 2005, we acquired substantially all of the assets of Computility, Inc., or Computility, a privately held developer and distributor of sales force automation and customer relationship management, or SFA/CRM, software applications based in Des Moines, Iowa. We operated this business under the name Smart CRM, Inc. (d/b/a Computility), or Smart CRM. Also during October 2005, we acquired all the stock of iMart Incorporated, or iMart, a privately held developer and distributor of multi-channel e-commerce systems based in Grand Rapids, Michigan. We operate this subsidiary as Smart Commerce.

Upon our integration of Smart CRM's SFA/CRM application into our OneBizSM platform, management determined that the remaining operations of Smart CRM, specifically consulting and network management, were not integral to our ongoing operations and business model. On September 29, 2006, we sold these non-integral Smart CRM assets to Alliance Technologies, Inc., or Alliance, and reclassified Smart CRM as a discontinued operation. For further information about this business closure, see Note 17, "Acquisitions & Dispositions" in our consolidated financial statements included in this report.

The Smart CRM assets sold to Alliance included the traditional SFA/CRM software application developed and sold by Smart CRM and its predecessor in interest, Computility. We retained all rights relating to the derivative SFA/CRM SaaS application developed by us with Smart CRM and incorporated into our OneBizSM platform.

Consistent with SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, or SFAS No. 131, we have defined two reportable segments based on factors such as geography, products, customers, how operations are managed, and how our chief executive officer, the chief operating decision-maker, views results. Those segments are our core operations, or the Smart Online segment, and the operations of our wholly-owned subsidiary, or the Smart Commerce segment.

The Smart Commerce segment's revenues are derived primarily from the development and distribution of multi-channel e-commerce systems including domain name registration and e-mail solutions, e-commerce solutions, website design and website hosting. In 2006, our Smart Commerce segment generated 86% of our total consolidated revenue and 96% and 100% of our subscription and professional services revenue, respectively.

The Smart Online segment generates revenues from the development and distribution of internet-delivered SaaS small business applications through a variety of subscription, integration and syndication channels. In 2006, our Smart Online segment generated 14% of our total consolidated revenue and 100% of our integration and syndication revenue, and 4% of our subscription revenue.
We include costs such as corporate general and administrative expenses and share-based compensation expenses that are not allocated to specific segments in the Smart Online segment, which includes the parent or corporate segment.

During the period from 2000 to 2006, we were functioning primarily in a research and development mode as we adapted our products for the SaaS model. We began shifting our focus to the marketing of our most current products in the fourth quarter of 2006. During fiscal 2006, the operations we acquired following the iMart acquisition, which we operate as Smart Commerce, were revenue-generating operations. Accordingly, the majority of current revenues is generated by our Smart Commerce segment.

PRINCIPAL PRODUCTS AND SERVICES

Our principal products and services include: