

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

STRONGHOLD TECHNOLOGIES INC
Form 10QSB
August 16, 2004

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

FORM 10-QSB

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 for the quarterly period ended June 30,
2004.

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT for the transition
period from _____ to _____.

Commission file number: 333-54822

STRONGHOLD TECHNOLOGIES, INC.

(Exact name of small business issuer as specified in its charter)

Nevada

22-3762832

(State or other jurisdiction of
incorporation or organization)

(IRS Employer Identification No.)

106 Allen Road, Basking Ridge, NJ 07920

(Address of principal executive offices)

(908) 903-1195

(Issuer's telephone number)

N/A

(Former name, former address and former
fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act during the past 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 No

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: as of August 13, 2004, 13,438,277 shares of the Registrant's common stock, (par value, \$0.0001), were outstanding.

Transitional Small Business Disclosure Format: (Check One): Yes No

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

TABLE OF CONTENTS

	Page
PART I - Financial Information	
Item 1. Financial Statements.....	2
Consolidated Balance Sheet as of June 30, 2004 (unaudited).....	2
Consolidated Statements of Operations For the Three Months Ended June 30, 2004 and 2003 and the six months ended June 30, 2004 and 2003 (unaudited).....	3
Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2004 and 2003 (unaudited).....	4
Notes to Consolidated Financial Statements.....	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	11
Item 3. Controls and Procedures.....	24
PART II - Other Information	
Item 1. Legal Proceedings.....	25
Item 2. Changes in Securities and Use of Proceeds.....	25
Item 3. Defaults Upon Senior Securities.....	27
Item 4. Submission of Matters to a Vote of Security Holders.....	27
Item 6. Exhibits and Reports on Form 8-K.....	27

i

PART I - Financial Information

Item 1. Financial Statements

CONSOLIDATED BALANCE SHEET

Stronghold Technologies, Inc. and Subsidiary
June 30, 2004 (Unaudited)

ASSETS

Current assets	
Cash	\$ 726,544
Accounts receivable, less allowance for returns and doubtful accounts of \$210,318	615,216
Other receivables	16,222

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

Inventories	100,161
Prepaid expenses	154,773

Total current assets	1,612,916

Property and equipment, net	124,111

Other assets	
Software development costs, net of amortization	885,594
Other	124,900

Total other assets	1,010,494

	\$ 2,747,521
	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT	
Current liabilities	
Accounts payable	\$ 568,143
Accrued expenses and other current liabilities	1,331,084
Interest payable, stockholders	421,756
Notes payable, stockholders, current portion	360,000
Notes payable, current portion	1,186,667
Deferred revenue	452,455
Obligations under capitalized leases, current portion	45,827

Total current liabilities	4,365,932

Long-term liabilities	
Notes payable, stockholders, less current portion	1,860,131
Notes payable, net of debt issuance costs of \$245,000	1,255,000
Obligations under capitalized leases, less current portion	13,384
Other long term accrued liabilities	605,000

Total long term liabilities	3,733,515

Commitments and contingencies	
Stockholders' deficit	
Preferred stock, Series A, \$.0001 par value; authorized 5,000,000 shares, 2,002,750 issued and outstanding (aggregate liquidation preference of \$3,004,125) and preferred stock, Series B, \$.0001 par value; authorized 2,444,444 shares, 2,444,444 issued and outstanding (aggregate liquidation preference \$2,200,000)	445
Common stock, \$.0001 par value, authorized 50,000,000 shares, 13,438,277 issued and outstanding	1,344
Additional paid-in capital	7,740,816
Stock subscription receivable	(3,000)
Accumulated deficit	(13,091,531)

Total stockholders' deficit	(5,351,926)

	\$ 2,747,521
	=====

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

-2-

Stronghold Technologies, Inc. and Subsidiary
Consolidated Statements of Operations

	Three months ended June 30, 2004 (Unaudited)	Three months ended June 30, 2003 (Unaudited)	Six months ended June 30, 2004 (Unaudited)	Six months ended June 30, 2003 (Unaudited)
Sales	\$ 700,250	\$ 626,779	\$ 1,343,928	\$ 1,545,000
Cost of sales	215,358	277,184	451,866	600,000
Gross profit	484,892	349,595	892,062	945,000
Selling, general and administrative	868,446	1,194,040	1,832,448	2,302,000
Loss from operations	(383,554)	(844,445)	(940,386)	(1,357,000)
Interest expense	67,359	90,220	94,255	197,000
Net loss applicable to common stockholders	\$ (450,913)	\$ (934,665)	\$ (1,034,642)	\$ (1,555,000)
Basic and diluted loss per common share	\$ (0.03)	\$ (0.09)	\$ (0.08)	\$ (0.09)
Weighted average number of common shares outstanding	13,438,277	10,301,212	13,390,104	10,080,000

-3-

Stronghold Technologies, Inc. and Subsidiary
Consolidated Statements of Cash Flows

Cash flows from operating activities				
Net loss				\$ (1,034,642)
Adjustments to reconcile net loss to				

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

net cash used in operating activities:	
Provision for returns and allowances (recoveries)	2
Depreciation and amortization	(1)
Non-cash interest expense for issuance of warrants	(1)
Changes in operating assets and liabilities:	
Accounts receivable	(1)
Inventories	(1)
Prepaid expenses	(1)
Other receivables	(1)
Accounts payable	(1)
Interest payable, stockholders	(1)
Accrued expenses and other current liabilities	(1)
Deferred revenue	1
Other	(1)
Net cash used in operating activities	(1,0)
Cash flows from investing activities,	
Payments for purchase of property and equipment	(2)
Payments for software development costs	(2)
Net cash used in investing activities	(2)
Cash flows from financing activities	
Proceeds from issuance of preferred stock, net of financing costs	8
Proceeds from issuance of common stock, net of financing costs	(1,2)
Proceeds from notes payable, stockholders	(1,2)
Principal repayments of notes payable, stockholders	(1,2)
Proceeds from notes payable	(1,2)
Principal repayments of notes payable, net of debt issuance costs	(1,2)
Principal payments for obligations under capital leases	(1,2)
Net cash provided by financing activities	2,0
Net increase in cash	7
Cash, beginning of period	(1,0)
Cash, end of period	\$ 7
Supplemental disclosure of cash flow information, cash paid during the period for interest	\$

-4-

Definitions

All references to "we," "us," "our," the "Company" or similar terms used herein refer to Stronghold Technologies, Inc., a Nevada corporation, formerly known as TDT Development, Inc. and its wholly-owned subsidiary, Stronghold Technologies, Inc., a New Jersey corporation. All references to "Stronghold" used herein refer to just our wholly-owned subsidiary, Stronghold Technologies,

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

Inc., a New Jersey corporation. All references to the "Predecessor Entity" refer to the New Jersey corporation we acquired on May 16, 2002, Stronghold Technologies, Inc., which was merged with and into Stronghold.

-5-

Stronghold Technologies, Inc. and Subsidiary Notes to Consolidated Financial Statements

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). These statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the results for the periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted pursuant to applicable SEC rules and regulations. Operating results for the three and six month periods ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report of Form 10-KSB for the fiscal year ended December 31, 2003.

2. INVENTORIES

Inventories, which are comprised of hardware for resale, are stated at cost, on an average cost basis, which does not exceed market value.

3. LOSS PER COMMON SHARE

Loss per common share is based on the weighted average number of common shares outstanding. The Company complies with SFAS No. 128, "Earnings Per Share," which requires dual presentation of basic and diluted earnings (loss) per share. Basic earnings (loss) per share excludes dilutions and is computed by dividing net loss applicable to common stockholders by the weighted average number of common shares outstanding for the year. Diluted earnings (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Since the effect of the outstanding options and warrants are anti-dilutive, they have been excluded from the Company's computation of diluted loss per common share..

4. STOCK-BASED COMPENSATION

In December 2002, FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," which amended SFAS No. 123, "Accounting for Stock-Based Compensation." This Statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation. It also amends the disclosure provisions to require more prominent disclosure about the effects on reported net income (loss) of an entity's accounting policy decisions with respect to stock-based employee compensation. As permitted by the Statement, the Company does not plan to adopt the fair value recognition provisions of SFAS No. 123 at this time. However, the Company has adopted the disclosure provisions of the Statement.

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

-6-

The Company accounts for its stock-based employee compensation plans under Accounting Principles Board Opinion No. 25, under which no compensation cost has been recognized in the accompanying consolidated statements of operations, as all options granted under those plans had an exercise price equal to or in excess of the market value of the underlying common stock at the date of grant.

Had compensation cost for these options been determined consistent with the fair value method provided by SFAS No. 123, the Company's net loss and net loss per common share would have been the following pro forma amounts for the three-month and six-month periods ended June 30, 2004 and 2003.

	Three months ended June 30,		Six mo Ju
	2004	2003	2004
Net loss applicable to common stockholders, as reported	\$ (450,913)	\$ (934,665)	\$ (1,034,642)
Deduct			
Total stock-based compensation expense determined under fair value method for all awards, net of related tax effect	10,882	20,572	23,701
Pro forma net loss	\$ (461,795)	\$ (955,237)	\$ (1,058,343)
Basic and diluted EPS			
As reported	\$ (0.03)	\$ (0.09)	\$ (0.08)
Pro forma	\$ (0.03)	\$ (0.09)	\$ (0.08)

The fair value of issued stock options is estimated on the date of grant using the Black-Scholes option-pricing model including the following assumptions: expected volatility of 2.06%, expected dividend yield rate of 0%, expected life of 10 years, and a risk-free interest rate of 4.73% and 3.33% for June 30, 2004 and 2003, respectively.

5. GOING CONCERN

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Since the beginning of the fiscal year, the Company has incurred a net loss of approximately \$1,035,000 and has negative cash flows from operations of approximately \$1,067,000 for the six months ended June 30, 2004, and has a working capital deficit of approximately \$2,753,000 and a stockholders' deficit of approximately \$5,352,000 as of June 30, 2004. These conditions raise substantial doubt about the Company's ability to continue as a going concern. During 2004, management of the Company will rely on raising additional capital to fund its future operations. If the Company is unable to generate sufficient revenues or raise sufficient additional capital, there could be a material adverse effect on the

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

consolidated financial position, results of operations and cash flows of the Company. The accompanying consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

-7-

6. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following at June 30, 2004:

Sales tax	\$ 83,670
Payroll taxes	456,359
401(k) withholding	9,925
Compensation	402,767
Commissions	165,673
Other accrued expenses	212,690
Total	\$1,331,084

Payroll Tax Payment Agreement with IRS

On April 30, 2004, the Company entered into an installment agreement with the United States Internal Revenue Service ("IRS") to pay overdue payroll taxes, under the terms of which the Company will pay \$35,000 each month, commencing June 28, 2004, until it has paid the withholding taxes due in full. The Company has posted the portion of the payroll taxes to be paid in the monthly periods of 13 through 29 of the payment plan to the "Other long term accrued liabilities" section of the balance sheet.

7. NOTES PAYABLE, STOCKHOLDERS

On March 15, 2004, the Company entered into a note payable with one of its stockholders for approximately \$900,000. The note bears interest at 8% per annum and is due on March 15, 2007. The balance of this note is located in the long-term portion of notes payable, stockholders.

8. COMMITMENTS AND CONTINGENCIES

Warrants

On June 16, 2004, in consideration of and as an inducement to Stanford for the Company to enter into the issuance of the 12% callable secured convertible notes (the "NIR Notes") referenced below, Stanford has been issued a warrant (the "Stanford Warrants") to purchase an additional 2,000,000 shares of Common Stock, expiring in five years, at an exercise price of \$.0001 in exchange for i) agreeing to a waiver of existing registration rights that included a lock up period for one year after the effective date of a registration statement prohibiting the registration and sale of Stanford's securities and ii) agreeing

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

as holder of Stronghold's Series A \$1.50 Convertible Preferred Stock ("Series A Stock") and Series B \$.90 Convertible Preferred Stock ("Series B Stock"), to waive any dilution protection which would otherwise accrue to the Series A Stock and the Series B Stock pursuant to the respective certificates of designation filed with the Secretary of State of the State of Nevada, as amended, as a result of the conversion of the NIR Notes or exercise of the Stanford Warrants into the Company's common stock. This issuance of the Stanford Warrants has been accounted for as an adjustment of capital for the waiving of the dilution protection for the Series A and Series B preferred stock. The Stanford Warrants were valued at approximately \$360,000 using the Black-Scholes option pricing model including the following assumptions: exercise price of \$0.0001, expected volatility of 2.06%, expected dividend yield rate of 0%, expected life of 5 years, and a risk free interest rate of 4.73% for June 30, 2004

-8-

Callable Secured Convertible Notes

To obtain funding for its ongoing operations, Stronghold Technologies, Inc. (the "Company") entered into a Securities Purchase Agreement (the "Securities Purchase Agreement") with New Millennium Capital Partners II, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd. and AJW Partners, LLC (collectively, the "Investors") on June 18, 2004 for the sale of (i) \$3,000,000 in callable convertible secured notes (the "Notes") and (ii) stock purchase warrants to buy 3,000,000 shares of the Company's common stock (the "Warrants").

On June 18, 2004, the Investors purchased \$1,500,000 in Notes and received Warrants to purchase 1,500,000 shares of the Company's common stock. In addition, provided that all of the conditions in the Securities Purchase Agreement are satisfied, the Investors are obligated to provide the Company with additional funds as follows:

- o \$500,000 will be funded within five business days of filing a registration statement registering shares of the Company's common stock underlying the Notes and the Warrants; and
- o \$1,000,000 will be funded within five business days of the effectiveness of the registration statement.

The Notes, which are shown net of debt issuance costs of \$245,000, bear interest at 12%, mature two years from the date of issuance, and are convertible into our common stock, at the Investors' option, at the lower of (i) \$0.70 or (ii) 50% of the average of the three lowest intraday trading prices for the Company's common stock during the 20 trading days before, but not including, the conversion date. The Company may prepay the Notes in the event that no event of default exists, there are a sufficient number of shares available for conversion of the Notes and the market price is at or below \$0.57 per share. The full principal amount of the Notes is due upon default under the terms of Notes. In addition, the Company has granted the investors a security interest in substantially all of its assets and intellectual property as well as registration rights.

-9-

The Warrants are exercisable until five years from the date of issuance at a purchase price of \$0.57 per share. In addition, the exercise price of the Warrants is adjusted in the event the Company issues common stock at a price below market. Since the Company does not intend to issue common stock at below

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

market price the warrants were valued at \$NIL using the Black-Scholes option pricing model including the following assumptions: exercise price of \$0.57, expected volatility of 2.06%, expected dividend yield rate of 0%, expected life of 5 years, and a risk free interest rate of 4.73% for June 30 ,2004

The Investors have contractually agreed to restrict their ability to convert the Notes and exercise the Warrants and receive shares of the Company's common stock such that the number of shares of the Company's common stock held by them and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of the Company's common stock.

All shares of the Company's common stock associated with this private placement are restricted securities in accordance with Rule 144 as promulgated under the of the Securities Act of 1933.

9. SUBSEQUENT EVENTS

Callable Secured Convertible Notes

On July 21, 2004, the Company filed the required SB-2 registration statement registering shares of the Company's common stock issuable in connection with the sale of (i) \$3,000,000 in callable convertible secured notes (the "NIR Notes") and (ii) stock purchase warrants to buy 3,000,000 shares of the Company's common stock (the "Warrants"). The Company received \$500,000 from the investors in connection with this filing.

Forebearance Agreement with PNC Bank

On April 27, 2004, PNC Bank, N.A., as successor by merger to UnitedTrust Bank filed a complaint in the Superior Court of New Jersey, Law Division, Union County (Docket No. UNN-L_001522-04) against the Company and Christopher J. Carey, in his capacity as guarantor, to collect the sums outstanding under the Loan Agreement, dated as of September 30, 2002 (\$1,186,667 at June 30, 2004).

On July 15, 2004, the Company entered into a fully executed forbearance agreement with PNC Bank, N.A. The Company made an initial principal payment of \$420,000 with the execution of the forbearance. Additionally, the Company is required to make four consecutive monthly installments of \$50,000 on August 15, 2004, September 15, 2004, October 15, 2004 and November 15, 2004 followed by the remaining principal on or before December 15, 2004. Failure to adhere to this schedule will cause the suit to be reinstated and PNC Bank will resume collection of the sum under the suit.

-10-

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

Overview

The following discussion should be read in conjunction with our financial statements and the accompanying notes appearing subsequently under the caption "Financial Statements", along with other financial and operating information included elsewhere in this quarterly report. Certain statements under this caption "Management's Discussion and Analysis and Results of Operation" constitute "forward-looking statements" under the Private Securities Litigation Reform Act of 1995.

The statements contained in this Quarterly Report on Form 10-QSB that are not historical facts are forward-looking statements within the meaning of

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

Section 21E of the Securities Exchange Act of 1934 ("the Securities Act"), as amended and the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may be identified by, among other things, the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. In particular, our statements regarding the anticipated growth in the markets for our technologies, the continued development of our products, the approval of our Patent Applications, the successful implementation of our sales and marketing strategies, the anticipated longer term growth of our business, and the timing of the projects and trends in future operating performance are examples of such forward-looking statements. The forward-looking statements include risks and uncertainties, including, but not limited to, the timing of revenues due to the uncertainty of market acceptance and the timing and completion of pilot project analysis, and other factors, including general economic conditions, not within our control. The factors discussed herein and expressed from time to time in our filings with the SEC could cause actual results to be materially different from those expressed in or implied by such statements. The forward-looking statements are made only as of the date of this filing and we undertake no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances.

Executive Overview

We are a Customer Relationship Management ("CRM") solutions provider for the retail automotive industry. Stronghold's DealerAdvance(TM) Sales Solution is designed to streamline dealership sales operations using software that integrates existing technology systems.

-11-

Stronghold's strategic focus since our entry into the automotive retail market in May 2002 has been:

- o Applying wireless technology, leveraging the Internet, providing software and process improvement methods to improve buying and servicing satisfaction at retail automobile dealerships.
- o Establishment and growth of our customer base.
- o Geographic diversification to penetrate large national markets.
- o Development of user friendly CRM applications.
- o Development of a best-of-breed seamless software solution that replaces multiple applications that typically are not designed to work together as seamlessly as DealerAdvance(TM).

Stronghold's current initiatives include the following:

- o Leveraging existing clients to generate new and recurring revenues through the introduction of new products and services.
- o Developing and refining products through internal research and development, strategic partnerships and acquisitions that target synergistic applications surrounding the dealership accounting systems (DMS - Dealer Management System). The goal of these efforts is to become a single source solution provider to automobile dealerships.

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

- o Stronghold's new products and concepts (or product candidates) include: in-coming call management; advertising effectiveness reporting; Internet lead management; services marketing; online credit reporting; and compliance with Do Not Call regulations.
- o Making Strategic Acquisitions

Our History

We were incorporated as a Nevada corporation on September 8, 2000, under the name TDT Development, Inc. On May 16, 2002 we acquired Stronghold Technologies, Inc., a New Jersey corporation referred to herein as our "Predecessor Entity", pursuant to a merger of Stronghold Technologies into our wholly-owned subsidiary, TDT Stronghold Acquisition Corp., referred to herein as "Acquisition Sub". As consideration for the merger, we issued 7,000,000 shares of our common stock, par value \$0.0001 per share, to the stockholders of the Predecessor Entity in exchange for all of the issued and outstanding shares of the Predecessor Entity. The stockholders of the Predecessor Entity continue to hold these shares of our common stock. Following the merger, Acquisition Sub, the survivor of the merger, changed its name to Stronghold Technologies, Inc. (NJ) and remains our only wholly-owned subsidiary. On July 11, 2002, we changed our name from TDT Development, Inc. to Stronghold Technologies, Inc. On July 19, 2002, we exchanged all of the shares that we held in our two other wholly-owned subsidiaries, Terre di Toscana, Inc. and Terres Toscanes, Inc., which conducted an import and distribution business specializing in truffle-based food product, for 75,000 shares of our common stock held by Mr. Pietro Bortolatti, our former president.

-12-

Our principal executive offices are located at 106 Allen Road, Basking Ridge, NJ 07920. Our telephone number at that location is 908-903-1195 and our Internet address is www.strongholdtech.com. Our Annual Report on Form 10-KSB, Quarterly Reports on Form 10-QSB, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 are available on our website (www.strongholdtech.com under the "For Investors-SEC Filings" caption) as soon as reasonably practicable after we electronically file such reports with the Securities and Exchange Commission ("SEC"). Our annual, quarterly and current reports, and, if applicable, amendments to those reports, filed or furnished pursuant to Section 13(a) of the Exchange Act are also available at the website maintained by the SEC at <http://www.sec.gov>. The information contained on our website is not incorporated by reference herein.

Overview of our Handheld Technology Business

On May 16, 2002, we entered the handheld wireless technology business via our acquisition by merger of the Predecessor Entity. The Predecessor Entity was founded on August 1, 2000 to develop proprietary handheld wireless technology for the automotive dealer software market. Since the merger of the Predecessor Entity into our subsidiary, we continue to conduct the Predecessor Entity's handheld wireless technology business.

Our Revenues

Stronghold's revenues are primarily received from system installation, software licenses and system maintenance. The approximate average selling package price of the system and installation also is \$70,000. Additional revenues are derived from monthly system maintenance agreements that have a monthly fee of \$850 per month and a total contract value of \$30,600. The

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

revenues derived from these categories are summarized below:

- o Software License Revenues: This represents the software license portion of the Dealer Advance Service Solution purchased by customers of the Company. The software and intellectual property of Dealer Advance has been developed and is owned by the Company.
- o System Installation Revenues: This represents the installation and hardware portion of the Dealer Advance Service Solution. All project management during the installation is performed by us. The installation and hardware portions include cable wiring subcontracting services and off the shelf hardware and handheld computers ("PDA"s).
- o Monthly Recurring Maintenance Revenue: This represents the maintenance and support contract for the Dealer Advance Service Solution that the customer executes with the system installation. The typical maintenance contract is for 36 months. In the three year operating history of the Company, approximately 50% of all the Company's customers have prepaid the maintenance fees through a third party leasing finance company. These prepaid maintenance fees have provided additional cash flow to us and have generated a deferred revenue liability on or balance sheet.

-13-

Cost of sales for software licensing with the installation are estimated at 10% of revenue for reproduction, minor customer specific configurations and the setup cost of interface with the customers' DMS. Cost of sales for the system installation includes direct labor and travel, subcontractors and third party hardware.

General and Administrative Operating Expenses:

The general operating expenses of the Company are primarily comprised of:

- o Marketing and Selling;
- o General and Administrative;
- o Development & Operations;

Our marketing and selling expenses include all labor, sales commissions and non-labor expenses of selling and marketing of our products and services. These include the salaries of two Vice Presidents of Sales and the Business Development Manager ("BDM") staff.

Our general and administrative expenses include expenses for all facilities, insurance, benefits, telecommunications, legal and auditing expenses are included as well as the executive management group wage expense.

Our development & operations expenses include the expenses for the Client Consultant group which advises and supports the installations of our Dealer Advance(TM) clients.

THREE MONTHS ENDED JUNE 30, 2004 AND THREE MONTHS ENDED JUNE 30, 2003.

Revenue

For the quarter ended June 30, 2004, we had revenue of \$700,250 compared

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

with revenue of \$626,779 for the quarter ended June 30, 2003. This modest increase in revenue of \$73,471 or 11.7% is primarily attributed to steps we made to address the Company's limited funding. The Company's decision to conserve capital and reduce head count through the first quarter and into the second quarter of 2004 limited our ability to generate significant revenue growth for the quarter ended June 30, 2004 as compared to the quarter ended June 30, 2003.

Revenue is comprised of one-time charges to the dealerships for hardware (including server, wireless infrastructure, desktop PCs, printers, interior/exterior access points/antennas and handheld devices), software licensing fees and installation/training services. Other sources of revenue include monthly support and maintenance contracts (required with purchase of DealerAdvance(TM)) and fee-based business development consulting and sales training services. Depending upon the dealership arrangement, the support and maintenance contracts are either billed monthly and recorded as revenue monthly, or are paid up front and recorded to unearned maintenance fees at the present value of the 36-month revenue stream and amortized monthly to revenue.

-14-

Gross Profits

We generated \$484,892 in gross profits from sales for the quarter ended June 30, 2004, which was an increase of \$135,297 from the quarter ended June 30, 2003, when we generated \$349,595 in gross profits. Our gross profit margin percentage increased from 55.8% in the quarter ended June 30, 2003 to 69.2% in the quarter ended June 30, 2004 for an improvement of 13.5%. This significant improvement in gross profit margin is primarily attributable to the following increases in efficiency:

- o a decrease in client data acquisition costs achieved through implementation of an interface developed by the Company and
- o are duction in the number of staff members required to service the client base.

These improvements in efficiency present the Company with the opportunity to consider alternative pricing and delivery methods in the future targeted to increasing the adoption rate of our product.

General and Administrative Expenses

Total Selling and General and Administrative expenses in the quarter ended June 30, 2004 were \$868,446, a decrease of 27.27% or \$325,594 from the quarter ended June 30, 2003 of \$1,194,040. The significant reduction in expense is primarily attributable to efficiencies gained through the reduction of staff from 41 in June 30, 2003 to 23 in the quarter ended June 30, 2004. Total operating expenses for the quarter ended June 30, 2004 and June 30, 2003 were comprised primarily of general and administrative expenses (which includes research and development expenses, consulting and professional costs, recruiting fees, office rent and investor relations expenses), professional salaries, benefits, stock compensation and bad debt write-off expense.

Our interest and penalty expense decreased from \$90,220 in the quarter ended June 30, 2003 to \$67,358 in the quarter ended June 30, 2004. This decrease of \$22,862 was primarily based on the forgiveness of interest on stockholder loans for the quarter.

Net Loss

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

We had a net loss of \$450,913 for the quarter ended June 30, 2004 compared to \$934,665 for the quarter ended June 30, 2003, a decrease in net losses of \$483,752. This significant reduction of net losses of 51.75% despite the modest increase of revenue reflects the effects of our reduction in overhead and improvement of gross profit percentage.

Our loss per share also reduced to \$.03 loss per share with a weighted average of 13,438,277 shares outstanding in the quarter ended June 30, 2004 as compared to \$.09 loss per share in the quarter ended June 30, 2003 with a weighted average of 10,301,212 shares outstanding.

-15-

We have never declared or paid any cash dividends on our common stock. We anticipate that any earnings will be retained for development and expansion of our business and we do not anticipate paying any cash dividends in the foreseeable future. Our board of directors, subject to any restrictions or prohibitions that may be contained in our loan or preferred stock agreements, has sole discretion to pay dividends based on our financial condition, results of operations, capital requirements, contractual obligations and other relevant factors.

Liquidity and Capital Resources

Overview

As of June 30, 2004, our cash balance was \$726,544. We had a net loss of \$450,913 for the quarter ended June 30, 2004. We had a net operating loss of approximately \$9,046,000 for the period from May 17, 2002 through June 30, 2004 to offset future taxable income. Losses incurred prior to May 17, 2002 were passed directly to the shareholders and, therefore, are not included in the loss carry-forward. There can be no assurance, however, that we will be able to take advantage of any or all tax loss carry-forwards, in future fiscal years. Our accounts receivable as of June 30, 2004 was \$825,534 (less allowances for doubtful accounts of \$210,318), and \$1,519,788 (less allowances for doubtful accounts of \$196,284) for the quarter ended June 30, 2003. Accounts receivable balances represent amounts owed to Stronghold for new installations and maintenance, service, training services, software customization and additional systems components.

Financing Needs

To date, we have not generated revenues in excess of our operating expenses. We have not been profitable since our inception, we expect to incur additional operating losses in the future and will require additional financing to continue the development and commercialization of our technology. We have incurred a net loss of approximately \$451,000 and have negative cash flows from operations of approximately \$1,067,000 for the six months ended June 30, 2004, and have a working capital deficit of approximately \$2,753,000 and a stockholders' deficit of approximately \$5,352,000 as of June 30, 2004. These conditions raise substantial doubt about our ability to continue as a going concern. During 2004, our management will rely on raising additional capital to fund its future operations. If we are unable to generate sufficient revenues or raise sufficient additional capital, there could be a material adverse effect on the consolidated financial position, results of operations and we may be unable to continue our operations.

We expect our capital requirements to increase significantly over the next several years as we continue to develop and market the DealerAdvance(TM) suite and as we increase marketing and administration infrastructure and develop

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

capabilities and facilities. Our future liquidity and capital funding requirements will depend on numerous factors, including, but not limited to, the levels and costs of our research and development initiatives, the cost of hiring and training additional sales and marketing personnel and the cost and timing of the expansion of our marketing efforts.

-16-

Financings

On July 31, 2000, the Predecessor Entity entered into a line of credit with Mr. Chris Carey, our President and Chief Executive Officer and the President and Chief Executive Officer of Stronghold. The terms of the line of credit made available \$1,989,500, which the Predecessor Entity could borrow from time to time, until August 1, 2001. The outstanding amounts accrued interest at the per annum rate equal to the floating base rate, as defined therein, computed daily, for the actual number of days elapsed as if each full calendar year consisted of 360 days. The first interest payment under the line of credit was due on August 1, 2001. On such date, the parties agreed to extend the line of credit for one more year, until August 1, 2002.

On November 1, 2001, the Predecessor Entity entered into a line of credit with UnitedTrust Bank (now PNC Bank) pursuant to which the Predecessor Entity borrowed \$1.5 million. This line of credit was due to expire by its terms, and all outstanding amounts were due to be paid, on June 30, 2002. On June 30, 2002, the line of credit came due and the bank granted a three-month extension. On September 30, 2002, we converted the outstanding line of credit with UnitedTrust Bank into a \$1,500,000 promissory note. Such promissory note is to be paid in 36 monthly installments, which commenced in February 2003 and is due to terminate on January 1, 2006. Interest accrues on the note at the prime rate, adjusted annually, which is the highest New York City prime rate published in The Wall Street Journal. The initial prime rate that applied to the promissory note was 4.750%.

On August 7, 2003, we entered into a modification of the loan agreement with UnitedTrust Bank, of which the principal balance was \$1,291,666 at the time of closing of the modification. Pursuant to the modification agreement, UnitedTrust Bank agreed to subordinate its lien against our assets to a new lender and reduce the monthly payments from \$41,666 per month principal plus accrued interest as follows: (a) from the date of closing through December 15, 2003, \$10,000 per month plus accrued interest (b) from January 15, 2004 through December 15, 2004, \$15,000 per month plus accrued interest, (c) from January 15, 2005 through December 15, 2005, \$20,000 per month plus interest and (d) on the maturity date of January 1, 2006, a balloon payment equal to all the outstanding principal and accrued interest. We are current with our payment of \$15,000 per month.

On January 9, 2004, we were served with a notice of an event of default by United Trust Bank, now PNC Bank, a successor by merger effective January 2004 with United Trust Bank, ("the Bank"), under its Loan Agreement. Pursuant to section 6.01(d) of the Loan Agreement, an Event of Default exists due to the Company's failure to pay Payroll Tax Obligations aggregating in the amount of \$1,089,897 as of December 31, 2003 (including estimated penalties and interest). The Company continues to make timely scheduled payments pursuant to the terms of the loan and is in forbearance negotiations with the Bank with respect to the default. On April 1, 2004, the Company received a second Notice of Event of Default stating that the Bank had accelerated the maturity of the Loan and declared all principal, interest, and other outstanding amounts due and payable. However, if the Company is unable to reach a forbearance agreement with the Bank, we may be required to pay off the amounts outstanding under the loan, and

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

if we are unable to pay off the amounts outstanding, the Bank could seize the assets of the Company pledged as security for the Loan. If either of these actions occur, we may be unable to continue our operations.

-17-

Because we are in default under the terms of the loan due primarily to our payroll tax default, the Bank has instituted the default rate of interest which is 5% above the "highest New York City prime rate" stated above. We have entered into an installment agreement with the United States Internal Revenue Service to pay the withholding taxes, under the terms of which we will pay \$100,000 by May 31, 2004 and \$35,000 each month, commencing June 28, 2004, until we have paid the withholding taxes due in full.

On April 22, 2002, the Predecessor Entity issued 500,000 shares of its common stock to Mr. Carey (which converted into 1,093,750 shares of our common stock when we acquired the Predecessor Entity on May 16, 2002) in exchange for cancellation of \$1 million of outstanding indebtedness under the July 31, 2000 line of credit from Mr. Carey.

On May 16, 2002, the total amount outstanding under the July 31, 2000 line of credit with Mr. Carey was \$2.2 million. On such date, we issued 666,667 shares of our common stock to Mr. Carey in exchange for the cancellation of \$1 million of the then outstanding amount under the line of credit. We agreed to pay Mr. Carey the remaining \$1.2 million according to the terms of a non-negotiable promissory note, which was issued on May 16, 2002.

On May 15, 2002, we entered into a Securities Purchase Agreement with Stanford Venture Capital Holdings, Inc., referred to herein as Stanford, in which we issued to Stanford (i) such number of shares of our Series A \$1.50 Convertible Preferred Stock, referred to herein as Series A Preferred Stock, that would in the aggregate equal 20% of the total issued and outstanding shares of our common stock, and (ii) such number of warrants for shares of our common stock that would equal the number of shares of Series A Preferred Stock issued to Stanford. The total aggregate purchase price for the Series A Preferred Stock and warrants paid by Stanford was \$3,000,000. The issuance of the Series A Preferred Stock and warrants took place on each of four separate closing dates from May 16, 2002 through and July 19, 2002, at which we issued an aggregate of 2,002,750 shares of our Series A Preferred Stock and warrants for 2,002,750 shares of our common stock to Stanford.

On April 24, 2003, we entered into a Securities Purchase Agreement with Stanford Venture Capital Holdings, Inc. for the issuance of 2,444,444 shares of our Series B \$0.90 Convertible Preferred Stock. The issuance of the Series B Preferred Stock took place on six separate closing dates beginning on May 5, 2003 through September 15, 2003. In connection with the Securities Purchase Agreement, we agreed to modify the previously issued five-year warrants to purchase 2,002,750 shares of our common stock: (i) to reduce the exercise price to \$.25 per share; and (ii) to extend the expiration date through August 1, 2008. In addition, our President and Chief Executive Officer, Christopher J. Carey, agreed to convert outstanding loans of \$543,000 to 603,333 shares of our common stock at a price of \$.90 per share. In addition, the Company and Stanford entered into a Registration Rights Agreement, dated April 30, 2003, in which the Company agreed to register the shares of the Company's common stock issuable upon conversion of the Series A and Series B Preferred Stock with the Securities and Exchange Commission, no later than November 15, 2003. The Company and Stanford agreed to extend the date of the filing requirements of the Registration Rights Agreement to March 14, 2004. We have not yet filed a registration statement, and are in negotiations with Stanford regarding an extension of the registration filing date.

-18-

During August and September 2002, we entered into 9 subscription agreements with accredited private investors, as defined in Rule 501 of the Securities Act, pursuant to which we issued an aggregate of 179,333 shares of our common stock at \$1.50 per share. These private investments generated total proceeds to us of \$269,000.

On September 30, 2002, we renegotiated the \$1,200,000 promissory note with Mr. Carey pursuant to a requirement contained in the promissory note with UnitedTrust Bank. According to the new terms of the loan, Mr. Carey extended the repayment of the principal amount until December 1, 2005. Until such time as the principal is paid, we will pay an interest only fee of 12% per year. Mr. Carey's promissory note is expressly subordinated in right of payment to the prior payment in full of all of the Company's senior indebtedness. Subject to the payment in full of all senior indebtedness, Mr. Carey is subrogated to the rights of the holders of such senior indebtedness to receive principal payments or distribution of assets. As of December 31, 2002, \$970,749 was outstanding under the promissory note issued to Mr. Carey.

On September 30, 2002, we entered into a loan agreement with CC Trust Fund to borrow an amount up to \$355,128. This bridge loan was for a period of twelve months, with all principal due and payable on September 30, 2003. The 12.5% interest on the outstanding principal is due each year. At the end of the loan period, the CC Trust Fund will be entitled to exercise 25,000 warrants at \$1.50 per share. On September 30, 2003, the CC Trust Fund agreed to extend the term of their loan to December 30, 2003. On December 30, 2003, the CC Trust Fund agreed to extend the term of their loan to June 30, 2004. On March 30, 2004, the CC Trust Fund agreed to extend the term of their loan to March 31, 2005. As of December 31, 2003, \$355,128 was outstanding under the CC Trust Fund loan agreement. Christopher Carey Jr., Mr. Carey's son, is the beneficiary of the trust, and Mary Carey, Mr. Carey's wife, is the trustee of the trust.

On September 30, 2002, we entered into a loan agreement with AC Trust Fund to borrow an amount up to \$375,404. This bridge loan is for a period of twelve months, with all principal due and payable on September 30, 2003. The 12.5% interest on the outstanding principal is due each year. At the end of the loan period, the Fund will be entitled to exercise 25,000 warrants at \$1.50 per share. On September 30, 2002, the AC Trust Fund agreed to extend the term of their loan to December 30, 2003. On December 30, 2003, the AC Trust Fund agreed to extend the term of their loan to June 30, 2004. On March 30, 2004, the AC Trust Fund agreed to extend the term of their loan to March 31, 2005. As of December 31, 2003, \$375,404 was outstanding under the AC Trust Fund loan agreement. Amie Carey, Mr. Carey's daughter, is the beneficiary of the trust, and Mary Carey, Mr. Carey's wife, is the trustee of the trust.

In October 2002, in connection with a loan to the Company in the amount of \$165,000, we issued a promissory note to Christopher J. Carey for \$165,000. Such promissory note was due on or before December 31, 2003. On December 30, 2003, Mr. Carey agreed to extend the term of his loan to June 30, 2004. On March 30, 2004, Mr. Carey agreed to extend the term of his loan to March 31, 2005. As of December 31, 2003, the amount outstanding on this promissory note was \$10,000. Until such time as the principal is paid, interest on the note will accrue at the rate of 12.5% per year.

-19-

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

On March 18, 2003, we entered into a bridge loan agreement with Christopher J. Carey, for a total of \$400,000. The agreement stipulates that the Company will pay an 8% interest rate on a quarterly basis until the loan becomes due and payable on June 30, 2004. We also issued to Mr. Carey 391,754 warrants exercisable for common stock for 10 years at a price of \$0.97 per share. On December 30, 2003, Christopher J. Carey agreed to extend the term of the promissory note to June 30, 2004. As of December 31, 2003, \$380,000 was outstanding under this bridge loan agreement.

In October 2003, the Company commenced offerings to accredited investors in private placements of up to \$3,000,000 of the Company's common stock. In the period of October 2003 through January 9, 2004 the Company raised \$225,000 under the terms of these private placements. The shares offered in the private placement are priced at the 5 trading day trailing average closing price of the common stock on the OTCBB, less 20%. For each share purchased in the private placements, purchasers received a warrant to purchase one half (0.5) share of common stock at 130% of the purchase price. A minimum of \$25,000 was required per investor. The number shares issued under this placement total 509,559, at an average price of \$0.44/share.

On March 3, 2004 and March 15, 2004 we received loans in the amount of \$437,500 each from Stanford. The final terms of the investment are to be determined but the Company expects to pay Stanford an 8% annual dividend on the funds invested and to redeem the securities not later than three years from the date of funding.

On June 16, 2004, to obtain funding for its ongoing operations, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement") with New Millennium Capital Partners II, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd. and AJW Partners, LLC (collectively, the "Investors") on June 18, 2004 for the sale of (i) \$3,000,000 in callable convertible secured notes (the "Notes") and (ii) stock purchase warrants to buy 3,000,000 shares of the Company's common stock (the "Warrants"). On June 18, 2004, the Investors purchased \$1,500,000 in Notes and received Warrants to purchase 1,500,000 shares of the Company's common stock. In addition, provided that all of the conditions in the Securities Purchase Agreement are satisfied, the Investors are obligated to provide the Company with additional funds as follows:

- o \$500,000 was funded within five business days of filing a registration statement registering shares of the Company's common stock underlying the Notes and the Warrants; and
- o \$1,000,000 will be funded within five business days of the effectiveness of the registration statement.

The Notes bear interest at 12%, mature two years from the date of issuance, and are convertible into our common stock, at the Investors' option, at the lower of (i) \$0.70 or (ii) 50% of the average of the three lowest intraday trading prices for the Company's common stock during the 20 trading days before, but not including, the conversion date. The Company may prepay the Notes in the event that no event of default exists, there are a sufficient number of shares available for conversion of the Notes and the market price is at or below \$.57 per share. The full principal amount of the Notes is due upon default under the terms of Notes. In addition, the Company has granted the investors a security interest in substantially all of its assets and intellectual property as well as registration rights.

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

The Warrants are exercisable until five years from the date of issuance at a purchase price of \$0.57 per share. In addition, the exercise price of the Warrants is adjusted in the event the Company issues common stock at a price below market.

The Investors have contractually agreed to restrict their ability to convert the Notes and exercise the Warrants and receive shares of the Company's common stock such that the number of shares of the Company's common stock held by them and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of the Company's common stock.

All shares of the Company's common stock associated with this private placement are restricted securities in accordance with Rule 144 as promulgated under the of the Securities Act of 1933.

To enable us to fund our research and development and commercialization efforts, during the next several months, we may enter into additional debt and/or equity transactions with individual investors.

CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES

Financial Reporting Release No. 60, recently released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. The notes to the consolidated financial statements include a summary of significant accounting policies and methods used in the preparation of our Consolidated Financial Statements. In addition, Financial Reporting Release No. 61 was recently released by the SEC requires all companies to include a discussion which addresses, among other things, liquidity, off-balance sheet arrangements, contractual obligations and commercial commitments. The following is a brief discussion of the more significant accounting policies and methods used by us.

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of financial statements in accordance with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including the recoverability of tangible and intangible assets, disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reported period.

-21-

On an on-going basis, we evaluate our estimates. The most significant estimates relate to our recognition of revenue and the capitalization of our software development.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue Recognition Policy

Revenue related to the sale of products is comprised of one-time charges to dealership customers for hardware (including server, wireless infrastructure, desktop PCs, printers, interior/exterior access points/antennas and handheld devices), software licensing fees and installation/training services. Stronghold

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

charges DealerAdvance Sales Solution(TM) dealers for all costs associated with installation. The most significant variable in pricing is the number of handheld devices purchased. Stronghold has not determined pricing for DealerAdvance Service Solution(TM).

Once DealerAdvance Sales Solution(TM) is installed, Stronghold provides hardware and software maintenance services for a yearly fee equal to approximately 10% of the one-time implementation fees. All dealerships are required to purchase maintenance with installations and pay maintenance fees on a monthly basis. Stronghold provides our customers with services, including software and report customization, business and operations consulting, and sales training services on an as needed basis and typically are charged on a time and expenses basis.

Stronghold offers all new customers a sixty-day performance trial period during which time performance targets are set. Stronghold installs the system and agrees to remove the system at no charge if the performance targets are not met. If performance is met, a large portion of the dealerships enter into a third party lease generally with lessors introduced by us. We have entered into a number of relationships with leasing companies in which the leasing company finances the implementation fees for the dealership in a direct contractual relationship with the dealership. The lease is based solely on the creditworthiness of the dealership without recourse to us. The leasing company receives an invoice from us, and remits funds upon acceptance by the dealership. We receive all funds as invoiced, with interest costs passed to the dealership. These leases typically run 36 months in duration, during which time we contract for service and maintenance services. Stronghold charges separately for future software customization after the initial installation, for additional training, and for additions to the base system (e.g., more handheld devices for additional sales people). Depending upon the dealership arrangement, the support and maintenance contracts are either billed monthly and recorded as revenue monthly, or are recorded up front to unearned maintenance fees at the present value of the 36-month revenue stream and amortized monthly to revenue over the life of the agreement.

Revenue Restatement

On December 26, 2002, we reclassified our consolidated financial statements for the first three quarters of 2002. This step was taken on the advice of Rothstein, Kass & Company, P.C., our accounting firm, to reflect accounting changes in accordance with revenue recognition guidelines released by the SEC.

-22-

Accordingly, our revenue was reclassified such that it may be recognized in future quarters. For the nine months ended September 30, 2002, revenue was reclassified from \$2,952,076 to \$1,898,884 with the difference treated as deferred revenue.

Historically, we recorded revenue as a three-stage process: at the time the equipment and software were delivered, installed and the personnel trained. We will now recognize each sale with an additional stage as outlined in the analysis provided by our accounting firm, which includes a fourth stage defined as, "the system is handed over to the customer to run on their own." This four-stage delivery process results in current sales revenues being carried into future quarters. We estimate that this change delays our recognition of revenue by approximately 20-50 days.

Software Development Capitalization Policy

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

Software development costs, including significant product enhancements incurred subsequent to establishing technological feasibility in the process of software production, are capitalized according to Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed." Costs incurred prior to the establishment of technological feasibility are charged to research and development expenses. For the quarter ended June 30, 2004, we capitalized \$134,326 of development costs in developing enhanced functionality of our DealerAdvance(TM) products.

Item 3. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2004. Based on this evaluation, our chief executive officer and acting chief financial officer concluded that as of June 30, 2004, our disclosure controls and procedures were (1) designed to ensure that material information relating to us, including its consolidated subsidiaries, is made known to our chief executive officer and chief financial officer by others within those entities, particularly during the period in which this report was being prepared and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

-23-

No change in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended June 30, 2004 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II - Other Information

ITEM 1. LEGAL PROCEEDINGS.

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. Except as disclosed below, we are currently not aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

On April 27, 2004, PNC Bank, N.A., as successor by merger to UnitedTrust Bank filed a complaint in the Superior Court of New Jersey, Law Division, Union County (Docket No. UNN-L_001522-04) against our company and Christopher J. Carey, in his capacity as guarantor, to collect the sums outstanding under the Loan Agreement, dated as of September 30, 2002. On July 15, 2004, we entered into a fully executed forbearance agreement with PNC Bank, N.A. We made an initial principal payment of \$420,000 with the execution of the forbearance. Additionally, we are required to make four consecutive monthly installments of \$50,000.00 on August 15, 2004, September 15, 2004, October 15, 2004 and November 15, 2004 followed by the remaining principal on or before December 15, 2004. Failure to adhere to this schedule will cause the suit to be reinstated and PNC

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

Bank will resume collection of the sum under the suit.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

In connection with the Series A Purchase Agreement and Series B Purchase Agreement, the Company and Stanford entered into a Registration Rights Agreement, dated April 30, 2003, in which the Company agreed to register the shares of the Company's common stock issuable upon conversion of the Series A and Series B Preferred Stock with the Securities and Exchange Commission, no later than November 15, 2003. The Company and Stanford have agreed to extend date of the filing requirements of the Registration Rights Agreement to March 14, 2004. To date we have not yet filed a registration statement.

Pursuant to the Amended and Restated Series A Certificate of Designation and Series B Certificate of Designation, dated November 11, 2003, by and between the Company and Stanford and a Written Notice, Consent, and Waiver Among The Holders Of Series A \$1.50 Convertible Preferred Stock, Series B \$.90 Convertible Preferred Stock and Warrants, the Company and Stanford agreed to certain amendments and restatements. In consideration of the Notice and the granting of the Consents and Waivers, the Company reduced the Exercise Price of the Stanford Warrants from \$0.25 per share to \$.001. On December 15, 2003, Stanford exercised in full the Stanford Warrant purchasing 2,002,750 shares of common stock for the purchase price of \$2,002.75.

In addition, on April 30, 2003 the Company and Stanford agreed to convert \$543,000 of the outstanding debt owed to Christopher J. Carey by the Company into 603,333 shares of common stock of the Company at a price of \$0.90 per share.

-24-

In addition, on March 24, 2004 the Company and Christopher J. Carey agreed to extend the maturity dates of the Promissory Notes, dated March 18, 2003, for an aggregate amount of \$400,000, to June 30, 2004.

In addition, the Company, Christopher J. Carey and Mary Carey (as trustee) agreed to extend the maturity dates of loans from the Carey family trusts to the Company in the amount of \$730,532, to December 31, 2003.

On June 15, 2004, the stockholders of the Company holding a majority of the outstanding shares of common stock of the Company approved an amendment to the Company's Articles of Incorporation, as amended, to replace Article III in its entirety, which will result in an increase to the number of authorized shares of Common Stock. The Company's Articles of Incorporation, as amended, currently authorizes for issuance of 55,000,000 shares consisting of 50,000,000 of common stock and 5,000,000 shares of preferred stock. The approval of this amendment to the Articles of Incorporation will increase the Company's authorized shares of common stock to 250,000,000.

On June 16, 2004, Stanford was issued a warrant to purchase an additional 2,000,000 shares of common stock at an exercise price of \$.0001 in exchange for i) agreeing to a waiver of existing registration rights that included a lock up period for one year after the effective date of a registration statement prohibiting the registration and sale Stanford's securities and ii) agreeing, as holder of Stronghold's Series A \$1.50 Convertible Preferred Stock ("Series A Stock") and Series B \$.90 Convertible Preferred Stock ("Series B Stock"), to waive any dilution rights pursuant to the Series A Stock and the Series B Stock, as a result of the issuance and conversion of the Notes, or exercise of the Warrants, into Stronghold common stock.

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

On June 16, 2004, to obtain funding for its ongoing operations, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement") with New Millennium Capital Partners II, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd. and AJW Partners, LLC (collectively, the "Investors") on June 18, 2004 for the sale of (i) \$3,000,000 in callable convertible secured notes (the "Notes") and (ii) stock purchase warrants to buy 3,000,000 shares of the Company's common stock (the "Warrants"). On June 18, 2004, the Investors purchased \$1,500,000 in Notes and received Warrants to purchase 1,500,000 shares of the Company's common stock. In addition, provided that all of the conditions in the Securities Purchase Agreement are satisfied, the Investors are obligated to provide the Company with additional funds as follows:

- o \$500,000 was funded within five business days of filing a registration statement registering shares of the Company's common stock underlying the Notes and the Warrants; and
- o \$1,000,000 will be funded within five business days of the effectiveness of the registration statement.

The Notes bear interest at 12%, mature two years from the date of issuance, and are convertible into our common stock, at the Investors' option, at the lower of (i) \$0.70 or (ii) 50% of the average of the three lowest intraday trading prices for the Company's common stock during the 20 trading days before, but not including, the conversion date. The Company may prepay the Notes in the event that no event of default exists, there are a sufficient number of shares available for conversion of the Notes and the market price is at or below \$.57 per share. The full principal amount of the Notes is due upon default under the terms of Notes. In addition, the Company has granted the investors a security interest in substantially all of its assets and intellectual property as well as registration rights.

-25-

The Warrants are exercisable until five years from the date of issuance at a purchase price of \$0.57 per share. In addition, the exercise price of the Warrants is adjusted in the event the Company issues common stock at a price below market.

The Investors have contractually agreed to restrict their ability to convert the Notes and exercise the Warrants and receive shares of the Company's common stock such that the number of shares of the Company's common stock held by them and their affiliates after such conversion or exercise does not exceed 4.99% of the then issued and outstanding shares of the Company's common stock.

All shares of the Company's common stock associated with this private placement are restricted securities in accordance with Rule 144 as promulgated under the of the Securities Act of 1933.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On June 15, 2004, the stockholders of the Company holding a majority of the outstanding shares of common stock of the Company approved an amendment to the Company's Articles of Incorporation, as amended, to replace Article III in its entirety, which will result in an increase to the number of authorized shares of Common Stock. The Company's Articles of Incorporation, as amended,

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

currently authorizes for issuance of 55,000,000 shares consisting of 50,000,000 of common stock and 5,000,000 shares of preferred stock. The approval of this amendment to the Articles of Incorporation will increase the Company's authorized shares of common stock to 250,000,000.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

See Exhibit Index.

(b) Reports on Form 8-K

On June 28, 2004, the Company filed a Form 8-K announcing, under Item 5, the entering into of a Securities Purchase Agreement with four institutional investors for the sale of (i) \$3,000,000 in callable convertible secured notes and (ii) stock purchase warrants to buy 3,000,0000 shares of the Company's common stock.

-26-

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 this 16th day of August, 2004.

STRONGHOLD TECHNOLOGIES, INC.

BY: /s/ Christopher J. Carey

Name: Christopher J. Carey,
Title: President and Chief Executive Officer
(principal executive officer)

BY: /s/ Robert M. Nawy

Name: Robert M. Nawy
Title: (principal financial officer)

BY: /s/ Karen S. Jackson

Name: Karen S. Jackson
Title: Controller (principal accounting officer)

Dated: As of August 16, 2004

ITEM 6. EXHIBIT INDEX

Exhibit Description
Number

4.8 (1) Securities Purchase Agreement dated June 18, 2004 between the Company and New Millennium Capital Partners II, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd. and AJW Partners, LLC

4.9 (1) Callable Secured Convertible Note in the name of New Millennium

Edgar Filing: STRONGHOLD TECHNOLOGIES INC - Form 10QSB

Capital Partners II, LLC dated June 18, 2004

- 4.10 (1) Callable Secured Convertible Note in the name of AJW Qualified Partners, LLC dated June 18, 2004
 - 4.11 (1) Callable Secured Convertible Note in the name of AJW Offshore, Ltd. dated June 18, 2004
 - 4.12 (1) Callable Secured Convertible Note in the name of AJW Partners, LLC dated June 18, 2004
 - 4.13 (1) Stock Purchase Warrant in the name of New Millennium Capital Partners II, LLC dated June 18, 2004
 - 4.14 (1) Stock Purchase Warrant in the name of AJW Qualified Partners, LLC dated June 18, 2004
 - 4.15 (1) Stock Purchase Warrant in the name of AJW Offshore, Ltd. dated June 18, 2004
 - 4.16 (1) Stock Purchase Warrant in the name of AJW Partners, LLC dated June 18, 2004
 - 4.17 (1) Registration Rights Agreement dated June 18, 2004 between the Company and New Millennium Capital Partners II, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd. and AJW Partners, LLC
 - 4.18(1) Security Agreement dated June 18, 2004 between the Company and New Millennium Capital Partners II, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd. and AJW Partners, LLC
 - 4.19(1) Intellectual Property Security Agreement dated June 18, 2004 between the Company and New Millennium Capital Partners II, LLC, AJW Qualified Partners, LLC, AJW Offshore, Ltd. and AJW Partners, LLC
 - 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
 - 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
 - 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.
 - 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. 1350.
- (1) Incorporated by reference to the exhibits to Registrants Form 8-K Current Report filed June 28, 2004.