

SMART ONLINE INC
Form 10-K/A
April 30, 2007

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

FORM 10-K/A
(Amendment No. 1)

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006
or

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 333-119385

SMART ONLINE, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation)

95-4439334

(I.R.S. Employer Identification No.)

2530 Meridian Parkway, 2nd Floor

Durham, North Carolina

(Address of principal executive offices)

27713

(Zip Code)

(919) 765-5000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$0.001 par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of common stock held by non-affiliates of the registrant as of March 15, 2007 was approximately \$24,010,000 (based on the closing sale price of \$2.80 per share).

The number of shares of the registrant's Common Stock, \$0.001 par value per share, outstanding as of April 27, 2007 was 17,872,137.

DOCUMENTS INCORPORATED BY REFERENCE

None.

EXPLANATORY NOTE

The purpose of this Amendment No. 1 to the Annual Report on Form 10-K/A is to include certain information that was omitted from Part III of the Annual Report on Form 10-K because it was incorporated by reference from our definitive Proxy Statement for the 2007 Annual Meeting of Stockholders. Because our definitive Proxy Statement for the 2007 Annual Meeting of Stockholders will not be filed with the Securities and Exchange Commission, or SEC, within 120 days after the end of the fiscal year ended December 31, 2006, the information required by Part III of the Annual Report on Form 10-K cannot be incorporated by reference and therefore must be included in the Annual Report. This Amendment No. 1 contains the information that was previously omitted from Part III of the Annual Report. In addition, we are including as exhibits updated certifications required under Section 302 of the Sarbanes-Oxley Act of 2002 and a current consent from our independent accountant. Solely for this reason, we also have amended Part IV of the Annual Report on Form 10-K to reflect the filing of these exhibits.

This Amendment No. 1 on Form 10-K/A does not attempt to modify or update any other disclosures set forth in the original Form 10-K, except as required to reflect the additional information included in Part III of this Form 10-K/A. Additionally, this Amendment No. 1 on Form 10-K/A, except for the additional information included in Part III, speaks as of the filing date of the original Form 10-K and does not update or discuss any other developments after the date of the original filing. All information contained in this Amendment No. 1 on Form 10-K/A and the original Form 10-K is subject to updating and supplementing as provided in the periodic reports that we have filed and will file after the original filing date with the SEC.

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Executive Officers and Directors

The names of our directors and executive officers are listed below. Except as otherwise disclosed below, none of our officers and directors named below serve on the Board of Directors of any other public reporting company. Our executive officers are appointed by our board of directors to hold office until their successors are appointed, and the terms of all directors expire at the later of the next annual meeting of stockholders or upon election and qualification of their respective successors. The following table sets forth the names of our directors and executive officers, along with their positions and ages, as of April 27, 2007.

| Name | Age | Position |
|---------------------------------|-----|-----------------------------------------------------------------------------------------------|
| Michael Nouri ⁽¹⁾⁽²⁾ | 53 | President, Chief Executive Officer, and Director |
| Henry Nouri ⁽²⁾ | 51 | Executive Vice President |
| Thomas Furr | 40 | Chief Operating Officer, Director |
| Anil Kamath | 40 | Chief Technology Officer |
| Nicholas A. Sinigaglia | 37 | Chief Financial Officer and Principal Accounting Officer |
| Gary Mahieu | 39 | Chief Operating Officer and Vice President of Smart Commerce, Inc., a wholly owned subsidiary |
| Mike Stuart | 38 | Vice President - Sales |
| Brian Donaghy | 38 | Vice President - Product Strategy |
| Jeff LeRose | 62 | Chairman of the Board and Director |
| Shlomo Elia | 64 | Director |
| Philippe Pouponnot | 37 | Director |
| C. James Meese, Jr. | 65 | Director |

(1) Michael Nouri's full name is Dennis Michael Nouri.

(2) Dennis Michael Nouri and Henry Nouri are brothers.

Michael Nouri, President and Chief Executive Officer, and Director. Michael Nouri's full name is Dennis Michael Nouri. Mr. Nouri co-founded Smart Online in 1993 to develop and market business productivity software to provide small businesses with cost-effective tools that address critical business issues and enhance their competitive positioning. He has been an officer and director of Smart Online since that time. Prior to founding Smart Online, Mr. Nouri was founder and CEO of the Nouri Group of Companies from 1980 to 1991. The Nouri Group of Companies acquired a number of government-owned manufacturers in Europe and privatized them. The Nouri Group was a multi-national conglomerate with diversified activities in real estate development, investment, construction, motor yacht manufacturing, high-end home design and architecture, and marketing and publishing. More than half of the company's business was derived from real estate development and investment and joint ventures. Another third of the company's business was derived from construction and motor yacht manufacturing. Mr. Nouri is a member of the National Association of Corporate Directors, or NACD.

Henry Nouri, Executive Vice President. Mr. Nouri co-founded Smart Online in 1993 and has been our Vice President since that time. Currently, he manages our research and development teams. He is responsible for development of our CD-ROM and Internet-hosted applications, for creating the extensive research and information management systems required to control the flow of vital validated business data and for the effective delivery of that information to the business user. In 1978, Mr. Nouri received a B.S. in Civil Engineering Technology from Florida International University.

Thomas Furr, Chief Operating Officer and Director. Mr. Furr is responsible for developing and implementing strategies to leverage existing direct and indirect distribution channels. He became Vice President, Sales of Smart Online in 2001. He became our Chief Operating Officer in November 2005. In 2002 he also became a Director. He was a co-founder and president of Kinetics, Inc., one of the first online commerce providers for the small business industry, from 1994 until 1995. Smart Online purchased Kinetics in 1995. After founding Kinetics, Mr. Furr was with the Plurimus Corporation from 1999 until 2001, where he managed Plurimus's southeast direct sales efforts. Previously, from 1996 until 1999 he managed East Coast direct sales and channel efforts in Canada and South Africa for Information Retrieval Corporation, a leading multi-national back-end CRM/help desk company. Mr. Furr holds a bachelor's degree in finance from East Carolina University.

Anil Kamath, Chief Technology Officer. Mr. Kamath joined Smart Online as Director of Database Implementation in July 1999 and became Vice President, Technology in 2000; he became our Chief Technology officer in November 2005. Mr. Kamath is responsible for the architecture of our web-native (SaaS) platform, supervises the development team, and provides architectural design direction for new software and hardware implementations. Before joining Smart Online he was the senior database architect for A⁴ Health Systems from 1998 to 1999 and senior software architect and technical manager of BSG Imonics from 1991 until 1997. He holds a master's degree in computer and information sciences from the University of Florida.

Nicholas A. Sinigaglia, Chief Financial Officer. Mr. Sinigaglia joined us as our Controller in February 2006, and was appointed to be our Chief Financial Officer in March 2006. From August 2005 to February 2006, he acted as an independent business consultant providing accounting and business consulting services as well as interim-CFO services to New York clients. From February 2004 to June 2005, Mr. Sinigaglia served as the Center Manager of MedQuest Associates, a leading provider of diagnostic imaging services. From 1997 to February 2004, Mr. Sinigaglia was the Vice President and Managing Partner of Ray-X Medical Management Services, Inc., an organization offering management services to various medical specialties. Mr. Sinigaglia was an Audit Senior Supervisor with Arthur Andersen LLP from 1991 to 1997 and is a licensed certified public accountant in New York and North Carolina.

Gary Mahieu, Chief Operating Officer and Vice President of Smart Commerce, Inc., a wholly owned subsidiary. Mr. Mahieu is responsible for the operations of our wholly owned subsidiary, Smart Commerce, Inc. (d/b/a iMart), or Smart Commerce, serving as its Chief Operating Officer and Vice-President since we acquired iMart in October of 2005. Mr. Mahieu founded and served as President and Chief Operating Officer of iMart Incorporated, or iMart, from December 1999 until October 2005. Prior to founding iMart, Mr. Mahieu served as a technical manager for Quixtar, Inc. from April 1998 until December 1999. Mr. Mahieu received his bachelor's degree in electrical engineering from Western Michigan University, and in 2006 he finished the Owners Presidents Management program at Harvard Business School. Mr. Mahieu is also the co-inventor on two e-Commerce patents.

Mike Stuart, Vice President of Sales. Mr. Stuart is responsible for sales and marketing. He joined Smart Online in October 2005 as Director of CRM and was promoted to Vice President of Sales and Marketing in January 2007. Mr. Stuart was the co-founder of Computility, Inc., or Computility, a leader in subscription computing and software as a service, or SaaS, applications to member based organizations. Mr. Stuart served as Chief Executive Officer of Computility until we purchased its assets in 2005. Mr. Stuart has an extensive background in founding technology start-ups. He received his BA from Baptist Bible College in 1992.

Brian Donaghy, Vice President of Product Strategy. Mr. Donaghy is responsible for market focused product and strategy development. He joined Smart Online in October 2005 as Director of CRM Technology and was promoted to Vice President of Product Strategy in January 2007. Mr. Donaghy was the co-founder of Computility, a leader in subscription computing and SaaS applications to member based organizations. Mr. Donaghy served as Chief Technology Officer of Computility until we purchased its assets in 2005. Mr. Donaghy has an extensive background in founding technology start-ups. He is also a committed philanthropist, currently serving on the United Way Board of Directors.

Jeffrey W. LeRose, Chairman of the Board and Director. Mr. LeRose was first appointed as a Director on September 13, 2005. Mr. LeRose is CEO and President of Research Triangle Software, an information technology company that he founded in 2001. Mr. LeRose was the Chairman of the Board of Directors of the business-to-business online e-commerce firm, Internet Commerce Corporation (NASDAQ: ICCA) from March 2001 until September 2001. He became Chairman of ICCA after selling Research Triangle Commerce, Inc., or RTCI, to ICCA in November 2000. Mr. LeRose was the founder and President of RTCI from September 1991 until November 2000. He currently sits on the Board of Advisors for the Love School of Business at Elon University and is a founding Board Member for the Research Triangle Chapter of the NACD. Mr. LeRose also is on the Board of Advisors for Southern Capitol Ventures, where he provides advice on the investments in emerging technology companies in central North Carolina. Mr. LeRose received his BA from New Jersey City University.

Shlomo Elia, Director. Mr. Elia has served on our Board of Directors since November 16, 2006, and was originally recommended for appointment to the Board by Atlas, one of our stockholders. Mr. Elia is a Director of 3Pen Ltd., or 3Pen, a private holding company, focusing on business opportunities in Internet infrastructure and telecommunications. Prior to founding 3Pen in 1999, Mr. Elia held several senior positions in the Israeli Defense Forces, or I.D.F., including the post of the Military Governor of the West-Bank (1982-1984) and Commander of the Liaison Unit for South Lebanon (1984-1985). During his service, among other activities, General Elia was engaged

for a year as a Research Fellow in the Institute of International Strategic Affairs at U.C.L.A. Since his retirement from the I.D.F., he is involved in communication projects in Nigeria and West Africa, and construction projects in Romania. Among his civilian activities, Mr. Elia was Chairman of the National Tourist Board and currently is Chairman of 3Pen Technologies Ltd. and co-chairman of the Israeli Soldiers Welfare Association. Mr. Elia holds a B.A. degree in Modern History of the Middle-East from Tel Aviv University.

Philippe Pouponnot, Director. Mr. Pouponnot has served on our Board of Directors since November 16, 2006, and was originally recommended for appointment to the Board by the Blueline Fund, one of our stockholders. Mr. Pouponnot is a Director of Azur Management SAL, or Azur, a business engaged in the study and management of assets and companies. Mr. Pouponnot has been a director of Azur since its founding in 1999. In his position with Azur, he has gained international experience working with banks and brokers in all phases of investment management, including administrative, investment and commercial transactions. He also serves as an asset and investment manager for companies and high net worth individuals. Mr. Pouponnot has also worked closely with companies in a variety of sectors in matters ranging from formation to reorganization to liquidation.

C. James Meese, Jr., Director. Mr. Meese has served on our Board of Directors since November 16, 2006. Mr. Meese is the President and founder of Business Development Associates, Inc., or BDA, a strategic advisory firm. Since 1989, BDA has provided advice and assistance to both middle market and emerging companies on issues of company valuations, acquisitions and divestitures, market development, corporate governance, capital acquisition, strategic planning, exit strategies and organizational structuring. Prior to 1989, Mr. Meese spent approximately 20 years in various senior corporate marketing, business development and finance positions. Sixteen of those years were spent with West Pharmaceutical Services Inc., or West. He was a member of the company's Top Management Committee during his last four years with West. Mr. Meese is also a director of Digital Recorders, Inc. (NASDAQ:TBUS), or DRI, The Altoona Railroaders Memorial Museum, and The Raleigh Rescue Mission and its Foundation. He is a former Chair and current member of the DRI Audit Committee, chairs the Railroaders Museum Board, is president of the Raleigh Rescue Mission Board and serves on a variety of committees in his directorships. He is a member of the NACD and is designated as our Audit Committee Financial Expert. Mr. Meese received a B.A. degree in Economics from the University of Pennsylvania and an M.B.A. from Temple University.

Except as disclosed below, none of the directors or executive officers has, during the past five years:

- (a) Had any bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time;
- (b) Been convicted in a criminal proceeding or a subject of a pending criminal proceeding;
- (c) Been the subject of any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities, futures, commodities or banking activities; and
- (d) Been found by a court of competent jurisdiction (in a civil action), the SEC or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated.

Michael Nouri and Henry Nouri were officers and directors of two companies in Italy which were ordered into bankruptcy by Italian courts in 1993. Under Italian laws, Michael Nouri and Henry Nouri cannot serve as an officer or director of any Italian company, because of these bankruptcies.

Audit Committee Financial Expert

Our Board of Directors has determined that C. James Meese, Jr., who serves on our Audit Committee, has the experience and qualification to meet the definition of an “audit committee financial expert” under SEC rules governing audit committees and that Mr. Meese is “independent” as defined by SEC and NASDAQ rules regarding board members, committees and other corporate governance standards.

Section 16(a) Beneficial Ownership Reporting Compliance

The members of our Board of Directors, our executive officers and persons who hold more than 10% of our outstanding common stock are subject to the reporting requirements of Section 16(a) of the Exchange Act of 1934, or the Exchange Act, which require them to file reports with respect to their ownership of our common stock and their transactions in such common stock. Based upon our review of the Section 16(a) reports in our records for 2006 fiscal year transactions in the common stock and their common stock holdings, we believe that, except as noted below, all reporting requirements under Section 16(a) for such fiscal year were met in a timely manner by our directors, executive officers and greater than 10% beneficial owners.

Atlas Capital, S.A. was delinquent in the filing of a Form 4 relating to the purchase of shares of our common stock on March 3, 2006. The Form 4 for that purchase was not filed until March 8, 2006.

Atlas Capital, S.A. was delinquent in the filing of a Form 4 relating to the purchase of shares of our common stock on June 29, 2006. The Form 4 for that purchase was not filed until July 19, 2006.

Code of Ethics

We have adopted a Code of Ethics applicable to our executives, including our principal executive officer, principal accounting officer and principal financial officer, as defined by applicable rules of the SEC. It is publicly available on our web site at www.smartonline.com. If we make any amendments to our Code of Ethics other than technical, administrative, or other non-substantive amendments, or grant any waivers, including implicit waivers, from a provision of our Code of Ethics to the chief executive officer, chief financial officer, or certain other finance executives, we will disclose the nature of the amendment or waiver, its effective date and to whom it applies on our web site at www.smartonline.com or in a report on Form 8-K filed with the SEC.

ITEM 11. EXECUTIVE COMPENSATION

Compensation Discussion & Analysis

Overview of Compensation Philosophy and Objectives

We established a Compensation Committee of the Board of Directors, or the Compensation Committee, to assist the full Board in discharging its duties with respect to determining the compensation to be paid to our named executive officers listed in the Summary Compensation Table below, or the named executive officers. The objective of the Compensation Committee is to establish compensation levels that will attract and retain managerial talent desired by us, reward employees for past contributions and motivate managerial efforts consistent with corporate growth, strategic progress and the creation of stockholder value. As we increase our revenues and approach profitability, our goal and objective is to review our overall compensation program to determine whether each compensation element fits into our overall compensation objectives. This review may result in changes to current procedures in determining executive compensation, the implementation of new procedures, the identification of specific corporate and/or personal performance measures in setting compensation policies, or a re-evaluation of how total compensation is determined among its different elements.

Role of Executive Officers

After its formation on July 22, 2005, the Compensation Committee left in place the existing compensation packages previously entered into with several named executive officers. In reaching these agreements, the Chief Executive Officer acted on our behalf. The Chief Executive Officer also reviews the performance of our other named executive officers that, as set forth below, is used to determine the compensation of these named executive officers. In general, the Compensation Committee has relied on recommendations made by the Chief Executive Officer in awarding compensation packages. The Compensation Committee reviews the performance of the Chief Executive Officer.

Elements of Executive Compensation

In fiscal 2006, the principal components of compensation for our named executive officers were salary and equity awards. Some of our named executive officers have also received performance-based incentive compensation. We have no pre-established policy for determining the allocation of compensation between cash and equity, or under what circumstances, terms or conditions to provide certain named executive officers with performance-based incentive compensation. However, some factors effecting the determination of the levels of each element of total compensation include length of service; nature, scope and level of responsibilities; accomplishment of tasks and goals; market analysis; and the attitude and work ethic of the employee.

Salary. Salaries are paid to our named executive officers in order to compensate them for their services to us. We establish the salaries for our named executive officers based on readily available public information regarding local market compensation levels, and, considering the fact that we have immaterial revenues and have only experienced net losses to date, we establish salaries for our named executive officers mostly at the low end of the market salary ranges. Our human resources manager has collected relevant market information using various websites.

Many of our named executive officers had employment contracts that were entered into prior to the formation of the Compensation Committee, which contracts provide for a base salary that can be increased. Any future compensation packages will be reviewed and approved by the Compensation Committee.

Factors considered in determining salary increases for named executive officers include: (i) length of time the executive has been employed by us and the last review and salary increase; (ii) the nature, scope and level of the executive's responsibilities; (iii) accomplishment of tasks and goals such as the release of new products or product enhancements, attainment of milestones regarding research and development, and project completion; (iv) recommendations of the Chief Executive Officer; (v) past performance when reviewing employment contract renewals; (vi) market analysis; and (vii) the attitude toward his or her job and responsibilities and work ethic of the executive.

During fiscal 2006, most of our named executive officers did not receive any increase in their salaries. Factors affecting the decision to freeze the salaries of these named executive officers were (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, Inc. (d/b/a Computility), or Smart CRM, and (4) we have only experienced net losses to date.

Because of the trading suspension, the related investigation, and the various financing transactions noted above, we believe that the attention of the named executive officers was diverted from our core business operations, possibly causing our performance to suffer. In addition, in light of the lack of adequate working capital, we tried to avoid any increase in costs in order to utilize the working capital we had to the greatest extent possible. Following the end of fiscal 2006 and as described in further detail below, several of our named executive officers have agreed to reductions in their base-salary and shifted to bonus compensation in an effort to reduce costs.

The lone exception to this salary freeze was the salary increases provided to our Chief Financial Officer, Nicholas A. Sinigaglia. Mr. Sinigaglia was originally hired in February 2006 as our Controller. On March 21, 2006, he was appointed our Chief Financial Officer, replacing our interim Chief Financial Officer, Scott Whitaker. In conjunction with his promotion to that position, Mr. Sinigaglia received graduated increases in his annual salary according to the following schedule:

| Dates | Annual Salary |
|-----------------------------------------|--------------------------|
| March 21 through 31, 2006 | \$ 90,000 |
| April 1 though May 31, 2006 | \$ 110,000 |
| June 1 through August 31, 2006 | \$ 120,000 |
| September 1, 2006 to date | \$ 135,000 |

Factors effecting the determination of the salary increases include comparable salaries based on company size, industry and position, experience, capabilities; work ethic; and responsibilities.

Equity Awards. Equity awards are made to provide each named executive officer with both the incentive and reward for achieving long-term success as reflected in the growth in our share value. The 2004 Equity Compensation Plan, or the 2004 Plan, is currently in effect. The 2004 Plan replaced the 2001 Equity Compensation Plan, or the 2001 Plan, which in turn replaced the 1998 Stock Option Plan, or the 1998 Plan. Under the 2004 Plan, the named executive officers, among others, may be awarded incentive stock options, restricted stock or a stock award. Under its terms, the committee administering the 2004 Plan determines the terms and conditions of each award, including but not limited to the amount of the award, vesting, and expiration. The outstanding options issued to our named executive officers under the 2001 Plan were fully vested upon the grant date. Most of the stock options granted to named executive officers under the 2004 Plan vest at the rate of 20% per year for five years on the anniversary of the grant date. Our Chief Financial Officer, who was hired and subsequently appointed to that position in 2006, was awarded stock options in fiscal 2006. The 2004 Plan is administered by the Compensation Committee. All stock option awards were made at or above the fair market value of our common stock on the date of the grant.

To date, named executive officers have only been granted incentive stock options under the 2004 Plan, but some named executive officers have, in prior years under prior plans, received awards of our common stock. Awards under the 2004 Plan are generally made when a named executive officer is first appointed to his position, and periodically in connection with awards that may be made to other employees. At this time, we do not have a plan establishing the dates, amounts or types of these awards.

In addition to the factors considered in determining named executive officers' base salary, factors considered in determining awards of stock options under the 2004 Plan include: (i) the scale of awards based on past practices, (ii) our overall practice regarding different managerial levels; (iii) the executive's past performance, and (iv) creating incentives for both the executive's and our future performance and goals.

Beginning January 1, 2006, we began accounting for stock option equity awards as required by Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, or SFAS No. 123R. Under SFAS No. 123R, all share-based payments to employees, including grants of employee stock options, must be recognized in our financial statements based on their fair values. The immediate effect has been to favor equity awards other than stock options to provide our named executive officers and other employees with equity based compensation.

Performance-Based Incentive Compensation. In prior years, certain of our named executive officers also received bonus compensation upon meeting or exceeding certain goals that we set for them. In the past, these bonuses have been tied to the development and release of certain applications within the OneBizSM suite. Factors that influence when we offer a bonus and the amount of that bonus include the importance of the goal to our overall success, the effort required to complete the goal, current salary level and the time since the last pay increase. No bonuses were paid to our named executive officers in 2006 for the same reasons that we froze salaries to most of our named executive officers in 2006 as described above.

Recent Developments

On January 12, 2007, the Compensation Committee approved the modification of the 2007 compensation for the following named executive officers: Michael Nouri, Thomas Furr, and Henry Nouri. Under the modified compensation arrangements, the 2007 annual base salary for each of these named executive officers has been reduced to \$100,000. In consideration for this reduction in salary, the employees have orally agreed to, and the Compensation Committee approved, a performance based aggregate quarterly bonus. The bonus, if any, to be paid to each of these named executive officers will be 2% of any "Free Cash Flow." For these purposes, "Free Cash Flow" is defined as our total revenue, less operating expenses (with non-cash items added back), less principal debt payments. After

considering the potential amount of the bonus, the Compensation Committee agreed to these reductions in salary as it would likely result in an overall reduction of our expenses and provide these officers with incentive-based compensation to improve our financial health, which was not an element of their compensation packages prior to this change. These bonuses relate only to "Free Cash Flow" during 2007 as this bonus arrangement expires on December 31, 2007. On January 1, 2008, compensation for these officers is scheduled to return to pre-reduction levels. The Compensation Committee approved and these officers agreed to amend their compensation arrangements. Effective April 16, 2007, each agreed to an increase in their salary to its pre-reduction level and to be paid the bonus described above for the period of the salary reduction. Because there was no "Free Chas Flow," no bonus is due or owing these officers.

On April 18, 2007, our Chief Financial Officer was granted a restricted stock award of 30,000 shares of our common stock. The restriction on these shares lapses in three equal installments at the following dates: (1) the date of agreement, (2) the first anniversary of such date, and (3) on the second anniversary of such date, if he is a service provider to us on such date.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Discussion & Analysis required by Item 402(b) of Regulation S-K with management, and based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion & Analysis be included in this Amendment No. 1 to the Annual Report on Form 10-K/A.

Jeffrey W. LeRose
(chairman)
C. James Meese, Jr.
Philippe Pouponnot

2006 Summary Compensation Table

The following table shows the annual and long-term compensation paid to, or accrued by us for, our Chief Executive Officer, the two individuals who served as our Chief Financial Officer, and our next three most highly compensated executive officers for services rendered to us during the fiscal year ended December 31, 2006. We refer to the persons identified on the table below as our “named executive officers.”

| Name and Principal Position | Year | Salary (\$) | Option awards (\$) ⁽¹⁾ | All other compensation (\$) | Total (\$) |
|--------------------------------------------------------------------|------|----------------|-----------------------------------------|-----------------------------------|---------------|
| Dennis Michael Nouri President and Chief Executive Officer | 2006 | \$ 170,000 | \$ 46,461 | - | \$ 216,461 |
| Scott Whitaker Former Chief Financial Officer ⁽²⁾ | 2006 | \$ 70,000 | \$ 18,098 | - | \$ 88,098 |
| Nicholas A. Sinigaglia Chief Financial Officer ⁽²⁾ | 2006 | \$ 108,333 | \$ 17,197 | - | \$ 125,530 |
| Henry Nouri Executive Vice President | 2006 | \$ 150,000 | \$ 46,461 | - | \$ 196,461 |
| Gary Mahieu COO and Vice President of Smart Commerce, Inc. | 2006 | \$ 150,000 | - | -(3) | \$ 150,000 |
| Thomas Furr Chief Operating Officer | 2006 | \$ 136,800 | \$ 23,230 | - | \$ 160,030 |

(1) See Note 2, “Summary of Significant Accounting Policies,” to our consolidated financial statements in our Annual Report on Form 10-K filed with the SEC on March 30, 2007 for a discussion of the assumptions made in the valuation of stock options.

- (2) Scott Whitaker ceased to be our Chief Financial Officer, and Nicholas A. Sinigaglia was appointed our Chief Financial Officer on March 21, 2006. Mr. Whitaker continues to serve as our Controller/Bookkeeper.
- (3) Does not include payments with respect to a covenant not to compete. See Item 13, "Certain Relationships and Related Transactions, and Director Independence" in this report.

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2006 Grants of Plan-Based Awards

| Name | Grant date | Estimated future payouts under equity incentive plan awards | | | Exercise or base price of awards (\$/Sh) | Grant date fair value of stock and option awards |
|------------------------|------------|-------------------------------------------------------------|-----------------------|-------------|------------------------------------------|--------------------------------------------------|
| | | Threshold (#) | Target (#) | Maximum (#) | | |
| Nicholas A. Sinigaglia | 03/24/06 | 0 | 50,000 ⁽¹⁾ | 50,000 | \$ 2.50 ⁽²⁾ | \$ 2.50 ⁽²⁾ |

(1) The incentive stock option award provides for only a single estimated payout.

(2) The exercise price and fair market value were determined by the Compensation Committee of our Board of Directors based on the light trading volume of our common stock around the time of the grant and the per share price agreed to in a private placement of common stock that was scheduled to occur around the time of the grant.

The option award was granted to Mr. Sinigaglia following his appointment as our Chief Financial Officer. As indicated in the table and footnotes above, the exercise price was set higher than the closing market price because of the low trading volume in our common stock at the time of the grant. During the month prior to the grant, the average trading volume for our common stock was approximately 2,900 shares per day. In addition, the private placement of 400,000 shares of our common stock at \$2.50 per share was scheduled to close shortly after the grant date. Based on these factors, the exercise price was set above the closing trading price of \$2.00. The option award provides for vesting over five years after the date of the grant, with 20% of the award vesting on March 24 of each year following the grant, provided Mr. Sinigaglia is still providing services to us. The full option vests and becomes exercisable immediately upon a change in control. The award has a ten year term.

Employment Agreements

We have the following employment agreements with our named executive officers. See “Potential Payments upon Termination or Change-in-Control” below for additional material terms of these agreements.

Dennis Michael Nouri. Elsewhere in this document, Mr. Nouri is referred to as Michael Nouri, because he uses his middle name instead of his first name in most business dealings. Effective April 1, 2004, covering employment commencing as of June 1, 2004, we entered into an employment agreement, which provided for an initial base salary of \$170,000. The agreement replaced an employment agreement dated July 14, 1999 that was about to expire. The new agreement had a termination date of December 31, 2005, but it is automatically extended for additional two-year terms, unless either party provides the other with written notice of intention not to renew at least 180 days prior to the end of the term or the end of any renewal period. Since neither party gave written notice of termination, the agreement was extended for an additional two years and thus has a termination date of December 31, 2007, which shall be renewed for additional two-year terms unless either party gives notice of intention not to renew. The agreement requires us to make a severance payment to Mr. Nouri if either we terminate Mr. Nouri’s employment without “Cause” or Mr. Nouri terminates his employment for “Good Reason,” because of death or “Disability,” or following a “Change in Control” (all as described under “Potential Payments upon Termination or Change-in-Control”). Mr. Nouri’s agreement contains non-competition and non-solicitation provisions. The non-competition provision prohibits him from directly or indirectly engaging in the same or similar business as ours in any jurisdiction where we do business for a period of one year following the termination of employment for any reason. The non-solicitation provision prohibits the direct or indirect solicitation of (a) any of our customers to either purchase similar products or services from others, (b) to take away the customers’ business from us, or (c) to induce employees to leave their employment with us, for a period of one year following the termination of employment for any reason.

Henry Nouri. Effective April 1, 2004, covering employment commencing as of June 1, 2004, we entered into an employment agreement with Mr. Nouri, which provided for an initial base salary of \$150,000. The agreement replaced an employment agreement dated July 14, 1999 that was about to expire. The new agreement had a termination date of December 31, 2005, but it would be automatically extended for additional two-year terms, unless either party provided the other with written notice of intention not to renew at least 180 days prior to the end of the term or the end of any renewal period. Since neither party gave written notice of termination, the agreement was extended for an additional two years and thus has a termination date of December 31, 2007, which shall be renewed for additional two-year terms unless either party gives notice of intention not to renew. The agreement requires us to make a severance payment to Mr. Nouri if either we terminate Mr. Nouri's employment without "Cause" or Mr. Nouri terminates his employment for "Good Reason," because of death or "Disability," or following a "Change in Control" (all as described under "Potential Payments upon Termination or Change-in-Control"). Mr. Nouri's agreement contains non-competition and non-solicitation provisions. The non-competition provision prohibits him from directly or indirectly engaging in the same or similar business as ours in any jurisdiction where we do business for a period of one year following the termination of employment for any reason. The non-solicitation provision prohibits the direct or indirect solicitation of (a) any of our customers to either purchase similar products or services from others, (b) to take away the customers' business from us, or (c) to induce employees to leave their employment with us, for a period of one year following the termination of employment for any reason.

Thomas Furr. Effective April 1, 2004, covering the employment period commencing on June 1, 2004, we entered into an employment agreement which was amended effective November 9, 2005. This agreement replaced an earlier agreement dated September 15, 2001 that was about to expire. The agreement provided for an initial base salary of \$70,000, which was increased to \$90,000 effective July 1, 2004 and \$136,800 effective November 9, 2006. The agreement had a termination date of December 31, 2005, but is automatically extended for additional one-year terms, unless either party provides the other with written notice of intention not to renew at least 30 days prior to the end of the term or of any renewal period. Since neither party has given written notice of termination, the agreement has been extended through December 31, 2007, and shall be renewed for additional one-year terms unless either party gives notice of intention not to renew. The agreement requires us to make a severance payment to Mr. Furr if either we terminate Mr. Furr's employment without "Cause" or Mr. Furr terminates his employment for "Good Reason" (as described under "Potential Payments upon Termination or Change-in-Control"). Mr. Furr's agreement contains non-competition and non-solicitation provisions. The non-competition provision prohibits Mr. Furr from directly or indirectly engaging in the same or similar business as ours in any jurisdiction where we do business for a period of two years following the termination of employment for any reason. The non-solicitation provision prohibits the direct or indirect solicitation of (a) any of our customers to either purchase similar products or services from others, (b) to take away the customers' business from us, or (c) to induce employees to leave their employment with us, for a period of two years following the termination of employment for any reason.

Scott Whitaker. Effective April 1, 2004, covering employment commencing on such date, we entered into an employment agreement which provided for an initial annual base salary of \$45,000, subject to approved increases. Effective March 2005, Mr. Whitaker's salary was increased to \$70,000. The agreement has no set termination date. The agreement was accompanied by a grant of incentive stock options for 25,000 shares of common stock at an exercise price of \$5.00, vesting as follows: 20% on the first anniversary of the grant, and 416.67 shares at the end of each month thereafter. Mr. Whitaker's agreement contains non-competition and non-solicitation provisions. The non-competition provision prohibits him from directly or indirectly engaging in the same or similar business as ours in any jurisdiction where we do business for a period of one year following the termination of employment for any reason. The non-solicitation provision prohibits the direct or indirect solicitation of (a) any of our customers to either purchase similar products or services from others, (b) to take away the customers' business from us, or (c) to induce employees to leave their employment with us, for a period of one year following the termination of employment for any reason.

Gary Mahieu. Effective October 17, 2005, covering employment commencing on such date, we entered into an employment agreement which provided for an initial base salary of \$150,000. The agreement has a termination date of October 17, 2007. The agreement requires us to make a severance payment to Mr. Mahieu if either we terminate Mr. Mahieu's employment without "Cause" or Mr. Mahieu terminates his employment for "Good Reason" (as described under "Potential Payments upon Termination or Change-in-Control"). Mr. Mahieu's agreement contains non-competition and non-solicitation provisions. The non-competition provision prohibits him from directly or indirectly engaging in the same or similar business as ours in any jurisdiction where we do business for a period of the later of (1) four years following the date of the agreement, or (2) one year following the termination of employment for any reason. The non-solicitation provision prohibits the direct or indirect solicitation of (a) any of our customers to either purchase similar products or services from others, (b) to take away the customers' business from us, or (c) to induce employees to leave their employment with us, for a period of the later of (1) four years following the date of the agreement, or (2) one year following the termination of employment for any reason. As consideration for the covenants not to compete contained in the agreement, Mr. Mahieu is entitled to receive payments totaling \$510,000 in equal quarterly installments commencing January 2, 2006, with the final payment originally scheduled to be made on October 1, 2007. As of February 7, 2007, all of these payments have been to Mr. Mahieu.

Nicholas A. Sinigaglia. Effective March 21, 2006, covering employment commencing on such date, we entered into an employment agreement which provided for an initial annual base salary of \$90,000, which was increased according to the following schedule: to \$110,000 effective April 1, 2006, to \$120,000 effective June 1, 2006, and to \$135,000 effective September 1, 2006. The agreement has a termination date of March 31, 2007, but it will be automatically extended for additional one-year terms, unless either party provides the other with written notice of intention not to renew at least 30 days prior to the end of the term or of any renewal period. Because the required notice to terminate this agreement was not provided, the agreement renewed and the new termination date is March 31, 2008. Mr. Sinigaglia's agreement contains non-competition and non-solicitation provisions. The non-competition provision prohibits him from directly or indirectly engaging in the same or similar business as ours in any jurisdiction where we do business for a period of one year following the termination of employment for any reason. The non-solicitation provision prohibits the direct or indirect solicitation of (a) any of our customers to either purchase similar products or services from others, (b) to take away the customers' business from us, or (c) to induce employees to leave their employment with us, for a period of one year following the termination of employment for any reason. The agreement was accompanied by a grant of incentive stock options for 50,000 shares of common stock at an exercise price of \$2.50 vesting over a five-year period in five equal installments, commencing one year from the date of the grant. Option vesting is accelerated upon a change of control or corporate reorganization such that all options would vest immediately.

Indemnity Agreements. In addition to the employment agreements, we have also entered into indemnity agreements with the following: Michael Nouri, Henry Nouri, Thomas Furr, Joan Keston (our former general counsel) and Scott Whitaker. These indemnification agreements provide that the officers will be indemnified, to the fullest extent

permitted under our bylaws and Delaware law, for their expenses incurred in connection with the SEC investigation involving us. Each officer also agreed to repay these amounts to us should it ultimately be determined that such indemnity was not permissible.

2006 Outstanding Equity Awards at Fiscal Year-End

| Name | Option Awards | | Option exercise price (\$/Sh) | Option expiration date |
|------------------------|------------------------------------------------------------------------|--------------------------------------------------------------------------|-------------------------------|------------------------|
| | Number of securities underlying unexercised options (#) Exercisable | Number of securities underlying unexercised options (#) Unexercisable | | |
| Dennis Michael Nouri | 250,000 ⁽¹⁾ | 0 | \$1.43 | 12/31/2008 |
| | 20,000 ⁽²⁾ | 80,000 | \$8.61 | 07/22/2015 |
| Scott Whitaker | 200 ⁽³⁾ | 0 | \$5.00 | 12/21/2008 |
| | 12,083 ⁽⁴⁾ | 12,917 | \$3.50 | 04/01/2014 |
| | 5,000 ⁽⁵⁾ | 20,000 | \$5.00 | 04/15/2015 |
| | 4,000 ⁽²⁾ | 16,000 | \$8.61 | 07/22/2015 |
| Nicholas A. Sinigaglia | 0 ⁽⁶⁾ | 50,000 | \$2.50 | 03/24/2016 |
| Henry Nouri | 250,000 ⁽¹⁾ | 0 | \$1.43 | 12/31/2008 |
| | 20,000 ⁽²⁾ | 80,000 | | |