NETSMART TECHNOLOGIES INC
Form 10-K
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2004

Commission File Number 0-21177

NETSMART TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	13-3680154
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

3500 Sunrise Highway, Suite D-122, Great River, NY 11739
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (631) 968-2000

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

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

Title of Each Class	Outstanding shares as of March 2, 2005
Common Stock, par value $.01 per share	5,346,607

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes_X_ No__

Indicate by a 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 an accelerated filer (as defined in Rule 12b-2 of the Act)

Yes [ ] No [X]

As of June 30, 2004, the last day of our second quarter, the aggregate market

value of the voting and non-voting common equity held by non affiliates was approximately $43,997,000.

DOCUMENTS INCORPORATED BY REFERENCE

None

PART I

Item 1. Business

Introduction

We develop, market and support application software products designed for providers of services in the health and human services market, including mental health clinics, substance abuse clinics, psychiatric hospitals, public health agencies and managed care organizations. Our software products perform various functions such as patient management, billing, scheduling, and electronic medical records solutions for all modalities of care. These products are deployed utilizing current technologies. We sell our software products through our wholly owned subsidiary, Creative Socio-Medics Corporation, either on a license or a subscription basis to health care providers and we offer our clients software support under maintenance agreements. These maintenance agreements provide us with a recurring revenue stream. We currently have over 500 contracts in place, representing approximately 50,000 clinicians, including 24 state agencies and installations in 43 states.

The cost of a new system to customers is typically in the range of $10,000 to $100,000 for a single facility healthcare organization to $250,000 to $1 million for multi-unit care organizations such as those run by state agencies. Governmental agencies such as mental health, mental retardation, child welfare, addiction, correction and public health facilities accounted for approximately 49% of revenue in 2004, with the remainder from private hospitals, smaller clinics, group and sole practitioners.

Our Data Center provides software which performs clinical and billing services for outpatient facilities, including mental health, alcohol and substance abuse facilities. Our services include statistical reporting, data entry, electronic billing and submission.

Application Service Provider ("ASP") services involves us offering our Avatar suite of products, our CareNet products and InfoScribeR products on a virtual private network or through an internet delivery approach, thereby allowing our customers to deploy products and pay on a monthly service basis, thus eliminating capital intensive system requirements.

Business Strategy

Our systems provide comprehensive healthcare information technology solutions including billing, patient tracking and scheduling for inpatient and outpatient environments, as well as clinical documentation and medical record generation and management. We target providers of services in the health and human services market. Our branded suite of products has integrated point-of-services technologies which also include personal digital assistants, which are commonly referred to as PDAs.

The health and human services market is always subject to changes in state and federal regulations as well as new demands required by the population. Some of

the factors which we believe are affecting the market demand include the following.

HIPAA. As a supplier of practice management solutions to the behavioral health and substance abuse industry, we believe that we can benefit as a result of the Health Insurance Portability and Accountability Act, generally known as HIPPA. HIPAA essentially mandates the Health and Human Services department of the U.S. Government to enact standards regarding the standardization, privacy and security of health care information.

This legislation requires more providers of services in the under-automated health and human services industry to make the leap to install automated systems. We believe that our product suite, in conjunction with products offered by other companies with which we have a marketing arrangement, enables us to offer comprehensive enterprise-wide solutions for most human service providers.

General Unrest. As a result of an increased awareness of terrorism, the demand for services in the mental health and public health services has increased. Anxiety and fear have gripped many people who are now seeking mental health services. This increased demand puts more pressure on providers to improve the efficiency of care through the use of practice management and clinical systems. We believe that the potential threat of bio terrorism will also put similar pressure on public health agencies to improve their delivery capabilities in much the same way.

Organization of the Company

We are a Delaware corporation formed in September 1992 under the name Medical Services Corp. Our name was changed to Carte Medical Corporation in October 1993 to CSMC Corporation in June 1995 and to Netsmart Technologies, Inc. in February 1996. Our executive offices are located at 3500 Sunrise Highway, Suite D-122, Great River, New York 11739, telephone (631) 968-2000. Reference to us and to Netsmart include our subsidiary, Creative Socio-Medics, which we acquired in June 1994, unless the context indicates otherwise. Our website is located at www.csmcorp.com. Neither the Information contained in our website nor the information contained in any Internet website is a part of this Form 10-K annual report.

Available Information:

The public may read and copy any materials filed by us with the SEC at the SEC's public reference room at 450 Fifth Street, NW, Washington D.C. 20549. The public may obtain information about the operation of the SEC's public reference rooms by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website at http://www.sec.gov that contains reports, proxy and information statements and other information about issuers such as us that file electronically with the SEC.

In addition, we make available free of charge on our website at www.csmcorp.com our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) under the Exchange Act as soon as reasonably practical after we electronically file such material with, or furnish it to, the SEC.

Risk Factors

<u>Because we are particularly dependent upon government contracts, any decrease in funding for entitlement programs could result in decreased revenue.</u>

We market our health information systems principally to behavioral health facilities, many of which are operated by state and local government entities and include entitlement programs. During 2004, we generated 49% of our revenue from contracts that are directly or indirectly with government agencies, as compared with 57% in 2003 and 52% in 2002. Government agencies generally have the right to cancel certain contracts at their convenience. Our ability to generate business from government agencies is affected by funding for entitlement programs, and our revenue would decline if state agencies reduce this funding.

<u>Changes in government regulation of the health care industry may adversely affect our revenue, operating expenses and profitability.</u>

Our business is based on providing systems for behavioral and public health organizations in both the public and private sectors. The federal and state governments have adopted numerous regulations relating to the health care industry, including regulations relating to the payments to health care providers for various services, and our systems are designed to provide information based on these requirements. The adoption of new regulations can have a significant effect upon the operations of health care providers, particularly those operated by state agencies. Furthermore, changes in regulations in the health care field may force us to modify our health information systems to meet any new record-keeping or other requirements and may impose added costs on our business. If that happens, we may not be able to generate revenues sufficient to cover the costs of developing the modifications. In addition, any failure of our systems to comply with new or amended regulations could result in reductions in our revenue and profitability.

<u>If we are not able to take advantage of technological advances, we may not be able to remain competitive and our revenue may decline.</u>

Our customers require software which enables them to store, retrieve and process very large quantities of data and to provide them with instantaneous communications among the various data bases. Our business requires us to take advantage of recent advances in software, computer and communications technology. This technology has been developing at rapid rates in recent years, and our future may be dependent upon our ability to use and develop or obtain rights to products utilizing such technology. New technology may develop in a manner which may make our software obsolete. Our inability to use new technology would have a significant adverse effect upon our business.

<u>Because of our size, we may have difficulty competing with larger companies that offer similar services, which may result in decreased revenue.</u>

Our customers in the human services market include entitlement programs, managed care organizations and specialty care facilities which have a need for access to

information over a distributed data network. The software industry in general, and the health information software business in particular, are highly competitive. Other companies have the staff and resources to develop competitive systems. We may not be able to compete successfully with such competitors. The health information systems business is served by a number of major companies and a larger number of smaller companies. We believe that price competition is a significant factor in our ability to market our health information systems and services, and our inability to offer competitive pricing may impair our ability to market our system.

Because we are dependent on our management, the loss of key executive officers could disrupt our business and our financial performance could suffer.

Our business is largely dependent upon our senior executive officers, Messrs. James L. Conway, our chief executive officer, Gerald O. Koop, our president, and Anthony F. Grisanti, our chief financial officer. Although we have employment agreements with these officers, the employment agreements do not guarantee that the officers will continue with us, and each of these officers has the right to terminate his employment with us on 90 days notice. Our agreements with Messrs. Conway and Grisanti are scheduled to expire on December 31, 2006. In addition, Mr. Koop's employment agreement is scheduled to expire on December 31, 2005, following which he is expected to continue to work with us for a six-year period pursuant to our Executive Retirement, Non-Competition & Consulting Plan dated April 1, 2004. Our business may be adversely affected if any of our key management personnel or other key employees left our employ.

If we are unable to protect our intellectual property, our competitors may gain access to our technology, which could harm our ability to successfully compete in our market.

We have no patent protection for our proprietary software. We rely on copyright protection for our software and non-disclosure and secrecy agreements with our employees and third parties to whom we disclose information. This protection does not prevent our competitors from independently developing products similar or superior to our products and technologies. To further develop our services or products, we may need to acquire licenses for intellectual property. These licenses may not be available on commercially reasonable terms, if at all. Our failure to protect our proprietary technology or to obtain appropriate licenses could have a material adverse effect on our business, operating results or financial condition. Since our business is dependent upon our proprietary products, the unauthorized use or disclosure of this information could harm our business.

We cannot guarantee that in the future, third parties will not claim that we infringed on their intellectual property. Asserting our rights or defending against third party claims could involve substantial costs and diversion of resources, which could materially and adversely affect us.

Government programs may suggest or mandate initiatives that could impact our ability to sell our products.

A major initiative being pushed by President Bush and the Department of Health

and Human Services is the National Electronic Health Record. The federal government is promoting this platform and technology which is based on supplying "freeware" to any agency who desires; however, support is not supplied. This initiative does compete with the private for profit Health Information Systems vendor community.

The covenants in our loan agreement restrict our financial and operational flexibility, including our ability to complete additional acquisitions, invest in new business opportunities, pay down certain indebtedness or declare dividends.

Our term loan agreement contains covenants that restrict, among other things, our ability to borrow money, make particular types of investments, including investments in our subsidiaries, make other restricted payments, swap or sell assets, merge or consolidate, or make acquisitions. An event of default under our loan agreement could allow the lender to declare all amounts outstanding to be immediately due and payable. We have pledged substantially all of our consolidated assets to secure the debt under our loan agreement. If the amounts outstanding under the loan agreement were accelerated, the lender could proceed against those consolidated assets. Any event of default, therefore, could have a material adverse effect on our business. Our loan agreement also requires us to maintain specified financial ratios. Our ability to meet these financial ratios can be affected by events beyond our control, and we cannot assure you that we will meet those ratios. We also may incur future debt obligations that might subject us to restrictive covenants that could affect our financial and operational flexibility or subject us to other events of default.

We have only paid one cash dividend after getting our lender's consent and we do not anticipate paying any further cash dividends on our common stock in the foreseeable future. We presently intend to retain future earnings, if any, in order to provide funds for use in the operation and expansion of our business. Consequently, investors cannot rely on the payment of dividends to increase the value of their investment on Netsmart. In addition, we are a party to a loan agreement which prohibits us from paying cash dividends without the prior consent of our lender.

Our growth may be limited if we cannot make acquisitions.

A part of our growth strategy is to acquire other businesses that are related to our current business. Such acquisitions may be made with cash or our securities or a combination of cash and securities. To the extent that we require cash, we may have to borrow the funds or issue equity, which could dilute our earnings or the book value per share of our common stock. Our stock price may adversely affect our ability to make acquisitions for equity or to raise funds for acquisitions through the issuance of equity securities. If we fail to make any acquisitions, our future growth may be limited.

If we make any acquisitions, they may disrupt or have a negative impact on our business.

If we make acquisitions, we could have difficulty integrating the acquired

company's personnel and operations with our own. In addition, the key personnel of the acquired business may not be willing to work for us, and our officers may exercise their rights to terminate their employment with us. We cannot predict the affect expansion may have on our core business. Regardless of whether we are successful in making an acquisition, the negotiations could disrupt our ongoing business, distract our management and employees and increase our expenses.

The employment contracts with our executive officers and provisions of Delaware law may deter or prevent a takeover attempt and may reduce the price investors might be willing to pay for our common stock.

The employment contracts between us and each of James Conway, Gerald Koop and Anthony Grisanti provide that in the event there is a change in control of Netsmart, the employee has the option to terminate his employment agreement. Upon such termination, each of Messrs. Conway, Koop and Grisanti has the right to receive a lump sum payment equal to his compensation for a forty-eight month period.

In addition, Delaware law restricts business combinations with stockholders who acquire 15% or more of a company's common stock without the consent of the company's board of directors.

These provisions could deter or prevent a takeover attempt and may also reduce the price that certain investors might be willing to pay in the future for shares of our common stock.

Any issuance of preferred stock may adversely effect the voting power and equity interest of our common stock.

Our certificate of incorporation gives our board of directors the right to create new series of preferred stock. As a result, the board of directors may, without stockholder approval, issue preferred stock with voting, dividend, conversion, liquidation or other rights which could adversely affect the voting power and equity interest of the holders of common stock. The preferred stock, which could be issued with the right to more than one vote per share, could be utilized as a method of discouraging, delaying or preventing a change of control. The possible impact on takeover attempts could adversely affect the price of our common stock. Although we have no present intention to issue any shares of preferred stock or to create any series of preferred stock, we may issue such shares in the future. If we issue preferred stock in a manner which dilutes the voting rights of the holders of the common stock, our listing on The Nasdaq SmallCap Market may be impaired.

Shares may be issued pursuant to options which may adversely affect the market price of our common stock.

We may issue stock upon the exercise of options to purchase shares of our common stock pursuant to our long term incentive plans, of which options to purchase 724,333 shares were outstanding at December 31, 2004. The exercise of these options and the sale of the underlying shares of common stock may have an adverse effect upon the price of our stock.

Business Segments

For a detailed description of the assets and profits of each of our business segments see note 14 to our consolidated financial statements.

Software and Related Systems and Services

We develop, market and support computer software which enables health and human services healthcare organizations to provide a full range of services in a network computing environment.

Users typically purchase one of several healthcare information and operating systems, in the form of a perpetual license to use the system, as well as purchasing professional services, support, and maintenance. In addition, we resell third party hardware and software to our customers pursuant to value added resale arrangements with them. Our products are designed to operate on most hardware platforms. Due to the fact that our products operate on a variety of platforms, we are not dependent on any single hardware vendor or operating system. Since our products utilize the Cache database and development software provided by Intersystems Corporation, we resell this software. Due to the fact that our products are designed to operate solely with Cache products, we are dependent on Cache products for our operations.

The professional services include project management, training, consulting and software development services, which are provided either on a time and material basis or pursuant to a fixed-price contract. The software development services may require the adaptation of health care information technology systems to meet the specific requirements of the customer.

Our typical license for a health information system ranges from $10,000 to $100,000 for a single facility healthcare organization to $250,000 to $1,000,000 for multi-unit care organizations such as those run by state agencies. Revenue from license fees were approximately $2,066,000, or 7.1% of revenue, for 2004, $2,781,000, or 10.2% of revenue, for 2003 and $1,753,000, or 7.9% of revenue, for 2002. A customer's purchase order may also include third party hardware or software. Revenue from hardware and third party software accounted for approximately $4,336,000, or 15.0% of revenue, for 2004, $4,444,000, or 16.4% of revenue, for 2003 and $3,822,000, or 17.3% of revenue, for 2002. Revenue from turnkey systems labor accounted for approximately $9,602,000, or 33.1% of revenue, for 2004, $9,548,000, or 35.1% of revenue, for 2003 and $7,418,000, or 33.5% of revenue in 2002.

Maintenance services have generated increasing revenue and have become a more significant portion of our business since most purchasers of health care information system licenses also purchase maintenance service. Maintenance revenue increases as existing customers purchase additional licenses and new customers purchase their initial software licenses. By agreement with our customers, we provide telephone help services and maintain and upgrade their software. Maintenance contracts may require us to make modifications to meet any new federal and state reporting requirements which become effective during the term of the maintenance contract. We do not maintain the hardware and third party software sold to our customers, but we provide a telephone help line service for certain third party software which we license to our customers. Our maintenance revenue was approximately $8,290,000, or 28.6% of revenue, for 2004, $7,069,000, or 26% of revenue, for 2003 and $6,247,000, or 28.2% of revenue, for 2002. Our small systems revenue was approximately $928,000, or 3.2% of revenue, for 2004, $768,000, or 2.8% of revenue, for 2003 and $929,000, or 4.2% of revenue, for 2002.

We currently offer four product modules that provide a range of core application requirements for behavioral healthcare providers. These products consist of a

suite of complete information technology applications developed by us, together with software provided by others which enables us to offer enterprise-wide

solutions to the behavioral health industry. We offer the products in a variety of delivery modes.

* Avatar - Practice Management: This system is a comprehensive solution providing patient management functions, billing, tracking, scheduling, and reporting for inpatient treatment facilities.

* Avatar - Clinician Workstation: This workstation provides a clinician with documentation and medical record management including assessment, care planning, progress notes, order entry and on-line medical records. The clinician workstation is our electronic medical record system for behavioral health, which integrates the clinical tools necessary for an interdisciplinary approach to the delivery of human services.

* Methadone Clinical System: This system offers a solution for dispensing, admissions and medical records, counselling and reception/security specifically for methadone clinics. We can integrate Methadone Clinical System with our other behavioral health products.

* Avatar - Managed Care: The managed care and employee assistance program modules include such features as service request management, contact tracking (patients, providers, others), import of eligibility information by contract, provider search by location, specialty, contract, hospital privileges, claims adjudication and payment.

Data Center

Our Data Center provides software which performs clinical and billing services for outpatient facilities, including mental health, alcohol and substance abuse facilities. Services include statistical reporting, data entry, electronic billing and submission.

Revenue from our Data Center was approximately $2,058,000 or 7.1% of revenue for 2004, $1,973,000 or 7.3% of revenue for 2003 and $1,957,000 or 8.9% of revenue for 2002.

During 2004, two customers each accounted for 10% or more of the total Data Center revenue. One customer was a New York State agency, which accounted for $207,000, or 10% of total Data Center revenue. The other client was a hospital in New York City, which accounted for $216,000, or 10.5% of total Data Center revenue. During 2003, one customer, a hospital in New York City, accounted for $274,000 or 13% of the total Data Center revenue. During 2002, two customers each accounted for more than 10% of the total Data Center revenue. One customer was a New York State agency, which accounted for $199,000, or 10.2% of total Data Center revenue. The other client was a hospital in New York City, which accounted for $225,000, or 11.5% of total Data Center revenue. None of the above mentioned clients accounted for more than 10% of our consolidated revenue.

Our Data Center backlog at December 31, 2004 was $2,132,000. We anticipate that all of this backlog will be earned in 2005. The Data Center backlog at December

31, 2003 was $2,006,000.

Application Service Provider

ASP services involves the offering of our Avatar suite of products, our CareNet products and our InfoScriber products on a virtual private network or internet delivery approach, thereby allowing our customers to rapidly deploy products and

pay on a monthly service basis, thus eliminating capital intensive system requirements. Our CareNet product is a subscription-based Internet solution for Managed Care Organizations that want tighter control over their providers without having to maintain an information technology infrastructure. CareNet establishes a private portal site where providers and partnering agencies can login via the Internet to access client information and complete their virtual paperwork and necessary reporting.

Our InfoScriber product is a secure, web-based system enabling practitioners in organizations or private practices to write and transmit electronic prescriptions to pharmacies of choice. This is the first year that we have accounted for ASP Services as a segment. Prior to our acquisition of CareNet on June 25, 2003, our ASP operations were immaterial.

All of our products and services are offered not only in a turnkey mode of operation but also in an ASP mode in which the client uses our software products with part or all of the software's operation taking place on the computer facilities of our data centers. At present we have a data center service facility in Great River, New York and an ASP facility in Columbus, Ohio.

Revenue from our ASP services was approximately for $1,725,000 for 2004 which consisted of revenue from our CareNet operations of $839,000, revenue from our InfoScriber operations of $243,000 and revenue from our Avatar ASP services operations of $643,000.

During 2004, one customer accounted for $443,000 or 26% of the total ASP revenue. This county did not account for more than 10% of our total consolidated revenue.

Our ASP backlog at December 31, 2004 was $2,233,000. We anticipate that all of this backlog will be earned in 2004.

Markets and Marketing; Customers

The market for information systems and related services consists of both private and publicly operated providers offering hospital or community-based outpatient behavioral/public healthcare services. These healthcare providers require a healthcare information system to administer their programs. We believe that there are at least 15,000 behavioral/public healthcare providers in the United States, including public and private hospitals, private and community-based residential facilities and federal, state and local governmental agencies.

Many long-term behavioral/public healthcare facilities are operated by government entities and include those operated as part of entitlement programs. During the years ended December 31, 2004, 2003 and 2002, approximately 49%, 57% and 52%, respectively, of revenue was generated from contracts with state and local government agencies. Contracts with government agencies generally include provisions which permit the contracting agency to cancel the contract for its

convenience, although we have not experienced a termination for convenience in the last five years.

We believe that the demand for information technology solutions will continue to increase as a result of federal initiatives for data standards as well as continuous pressure from managed care providers to reduce healthcare delivery costs while expanding the availability of services.

In order to remain competitive, the health and human services health delivery networks need detailed clinical and management information systems that enable providers within the networks to maintain a broad scope of accurate medical and financial information, manage costs and deliver quality care efficiently. In addition, the need to upgrade existing systems to meet the increased demand for

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data processing needs of managed care and regulatory oversight has also resulted in an increased demand for behavioral/public healthcare information technology. These data processing needs include analysis of patient assessments, maintenance of patient records, administration of patient treatment plans and the overall coordination of patient case management.

We coordinate our marketing effort with the state agencies and other major users of our systems. Our state agency clients formed a User Group Association, presently consisting of state organizations or agencies from 26 states. The association's members work with us to assess and determine future requirements in both patient managed care coordination and regulatory reporting.

No one customer accounted for more than 10% of consolidated revenue for the years ended December 31, 2004. During the year ended December 31, 2003, one customer accounted for approximately $2,861,000 or 11.4% of software and related systems and services revenue and 10.5% of consolidated revenue. The account receivable from this customer at December 31, 2003 was $589,000 or 7% of the total accounts receivable.

Backlog

We had a backlog of orders, including ongoing maintenance and data center contracts for our behavioral health information systems of $25.8 million at December 31, 2004 and $24.0 million at December 31, 2003. We expect to fill approximately $21.1 million of the 2004 backlog during 2005.

Our backlog consists of revenue of approximately $10.3 million from existing turnkey contracts; maintenance of approximately $10.1 million that is comprised of both amounts expected to be filled under unexpired maintenance contracts and also amounts that are subject to automatic renewal; unexpired Data Center contracts of approximately $2.1 million calculated using historical experience to determine future useage and unexpired application service provider backlog of approximately $2.2 million and facility management contracts of approximately $1.1 million which are also calculated using historical experience to determine twelve months of future usage.

Product Development

We incurred product development costs relating to our health and human services information systems of approximately $3,498,000 in 2004, $2,255,000 in 2003 and $1,318,000 in 2002, all of which was company-sponsored and expensed as research, development and maintenance. In 2004, we capitalized software development costs of $185,000 relating to our RAD Plus 2004 product. The RAD Plus 2004 product is being amortized over a three year period and in 2004 we charged $19,600 to

operations. In 2004, we incurred capitalized software development costs of approximately $150,000 associated with our acquisition of TxM software which was related to our partnership arrangement with the MSJ Communications Corporation, a wholly-owned subsidiary of the Betty Ford Center. In 2003, we capitalized software development costs of $179,500 relating to our Avatar AM, Order Entry and RAD Plus 2004 products. The Avatar AM and Order Entry products are being amortized over a three year period and in 2004, we charged $43,100 to operations. In 2003, we incurred capitalized software development costs of approximately $883,000 associated with our acquisition of software products from CareNet.

Competition

The healthcare software industry is highly competitive. Although we believe that we can provide a health care facility or managed care organization with software to enable it to perform its services more effectively, other software companies provide comparable systems and also have the staff and resources to develop competitive systems.

Healthcare information technology is a multi-billion dollar industry served by numerous vendors. Some dominant health care information technology vendors have achieved annual sales of more than $1 billion by focusing on solutions for large medical/surgical health care providers, such as large hospital systems and health maintenance organizations, and, have not focused on the behavioral/public healthcare industry. We believe that most of the presently available healthcare management software does not meet the specific needs of the behavioral/public healthcare industry, and that the functionality of our information systems are better designed to meet the needs of this market. However, the behavioral health information systems business is serviced by a number of companies, some of which are better capitalized with larger infrastructure than we, and we may not be able to continue to compete effectively with such companies. As our business expands and includes sales to larger integrated healthcare delivery networks, we begin to compete with companies such as Siemens, HBOC, IDX, Meditech, Quadramed, and Misys.

Additionally, we face significant competition in the Data Center medical systems ASP market. General ASP utilities offer clients use of computer facilities and operations staff to process either generalized medical software or software selected by the client from other software vendors. Large billing and clearing house computer service companies provide a broad area of billing for a diverse marketplace. Many organizations start with billing as their primary reason for automation spending. Several types of professional service firms offer departmental staff to operate a client's already in-house system when the client believes that such an approach will provide the needed expertise at a cost effective price. Our ASP service is focused on providing a complete and cost effective service to a specific set of sectors in the large health and human services marketplace. Behavioral health requires the ideal organization of software, systems and staff to enable a client to maximize service at a reasonable cost. Most important is that the service is based on the exclusive use of the Company's proprietary suite of Avatar products which enables a potential client to initiate the use of any part of a broad array of needed clinical and financial systems for as long as these functions are needed knowing that these services are developed, operated, and updated by a professional IT staff which is on call as needed. In addition, our experience is that, once a client has contracted for services, it generally remains a client and is unaffected by competitive offerings. Some of our clients have been working with us for up to thirty years. We believe our specialized experience and investment in related software provides us with a competitive advantage.

We compete in the Health and Human Services Systems market with the following behavioral healthcare vendors among others:

Anasazi Software, Inc.
Askesis Development Group, Inc.
Civerex Systems, Inc.
CMHC Systems
Geneva Software
InfoMC, Inc.
IMPEL Strategic Solutions
Multi-Health Systems, Inc.
Qualifacts System inc.
Raintree Systems Inc.
SecureHEALTH Inc.
Sequest Technologies Inc.
The Echo Group
UNI/CARE Systems, Inc.
XAKTsoft, Inc.

Competitive Position:

As a core part of our strategic business model, we bid on numerous competitive procurements during the calendar year and have a high win ratio, especially in the statewide mental health/mental retardation field for which we have 26 statewide systems. This has contributed to our growth.

We have an established base of more than 500 providers nationwide, including substantial private and government providers of healthcare services. These providers represent approximately 50,000 clinicians, including 26 state agencies and installations in 43 states.

Government Regulations and Contracts

The federal and state governments have adopted numerous regulations relating to the health care industry, including regulations relating to the payments to health care providers for various services. The adoption of new regulations can have a significant effect upon the operations of health care providers and insurance companies. Although our business is aimed at meeting certain of the problems resulting from government regulations and from efforts to reduce the cost of health care, we cannot predict the effect of future regulations by governments and payment practices by government agencies or health insurers, including reductions in the funding for or scope of entitlement programs. Any change in the structure of health care in the United States can have a material effect on companies, such as us, that provide services to the health care industry, including those providing software. Although we believe that the likely direction which may result from the current study of the health care industry would be an increased trend to managed care programs, thereby increasing the importance of automation, our business may not benefit from any changes in the industry structure. Even if the industry does evolve toward more healthcare being provided by managed care organizations, it is possible that there will be substantial concentration in a few very large organizations, which may seek to develop their own software or obtain software from other sources. To the extent that the health care industry evolves with greater government-sponsored programs and less privately run organizations, our business may be adversely affected. Furthermore, to the extent that each state changes its own regulations in the health care field, it may be necessary for us to modify our behavioral health information systems to meet any new record-keeping or other requirements imposed by changes in regulations, and we may not be able

to generate revenues sufficient to cover the costs of developing the modifications.

A significant amount of our business has been with government agencies, including specialized care facilities operated by, or under contract with, government agencies. The decision on the part of a government agency to enter into a contract is dependent upon a number of factors, including economic and budgetary problems affecting the local area, and government procurement regulations, which may include the need for approval by more than one agency before a contract is signed. In addition, government agencies generally include provisions in their contracts which permit the contracting agency to cancel the contract at its convenience. We have not experienced a termination for convenience in the last five years.

Intellectual Property Rights

We have no patent rights for our behavioral health information system software, but we rely upon copyright protection for our software, as well as non-disclosure and secrecy agreements with our employees and third parties to whom we disclose information. We may not be able to protect our proprietary rights to our system and third parties may claim rights in the system. Disclosure of the codes used in any proprietary product, whether or not in violation of a non-disclosure agreement, could have a material adverse affect upon us, even if we are successful in obtaining injunctive relief. We must continue to invest in product development, employee training, and client support.

Employees

As of December 31, 2004, we had 168 employees, including 3 executive, 17 sales and marketing, 136 technical and 12 clerical and administrative employees.

Executive Officers

Information concerning our executive officers is included in Item 11, Directors and Executive Officers for the Registrant.

Item 2. Property

We lease office space at the following locations:

Location	Purpose	Space	Annual Rental	Expir
3500 Sunrise Highway Great River, New York	Executive offices Software and Related Systems and Services Data Center Services	32,600 square feet	$521,000, plus 3% annual increases	10/22
1335 Dublin Road Columbus, Ohio	Software and Related Systems and Services ASP Services	3,500 square feet	$59,000	11/30
5120 Shoreham Place San Diego, California	Software and Related Systems and Services	2,800 square feet	$71,000	05/31

69-730 Highway 11 Ranch Mirage, California	Software and Related Systems and Services	1,400 square feet	$30,000	10/31
117 North 1st Street Ann Arbor, Michigan	ASP Services	2,200 square feet	$49,000	1/31/
220 E. Huron Ann Arbor, Michigan	Software and Related Systems and Services	625 square feet	$989 per month	Month month

We believe that our space is adequate for our immediate needs and that, if additional space is required, it would be readily available at commercially reasonable rates.

Item 3. Legal Proceedings

From time to time we are involved in ordinary and routine litigation matters in the normal course of business. We believe that the resolution of these matters will not have a material adverse effect on our consolidated financial position and results of operations.

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

None

Part II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Our common stock is traded on The Nasdaq SmallCap Market under the symbol NTST. Set forth below is the reported high and low bid prices of our Common Stock for each quarterly period during 2004 and 2003.

Quarter Ended	High	Low
March 31, 2004	$18.70	$11.49
June 30, 2004	13.85	7.11
September 30, 2004	10.00	6.07
December 31, 2004	9.25	7.30
March 31, 2003	$ 6.00	3.53
June 30, 2003	5.53	4.00
September 30, 2003	10.90	5.15
December 31, 2003	19.85	8.45

As of December 31, 2004, there were approximately 2,900 beneficial owners of our common stock. The closing price of our common stock was $10.00 per share on March 1, 2005. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

In July 2003, the Company's Board of Directors approved a one-time cash dividend of $.10 per share of common stock which was paid in September 2003 to all stockholders of record on August 20, 2003. The amount charged to surplus in August 2003, based upon the shares outstanding on August 20, 2003, the record date of the dividend, was $441,447. We do not anticipate that we will pay any further dividends in the foreseeable future. We currently intend to retain future earnings for use in operation and development of our business and for potential acquisitions. In addition, the terms of our term loan agreement requires our lender's consent with respect to the payment of cash dividends.

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During the year ended December 31, 2004, no purchases were made under the Company's stock buyback plan.

Equity Compensation Plan Information

The following table sets forth information relating to our compensation plans as of December 31, 2004.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of se remaining av future issua equity compe plans (exclu securities r column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	724,333	$6.476	
Equity compensation plans not approved by security holders	--	--	
Total	724,333	$6.476	

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Item 6. Selected Financial Data

The selected consolidated financial data set forth below for the five years in

the period ended December 31, 2004 has been derived from the company's audited consolidated financial statements. This information should be read in conjunction with the audited consolidated financial statements and notes thereto.

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(in thousands except per share data)				
Selected Statements of Operations Data:					
Revenue	$ 29,005	$ 27,175	$ 22,126	$ 18,119	$ 20,171
Income from Continuing Operations before interest and other financing costs	3,065	2,368	1,095	399	2,141
Income from Discontinued Operations	--	--	--	--	70
Net Income	2,753(1)	3,028(2)	1,195(3)	315	2,386
Dividends Declared Per Common Share	--	.10	--	--	--
Per Share Data - Diluted:					
Continuing Operations	.50	.64	.29	.08	.61
Discontinued Operations	--	--	--	--	.02
Net Income	$ .50	$ .64	$ .29	$ .08	$ .63
Weighted average number of shares outstanding	5,537	4,752	4,153	3,872	3,771
Selected Balance Sheet Data:					
Working Capital	$ 18,216	$ 14,714	$ 9,215	$ 7,903	$ 5,858
Total Assets	37,707	34,633	22,416	18,007	15,301
Long Term Debt Including Current Portion	1,000	1,667	1,750	2,250	--
Capitalized Leases Including Current Portion	86	147	12	41	76
Stock dividend	--	441	--	--	--
Total Liabilities	13,080	13,633	11,110	8,060	5,997
Accumulated Deficit	(3,594)	(6,347)	(9,376)	(10,571)	(10,886
Stockholders' Equity	$ 24,627	$ 21,000	$ 11,306	$ 9,948	$ 9,303

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(1) The Company's tax provision has been reduced as a result of a $1,014,000

reduction in its deferred tax asset valuation allowance

(2) The Company's tax provision has been reduced as a result of available net operating loss carry forwards. In addition, a $900,000 tax benefit was recognized, as a result of a further reduction in its deferred tax asset valuation allowance.

(3) The Company's tax provision has been reduced as a result of available net operating loss carry forwards. In addition, a $400,000 tax benefit was recognized, as a result of a further reduction in its deferred tax asset valuation allowance..

(4) The Company's tax provision has been reduced as a result of available net operating loss carry forwards. In addition, a $494,000 tax benefit was recognized, as a result of a further reduction in its deferred tax asset valuation allowance

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Our operations are grouped into three segments:
|X| Software and Related Systems and Services
|X| Data Center (service bureau services)
|X| Application Service Provider Services (ASP)

Software and Related Systems and Services is the design, installation, implementation and maintenance of computer information systems that provide comprehensive healthcare information technology solutions, including billing, patient tracking and scheduling for inpatient and outpatient environments, as well as clinical documentation and medical record generation and management. Data Center Services involves our personnel performing data entry and data processing services for customers. Application Service Provider services involves us offering our Avatar suite of products, our CareNet products and InfoScriber products on a virtual private network or through an internet delivery approach, thereby allowing our customers to deploy products and pay on a monthly service basis, thus eliminating capital intensive system requirements. Prior to the acquisition of CareNet, our ASP operations were immaterial and were included in Software and Related Systems and Services.

Years Ended December 31, 2004 and 2003

Results of Operations

Fixed price software development contracts, third party hardware and software components and licenses accounted for 34% and 44% of consolidated revenue for the years ended December 31, 2004 and 2003, respectively. This decrease is the result of more labor revenue being generated on an as incurred basis, as well as a change in the overall mix of our revenue components. Our recurring revenue components, which include our maintenance contract services and our Data Center and ASP services, accounted for 42% of our consolidated revenue for the year ended December 31, 2004 compared to 35% of consolidated revenue for the year ended December 31, 2003. We recognize revenue for fixed price contracts on the estimated percentage of completion basis. Since the billing schedules under the contracts differ from the recognition of revenue, at the end of any period, these contracts generally result in either costs and estimated profits in excess

of billing or billing in excess of costs and estimated profits. Revenue from fixed price software development contracts is determined using the percentage of completion method which is based upon the time spent by our technical personnel on a project.

Our total revenue for 2004 was $29,005,000, an increase of $1,830,000, or 7%, from our revenue for 2003, which was $27,175,000.

Revenue from contracts with state and local government agencies represented 49% of revenue in 2004 and 57% of revenue in 2003. This decrease is the result of the substantial completion towards the end of 2003 of one state contract and two county contracts.

Software and Related Systems and Services

Our Software and Related Systems and Services revenue for 2004 was $25,221,000, an increase of $611,000, or 2%, from our revenue for 2003, which was $24,610,000. Software and related systems and services revenue is comprised of turnkey systems labor revenue, revenue from sales of third party hardware and

software, license revenue, maintenance revenue and revenue from small turnkey systems.

The largest component of revenue was turnkey systems labor revenue, which increased to $9,602,000 in 2004 from $9,548,000 in 2003, reflecting a 1% increase. Turnkey systems labor revenue refers to labor associated with turnkey installations and includes categories such as training, installation, project management and development. Revenue from third party hardware and software decreased to $4,335,000 in 2004, from $4,444,000 in 2003, which represents a decrease of 2%. Sales of third party hardware and software, such as pharmacy and database software, are made in connection with the sales of turnkey systems. These sales are typically made at lower gross margins than our human services revenue. During 2004, we did not sell and perform on as many contracts containing such third party items. License revenue decreased to $2,066,000 in 2004, from $2,781,000 in 2003, reflecting a decrease of 26%. License revenue is generated as part of a sale of a human services information system pursuant to a contract or purchase order that includes delivery of the system and maintenance. We did not sell and perform on as many contracts containing license revenue in 2004 as we did in 2003. In addition, in order to encourage our existing customers to upgrade from our old product to our new Avatar product, we discounted the license fees to our existing clients. Maintenance revenue increased to $8,290,000 in 2004 from $7,069,000 in 2003, reflecting an increase of 17%. As turnkey systems are completed, they are transitioned to the maintenance division, thereby increasing our installed base. Revenue from the sales of our small turnkey division increased to $928,000 in 2004 from $768,000 in 2003, reflecting an increase of 21%. This increase is the result of the introduction of our new Avatar Addictions Management product into the market place during the latter part of 2003. Small turnkey division sales relate to turnkey contracts that are less than $50,000 and are usually completed within one month.

Gross profit decreased to $11,849,000 in 2004 from $11,953,000 in 2003, reflecting a decrease of 1%. Our gross margin percentage was 47% in 2004 compared to 49% in 2003. Our gross margin decreased as a result of the decrease in license revenue. This decrease was partially offset by improved labor efficiency on our fixed price contracts.

Data Center Services (Service Bureau)

Data center clients typically generate approximately the same amount of revenue each year. We bill on a transaction basis or on a fixed fee arrangement. Historically, each year we increase the transaction or fixed fees by an amount that approximates the New York urban consumer price index increase. The data center revenue increased to $2,058,000 in 2004 from $1,973,000 in 2003, representing an increase of $85,000, or 4%. This increase was due to an increase in the client base as well as increases in pricing.

Gross profit increased to $1,209,000 in 2004 from $939,000 in 2003, reflecting an increase of 29%. Our gross margin percentage increased to 59% in 2004 from 48% in the 2003. This increase was the result of the increase in revenue as well as a reduction in costs of approximately $185,000. The major areas of cost reductions were in the area of payroll and fringe benefits in the amount of $21,000, support overhead in the amount of $65,000, facility costs in the amount of $22,000, supplies in the amount of $22,000, depreciation in the amount of $15,000, and other costs in the amount of $23,000.

Application Service Provider Services ("ASP")

ASP Services involves the offering of our Avatar suite of products, our CareNet products and our InfoScriber products on a virtual private network or internet delivery approach, thereby allowing our customers to rapidly deploy products and pay on a monthly service basis, thus eliminating capital intensive system requirements. This is the first year that we have accounted for ASP Services as a segment. Prior to our acquisition of CareNet on June 25, 2003, our ASP operations were immaterial.

Revenue for 2004 was $1,725,000, which consisted of revenue from our CareNet operations of $839,000, revenue from our InfoScriber operations of $243,000 and revenue from our Avatar ASP services operations of $643,000. Revenue for the 2003 was $591,000, which consisted of revenue from our CareNet operations of $380,000 and revenue from our Avatar ASP services operations of $211,000.

Gross profit for 2004 was $799,000 and our gross margin percentage was 46%. The gross profit for 2003 was $214,000 and our gross margin percentage was 36%. Because the ASP operations were in their infancy during the 2003, any comparisons between the periods would not be meaningful.

Operating Expenses

Selling, general and administrative expenses were $7,294,000 in 2004, reflecting a decrease of $675,000, or 8%, from $7,969,000 in 2003. The decreases were in: bad debt expense, which decreased by $1,250,000; provision for bonuses which decreased by $172,000; and general and administrative salaries and related fringe expense, which decreased by $101,000. These costs decreases were partially offset by increases in: depreciation expense which increased by $351,000; amortization of the CareNet acquisition costs, which increased by $139,000; consulting costs which increased by $124,000; commissions, which increased by $87,000; sales salaries and related fringe benefits expense, which increased by $54,000; advertising and promotion, which increased by $47,000; accounting costs, which increased by $40,000; and sales and marketing travel and living costs, which increased by $41,000.

We incurred research, development and maintenance expenses of $3,498,000 in the 2004, an increase of 26% from $2,770,000 in 2003. During 2004, we invested in infrastructure to improve the way we support our customers and products. These

changes related to redirecting personnel that were previously employed performing actual customer program "bug" fixing procedures, which would be included in costs of goods sold, to our research, development and maintenance area. These personnel now perform product version control, which includes design, programming, testing, documentation and quality control of our products. These efforts accounted for a substantial increase in our research, development and maintenance expenses. The increase in research, development and maintenance expense is also the result of continuing investment in product enhancement and extensions. These extensions include the development of new software modules which addresses Federal reporting requirements, as well as continued investment in core products. These amounts have been appropriately accounted for in accordance with SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed."

Interest and other expense was $129,000 in 2004, a decrease of $71,000, or 35%, from $200,000 in 2003. This decrease is the result of the completion of the amortization of the financing costs associated with our loan agreement, which was amortized over a three year period, as well as reduced borrowing during 2004 under our loan with Bank of America. This decrease was partially offset by an increase in borrowing related to the promissory note issued to Shuttle Data Systems Corp. in connection with our acquisition of CareNet.

Interest income was $126,000 in 2004, an increase of $52,000, or 70%, from the $74,000 in 2003. Interest income is generated from short-term investments made with a substantial portion of the proceeds received from the term loan, as well as cash generated from operations and the proceeds of the exercise of options and warrants.

We have a net operating loss tax carry forward of approximately $4.0 million at December 31, 2004. In the 2004 period, we recorded a current income tax expense of $187,000, which related to various state and local taxes, as well as a provision for the Federal alternative minimum tax. The current provision was reduced by $952,000 as a result of a use of the available net operating loss carry forward. The income tax provision was increased by a net deferred tax provision of $122,000. The deferred tax asset valuation allowance of $1,731,000

was reversed of which $717,000 was recorded as an addition to additional paid in capital and $1,014,000 as a deferred tax benefit, during 2004. The deferred tax provision was $1,136,000 based on utilization of net operating loss carry forwards offset by the reduction in the deferred tax asset valuation allowance of $1,014,000. In 2003, we recorded a current income tax expense of $113,000, which related to various state and local taxes, as well as a provision for the Federal alternative minimum tax. The current income tax provision was reduced by $942,000 as a result of the use of available net operating losses. The deferred tax asset and the valuation allowance were reduced by the same amount. We also re-evaluated the deferred tax asset valuation allowance and further reduced the allowance by $900,000 to zero, which was recorded as a tax benefit.

As a result of the foregoing factors, in the 2004 period we had net income of $2,753,000, or $.52 per share (basic) and $.50 per share (diluted). For 2003, we had net income of $3,029,000, or $.69 per share (basic) and $.64 per share (diluted).

Years Ended December 31, 2003 and 2002

Our total revenue for 2003 was $27,175,000, an increase of $5,049,000, or 23%, from our revenue for 2002, which was $22,126,000.

Revenue from contracts from government agencies represented 57% of revenue in

2003 and 52% of revenue in 2002. This reflects an increase in new government contracts, primarily relating to contracts with two new county agencies.

Software and Related Systems and Services

Our Software and Related Systems and Services revenue for 2003 was $24,610,000, an increase of $4,441,000, or 22%, from our revenue for 2002, which was $20,169,000. Software and related systems and services revenue is comprised of turnkey systems labor revenue, revenue from sales of third party hardware and software, license revenue, maintenance revenue and revenue from small turnkey systems.

The largest component of revenue was turnkey systems labor revenue, which increased to $9,548,000 in 2003, from $7,418,000 in 2002, reflecting a 29% increase. Turnkey systems labor revenue refers to labor associated with turnkey installations and includes categories such as training, installation, project management and development. This increase was substantially the result of an increase in spending for information systems in the human services marketplace and our ability to provide the staff necessary to generate additional revenue. Labor rate price changes from 2003 to 2002 resulted in an 11% increase in the average daily billing rate and accounted for approximately $567,000, or 27%, of the total turnkey systems labor increase. Revenue from third party hardware and software increased to $4,444,000 in 2003, from $3,822,000 in 2002, which represents an increase of 16%. Sales of third party hardware and software are made in connection with the sales of turnkey systems. These sales are typically made at lower gross margins than our human services revenue. License revenue increased to $2,781,000 in 2003, from $1,753,000 in 2002, reflecting an increase of 59%. License revenue is generated as part of a sale of a human services information system pursuant to a contract or purchase order that includes delivery of the system and maintenance. This increase in license revenue was the result of an increase in spending for information systems in the human services marketplace. Maintenance revenue increased to $7,069,000 in 2003, from $6,247,000 in 2002, reflecting an increase of 13%. As turnkey systems are completed, they are transitioned to the maintenance division, thereby increasing our installed base. Revenue from the sales of our small turnkey division decreased to $768,000 in 2003, from $929,000 in 2002, reflecting a decrease of 17%. This decrease is the result a redirection of our sales efforts to larger turnkey sales. Small turnkey division sales relate to turnkey contracts that are less than $50,000 and are usually completed within one month.

Gross profit increased to $11,953,000 in 2003 from $7,357,000 in 2002, reflecting an increase of 62%. Our gross margin percentage increased to 49% in

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2003 from 37% in 2002. Our gross margin percentage increased primarily as a result of increased maintenance and license revenue and, to a lesser extent, an increase in our labor revenue. Our infrastructure costs with respect to our maintenance division are substantially in place and as new maintenance revenue occurs, our gross profit margins are improved accordingly.

Data Center (Service Bureau Services)

Data center clients typically generate approximately the same amount of revenue each year. We bill on a transaction basis or on a fixed fee arrangement. Historically, each year, we increase the transaction or fixed fees by an amount that approximates the New York urban consumer price index increase. The data center revenue increased to $1,973,000 in 2003, from $1,957,000 in 2002, representing an increase of $16,000, or 1%. This increase was due to an increase in the client base.

Gross profit decreased to $939,000 in 2003 from $946,000 in 2002, reflecting a decrease of less than 1%. Our gross margin percentage however, remained constant at 48% for 2003 and 2002.

Application Service Provider Services

ASP Services involves the offering of our Avatar suite of products, our CareNet products and our InfoScriber products on a virtual private network or internet delivery approach, thereby allowing our customers to rapidly deploy products and pay on a monthly service basis, thus eliminating capital intensive system requirements. The year 2004 is the first year that we have accounted for ASP Services as a segment. Prior to our acquisition of CareNet on June 25, 2003, our ASP operations were immaterial. Certain items in the year 2003 has been reclassified to conform to the 2004 presentation.

Revenue for 2003 was $591,000, which consisted of revenue from our CareNet operations of $380,000 and revenue from our Avatar ASP services operations of $211,000. There was no ASP revenue in 2002.

Gross profit for 2003 was $214,000 and our gross margin percentage was 36%. Because the ASP operations were in their infancy during the 2003 period, any comparisons between the periods would not be meaningful.

Operating Expenses

Selling, general and administrative expenses were $7,969,000 in 2003, reflecting an increase of $2,431,000, or 44%, from $5,538,000 in 2002. This increase was in the area of sales and marketing salaries, which increased by $342,000; sales commissions, which increased by $210,000; advertising and promotion, which increased by $181,000; an increase in general and administrative salaries, which increased by $316,000; provisions for bonuses, which increased by $404,000 provision for bad debts, which increased by $676,000 and the addition of the amortization of the CareNet acquisition which was $139,000 in 2003 and was not present in 2002.

We incurred product development and maintenance expenses of $2,770,000 in 2003, an increase of 66% from the $1,669,000 in 2002. The increase in product development and maintenance expense was the result of continuing investment in product enhancement and extensions. These extensions include the development of new software modules including Minimum Data Set (MDS) reporting, which was designed to address Federal reporting requirements, as well as continued investment in core products. These amounts have been appropriately accounted for in accordance with SFAS No. 86, "Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed."

Interest and other expense was $200,000 in 2003, a decrease of $62,000, or 24%, from the $262,000 in 2002. This decrease was the result of reduced borrowing during 2003 with respect to our bank. The decrease in interest expense was

partially offset by in increase in borrowing related to the promissory note issued to Shuttle Data Systems Corp. in connection with our acquisition of CareNet and an increase in our capitalized lease arrangements.

Interest income was $74,000 in 2003, an increase of $28,000, or 61%, from 46,000 in 2002. Interest income is generated from short-term investments made with a substantial portion of the proceeds received from the term loan, as well as cash generated from operations and the proceeds the exercise of options and warrants.

We have a net operating loss tax carry forward of approximately $6.5 million. In

2003, we recorded a current income tax expense of $113,000, which related to various state and local taxes, as well as a provision for the Federal alternative minimum tax. The current income tax provision was reduced by $942,000 as a result of the use of available net operating losses. The deferred tax asset and the valuation allowance were reduced by the same amount. We also re-evaluated the deferred tax asset valuation allowance and further reduced the allowance by $900,000, which was recorded as a tax benefit. In 2002, we recorded current income tax expense of $84,000, which related to various state and local taxes. In addition, we recognized a partial deferred tax benefit in the amount of $400,000 principally due to a reduction in the valuation allowance of $400,000 related to our net operating loss carry forward.

As a result of the foregoing factors, in 2003, we had net income of $3,029,000, or $.69 per share (basic) and $.64 per share (diluted). For 2002, we had net income of $1,195,000, or $.32 per share (basic) and $.29 per share (diluted).

Liquidity and Capital Resources

We had working capital of approximately $18.2 million at December 31, 2004 as compared to working capital of approximately $14.7 million at December 31, 2003. This increase of approximately $3.5 million in working capital was the result of the following: our net income, after adding back depreciation and amortization, increased working capital by $4,377,000. The increase in working capital also included $113,000 in net proceeds from the exercise of our stock options and an increase in the current portion of the deferred tax asset in the amount of $193,000. These increases were partially offset by an investment in capitalized software of $185,000, by an additional $621,000 for the acquisition of equipment and by $233,000 for the acquisition of certain software and customer lists. The remaining decrease in working capital of $142,000 was due to changes in other current assets and liabilities.

In June 2001, we entered into a term loan agreement with Fleet Bank, which was subsequently acquired by the Bank of America ("B of A"). This financing provides us with a five-year term loan of $2.5 million. The current term loan bears interest at LIBOR plus 2.5%. We have entered into an interest rate swap agreement with B of A for the amount outstanding under the term loan whereby we converted our variable rate on the term loan to a fixed rate of 7.95% in order to reduce the interest rate risk associated with these borrowings. We have made principal payments on the $2.5 million term loan and the amount outstanding at December 31, 2004 is $750,000.

The terms of our term loan agreement require compliance with certain covenants, including maintaining a minimum net equity of $9 million, minimum cash reserves of $500,000, maintenance of certain financial ratios, limitations on capital expenditures and indebtedness and prohibition of the payment of cash dividends. As of December 31, 2004, we were in compliance with the financial covenants of this agreement.

On February 27, 2003, our Board of Directors authorized the purchase of up to $100,000 of our common stock at any time that the market price is less than $3.50 per share. Purchases of stock will be made from time to time, depending on market conditions, in open market or in privately negotiated transactions, at prices deemed appropriate by management. There is no set time limit on the

purchases. We expect to fund any stock repurchases from our operating cash flow. As of December 31, 2004, we have not made any stock repurchases.

In June 2003, we acquired substantially all of the assets of the CareNet segment

of Shuttle Data Systems Corporation, d/b/a Adia Information Management Corp. The total purchase price included, among other consideration, a three year promissory note in the principal amount of $500,000 payable in 36 equal monthly installments of principal plus interest at the prime rate plus 1%. We have made the required principal and interest payments on the note and the principal amount outstanding at December 31, 2004 is $250,000.

In 2004, we capitalized software development costs of $185,000 relating to our RAD Plus 2004 product.

A part of our growth strategy is to acquire other businesses that are related to our current business. Such acquisitions may be made with cash, our securities, or a combination of cash and securities. If we fail to make any acquisitions our future growth will be limited to only internal growth. As of the date of this Form 10-K annual report, we did not have any formal or informal agreements or understandings with respect to any material acquisitions, and we cannot give any assurance that we will be able to complete any material acquisitions.

Based on our outstanding contracts and our continuing business, we believe that our cash flow from operations and our cash on hand will be sufficient to enable us to fund our operations for at least the next twelve months. It is possible that we may need additional funding if we go forward with certain acquisitions or if our business does not develop as we anticipate or if our expenses, including our software development costs relating to our expansion of our product line and our marketing costs for seeking to expand the market for our products and services to include smaller clinics and facilities and sole group practitioners, exceed our expectation.

Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements.

Contractual Obligations

The following table summarizes, as of December 31, 2004, our obligations and commitments to make future payments under debt, capital leases and operating leases:

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1 - 3 years	4 - 5 years	Ove yea
Long Term Debt(1)	$1,000,028	$ 666,667	$ 333,361	$ --	$
Capital Lease Obligations(2)	90,834	68,957	21,877	--	
Operating Leases(3)	6,597,155	745,379	1,340,772	1,253,124	3,25
Total Contractual Cash Obligations	$7,688,017	$1,481,003	$1,696,010	$1,253,124	$3,25

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(1) See Note 7 to Netsmart's Consolidated Financial Statements for the years

ended December 31, 2004, 2003 and 2002, which describes the Company's financing agreement.
(2) See Note 10 to Netsmart's Consolidated Financial Statements for the years ended December 31, 2004, 2003 and 2002, which describes the Company's Capital Lease Obligation.
(3) See Note 12 to Netsmart's Consolidated Financial Statements for the years ended December 31, 2004, 2003 and 2002, which describes the Company's Operating Lease Obligations.

Critical Accounting Policies and Estimates

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

Revenue Recognition
Capitalized Software Development Costs
Impairment of Customer Lists

Revenue Recognition - Revenue associated with fixed price turnkey sales consists of the following components: licensing of software, labor associated with the installation and implementation of the software; and maintenance services rendered in connection with such licensing activities. Revenue from fixed price

software development contracts and revenue under license agreements, which require significant modification of the software package to the customer's specifications, are recognized utilizing the estimated percentage-of-completion method which uses the units-of-work-performed method to measure progress towards completion. Revisions in cost estimates and recognition of losses on these contracts are reflected in the accounting period in which the facts become known. The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent with the application of the percentage of completion method of accounting affect the amounts of revenue and related expenses reported in our Consolidated Financial Statements. A number of internal and external factors can affect our estimates, including labor rates, utilization and efficiency variances and specification and testing requirement changes. Maintenance contract revenue is recognized on a straight-line basis over the life of the respective contract. We also derive revenue from the sale of third party hardware and software which is recognized based upon the terms of each contract. Consulting revenue is recognized when the services are rendered. Data Center revenue and Application Service Provider revenue are recognized in the period in which the services are provided. The above sources of revenue are recognized when persuasive evidence of an arrangement exists, delivery has

occurred, the fee is fixed and determinable and collectibility is probable.

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

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

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

Capitalized Software Development Costs - Capitalization of computer software development costs begins upon the establishment of technological feasibility and ends upon its availability for general release to customers. Technological feasibility for our computer software products is generally based upon achievement of a detail program design free of high risk development issues. We capitalize only those costs directly attributable to the development of the software. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized computer software development costs require considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology. Prior to reaching technological feasibility these costs are expensed as incurred and included in research, development and maintenance. Activities undertaken after the products are available for general release to customers to correct errors or keep the product updated are expensed as incurred and included in research, development and maintenance. Amortization of capitalized computer software development costs commences when the related products become available for general release to customers. Amortization is provided on a product by product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product bears to the total of current and anticipated future gross revenue for that product or (b) the straight-line method over the remaining estimated economic life of the product. The estimated life of these products range from 3 to 8 years.

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

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

Risk Factors - The results of the Company's operations are subject to certain risks and uncertainties. See "Risk Factors", above.

Forward-Looking Statements

Statements in this Form 10-K annual report may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, but are not limited to, statements that express our intentions, beliefs, expectations, strategies, predictions or any other statements relating to our future activities or other future events or conditions. These statements are based on current expectations, estimates and projections about our business based, in part, on assumptions made by management. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in the forward-looking statements due to numerous factors, including those described above and those risks discussed from time to time in this Form 10-K annual report for the year ended December 31, 2004, including the risks described under "Risk Factors" and in other documents which we file with the Securities and Exchange Commission. In addition, such statements could be affected by risks and uncertainties related to product demand, market and customer acceptance, competition, government regulations and requirements, pricing and development difficulties, as well as general industry and market conditions and growth rates, and general economic conditions. Any forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Form 10-K.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

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

Most of our invested cash and cash equivalents, which are invested in money market accounts and commercial paper, are at variable rates of interest. If market interest rates decrease by 10 percent from levels at December 31, 2004, the effect on our net income would be a decrease of approximately $12,300 per year.

Netsmart Technologies, Inc.
Quarterly Summary
Unaudited

The following table sets forth certain unaudited quarterly results of operations for each of the quarters in the years ended December 31, 2004 and 2003. All quarterly information was obtained from unaudited financial statements not

otherwise contained in this report. We believe that all necessary adjustments have been made to present fairly the quarterly information when read in conjunction with the consolidated financial statements and notes thereto included elsewhere in this report. The operating results for any quarter are not necessarily indicative of the results for any future period.

In thousands, except per share data amounts

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
2004 (a)(c)				
Total revenue	$6,823	$7,189	$7,421	$7,572
Gross profit	3,163	3,435	3,565	3,694

Net income	325	493	633	1,302
Per share amounts:				
Net earnings - Basic:	$ .06	$ .09	$ .12	$ .24
Net earnings - Diluted:	$ .06	$ .09	$ .11	$ .24

(a) The Company utilized an effective income tax rate of approximately 28% through the third quarter of 2004. In the fourth quarter of 2004, the Company determined that the effective income tax rate should approximate 10%. Accordingly, the change in estimate recorded in the fourth quarter was to reduce the income tax provision by approximately $360,000 related to the first three quarters of 2004.

(c) During the fourth quarter the Company changed its method of calculating overhead for its research, development and maintenance costs, from using a standard overhead rate factor to a specific costs method. As a result, $1,248 of costs have been reclassified from research, development and maintenance costs into costs of goods sold. The effect of this reclassification on gross profit for each quarter during 2004 has been reflected above.

2003 (b) (d)				
Total revenue	$6,119	$6,589	$7,108	$7,359
Gross profit	2,576	2,868	3,388	4,275
Net income	271	521	1,546	691
Per share amounts:				
Net earnings - Basic:	$ .07	$ .13	$ .34	$ .13
Net earnings - Diluted:	$ .06	$ .12	$ .33	$ .13

(b) Includes a $100 and $800 reduction in the deferred tax asset valuation allowance for the second and third quarters of 2003 respectively.

(d) The effect of the $515 reclassification to research, development and maintenance, from costs of goods sold on each quarter, has been reflected above.

The Company recorded a $701 increase in its allowance for bad debts in the fourth quarter of 2003. Also during the fourth quarter of 2003, the Company capitalized $144 of software development costs incurred in quarters one through three of 2003, totaling $62, $62 and $20 respectively.

Item 8. Financial Statements and Supplementary Data

The financial statements and supplementary data begin on page F-1 of this Form 10-K.

Item 9. Changes and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Evaluation and Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13d-15(e) and 15d-15(e)). Based upon that evaluation and the material weaknesses described below, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this Annual Report on Form 10-K our disclosure controls and procedures were not adequate to enable us to record, process, summarize and report information required to be included in the Company's periodic SEC filings within the required time period.

Changes in Internal Controls

We are not an accelerated filer (as defined in the Securities Exchange Act) and are not required to deliver management's report on control over financial reporting until our fiscal year ended December 31, 2006 (or December 31, 2005 in the event we become an accelerated filer). Nevertheless, in our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002, during the quarter ended December 31, 2004, we identified certain matters that would constitute material weaknesses (as such term is defined under the Public Company Accounting Oversight Board Auditing Standard No. 2) in our internal controls over financial reporting.

The first material weakness is the lack of the necessary corporate accounting resources to ensure consistently complete and accurate reporting of financial information with respect to the preparation of our tax accrual. In order to correct this deficiency, in November 2004, we engaged an outside consultant to prepare and review our tax accruals. This consultant prepared our tax provision for the year ended December 31, 2004.

The other material weakness is the lack of the necessary corporate accounting resources to realign and cross-train current finance and accounting personnel. This has led to a dependence on our Chief Financial Officer, the loss of whom could impair our ability to ensure consistently complete and accurate financial reporting, particularly with respect to our revenue recognition on work in process contracts. In order to correct this deficiency, we are seeking to hire additional competent personnel to assist in the segregation of duties with respect to financial reporting, Sarbanes Oxley 404 compliance and revenue recognition on work in process contracts.

We believe that for the reasons described above we will be able to improve our disclosure controls and procedures and remedy the material weaknesses identified above. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, will be or have been detected.

Except as described above, there were no significant changes in our internal controls over financial reporting that occurred during the year ended December 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on the Effectiveness of Controls

We believe that a control system, no matter how well designed and operated,

cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Our disclosure controls and procedures are designed to provide a reasonable assurance of achieving their objectives and our Chief Executive Officer and Chief Financial Officer have concluded that such controls and procedures are effective at the "reasonable assurance" level.

Item 9B. Other Information

None

Part III

Item 10. Directors and Executive Officers of the Registrant.

Our directors and executive officers are as follows:

Name	Age	Position
James L. Conway	57	Chief executive officer and director
Gerald O. Koop	66	President and director
Anthony F. Grisanti	55	Chief financial officer, treasurer and secretary
John F. Phillips	66	Director
Joseph G. Sicinski(1 & 2)	72	Director
Francis J. Calcagno(1, 2 & 3)	55	Director
John S.T. Gallagher(1, 2 & 3)	74	Director
Yacov Shamash(3)	55	Director

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(1) Member of the compensation committee.
(2) Member of the audit committee.
(3) Member of the nominating and governance committee.

Director Biographies

Mr. James L. Conway has been our Chief Executive Officer since April 1998, a director since January 1996 and was President from January 1996 until January 2001. From 1993 until April 1998, he was president of a Long Island based manufacturer of specialty vending equipment for postal, telecommunication and other industries. He was previously vice president, treasurer and director of ITT Credit Corporation. Mr. Conway was recently elected to the board of LISTnet which is an organization with the objective of promoting Long Island as one of the national centers of execellence for software and technology solutions. He also serves and is a member of the CEO Roundtable for Long Island.

Mr. Gerald O. Koop has been one of our directors since June 1998 and president since January 2001. He has held management positions with Creative Socio-Medics for more than the past five years, most recently as its Chief Executive Officer, a position he has held since 1996.

Mr. John F. Phillips has been one of our directors of Creative Socio-Medics since June 1994, when Creative Socio-Medics was acquired.

Mr. Anthony F. Grisanti has been our Treasurer since June 1994, Secretary since February 1995 and Chief Financial Officer since January 1996.

Mr. Joseph G. Sicinski has been one of our directors since June 1998. He was president and a director of the Trans Global Services, Inc., a technical staffing company, a position he held with Trans Global and its predecessor from September 1992 until September 2003. From April 1998 until December 2001, he was also chief executive officer of Trans Global.

Mr. Francis J. Calcagno has been one of our directors since September 2001. He is a senior managing director of Dominick & Dominick LLC, a company engaged in investment banking, a position he has held since 1997. From 1993 until 1997, he was a managing director of Deloitte and Touche, LLP.

Mr. John S.T. Gallagher has been one of our directors since March 2002. He is deputy county executive for health and human services in Nassau County, New York, a position he has held since February 2002. He has been a senior executive officer of North Shore University Hospital and North Shore - Long Island Jewish Health System since 1982, having served as executive vice president of North Shore from 1982 until 1992, president from 1992 until 1997 and chief executive officer of the combined hospital system from 1997 until January 2002. In January 2002, he became co-chairman of the North Shore - Long Island Jewish Heath System Foundation. Mr. Gallagher is also a director of Perot Systems Corporation, a worldwide provider of information technology services.

Dr. Yacov Shamash is Vice President for Economic Development and the Dean of the College of Engineering and Applied Sciences at Stony Brook University. Prior to joining SUNY Stony Brook in 1992, Dr. Shamash served as the Director of the School of Electrical Engineering and Computer Science at Washington State University. He has also held faculty positions at Florida Atlantic University, the University of Pennsylvania and Tel Aviv University. He received his undergraduate and graduate degrees from Imperial College of Science and Technology in London, England. Dr. Shamash has been a member of the Board of Directors of KeyTronic Corporation, a contract manufacturer, since 1989, of American Medical Alert Corporation, a healthcare service provider, since 2001 and of Manchester Technologies, Inc., a hardware and software technology provider, since December 2003. He is also on the Boards of Directors of a number of start-up companies and serves on the Boards of not-for-profit organizations. Dr. Shamash has authored over 110 technical publications and he is a Fellow of the IEEE.

Directors are elected for a term of one year.

None of our officers and directors are related.

Our certificate of incorporation includes certain provisions, permitted under Delaware law, which provide that a director shall not be personally liable to us or our stockholders for monetary damages for breach of fiduciary duty as a director except for liability (i) for any breach of the director's duty of loyalty to us or our stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) for any transaction from which the director derived an improper personal benefit, or (iv) for certain conduct prohibited by law. The Certificate of Incorporation also contains broad indemnification provisions. These provisions do not affect the liability of any director under federal or applicable state securities laws.

Board Committees

Our board of directors has three committees - the audit committee, the compensation committee and the nominating and governance committee.

The audit committee consists of three independent directors, Messrs. John S.T. Gallagher, who is chairman of the committee, Francis Calcagno and Joseph G. Sicinski. The responsibilities of the audit committee include overseeing our financial reporting process, reporting the results of its activities to the board, retaining and ensuring the independence of our auditors, approving services to be provided by our auditors, reviewing our periodic filings with the independent auditors prior to filing, and reviewing and responding to any matters raised by the Independent Registered Public Accountants in their management letter. The board of directors has determined that each of Messrs. Gallagher, Sicinski and Calcagno, qualifies as an "Audit Committee financial expert," as defined by Securities and Exchange Commission rules, based in his education, experience and background. A copy of the Audit Committee charter can be found on our website at www.csmcorp.com.

The compensation committee, which is composed of Mr. Gallagher, who is chairman of the committee and Messrs. Calcagno and Sicinski, serves as the stock option committee for our stock option plans and the employee stock purchase plan, and it reviews and approves any employment agreements with management and changes in compensation for our executive officers. A copy of the Compensation Committee charter can be found on our website at www.csmcorp.com.

In February 2004, we formed our Nominating and Governance Committee. The Nominating and Governance Committee is primarily responsible for reviewing our corporate governance principles and independence standards: overseeing the annual evaluation of our board and its committees; discharging the board's responsibilities related to compensation of directors; identifying and evaluation individuals for board and committee membership and chairs; making recommendations to the board concerning the selection of director nominees and making recommendations as to the size and composition of the board and its committees. The members of the Nominating and Governance Committee are Dr. Shamash, who is the chairman of the committee and Messrs. Gallagher and Calcagno. A copy of the Nominating and Governance Committee charter can be found on our website at www.csmcorp.com.

Excluding actions by unanimous written consent, during 2004, the board of directors held eight meetings, the compensation committee held three meetings, the independent directors held one meeting and the audit committee held five meetings. The audit committee met with our independent registered public accountants and chief financial officer prior to filing of this Form 10-K annual report to review the 2004 audited financial statements with the independent registered public accountants. During 2004, all of our directors attended at least 85% of the meetings of the board and 100% of the meetings of any committee of which they are members, except one director who attended 60% of the audit committee meetings.

Directors' Fees

We pay an annual fee of $20,000 to Messrs. Calcagno, Sicinski, Shamash and Gallagher and we pay an additional $12,500 per annum to Mr. Gallagher in respect of his services as chairman of our Audit Committee and Compensation Committee.

Stockholder Nomination Procedures

Any stockholder who wants to nominate a candidate for election to the Board must deliver timely notice to our Secretary at our principal executive offices. In order to be timely, the notice must be delivered

* in the case of an annual meeting, not less than 120 days prior to the anniversary date of the immediately preceding annual meeting of stockholders, although if we did not hold an annual meeting or the annual meeting is called for a date that is not within 30 days of the anniversary date of the prior year's annual meeting, the notice must be received a reasonable time before we begin to print and mail our proxy materials; and

* in the case of a special meeting of stockholders called for the purpose of electing directors, the notice must be received a reasonable time before we begin to print and mail our proxy materials.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our executive officers, directors and persons who own more than ten percent of a registered class of our equity securities ("Reporting Persons") to file reports of ownership and changes in ownership on Forms 3, 4 and 5 with the Securities and Exchange Commission and the Nasdaq Stock Exchange. These Reporting Persons are

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required by SEC regulation to furnish us with copies of all Forms 3, 4 and 5 they file with the SEC and Nasdaq. Based solely upon our review of the copies of the forms we have received, and upon representations received from such Reporting Persons, we believe that all Reporting Persons complied on a timely basis with all filing requirements applicable to them with respect to transactions during fiscal 2004, except for Mr. Phillips who filed a Form 4 to report sale transactions forty-eight days late.

Code of Ethics

We have adopted a Code of Ethics applicable to our principal executive officers, principal financial officer, principal accounting officer and controller and a Code of Business Conduct applicable to all of our employees, each which is posted on our website at www.csmcorp.com. A copy of the Code of Ethics and Code of Business Conduct may also be obtained without charge by writing to Mr. Anthony F. Grisanti, Chief Financial Officer, Netsmart Technologies, Inc, 3500 Sunrise Highway, Great River, NY 11739.

Item 11. Executive Compensation.

Set forth below is information with respect to compensation paid or accrued by us for the three years ended December 31, 2004, 2003 and 2002 to our chief executive officer and to each of our other officers whose salary and bonus for 2004 exceeded $100,000.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation Salary	Annual Compensation Bonus	Long-Term Compensation (Awards) Options, SARs (Number)
James L. Conway, CEO	2004	$218,698	$175,000	42,500
	2003	207,814	188,000	49,500
	2002	193,151	120,000	20,000
Gerald O. Koop, president	2004	194,665	174,078	40,000
	2003	189,880	206,539	49,500
	2002	170,807	170,408	20,000
Anthony F. Grisanti, chief financial officer	2004	167,535	125,000	27,500
	2003	162,343	144,000	27,500
	2002	148,463	106,000	16,000

The bonuses for Mr. Koop includes accrued commissions of $111,578 for 2004, $135,539 for 2003 and $165,408 for 2002. The 2004 commissions will be paid in installments through 2005, the 2003 commissions were paid in installments through 2004 and the 2002 commissions were paid in installments through 2003.

Employment Agreements

In April 2004, we entered into revised employment agreements with Messrs. James L. Conway, Gerald O. Koop and Anthony F. Grisanti. The terms and conditions of the revised contracts are identical in all material respects to the previous contracts except that (i) the term of each individual's contract was extended by one year, so that Messrs. Conway and Grisanti's contract will expire on December 31, 2006 and Mr. Koop's contract will expire on December 31, 2005 and (ii) the revised contracts do not provide for a five-year consulting period following each

individual's respective term of employment during which such individual would have been entitled to compensation of $75,000 per year. Messrs. Conway and Grisanti's contracts also provide for an option to extend their contracts for one additional year so that upon the exercise of such option, their contracts would expire on December 31, 2007. We believe that these officers are vital to our business.

Pursuant to these employment agreements, these officers received the following salaries in 2004: Mr. Conway - $211,473, Mr. Koop - $186,839, and Mr. Grisanti - $162,204. The agreements provide for annual increases associated with cost of living indexes or 5%, whichever is greater. The agreements provide that the executives are eligible to participate in a bonus pool to be determined annually by the board, based on the executive's performance. The agreements also provide each of these officers with an automobile allowance, which is included under "Salary", and insurance benefits. In the event of the officer's dismissal or resignation or a material change in his duties or in the event of a termination of employment by the executive or by us as a result of a change of control, the officer may receive severance payments of 36 months' compensation. In January 2001, we entered into a consulting agreement with Mr. Bright, which was amended in March 2004 and in April 2004 we entered into a consulting agreement with Mr. Phillips - see Item 13, Certain Relationships and Related Transactions.

Effective April 1, 2004, we adopted an Executive Retirement, Non-Competition and Consulting Plan which was subsequently amended August 5, 2004 effective April 1, 2004, pursuant to which, following their retirement, selected officers will be entitled to receive a minimum payment of approximately $85,000 per year for a period of six years, provided, that such officers (i) provide a minimum amount of consulting days each month and (ii) agree to certain covenants not to compete. The annual payments are subject to 10% increases up to a maximum of $136,893 per year. Pursuant to the Executive Retirement, Non-Competition and Consulting Plan, the selected officers are also entitled to receive health benefits for life, provided that there are no breaches of the covenants not to compete. Each of Messrs. Conway, Koop and Grisanti are entitled to receive benefits under the plan.

Mr. Phillip's employment contract expired on December 31, 2003 and he retired effective April 1, 2004. Pursuant to the terms of our Executive Retirement, Non-Competition and Consulting Plan, Mr. Phillips will receive $85,000 per year for each of the next six years; provided that he complies with the non-competition covenants of the plan.

Compensation Committee Interlocks and Insider Participation

During fiscal 2004, our compensation committee consisted of Messrs. Calcagno, Gallagher and Sicinski. None of them were our officers or employees during fiscal 2004 or were previously an officer of ours nor did any of them have any relationship with us that is required to be disclosed under this heading.

COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The compensation of our executive officers is determined by the Compensation Committee of our board of directors, subject to applicable employment agreements. Each member of the Compensation Committee is a director who is not employed by us or any of our affiliates. The following report with respect to certain compensation paid or awarded to our executive officers during fiscal 2004 is furnished by the directors who comprised the Compensation Committee during fiscal 2004.

General Policies

Our compensation programs are intended to enable us to attract, motivate, reward and retain the management talent required to achieve our corporate objectives, and thereby increase shareholder value. It is our policy to provide incentives to our senior management to achieve both short-term and long-term objectives and to reward exceptional performance and contributions to the development of our businesses. To attain these objectives, our executive compensation program includes a competitive base salary, cash incentive bonuses and stock-based compensation. See "Executive Compensation -- Employment Agreements".

Stock options are granted to employees, including our executive officers, under our option plans. The Committee believes that stock options provide an incentive that focuses the executive's attention on managing Netsmart from the perspective of an owner with an equity stake in the business. Options are awarded with an exercise price equal to the market value of common stock on the date of grant. Among our executive officers, the number of shares subject to options granted to each individual generally depends upon the level of that officer's responsibility. The largest grants are awarded to the most senior officers who,

in the view of the Compensation Committee, have the greatest potential impact on our profitability and growth. Previous grants of stock options are reviewed but are not considered the most important factor in determining the size of any executive's stock option award in a particular year.

Relationship of Compensation to Performance and Compensation of Chief Executive Officer

The Compensation Committee annually establishes, subject to the approval of our board of directors and any applicable employment agreements, the salaries to be paid to our executive officers during the coming year. The base salary of each of Messrs. Conway, Koop and Grisanti is established by contract. In setting salaries, the Compensation Committee takes into account several factors, including the extent to which an individual may participate in the stock plans maintained by us, and qualitative factors bearing on an individual's experience, responsibilities, management and leadership abilities, and job performance.

For fiscal 2004, pursuant to the terms of his employment agreement with us, our Chairman received a base salary and additional compensation (See "Executive Compensation - Employment Agreements").

The Compensation Committee:
John S.T. Gallagher (Chairman)
Francis J. Calcagno
Joseph G. Sicinski

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Option Exercises and Outstanding Options

The following table sets forth information concerning the grants of options made during the year ended December 31, 2004.

Options Grants in Last Fiscal Year

	Number of Securities Underlying Options Granted (1)	% of Total Options Granted to Employees in 2004 (2)	Exercise or Base Price $/Sh (3)	Expiration Date	Potential Reali at Assumed Annu of Stock Price Ap for Option Te
					5%
Koop	40,000	10.1%	$ 8.49	5/13/09	$11
					$
	-------	-----			--
	40,000	10.1%			$11
	-------	-----			--
Phillips	15,000	3.8%	$ 8.49	5/13/09	$ 4
					$
	-------	-----			--
	15,000	3.8%			$ 4
	-------	-----			--
Yacov Shamash	5,625	1.4%	$ 8.49	5/13/09	$ 1
Yacov Shamash	375	0.1%	$ 13.29	4/1/09	$

	-------	-----			--
	6,000	1.5%			$ 1
	-------	-----			--
Anthony Grisanti	27,500	6.9%	$ 8.49	5/13/09	$ 7 $
	-------	-----			--
	27,500	6.9%			$ 7
	-------	-----			--
James Conway	42,500	10.7%	$ 8.49	5/13/09	$12 $
	-------	-----			--
	42,500	10.7%			$12
	-------	-----			--
Joseph Sicinski	5,625	1.4%	$ 8.49	5/13/09	$ 1
Joseph Sicinski	375	0.1%	$ 13.29	4/1/09	$
	-------	-----			--
	6,000	1.5%			$ 1
	-------	-----			--
Frank Calcagno	5,625	1.4%	$ 8.49	5/13/09	$ 1
Frank Calcagno	375	0.1%	$ 13.29	4/1/09	$
	-------	-----			--
	6,000	1.5%			$ 1
	-------	-----			--
Jack Gallagher	7,125	1.8%	$ 8.49	5/13/09	$ 2
Jack Gallagher	375	0.1%	$ 13.29	4/1/09	$
	-------	-----			--
	7,500	1.9%			$ 2
	-------	-----			--

(1) Includes options granted in 2004
(2) Based on a total of 397,455 shares subject to options granted to employees under Netsmart's options plans in 2004.
(3) Under all stock option plans, the option purchase price is equal to the fair market value at the date of grant. Options were granted to executives on April 1, 2004 and May 13, 2004.
(4) In accordance with the U.S. Securities and Exchange Commission rules, these columns show gains that could accrue for the respective options, assuming that the market price of Netsmart common stock appreciates from the date of grant over a period of 6 years at an annualized rate of 5% and 10%, respectively. If the stock price does not increase above the exercise price at the time of exercise, realized value to the named executive from these options would be zero.

The following table sets forth information concerning the exercise of options during the year ended December 31, 2004 and the year-end value of options held by our officers named in the Summary Compensation Table. No stock appreciation rights have been granted.

Aggregate Option Exercises in Last Fiscal Year and Fiscal
Year-End Option Value (Includes options that were fully exercisable

at year end or by 60 days after the date as of which the information is provided)

Name	Shares Acquired Upon Exercise	Value Realized ($)	Number of Securities Underlying Unexercised Options/At Fiscal Year-End (#) Exercisable/ Unexercisable	Value o Unexerci In-the-Mo Options/At F Year-End Exercisab Unexerci
(a)	(b)	(c)	(d)	(e)
James L. Conway	0	$0	46,000/21,250	$117,510/
Gerald O. Koop	12,250	$101,063	57,000/20,000	$173,370/
Anthony F. Grisanti	0	$0	76,000/13,750	$361,831/

The determination of "in the money" options at December 31, 2004, is based on the closing price of the common stock on the Nasdaq SmallCap Market on December 31, 2004, which was $8.98 per share.

Information relating to securities issued under equity compensation plans is disclosed in response to "Item 5. Market for Registrant's Common Equity and Related Stockholder Matters".

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Item 12. Security Ownership of Certain Beneficial Owners and Management.

Set forth below is information as of March 3, 2005, as to each person known by us, based on information provided to us by the persons named below and filings with the Securities and Exchange Commission, to own beneficially at least 5% of our common stock, each director, each officer listed in the Summary Compensation Table and all officers and directors as a group.

Name and Address	Shares	Percent of Outstanding Common Stock
John F. Phillips	109,825	2.0%
Gerald O. Koop	183,576	3.4%
James L. Conway	152,498	2.8%
Anthony F. Grisanti	159,815	2.9%
Joseph G. Sicinski	31,000	*
Francis J. Calcagno	16,000	*
John S.T. Gallagher	22,500	*
Yacov Shamash	6,000	*
All directors and officers as a group (eight individuals)	681,214	12.0%
Eagle Asset Management 880 Carillon Parkway St. Petersburg, FL	564,618	10.6%

Dawson Herman 354 Pequot Avenue Southport, CT	562,250	10.5%
Daniel Zeff 50 California St. San Francisco, CA.	330,870	6.2%

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* Less than 1%.

Except as set forth in the following paragraphs, each person has the sole voting and sole investment power and direct beneficial ownership of the shares. Each person is deemed to beneficially own shares of common stock issuable upon exercise of options or warrants which are exercisable on or within 60 days after the date as of which the information is provided.

Except as otherwise noted above, the address of each person listed is c/o Netsmart Technologies, Inc., 3500 Sunrise Highway, Great River, NY 11739.

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The number of shares owned by our directors and officers shown in the table above includes shares of common stock which are issuable upon exercise of options that are exercisable at February 2, 2005 or will become exercisable within 60 days after that date. Set forth below is the number of shares issuable upon exercise of those options for each of such directors and the officers.

Name	Number
John F. Phillips	41,250
Yacov Shamash	6,000
Gerald O. Koop	64,750
James L. Conway	67,250
Anthony F. Grisanti	89,750
Joseph G. Sicinski	11,000
Francis J. Calcagno	16,000
John S.T. Gallagher	17,500
All officers and directors as a group	313,500

Item 13. Certain Relationships and Related Transactions.

We entered into a consulting agreement with Mr. Bright, a former director, dated January 1, 2001, as amended in March 2004, pursuant to which Mr. Bright is to devote 50% of his time to our business for a period of two years. Following the completion of the term, or earlier at the discretion of Mr. Bright, Mr. Bright continues as a consultant for an additional five years. Mr. Bright receives compensation at the annual rate of $75,000 during the consulting term, and we provide him with an automobile allowance and insurance benefits. Mr. Bright is eligible, at the discretion of the board, to participate in a bonus pool which may be established by the board. In the event that Mr. Bright's consultant relationship is terminated as a result of a change of control, we are to pay him as severance pay of 36 months compensation. We paid Mr. Bright total compensation of $102,000 for 2004.

Effective April 1, 2004, we adopted an Executive Retirement, Non-Competition and Consulting Plan which was subsequently amended August 5, 2004 effective April 1, 2004, pursuant to which, following their retirement, selected officers will be entitled to receive a minimum payment of approximately $85,000 per year for a

period of six years, provided, that such officers (i) provide a minimum amount of consulting days each month and (ii) agree to certain covenants not to compete. The annual payments are subject to 10% increases up to a maximum of $136,893 per year. Pursuant to the Executive Retirement, Non-Competition and Consulting Plan, the selected officers are also entitled to receive health benefits for life, provided that there are no breaches of the covenants not to compete. Each of Messrs. Conway, Koop and Grisanti are entitled to receive benefits under the plan.

Mr. Phillip's employment contract expired on December 31, 2003 and he retired effective April 1, 2004. Pursuant to the terms of our Executive Retirement, Non-Competition and Consulting Plan, Mr. Phillips will receive $85,000 per year for each of the next six years; provided, that he complies with the non-competition covenants of the plan. In addition, Mr. Phillips has a one year consulting agreement with us. We paid Mr. Phillips total compensation of $131,293 in 2004, of which $13,049 was for consulting services.

Item 14. Principal Accounting Fees and Services

Audit Fees

We were billed by Marcum & Kliegman LLP the aggregate amount of approximately $151,000 in respect of fiscal 2004 and $142,500 in respect of fiscal 2003 for

fees for professional services rendered for the audit of our annual financial statements and review of our financial statements included in our Forms 10-Q.

Audit-Related Fees

We were billed by Marcum & Kliegman LLP in fiscal 2004 and 2003 in the amounts of $13,241 and $76,798, respectively for assurance and related services such as fees for our 401K audit and acquisition services, that were reasonably related to the performance of the audit or review of our financial statements that are not reported under the preceding paragraph. Including, services rendered in connection with acquisitions, reviews of registration statements and issuances of related consents, audits of employees benefit plans and advice regarding common stock purchase warrants and Sox 404 related efforts.

Tax Fees

We were billed by Marcum & Kliegman LLP the aggregate amount of $25,600 in respect of fiscal 2004 and $25,819 in respect of fiscal 2003 for fees for services consisting primarily of tax compliance, tax advice or tax planning in respect of the preparation of our federal and state tax returns.

Our Audit Committee has determined that the provision of services by Marcum & Kliegman LLP other than for audit related services is compatible with maintaining the independence of Marcum & Kliegman as our independent accountants.

Pre-Approval Policies

Our Audit Committee has pre-approved the provision by Marcum & Kliegman LLP of audit services and of non-prohibited audit related services for fees in an amount not to exceed an aggregate of $10,000 as well as $25,000 for acquisition due diligence services. Our Audit Committee has not otherwise adopted any blanket pre-approval policies.

Our Audit Committee approved all of the services provided by Marcum & Kliegman LLP and described in the preceding paragraphs.

Part IV

Item 15. Exhibits, Financial Statements Schedules and Reports on Form 8-K.

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1. Financial Statements
   - Report of Marcum & Kliegman LLP
   - Consolidated Balance Sheets as of December 31, 2004 and 2003
   - Consolidated Statements of Income for the Years Ended December 31, 2004, 2003 and 2002 Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2004, 2003 and 2002
   - Consolidated Statements of Cash Flows for the Years Ended December 31, 2004, 2003 and 2002
   - Notes to Consolidated Financial Statements

2. Financial Statement Schedules
   None

3. Exhibits

3.1(1)	Restated Certificate of Incorporation, as amended
3.2(1)	By-Laws
10.1(9)	Employment Agreement dated April 1, 2004, between the Registrant and James L. Conway
10.2(9)	Consulting Agreement dated April 1, 2004, between the Registrant and John F. Phillips
10.3(9)	Employment Agreement dated April 1, 2004, between the Registrant and Gerald O. Koop
10.4(9)	Employment Agreement dated April 1, 2004, between the Registrant and Anthony F. Grisanti
10.5(2)	Consulting Agreement dated January 1, 2001, between the Registrant and Edward D. Bright
10.6(1)	1993 Long-Term Incentive Plan
10.7(3)	1998 Long-Term Incentive Plan
10.8(4)	1999 Long-Term Incentive Plan
10.9(5)	2001 Long-Term Incentive Plan - Amended
10.10(4)	1999 Employee Stock Purchase Plan
10.11(2)	Agreement dated June 1,2001, between the Registrant and Fleet Bank
10.12(6)	AIMS Acquisition Agreement
10.13(7)	Agreement dated June 25, 2003, among Registrant, Creative Socio-Medics Corp., Shuttle Data Systems Corp., d/b/a/ ADIA Information Management Corp. and Steven Heintz, Jr.
10.14(8)	Lease agreement dated as of December 22, 2003, between Registrant and Spacely LLC.
10.14(10)	Amended Executive Retirement, Non Competition and Consulting Plan.
21.1	Subsidiary of the Registrant
23.1	Consent of Marcum & Kliegman LLP
24	Powers of Attorney (See Signature Page)
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer

32	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(1) Filed as an exhibit to the Registrant's registration statement on Form S-1, File No. 333-2550, which was declared effective by the Commission on August 13, 1996, and incorporated herein by reference.

(2) Filed as an exhibit to the Registrant's 10-K/A dated August 21, 2003.

(3) Filed as an appendix to the Registrant's proxy statement dated September 30, 1999, relating to its 1999 Annual Meeting of Stockholders and incorporated herein by reference.

(4) Filed as an appendix to the Registrant's proxy statement dated November 9, 2000, relating to its 2000 Annual Meeting of Stockholders and incorporated herein by reference.

(5) Filed as an appendix to the Registrant's proxy statement dated March 30, 2004, relating to its 2004 Annual Meeting of Stockholders and incorporated herein by reference.

(6) Filed as an exhibit to the Registrant's 8-K dated May 10, 2001.

(7) Filed as an exhibit to the Registrant's 8-K dated July 8, 2003.

(8) Filed as an exhibit to the Registrant's 10-K dated March 23, 2004.

(9) Filed as an exhibit to the Registrant's 10-Q dated May 5, 2004.

(10) Filed as an exhibit to the Registrant's 10-Q dated August 9, 2004.

NETSMART TECHNOLOGIES, INC.
AND SUBSIDIARY

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Audit Committee of the
Board of Directors and Stockholders of
Netsmart Technologies, Inc.

We have audited the accompanying consolidated balance sheets of Netsmart Technologies, Inc. and subsidiary ("the Company") as of December 31, 2004 and 2003, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

/s/ Marcum & Kliegman LLP

Marcum & Kliegman LLP
Melville, NY
February 4, 2005

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
Assets:		
Current Assets:		
Cash and Cash Equivalents	$16,411,735	$15,920,993
Accounts Receivable - Net	11,714,691	8,004,481
Costs and Estimated Profits in Excess of Interim Billings	636,985	1,817,135
Deferred taxes	1,111,000	918,000
Other Current Assets	596,253	541,458
Total Current Assets	30,470,664	27,202,067
Property and Equipment - Net	2,546,948	2,591,758
Other Assets:		
Capitalized Software Costs - Net	1,132,453	1,087,116
Customer Lists - Net	2,179,237	2,701,751
Deferred Taxes	1,284,000	882,000
Other Assets	93,599	168,697
Total Other Assets	4,689,289	4,839,564
Total Assets	$37,706,901	$34,633,389

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
Liabilities and Stockholders' Equity:		
Current Liabilities:		
Current Portion - Long Term Debt	$ 666,667	$ 666,
Current Portion Capital Lease Obligations	64,450	61,
Accounts Payable	1,572,930	1,329,

Accrued Expenses	1,545,127	2,295,
Interim Billings in Excess of Costs and Estimated Profits	7,497,773	7,263,
Deferred Revenue	907,630	871,
Total Current Liabilities	12,254,577	12,488,
Long Term Debt - Less current portion	333,361	1,000,
Capital Lease Obligations - Less current portion	21,532	85,
Interest Rate Swap at Fair Value	15,152	59,
Deferred Rent Payable	455,427	
Total Non Current Liabilities	825,472	1,145,
Commitments and Contingencies		
Stockholders' Equity:		
Preferred Stock - $.01 Par Value, 3,000,000 Shares Authorized; None issued and outstanding	--	
Common Stock - $.01 Par Value; Authorized 15,000,000 Shares; Issued and outstanding 5,567,124 and 5,339,200 shares at December 31, 2004, 5,528,247 and 5,304,489 shares at December 31, 2003	55,671	55,
Additional Paid-in Capital	29,893,223	29,010,
Accumulated Comprehensive loss - Interest Rate Swap	(15,152)	(59,
Accumulated Deficit	(3,593,908)	(6,346,
	26,339,834	22,659,
Less: cost of shares of Common Stock held in treasury - 227,924 shares at December 31, 2004 and 223,758 shares at December 31, 2003	1,712,982	1,659,
Total Stockholders' Equity	24,626,852	21,000,
Total Liabilities and Stockholders' Equity	$ 37,706,901	$ 34,633,

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31,		
	2004	2003	2002

Revenues:			
Software and Related Systems and Services:			
General	$16,931,606	$17,541,356	$13,921,
Maintenance Contract Services	8,289,525	7,069,000	6,247,
Total Software and Related Systems and Services	25,221,131	24,610,356	20,168,
Application Service Provider Services	1,725,473	591,202	
Data Center Services	2,058,240	1,973,492	1,957,
Total Revenues	29,004,844	27,175,050	22,126,
Cost of Revenues:			
Software and Related Systems and Services:			
General	9,203,071	9,250,378	9,463,
Maintenance Contract Services	4,168,975	3,406,183	3,348,
Total Software and Related Systems and Services	13,372,046	12,656,561	12,811,
Application Service Provider Services	926,333	377,305	
Data Center Services	849,353	1,034,382	1,011,
Total Cost of Revenues	15,147,732	14,068,248	13,823,
Gross Profit	13,857,112	13,106,802	8,302,
Selling, General and Administrative Expenses	7,293,865	7,968,892	5,538,
Research, Development and Maintenance	3,498,448	2,769,811	1,669,
Total	10,792,313	10,738,703	7,207
Operating Income	3,064,799	2,368,099	1,095
Interest and Other Income	126,379	73,800	46
Interest and Other Expense	(129,213)	(199,573)	(262
Income before Income Tax (Benefit)	3,061,965	2,242,326	879
Income Tax (Benefit)	309,000	(786,575)	(316

Net Income	$ 2,752,965	$ 3,028,901	$ 1,195

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31, 2004	2003	2002
Earnings Per Share ("EPS") of Common Stock			
Basic EPS	$ .52	$ .69	$
Weighted Average Number of Shares of Common Stock Outstanding	5,331,700	4,418,364	3,748,
Diluted EPS	$ .50	$ .64	$
Weighted Average Number of Shares of Common Stock and Common Stock Equivalents Outstanding	5,536,731	4,752,068	4,153,

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock	Additional Paid-in	Unearned	Accumulated	Accumulated Comprehensive Loss Interest Rate	Comprehen

	Shares	Amount	Capital	Compensation	Deficit	Swap	Income
	------	------	-------	------------	-------	----	------
Balance - January 1, 2002	3,719,247	$37,192	$20,856,166	$ --	$(10,570,992)	$ (74,875)	$ --
Common Stock Issued - Exercise of Options	327,183	3,272	501,938	--	--	--	--
Issuance of Warrants and Options	--	--	53,673	(14,400)	--	--	--
Change in Fair Value of Interest Rate Swap	--	--	--	--	--	(32,838)	(32,838
Net Income	--	--	--	--	1,195,218	--	1,195,218
	---------	------	----------	-------	-----------	-------	---------
							$1,162,380
							=========
Balance - December 31, 2002	4,046,430	40,464	21,411,777	(14,400)	(9,375,774)	(107,713)	
Common Stock Issued - Exercise of Options	668,197	6,682	1,793,574	--	--	--	$ --
Common Stock Issued - Exercise of Warrants	713,620	7,136	5,712,972	--	--	--	--
Common Stock Issued - Acquisition	100,000	1,000	527,000	--	--	--	--
Cost Related to Warrant Extension	--	--	6,336	--	--	--	--
Change in Fair Value of Interest Rate Swap	--	--	--	--	--	48,645	48,645
Amortization of Warrants Issued for Services	--	--	--	14,400	--	--	--
Dividends	--	--	(441,447)	--	--	--	--
Net Income	--	--	--	--	3,028,901	--	3,028,901
	---------	------	----------	-------	-----------	-------	---------
							$3,077,546
							=========
Balance -							

December 31, 2003	5,528,247	55,282	29,010,212	--	(6,346,873)	(59,068)	
Common Stock Issued - Exercise of Options	38,877	389	166,011	--	--	--	$ --
Change in Deferred Tax Asset Valuation Allowance	--	--	717,000	--	--	--	--
Change in Fair Value of Interest Rate Swap	--	--	--	--	--	43,916	43,916
Net Income	--	--	--	--	2,752,965	--	2,752,965
							$2,796,881
Balance - December 31, 2004	5,567,124	$55,671	$29,893,223	$ --	$(3,593,908)	$ (15,152)	

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2004	2003	2002
Operating Activities:			
Net Income	$ 2,752,965	$ 3,028,901	$ 1,195
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Depreciation and Amortization	1,624,393	1,233,592	1,036
Costs Related to Issuance of warrants and options	--	20,736	39
Provision for Doubtful Accounts	(204,000)	1,046,094	370
Deferred Income Taxes	122,000	(900,000)	(400
Loss on Retirement of Property and Equipment	--	18,632	
Changes in Assets and Liabilities:			
[Increase] Decrease in:			
Accounts Receivable	(3,506,210)	(1,991,720)	(1,551
Costs and Estimated Profits in			

Excess of Interim Billings	1,180,150	2,040,387	(74
Other Current Assets	(54,795)	(344,881)	(68
Other Assets	28,431	69,389	89
Increase [Decrease] in:			
Accounts Payable	243,165	163,620	477
Accrued Expenses	(43,046)	645,226	562
Deferred Rent Payable	455,427	--	
Interim Billings in Excess of Costs and Estimated Profits	234,488	1,287,055	1,955
Deferred Revenue	(197,705)	(223,784)	409
Total Adjustments	(117,702)	3,064,346	2,846
Net Cash Provided by Operating Activities	2,635,263	6,093,247	4,041
Investing Activities:			
Acquisition of Property and Equipment	(1,328,050)	(1,633,226)	(254
Capitalized Software Development	(185,000)	(179,500)	
Other	(16,263)	--	
CareNet Acquisition	--	(1,047,845)	
Net Cash Used In Investing Activities	$ (1,529,313)	$ (2,860,571)	$ (254

See Notes to Consolidated Financial Statements.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31, 2004	2003	2002
Financing Activities:			
Payment of Capitalized Lease Obligations	$ (61,416)	$ (47,678)	$ (29,
Dividend Paid	--	(441,447)	
Net Proceeds from Stock Options and Warrants Exercised	112,867	6,509,027	156,
Payments of Term Loan	(666,659)	(583,325)	(499,
Net Cash (Used in) Provided by Financing Activities	(615,208)	5,436,577	(372,
Net Increase in Cash and Cash Equivalents	490,742	8,669,253	3,414,
Cash and Cash Equivalents -			

Beginning of Year	15,920,993	7,251,740	3,837,
Cash and Cash Equivalents - End of Year	$ 16,411,735	$ 15,920,993	$ 7,251,
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the years for:			
Interest	$ 132,635	$ 159,940	$ 167,
Income Taxes	$ 237,879	$ 93,639	$ 41,

Supplemental Disclosures of Non-Cash Investing and Financing Activities:

Year Ended December 31, 2004:

During 2004, the Company received 4,166 shares of its common stock as consideration for the exercise of certain stock options. The value of the shares received was $53,533, which was the market value of the common stock on the date of exercise.

During 2004, the Company acquired for $250,000 TxM software and customer lists. The consideration consisted of $16,263 in cash and the assumption of $233,707 for certain liabilities for services to be performed in the future.

The fair value of the interest rate swap decreased by $43,916 for the year ended December 31, 2004. At December 31, 2004, it is valued at $15,152.

Year ended December 31, 2003:

During 2003, the Company acquired equipment in the amount of $183,326 in connection with a capital lease.

During 2003, the Company received 133,961 shares of its common stock as consideration for the exercise of certain stock options. The value of the shares

received was $1,011,337, which was the market value of the common stock on the date of exercise.

During 2003, the Company accrued $721,003 of fixed assets related to its new facility.

During 2003, the Company issued 100,000 shares of its common stock in connection with the acquisition of CareNet. See Note 5. These shares were valued at $528,000, which was based upon the average stock price three days before and after the acquisition was agreed to and announced. The Company also issued a $500,000 three-year promissory note and assumed contract obligations and vacation liabilities totaling $68,068.

The fair value of the interest rate swap decreased by $48,645 for the year ended December 31, 2003. At December 31, 2003, it is valued at $59,068.

Year ended December 31, 2002:

During 2002, stock options to purchase 327,183 shares of common stock were exercised and proceeds of $505,210 includes $348,302, representing the market value of the Company's common stock which was received for the exercise price of

certain of these options.

The fair value of the interest rate swap calculated at December 31, 2002 was $107,713.

See Notes to Consolidated Financial Statements

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Sheet #1

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[1] The Company

Netsmart Technologies, Inc. and subsidiaries (the "Company") licenses, customizes and installs its proprietary software products, operates a service bureau and provides Application Service Provider ("ASP") Services and enters into long term maintenance agreements with behavioral health and public health organizations, methadone clinics and other substance abuse facilities throughout the United States.

[2] Summary of Significant Accounting Policies

Principles of Consolidation - The consolidated financial statements include Netsmart Technologies, Inc. ("Netsmart"), and its wholly-owned subsidiary, Creative Socio-Medics Corp. ("CSM"). In addition, the results of operations from the CareNet acquisition (see note 5) is included from July 2003. All intercompany transactions are eliminated in consolidation.

Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Critical estimates include management's judgements associated with: the application of the percentage of completion method to the recognition of revenue, determination of an allowance for doubtful accounts receivable, deferred income tax valuation allowance and the capitalization, depreciation and amortization of certain long-term assets (primarily software development costs and customer lists). Actual results could differ from those estimates.

Cash and Cash Equivalents - The Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents totaled approximately $1,053,000 and $1,042,000 at December 31, 2004 and 2003, respectively.

Concentration of Credit Risk - The Company extends credit to customers which results in accounts receivable and costs and estimated profits in excess of interim billings arising from its normal business activities. The Company does not require collateral or other security to support financial instruments subject to credit risk. The Company routinely assesses the financial strength of its customers and based upon factors surrounding the credit risk of the customers, believes that its accounts receivable credit risk exposure is limited.

The Company's behavioral health information systems are marketed to specialized care facilities, many of which are operated by various state and local government entities and include entitlement programs. During the years ended December 31, 2004, 2003 and 2002, approximately 49%, 57% and 52% respectively, of the Company's revenue were generated from contracts directly or indirectly with government agencies.

No one customer accounted for more than 10% of revenue for the years ended December 31, 2004 and 2002. During the year ended December 31, 2003, one customer accounted for approximately $2,861,000 or 10.5% of revenue. The account receivable from this customer at December 31, 2003 was $589,000 or 7% of the total accounts receivable.

[2] Summary of Significant Accounting Policies - [Continued]

The Company places its cash and cash equivalents with high credit quality financial institutions. The amount on deposit in any one institution that exceeds federally insured limits is subject to credit risk. At December 31, 2004 and 2003, cash and cash equivalent balances of $16.4 million and $15.8 million respectively, were held at a financial institution in excess of federally insured limits.

Revenue Recognition - The Company derives revenue principally from the licensing of its software and maintenance services rendered in connection with such licensing activities. Information processing revenue is recognized in the period in which the service is provided. Maintenance contract revenue and ASP revenue are recognized on a straight-line basis over the life of the respective contract. The Company also derives revenue from the sale of third party hardware and software which is recognized based upon the terms of each contract. The above sources of revenue which do not require significant customization or modification are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed and determinable and collectibility is probable. In addition, consulting revenue is recognized when the services are rendered

Software development revenue from time-and-materials contracts, which require customization and modification, are recognized as services are performed. Revenue from fixed price software development contracts and revenue under license agreements which require significant modification of the software package to the customer's specifications, are recognized on the estimated percentage-of-completion method. Progress towards completion on a contract is measured using the units of work performed method. Revisions in cost estimates and recognition of losses on these contracts are reflected in the accounting period in which the facts become known. Contract terms provide for billing schedules that differ from revenue recognition and give rise to costs and estimated profits in excess of billings, and billings in excess of costs and estimated profits.

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

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

Property and Equipment and Depreciation and Amortization - Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment is computed using the straight-line method at rates adequate to allocate the cost of applicable assets over their expected useful lives. Amortization of leasehold improvements is computed using the shorter of the lease term or the expected useful life of these assets.

Estimated useful lives are as follows:

Equipment	3-7 Years
Furniture and Fixtures	5-10 Years
Leasehold Improvements	Life of the Lease

Capitalized Software Costs - Capitalization of computer software development costs begins upon the establishment of technological feasibility. Technological feasibility for the Company's computer software products is generally based upon achievement of a detail program design free of high risk development issues. The Company capitalizes only those costs directly attributable to the development of the software. The establishment of technological feasibility and the ongoing assessment of recoverability of capitalized computer software development costs requires considerable judgment by management with respect to certain external factors, including, but not limited to, technological feasibility, anticipated future gross revenue, estimated economic life and changes in software and hardware technology. Prior to reaching technological feasibility these costs are expensed as incurred and included in research development and maintenance. Activities undertaken after the products are available for general release to customers to correct errors or keep the product updated are expensed as incurred and included in research, development and maintenance. Amortization of capitalized computer software development costs commences when the related products become available for general release to customers.

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[2] Summary of Significant Accounting Policies - [Continued]

Amortization is provided on a product by product basis. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenue for a product bear to the total of current and anticipated future gross revenue for that product or (b) the straight-line method over the remaining estimated economic life of the product. The estimated life of these products range from 3 to 8 years.

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

The amount allocated to purchased software related to the CareNet acquisition (see note 5), totaled $883,075.

Information related to capitalized software development costs applicable to operations is as follows:

Year ended December 31,	2004	2003	2002

Beginning of Year	$1,087,116	$ 382,387	$ 686,301
Capitalized	334,872	1,062,575	--
Amortization	(289,535)	(357,846)	(303,914)
Net	$1,132,453	$ 1,087,116	$ 382,387

Customer Lists - Customer lists represent a listing of customers obtained through the acquisitions of CSM, Johnson Computing System, ("Johnson"), AIMS, CareNet (see note 5), and other to which the Company can market its products. Customer lists are being amortized on the straight-line method over an estimated useful life of 12 years for the CSM and Johnson lists, 9 years for the CareNet list, 7 years for the AIMS list and 6 years for other list. The amount allocated to customer lists related to the CareNet acquisition totaled $1,097,138.

Customer lists at December 31, 2004 and 2003 are as follows:

	December 31, 2004	2003
Customer Lists	$ 6,281,299	$ 6,197,461
Less: Accumulated Amortization	(4,102,062)	(3,495,710)
Net	$ 2,179,237	$ 2,701,751

Amortization expense amounted to $606,352, $537,242 and $476,290, respectively, for the years ended December 31, 2004, 2003 and 2002.

Future amortization of customer lists are approximately $612,000, $611,000,$299,000, $193,000 and $154,000 for the years ending December 31, 2005, 2006, 2007, 2008 and 2009 respectively, and $310,000 thereafter.

Pursuant to Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", the Company evaluates its long-lived assets for financial impairment, and continues to evaluate them as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

The Company evaluates the recoverability of long-lived assets by measuring the carrying amount of

[2] Summary of Significant Accounting Policies - [Continued]

the assets against the estimated undiscounted future cash flows associated with them. At the time such evaluations indicate that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their fair values.

Stock Options and Similar Equity Instruments - At December 31, 2004, the Company had three stock-based employee compensation plans, which are described more fully in Note 13. As permitted under SFAS No. 148, "Accounting for Stock-Based Compensation--Transition and Disclosure", which amended SFAS No. 123, "Accounting for Stock-Based Compensation", the Company has elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangements as defined by Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees", and related interpretations including Financial Accounting Standards Board ("FASB") Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of APB No. 25. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

		Year ended December 31,	
	2004	2003	2002
Net Income as Reported	$2,752,965	$3,028,901	$1,195,218
Deduct: Total stock-based employee compensation expense determined under the fair value-based method for all awards, net of related tax effect	1,368,139	857,768	123,952
Pro Forma Net Income	$1,384,826	$2,171,133	$1,071,266
Basic Net Income Per Share as Reported	$ .52	$ .69	$ .32
Basic Pro Forma Net Income Per Share	$ .26	$ .49	$ .29
Diluted Net Income Per Share as Reported	$ .50	$ .64	$ .29
Diluted Pro Forma Net Income Per Share	$ .25	$ .46	$ .26

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

	2004	2003	2002
Expected Life (Years)	5	5	5
Interest Rate	4.00%	4.00%	4.00%
Annual Rate of Dividends	0%	0%	0%
Volatility	68%	66%	63%

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Sheet #5

[2] Summary of Significant Accounting Policies - [Continued]

The weighted average fair value of options at date of grant using the fair value based method during 2004, 2003 and 2002 is estimated at $3.95, $2.38 and $1.42, respectively.

In December 2004, FASB issued SFAS No. 123 (Revised), "Share-Based Payments (Revised 2004)". See new accounting pronouncements.

Earnings Per Share - Basic earnings per share of common stock is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflects the amount of earnings for the period available to each share of common stock outstanding during the reporting period, giving effect to all potentially dilutive shares of common stock from the potential exercise of stock options and warrants.

The computation of diluted earnings per share does not assume conversion, exercise or contingent issuance of securities that would have an antidilutive effect on earnings per share (i.e. improving earnings per share). The dilutive effect of outstanding options and warrants and their equivalents are reflected in diluted earnings per share by the application of the treasury stock method. Options and warrants will have a dilutive effect only when the average market price of the common stock during the period exceeds the exercise price of the options or warrants. The Company had potentially dilutive options and warrants outstanding of 300,780, -- and 713,544 during the years ended December 31, 2004, 2003 and 2002, respectively, that were not included in the calculation of diluted earnings per share because they were anti dilutive.

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

	Year ended December 31,		
	2004	2003	2002
Numerator:			
Net Income	$2,752,965	$3,028,901	$1,195,218
Denominator:			
Weighted average shares	5,331,700	4,418,364	3,748,537
Effect of dilutive securities:			
Employee stock options	205,031	333,704	395,668
Stock warrants	--	--	9,279
Dilutive potential common shares	205,031	333,704	404,947
Denominator for diluted earnings per share-adjusted weighted average shares after assumed conversions	5,536,731	4,752,068	4,153,484

Advertising - Advertising costs are expensed as incurred. Advertising expense

amounted to $392,575, $328,199 and $139,110 for the years ended December 31, 2004, 2003 and 2002, respectively.

Reclassification - Certain prior years' amounts have been reclassified to conform to the current year's presentation.

Financial Instruments - SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended requires the recognition of all derivative instruments as either assets or liabilities on the balance sheet measured at fair value. Generally, increases or decreases in the fair value of derivative instrument will be recognized as gains or losses in earnings in the period of change. If the derivative instrument is designated and qualifies as a cash flow hedge, the change in fair value of the derivative instrument will be recorded as a separate component of stockholders' equity.

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[2] Summary of Significant Accounting Policies - [Continued]

The Company entered into an interest rate swap to hedge exposure related to changes in the LIBOR rate. Before entering into a derivative transaction for hedging purposes, it is determined that a high degree of initial effectiveness exists between the change in value of the hedged item and the change in the value of the determinative instrument from movement in interest rates. High effectiveness means that the change in the value of the derivative instrument will effectively offset the change in the fair value of the hedged item. The effectiveness of each hedged item is measured throughout the hedged period. Any hedge ineffectiveness as defined by SFAS No. 133 is recognized in the income statement.

New Accounting Pronuncements - In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment." SFAS No. 123R eliminates the alternative to use APB No. 25's intrinsic value method of accounting that was provided in SFAS No 123 as originally issued. SFAS No. 123R requires entities to recognize the cost of employee services in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). That cost will be recognized over the period during which the employee is required to provide the service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. SFAS No. 123R requires entities to initially measure the cost of employee services received in exchange for an award of liability instruments based on its current fair value; the fair value of the award will be remeasured at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period. The grant date fair value of employee share options and similar instruments will be estimated using option-pricing models adjusted for the unique characteristics of those instruments. SFAS No. 123R is effective as of the beginning of the Company's interim reporting period that begins on July 1, 2005. The transitional provisions of SFAS No. 123R will not have a material effect on the Company's consolidated financial position or results of operations as substantially all outstanding equity instruments vest on or prior to June 30, 2005. The Company will utilize the fair value method for any future instruments after the implementation date.

In December 2004, the FASB issued FAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29." This Statement eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29 and replaces it with an exception for exchanges that do not have commercial substance. This Statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company will apply the provisions of this Statement prospectively to nonmonetary asset exchanges occurring on or after January 1, 2006.

In April 2004, the EITF issued Statement No. 03-06 "Participating Securities and the Two-Class Method Under FASB Statement No. 128, Earnings Per Share" ("EITF 03-06"). EITF 03-06 addresses a number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The issue also provides further guidance in applying the two-class method of calculating earnings per share, clarifying what constitutes a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. EITF 03-06 is effective for fiscal periods beginning after March 31, 2004. The adoption of this statement did not have any effect on the Company's calculation of EPS.

In September 2004, the EITF issued statement EITF Issue No. 04-08, "The Effect of Contingently Convertible on Debt on Diluted Earnings per Share" ("EITF 04-08"). Contingently convertible debt instruments are generally convertible into common shares of an issuer after the common stock price has exceeded a predetermined threshold for a specified period of time (the "market price contingency"). EITF 04-08 requires that shares issuable upon conversion of contingently convertible debt be included in diluted earnings per share computations regardless of whether the market price contingency contained in the debt instrument has been met. EITF 04-08 is effective for reporting periods ending after

[2] Summary of Significant Accounting Policies - [Continued]

December 15, 2004 and requires restatement of prior periods to the extent applicable. The adoption of this statement is not expected to have an effect on the Company's calculation of EPS.

[3] Accounts Receivable

Accounts receivable is shown net of allowance for doubtful accounts of $423,720 and $1,126,236 at December 31, 2004 and 2003 respectively. The changes in the allowance for doubtful accounts are summarized as follows:

	Year Ended December 31,	
	2004	2003

Beginning Balance	$ 1,126,236	$ 530,640
Provision for Doubtful Accounts	(204,000)	1,046,094
Charge-offs	(498,516)	(450,498)
Ending Balance	$ 423,720	$ 1,126,236

[4] Costs, estimated profits, and billings on uncompleted contracts are summarized as follows:

	December 31, 2004	December 31, 2003
Costs Incurred on Uncompleted Contracts	$10,663,115	$11,540,502
Estimated Profits	5,657,902	7,615,475
Total	16,321,017	19,155,977
Billings to Date	23,181,805	24,602,127
Net	$(6,860,788)	$(5,446,150)

Included in the accompanying consolidated balance sheet under the following captions:

Costs and estimated profits in excess of interim billings	$ 636,985	$ 1,817,135
Interim billings in excess of costs and estimated profits	(7,497,773)	(7,263,285)
Net	$(6,860,788)	$(5,446,150)

[5] Acquisitions

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Sheet #8

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[5] Acquisitions - [Continued]

$69,105 in legal and accounting costs which are included in the purchase price.

The cost of the acquisition was allocated to purchased software in the amount of $883,075, customer lists in the amount of $1,097,138, and computer hardware in the amount of $23,700. The Company is amortizing the purchased software over an eight-year life and the customer lists over a nine-year life.

In addition, in connection with the acquisition, the Company entered into a three year non-compete and non-solicitation agreement with Steven Heintz, Jr. and Jennifer Lindbert for which they were paid an aggregate fee of $140,000, which fee was paid in cash out of existing working capital and is included in "other assets" on the consolidated balance sheet. The covenant not to compete is being amortized over the three year life. Amortization expense for the years ended December 31, 2004 and 2003 was $46,667 and $23,333 respectively.

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

The following unaudited proforma operating results assumes the CareNet acquisition occurred on January 1, 2002. In the opinion of management, all adjustments necessary to present fairly such unaudited proforma information has been made. The results presented are not necessarily indicative of the results of operations had the acquisition actually occurred on January 1, 2002.

	Year ended December 31, (in 000's except Per Share Data)	
	2003	2002
Revenue	$27,530	$22,773
Net Income	$ 3,040	$ 1,218
Net Income Per Share - Basic	$ .69	$ .32
Diluted	$ .64	$ .29

[6] Property and Equipment

Property and equipment consist of the following:

	December 31,	
	2004	2003
Equipment, Furniture and Fixtures	$2,980,440	$2,337,632
Leasehold Improvements	556,893	562,672
Totals - At Cost	3,537,333	2,900,304
Less: Accumulated Depreciation and Amortization	990,385	308,546
Net	$2,546,948	$2,591,758

Depreciation and amortization expense amounted to $681,839, $315,171, and

$256,517, respectively for the years ended December 31, 2004, 2003 and 2002.

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Sheet #9

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[7] Long Term Debt

Long-term debt at December 31, 2004 consists of the following:

Term loan payable, bank - due in monthly installments of $41,666.	$ 750,028
Note payable, ADIA - due in monthly installments of $13,889.	250,000
Total Long-Term Debt	1,000,028
Less: Current Portion	666,667
Long-Term Debt, Less Current Portion	$ 333,361

The Company has a five-year term loan with a bank with an original principal balance of $2.5 million which matures in June 2006. The term loan is paid in equal monthly installments during the term of the loan plus interest. The term loan bears interest at LIBOR plus 2.5%. In addition, the Company entered into an interest rate swap agreement on the term loan at 7.95% for five years (Note 12). The financing agreement contains certain covenants including limitations on the Company's ability to incur liens, enter into change of control transactions, maintain a minimum net worth at $9,000,000 and requires the maintenance of certain financial ratios. The borrowing is collateralized by a first priority security interest and lien on all the assets of the Company. As of December 31, 2004, the Company was in compliance with the financial covenants of this agreement.

In connection with the acquisition of CareNet (see note 5), the Company issued a three year promissory note to Adia in the principal amount of $500,000 payable in 36 equal monthly installments of principal plus interest at the prime rate plus 1% on the date of issuance adjusted on each note anniversary date (5.25% at December 31, 2004).

Maturities of long-term debt at December 31, 2004 are as follows:

For the Year Ending December 31,	Amount
2005	$ 666,667
2006	333,361
Total	$ 1,000,028

[8] Income Taxes

The Company utilizes an asset and liability approach to determine the extent of any deferred income taxes, as described in SFAS No. 109, "Accounting for Income Taxes." This method gives consideration to the future tax consequences associated with differences between financial statement and tax bases of assets and liabilities.

During the years ended December 31, 2004 and 2003, the Company utilized approximately $2.4 million and $2.8 million, respectively of net operating loss carryforwards. At December 31, 2004, the Company has remaining net operating loss carryforwards of approximately $4,026,000 expiring through 2020. Pursuant to Section 382 of the Internal Revenue Code regarding substantial changes in Company ownership, utilization of this net operating loss carryforward is limited. Approximately $3,199,000 can be used in 2005 and $827,000 can be used in 2006; unused amounts can be carried forward. In addition, the $717,000 tax benefit related to approximately $1,800,000 of net operating losses generated in 2000 on exercise of non-qualified compensatory stock options and warrants was credited to paid-in-capital in 2004.

[8] Income Taxes - [Continued]

The Company's provision for taxes for the year ended December 31, 2004 includes certain state and local taxes.

The expiration dates of net operating loss carryforwards are as follows:

December 31,	Amount
2017	2,216,000
2020	1,810,000
	$ 4,026,000

Provision for income taxes consists of the following:

	Year ended December 31,		
	2004	2003	2002
Current:			
Federal	$ 56,000	$ 24,000	$ --
State	131,000	89,425	84,000
	187,000	113,425	84,000
Deferred:			
Federal	104,000	(900,000)	(400,000)
State	18,000	--	--
	122,000	(900,000)	(400,000)

Total	$ 309,000	$ (786,575)	$ (316,000)

The difference between income taxes at the statutory Federal income tax rate and income taxes reported in the income statement is as follows:

	Year ended December 31,		
	2004	2003	2002
Income taxes at the federal statutory rate	34%	34%	34%
State and local income taxes net of Federal taxes	3	3	5
Nondeductible expenses	2	2	6
Federal Minimum Tax		2	--
Decrease in valuation allowance	(31)	(76)	(82)
Other	--	--	1
	10%	(35)%	(36)%

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Sheet #11

[8] Income Taxes - [Continued]

Significant components of the Company's deferred tax assets are comprised of the following:

	December 31,	
	2004	2003
Net operating loss carryforward	$ 1,605,000	$ 2,640,000
Allowance for doubtful accounts	169,000	457,000
Accrued vacation and bonuses	317,000	364,000
Alternative minimum tax credit carryforward	147,000	98,000
Other	157,000	(28,000)
Total deferred tax assets	2,395,000	3,531,000
Valuation allowance	--	(1,731,000)
Net deferred tax assets	$ 2,395,000	$ 1,800,000

The valuation allowance decreased by $1,731,000 at December 31, 2004 of which $717,000 was recorded as an addition to Additional Paid in Capital from stock based net operating loss carry forwards. During 2004, the Company reduced the valuation allowance to zero based upon its belief that it is more likely than not that the entire net operating loss carry forward will be utilized.

The change in the valuation allowance for deferred tax assets are summarized as follows:

	Year Ended December 31,		
	2004	2003	2002
Beginning Balance	$ 1,731,000	$ 4,010,000	$ 4,467,000
Change in Allowance	(1,731,000)	(2,279,000)	(457,000)
Ending Balance	$ --	$ 1,731,000	$ 4,010,000

[9] Stockholders' Equity

The Company's Board of Directors is authorized to issue preferred stock from time to time without stockholder action, in one or more distinct series. The Board of Directors is authorized to determine the rights and preferences of the preferred stock when issued. The Board of Directors has authorized the issuance of Series A, Series B and Series D preferred stock. No shares of any series of preferred stock were outstanding on December 31, 2004.

Common Stock Issuances - On June 25, 2003 the Company issued 100,000 shares of its common stock in connection the acquisition of CareNet. See note 5 for information relating to this acquisition.

Treasury Stock - During 2004, options to purchase 38,877 shares were exercised and the Company received gross proceeds of $166,400. Pursuant to the option grants, employees have the right to pay for the exercise price of the options by delivering shares of common stock owned by them. Included in the 2004 exercise of options were 12,250 options owned by a Company officer. These options were exercised by the delivery of 4,166 shares of the Company's common stock, which were valued at $53,533, which was based upon the market price of the common stock on the date of exercise in accordance with the cashless exercise provisions of the Company's stock option plans.

During 2003, stock options to purchase 668,197 shares were exercised and the Company received gross proceeds of $1,800,256. Included in the gross proceeds received from the exercise of the options was the

[9] Stockholders' Equity - [Continued]

delivery of 133,961 shares of the Company's common stock, which were valued at $1,011,337, which was based upon the market price of the common stock on the date of the exercise in accordance with the cashless exercise provisions fo the Company's stock option plans.

Included in the 2003 option exercises were 350,280 options owned by certain of the Company's officers and members of the Board of Directors. Pursuant to the option grants, employees have the right to pay for the exercise price of the options by delivering shares of common stock owned by them. These options were exercised by delivery of 97,718 shares of the Company's common stock valued at $682,965, which was based upon the market price of the common stock on the date of exercise in accordance with the cashless exercise provisions of the Company's stock option plans.

During 2002, stock options to purchase 327,183 shares were exercised and the Company received gross proceeds of $505,210. Pursuant to the option grants, employees have the right to pay for the exercise price of the options by delivering shares of common stock owned by them. During 2002, the Company received 61,759 shares having a value of $348,302, as the exercise price of the options which was based upon the market price of the common stock on the date of exercise in accordance with the cashless exercise provisions of the Company's stock option plans.

Stock Options and Warrants - See Note 13 for information relating to the Company's 1998, 1999 and 2001 Long-Term Incentive Plans.

During 2003, warrants to purchase 713,620 shares were exercised and the Company received net proceeds of $5,720,108.

On February 27, 2003, the Board of Directors authorized management to purchase up to $100,000 of the Company's common stock at any time the market price of the common stock is less than $3.50 per share. Purchases of stock will be made from time to time, depending on market conditions, in the open market or in privately negotiated transactions, at prices deemed appropriate by management. There is no set time limit on the purchases. The Company expects to fund any stock repurchases from its operating cash flow. As of December 31, 2004, the Company had not made any stock repurchases.

On December 21, 2000, the stockholders of the Company approved the 1999 Employee Stock Purchase Plan. The plan reserves 150,000 shares of common stock. The plan provides eligible employees with the opportunity to purchase shares of common stock at a discounted price through regular payroll deductions. No shares have been issued as of December 31, 2004 under this plan.

Dividends - In July 2003, the Company's Board of Directors approved a cash dividend of $.10 per share of common stock which was paid in September 2003 to all stockholders of record on August 20, 2003. The amount charged to additional paid-in capital in August 2003, based upon the shares outstanding on August 20, 2003, the record date of the dividend, was $441,447.

[10] Capital Lease Obligations

Future minimum payments under capital lease obligations as of December 31, 2004 are as follows:

Year ending December 31,	
2005	68,957
2006	21,877
Total Minimum Payments	90,834
Less Amount Representing Interest at 7.9% Per annum	4,852

Balance	$ 85,982
	========

[10] Capital Lease Obligations - [Continued]

Capital lease obligations are collateralized by equipment which has a cost of $183,326 at December 31, 2004 and $223,326 at December 31, 2003 and accumulated amortization of $91,663 and $66,554 at December 31, 2004 and 2003, respectively. Amortization of $61,109 in 2004 and $38,554 in 2003 and 8,000 in 2002, respectively, has been included in depreciation expense.

[11] Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable, accounts payable and the note payable to Adia approximate the fair value of these instruments because of their short maturities or floating interest rates.

The Bank debt, including current maturities, has a carrying value of approximately $750,028 and an estimated fair value of $757,000. Estimated fair value is based on the expected current rates offered to the Company for instruments of the same or similar maturities, after considering the effect of the interest rate swap.

[12] Commitments and Contingencies

Leases

The Company leases space for its executive offices and facilities under a cancellable operating lease expiring October 2014. In addition the Company leases four sales and service offices under non cancelable operating leases expiring at various times through January 2007.

In December 2003, the Company relocated its Islip, New York headquarters facility to a larger facility in Great River, New York. The lease is for a ten year and ten month period. The lease provides for a fixed monthly rent of $45,700 and includes an annual escalation increase of 3%. There are no lease payments required during the first ten months of the lease and the Company has the option of canceling the lease after six years. However, upon cancellation, certain unamortized costs must be reimbursed to the landlord. Future maturities of this lease were considered for the entire ten year and ten month period.

Minimum annual rentals under noncancellable operating leases having terms of more than one year are as follows:

Year ending December 31,	
2005	$ 745,000

2006		724,000
2007		617,000
2008		629,000
2009		624,000
Thereafter		3,258,000
	Total	$ 6,597,000

Rent expense amounted to $833,000, $519,000 and $455,000 respectively, for the years ended December 31, 2004, 2003 and 2002.

[12] Commitments and Contingencies [Continued]

Employment Agreements

In April 2004, the Company entered into revised employment agreements with Messrs. James L. Conway, Chief Executive Officer, Gerald O. Koop, President and Anthony F. Grisanti, Chief Financial Officer. Messrs. Conway and Grisanti's contract will expire on December 31, 2006 and Mr. Koop's contract will expire on December 31, 2005. Messrs. Conway and Grisanti's contracts also provide for an option to extend their contracts for one additional year so that upon the exercise of such option, their contracts would expire on December 31, 2007. The minimum aggregate base compensation for its three officers is $543,000 for 2005 and $362,000 for each of 2006 and 2007, subject to annual increases equal to the greater of 5% or the increase in the cost of living index. The agreements also provide the officers with an automobile allowance. In the event of a change of control, the executive may receive severance payments equal to 36 months compensation.

The Company also has a consulting agreement with a former Director, which provides for annual fees of $75,000 through December 31, 2007. The agreement also provides the former Director with an automobile allowance. In the event of a change of control, the former Director may receive severance payments of 36 months compensation.

Effective April 1, 2004, we adopted an Executive Retirement, Non-Competition and Consulting Plan which was subsequently amended August 5, 2004 effective April 1, 2004, pursuant to which, following their retirement, selected officers will be entitled to receive a minimum payment of approximately $85,000 per year for a period of six years, provided, that such officers (i) provide a minimum amount of consulting days each month and (ii) agree to certain covenants not to compete. The annual payments are subject to 10% increases up to a maximum of $136,893 per year. Pursuant to the Executive Retirement, Non-Competition and Consulting Plan, the selected officers are also entitled to receive health benefits for life, provided that there are no breaches of the covenants not to compete. Each of Messrs. Conway, Koop and Grisanti are entitled to receive benefits under the plan.

Mr. Phillip's employment contract expired on December 31, 2003 and he retired effective April 1, 2004. Pursuant to the terms of our Executive Retirement, Non-Competition and Consulting Plan, Mr. Phillips will receive $85,000 per year for each of the next six years; provided that he complies with the non-competition covenants of the plan.

Future minimum payments related to consulting and Executive Retirement, Non-Competition and Consulting agreements for the next five years are as follows:

Year Ending December 31,	Amount
2005	169,000
2006	160,000
2007	160,000
2008	85,000
2009	85,000
Thereafter	21,000
Total	$ 680,000

Interest Rate Swap

In June 2001 the Company entered into an interest rate swap with a bank, which expires on June 1, 2006. The swap transaction was entered into to protect the Company from upward movement in interest rates

[12] Commitments and Contingencies - [Continued]

relating to outstanding bank debt (See note 7) and calls for a fixed rate of 7.95%. When the one-month LIBOR rate is below the fixed rate then the Company is obligated to pay the bank for the difference in rates. When the one-month LIBOR rate is above the fixed rate then the bank is obligated to pay the Company for the difference in rates. At December 31, 2004 and 2003 the fair value of the swap of $15,152 and $59,068, respectively, is recorded as a non-current liability. The swap transaction has been accounted for as a hedge, and accordingly, the change in the fair value of the swap of $43,916, $48,645 and $32,838 during the years ended December 31, 2004, 2003, and 2002, respectively, has been recorded as part of comprehensive income.

Letter of Credit

The Company relocated its Islip, New York headquarters to a larger facility in Great River, New York. Included in the terms and conditions of the Great River lease is the requirement that the Company provide to the landlord a letter of credit in the amount of $292,980, which represents approximately six months rent. This letter of credit was provided to the landlord on October 31, 2003. After the first 22 months of the lease the letter of credit will be reduced to the amounts as follows:

$224,150 for months 23 through 34 of the lease.
$195,320 for months 35 through 46 of the lease.
$146,490 for months 47 through 58 of the lease.
$97,660 for months 59 to the expiration of the lease.

[13] Stock-Based Compensation

Long Term Incentive Plans - The Company has three long-term incentive plans, the 1998 Long-Term Incentive Plan (the "1998 Plan"), as amended, the 1999 Long-Term Incentive Plan (the "1999 Plan") and the 2001 Long-Term Incentive Plan (the "2001 Plan"), as amended. The 2001 Plan was approved by the stockholders on March 7, 2002 and originally provided for the issuance of 180,000 shares of common stock. In January 2003, the 2001 Plan was amended and approved by the stockholders to provide for an increase in the number of shares subject to the plan from 180,000 to 550,000. In May 2004, the 2001 Plan was further amended and approved by the stockholders to provide an increase in the number of shares subject to the plan from 550,000 to 950,000. The Company may issue 790,000, 300,000 and 950,000 shares of Common Stock pursuant to the 1998 Plan, the 1999 Plan and the 2001 Plan, respectively. The options, when granted vest ratably over one year. At December 31, 2004 there were 0, 4,250 and 4,045 shares available for further issuance under the 1998 Plan, the 1999 Plan and 2001 Plan, respectively.

The 1998 Plan, the 1999 Plan and the 2001 Plan (collectively, the "Plans") are administered by the Compensation Committee of the board of directors. Officers and other key employees, consultants and directors (other than non-employee directors) are eligible to receive options or other equity-based incentives under the Plans.

The Plans provides that each non-employee director automatically receives a nonqualified stock option to purchase 6,000 shares of common stock and the chairman of the audit committee and the compensation committee will receive a nonqualified stock option to purchase 7,500 shares of common stock on April 1 of each year. However, if there are not sufficient shares available under the applicable Plan, the non-employee director will receive a lesser number of shares.

During 2002, pursuant to an arrangement with a consultant, the Company issued a non-qualified stock option to purchase 10,000 shares of stock at an exercise price of $2.75, which was the fair market value of the stock at the date of grant. The options were valued at $.57 per option based upon the Black-Scholes calculation, which had an interest rate of 4% and a volatility rate of .48. These options had a term of one year, and were exercised during 2002. The Company recognized a charge to income under the Black-Scholes formula in the amount of $5,673.

[13] Stock-Based Compensation - [Continued]

A summary of the activity under the Plans is as follows:

2004	2003

	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Sh
Outstanding - Beginning of Year	365,755	$4.111	664,702	$2.276	79
Granted During the Year	397,455	8.438	381,000	4.754	19
Canceled During the Year	--	--	(11,750)	1.724	
Exercised During the Year	(38,877)	4.280	(668,197)	2.694	(32
Outstanding - End of Year	724,333	$6.476	365,755	$4.111	66
Exercisable - End of Year	525,606	$5.734	226,253	$3.721	57

The following table summarizes stock option information as of December 31, 2004:

		Options Outstanding	
Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Options Exercisable
$13.29	1,500	4.25 Years	750
$8.49	299,280	4.42 Years	149,640
$8.20	96,675	4.50 Years	48,338
$6.61	9,000	3.58 Years	9,000
$4.93	124,628	3.08 Years	124,628
$4.37	7,500	8.50 Years	7,500
$4.37	106,250	3.50 Years	106,250
$2.50	24,000	2.25 Years	24,000
$2.40	5,000	2.50 Years	5,000
$2.38	5,000	2.50 Years	5,000
$1.81	45,500	1.00 Years	45,500
Totals	724,333	3.78 Years	525,606

Warrants Issued as Compensation - In 2001, the term of the Company's $12 Series B Common Stock Purchase Warrants for 448,544 shares, was extended to January 31, 2002. In January 2002, the term of the 448,544 $12 warrants was further extended to July 31, 2002. In July 2002, the term of the warrants was further extended to January 31, 2003. There was no financing costs associated with the warrant extensions in 2001 and 2002 because of the variance between the $12 exercise price and the market value of the Company's stock at the date of the warrant extension. In January 2003, the term of the warrants was further extended to April 30, 2003. In April 2003, the Company agreed to extend the term of these warrants to July 31, 2003. The Company re-measured the fair value of the

warrants at the dates of extension. No financing costs were recorded associated with the warrant extension made in January 2003, as there was no material change in their fair value. The Company charged $1,125 to operations related to the warrant extension made in April 2003. In July 2003, the Company agreed to extend the term of these same warrants from July 31, 2003 to October 31, 2003. The Company re-measured the fair value of the warrants at the date of extension and charged $5,211 of financing costs to operations

[13] Stock-Based Compensation - [Continued]

in July 2003. On October 23, 2003, the Company reduced the exercise price of the warrants from $12.00 per share to $10.00 per share and through October 31, 2003, 423,620 warrants were exercised and the Company received gross proceeds of $4,236,200 less $59,592 of costs. The remaining 24,924 warrants expired unexercised.

During 2003, 120,000 warrants that were issued in 1999 were exercised and the Company received gross proceeds of $629,000.

During 2002, the Company issued warrants to purchase 200,000 shares in connection with a financial advisory agreement whereby the Company would pay consulting fees in addition to the issuance of warrants. These warrants, expired over various times ranging from one to two years, were valued at $.24 per warrant, which represented the costs of the services based upon the contractual agreement. The warrants had the following exercise price, vesting dates and expiration date for the number of shares set forth below:

Shares	Exercise Price	Vesting Date	Expiration Date
50,000	$2.69	April 10, 2002	March 31, 2003
30,000	$4.00	June 1, 2002	May 31, 2003
30,000	$5.00	September 1, 2002	February 28, 2004
30,000	$6.00	November 1, 2002	April 30, 2004
30,000	$7.00	January 1, 2003	December 31, 2004
30,000	$8.00	February 28, 2003	January 31, 2005

The $48,000 value of the warrants is being charged to operations over the vesting period. As a result, $33,600 was charged to operations in 2002 and $14,400 was charged to operations in 2003. During 2003, 170,000 of these warrants were exercised and the Company received gross proceeds of $914,500 and 30,000 warrants with an exercise price of $4.00 expired.

A summary of warrant activity is as follows:

	2004		2003	
		Weighted		Weighted

	Shares	Average Exercise Price	Shares	Average Exercise Price	Sha
Outstanding - Beginning of Year	--	--	768,544	$9.17	608,
Granted During the Year	--	--	--	--	648,
Expired During the Year	--	--	(54,924)	$6.72	(488,
Exercised During the Year	--	--	(713,620)	$8.10	
Outstanding - End of Year	--	--	--	$ --	768,
Exercisable - End of Year	--	--	--	$ --	708,

NETSMART TECHNOLOGIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, Sheet #18

[14] Operating Segments

The Company currently classifies its operations into three business segments: (1) Software and Related Systems and Services, (2) Data Center Services, (3) Application Service Provider Services ("ASP"). Software and Related Systems and Services is the design, installation, implementation and maintenance of computer information systems that provide comprehensive healthcare information technology solutions including billing, patient tracking and scheduling for inpatient and outpatient environments, as well as clinical documentation and medical record generation and management. Data Center Services involve Company personnel performing data entry and data processing services for customers. ASP services involve the Company offering several of its software products on a virtual private network or internet delivery approach, thereby allowing its customers to utilize the Company's products and pay on a monthly service basis. ASP services is a new segment established as a result of the CareNet acquisition in June 2003. Prior to the acquisition of CareNet, the Company's ASP operations were immaterial and were included in Software and Related Systems and Services. Intersegment sales and sales outside the United States are not material. Information concerning the Company's business segments is as follows:

	Year ended December 31, 2004	2003	2002
Revenues:			
Software and Related Systems and Services	$25,221,131	$24,610,356	$20,168,78
Data Center Services	2,058,240	1,973,492	1,957,39
Application Service Provider Services	1,725,473	591,202	-

Total Revenues	$29,004,844	$27,175,050	$22,126,17
Gross Profit:			
Software and Related Systems and Services	$11,849,085	$11,953,795	$ 7,357,18
Data Center Services	1,208,887	939,110	945,79
Application Service Provider Services	799,140	213,897	-
Total Gross Profit	$13,857,112	$13,106,802	$ 8,302,97
Income before Income Taxes:			
Software and Related Systems and Services	$ 2,095,722	$ 1,700,571	$ 486,37
Data Center Services	784,353	476,959	392,84
Application Services Provider Services	181,890	64,796	-
Total Income before Income Taxes	$ 3,061,965	$ 2,242,326	$ 879,21
Depreciation and Amortization:			
Software and Related Systems and Services	$ 1,247,962	$ 1,012,367	$ 866,11
Data Center Services	113,676	103,285	170,60
Application Services Provider Services	262,755	117,940	-
Total Depreciation and Amortization	$ 1,624,393	$ 1,233,592	$ 1,036,72
Capital Expenditures:			
Software and Related Systems and Services	$ 950,094	$ 2,546,295	$ 248,20
Data Center Services	12,144	151,390	6,26
Application Services Provider Services	93,501	2,006,683	-
Total Capital Expenditures	$ 1,055,739	4,704,368	$ 254,46
Identifiable Assets:			
Software and Related Systems and Services	$31,291,838	$29,530,139	$20,540,03
Data Center Services	2,775,036	2,607,681	1,875,77
Application Services Provider Services	3,640,027	2,495,569	-
Total Identifiable Assets	$37,706,901	$34,633,389	$22,415,80

[15] Legal Proceedings

From time to time the Company is involved in ordinary and routine litigation

matter in the normal course of business. The Company believes that the resolution of these matters will not have a material adverse effect on its consolidated financial position and results of operations.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NETSMART TECHNOLOGIES, INC.

Dated: March 17, 2005

By: /s/ James L. Conway

James L. Conway, Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. Each person whose signature appears below hereby authorizes James L. Conway and Anthony F. Grisanti (or any of them acting in the absence of the others), as his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution for him and in his name, place and stead, in any and all capacities to sign any and all amendments to this report, and to file same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission.

Signature	Title	Date
/s/ James L. Conway ----------------------- James L. Conway	Chief Executive Officer and Director (Principal Executive Officer)	March 17, 2005
/s/ Anthony F. Grisanti ----------------------- Anthony F. Grisanti	Chief Financial Officer (Principal Financial and Accounting Officer)	March 17, 2005
/s/ John F. Phillips ----------------------- John F. Phillips	Director	March 17, 2005
----------------------- Gerald O. Koop	President and Director	March __, 2005

/s/ Joseph G. Sicinski Joseph G. Sicinski	Director	March 17, 2005
Francis J. Calcagno Francis J. Calcagno	Director	March 17, 2005
/s/ John S.T. Gallagher John S.T. Gallagher	Director	March 17, 2005
___________________ Dr. Yacov Shamash	Director	March __, 2005

EXHIBIT INDEX

3.1(1)	Restated Certificate of Incorporation, as amended
3.2(1)	By-Laws
10.1(9)	Employment Agreement dated April 1, 2004, between the Registrant and James L. Conway
10.2(9)	Consulting Agreement dated April 1, 2004, between the Registrant and John F. Phillips
10.3(9)	Employment Agreement dated April 1, 2004, between the Registrant and Gerald O. Koop
10.4(9)	Employment Agreement dated April 1, 2004, between the Registrant and Anthony F. Grisanti
10.5(2)	Consulting Agreement dated January 1, 2001, between the Registrant and Edward D. Bright
10.6(1)	1993 Long-Term Incentive Plan
10.7(3)	1998 Long-Term Incentive Plan
10.8(4)	1999 Long-Term Incentive Plan
10.9(5)	2001 Long-Term Incentive Plan - Amended
10.10(4)	1999 Employee Stock Purchase Plan
10.11(2)	Agreement dated June 1, 2001, between the Registrant and Fleet Bank
10.12(6)	AIMS Acquisition Agreement
10.13(7)	Agreement dated June 25, 2003, among Registrant, Creative Socio-Medics Corp., Shuttle Data Systems Corp., d/b/a/ ADIA Information Management Corp. and Steven Heintz, Jr.
10.14(8)	Lease agreement dated as of December 22, 2003, between Registrant and Spacely LLC.
10.14(10)	Amended Executive Retirement, Non Competition and Consulting Plan.
21.1	Subsidiary of the Registrant
23.1	Consent of Marcum & Kliegman LLP
24	Powers of Attorney (See Signature Page)
31.1	Certification of Chief Executive Officer
31.2	Certification of Chief Financial Officer
32	Certification pursuant to 18 U.S.C. Section 1350 as

adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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(1) Filed as an exhibit to the Registrant's registration statement on Form S-1, File No. 333-2550, which was declared effective by the Commission on August 13, 1996, and incorporated herein by reference.

(2) Filed as an exhibit to the Registrant's 10-K/A dated August 21, 2003.

(3) Filed as an appendix to the Registrant's proxy statement dated September 30, 1999, relating to its 1999 Annual Meeting of Stockholders and incorporated herein by reference.

(4) Filed as an appendix to the Registrant's proxy statement dated November 9, 2000, relating to its 2000 Annual Meeting of Stockholders and incorporated herein by reference.

(5) Filed as an appendix to the Registrant's proxy statement dated March 30, 2004, relating to its 2004 Annual Meeting of Stockholders and incorporated herein by reference.

(6) Filed as an exhibit to the Registrant's 8-K dated May 10, 2001.

(7) Filed as an exhibit to the Registrant's 8-K dated July 8, 2003.

(8) Filed as an exhibit to the Registrant's 10-K dated March 23, 2004.

(9) Filed as an exhibit to the Registrant's 10-Q dated May 5, 2004.

(10) Filed as an exhibit to the Registrant's 10-Q dated August 9, 2004.