SmartPros Ltd.
Form 10QSB
May 12, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2005

Commission File Number 001-32300

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

Delaware	13-4100476
(State or other jurisdiction incorporation or organization)	(I.R.S. Employer of Identification No.)

12 Skyline Drive, Hawthorne, New York 10532
(Address of principal executive office)

(914) 345-2620
(Issuer's telephone number, including area code)

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

Yes |_| No |X|

Number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of May 11, 2005, there were 5,082,539 shares of common stock outstanding.

Transitional Small Business Disclosure Format. Yes |_| No |X|

SMARTPROS LTD.
FORM 10-QSB REPORT

March 31, 2005

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FORWARD-LOOKING STATEMENTS

Certain statements made in this Quarterly Report on Form 10-QSB are "forward-looking statements" within the meaning of Section 21E of the Securities and Exchange Act of 1934 regarding the plans and objectives of management for future operations and market trends and expectations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the continued expansion of our business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the

inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. The terms "we", "our", "us", or any derivative thereof, as used herein refer to SmartPros Ltd., a Delaware corporation, and its predecessors.

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SMARTPROS LTD. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS

	MARC 20 (UNAUD
ASSETS	
Current Assets:	
Cash and cash equivalents	$ 2,916
Investment securities available-for-sale	4,000
Accounts receivable, net of allowance for doubtful accounts of $71,000	1,068
Prepaid expenses and other current assets	143
TOTAL CURRENT ASSETS	8,128
Property and equipment, net	570
Goodwill	53
Other intangible, net	2,387
Other assets, including restricted cash of $150,000	150
	3,161
TOTAL ASSETS	$ 11,289
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Accounts payable	$ 292
Accrued expenses	283
Current portion of capital lease and equipment financing obligations	50
Deferred revenue	3,802
TOTAL CURRENT LIABILITIES	4,429
Long-Term Liabilities:	
Capital lease and equipment financing obligations	53
Other liabilities	163
TOTAL LONG-TERM LIABILITIES	217

Commitments and Contingencies	
Stockholders' Equity:	
Convertible preferred stock, $.001 par value, authorized 1,000,000 shares, no shares issued and outstanding	
Common stock, $.0001 par value, authorized 30,000,000 shares, 5,140,545 issued and 5,082,539 outstanding	
Common stock in treasury, at cost - 58,006 shares	(220
Additional paid-in capital	16,407
Accumulated (deficit)	(9,238
	6,949
Deferred compensation	(106
Note receivable from stockholder	(200
TOTAL STOCKHOLDERS' EQUITY	6,642
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 11,289

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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SMARTPROS LTD. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

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Net Revenues	$ 2,848
Cost of Revenues	1,082
Gross Profit	1,766
Operating Expenses:	
Selling, general and administrative	1,435
Depreciation and amortization	141
	1,576
Operating Income (Loss)	189
Other Income (Expense):	
Interest income	29
Interest expense	(3
	26
Income (loss) before provision for income taxes	216

Provision for Income Taxes	
Net Income (Loss)	$ 216
Net Income (Loss) Per Common Share:	
Basic net income (loss) per common share	$
Diluted net income (loss) per common share	$
Weighted Average Number of Shares Outstanding	
Basic	5,082
Diluted	5,117

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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SMARTPROS LTD. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	THR
	2005
Cash Flows from Operating Activities:	
Net income (loss)	$ 216
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Depreciation and amortization	141
Reduction in deferred compensation	21
Changes in operating assets and liabilities:	
(Increase) decrease in operating assets:	
Accounts receivable	(83
Prepaid expenses and other current assets	31
Other assets	17
(Decrease) increase in operating liabilities:	
Accounts payable and accrued expenses	(156
Deferred revenue	61
Other liabilities	(1
Total adjustments	31
Net Cash Provided by Operating Activities	247

Cash Flows from Investing Activities:	
Reduction in investment securities available-for-sale	1,000
Acquisition of property and equipment	(72
Net Cash Provided by (Used in) Investing Activities	927
Cash Flows from Financing Activities:	
Payments on note payable - treasury stock	
Proceeds from issuance of long-term debt	
Payments on long-term debt	
Payments under capital lease obligations	(16
Net Cash Used in Financing Activities	(16
Net Increase in Cash and Cash Equivalents	1,159
Cash and Cash Equivalents, beginning of period	1,756
Cash and Cash Equivalents, end of period	$ 2,916
Supplemental Disclosure:	
Cash paid for interest	$ 3
Supplemental Disclosure of Non Cash Investing and Financing Activities:	
Equipment purchased under capital leases	$

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

SMARTPROS LTD. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of SmartPros Ltd. ("SmartPros" or the "Company"), included herein have been prepared by the Company in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2004 and the notes thereto included in the Company's Annual Report on Form 10-KSB with the United States Securities and Exchange Commission. Results of consolidated operations for the interim period are not necessarily indicative of the operating results to be

attained for the entire fiscal year. The unaudited condensed consolidated financial statements herein include the accounts of the Company and its wholly owned subsidiary, Working Values, Ltd., since its inception (April 2003). All material inter-company accounts and transactions have been eliminated.

NOTE 2. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company, a Delaware corporation, was organized in 1981 as Center for Video Education, Inc. for the purpose of producing educational videos primarily directed to the accounting profession. SmartPros' primary products today are periodic video and Internet subscription services directed to corporate accountants, financial managers and accountants in public practice. In addition, the Company also produces a series of continuing education courses directed to the engineering profession as well as a series of courses designed for candidates for the professional engineering exam. Through its Working Values subsidiary, the Company also develops various programs on governance, compliance and ethics for corporations. SmartPros also produces custom videos and rents out its studios. SmartPros is located in Hawthorne, New York, where it maintains its corporate offices, new media lab, video production studios and tape duplication facilities. While the Company's management monitors the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a company wide basis. Accordingly, all of the Company's operations are considered by management to be aggregated in one reportable segment.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles 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 dates of financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

REVENUE RECOGNITION

The Company recognizes revenues from its subscription services as earned. Video subscriptions are generally billed on an annual basis, while on-line subscriptions are paid by credit card at point of sale. Both of these types of sales are deferred at the time of billing or payment and amortized into revenue on a monthly basis over the term of the subscription, which is generally one year. Engineering products are non-subscription based and revenue is recognized upon shipment or, in the case of on-line sales, payment. Revenues from non-subscription services provided to customers, such as website design, video production, consulting services and custom projects are generally recognized on a proportional performance basis where sufficient information relating to project status and other supporting documentation is available. The contracts may have different billing arrangements resulting in either unbilled or deferred revenue. The Company obtains either signed agreements or purchase orders from its non-subscription customers outlining the terms and conditions of the sale or service to be provided. Otherwise, such services are recognized as revenues after completion and delivery to the customer. Duplication and related services are generally recognized upon shipment or, if later, when the Company's obligations are complete and realization of receivable amounts is assured.

NOTE 2. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

CAPITALIZED COURSE COSTS

Capitalized course costs include the direct cost of internally developing proprietary educational products and materials that have extended useful lives. Amortization of these capitalized course costs commences with the realization of course revenues. The amortization period is three years. Other course costs incurred in connection with any of the Company's monthly subscription products or custom work are charged to expense as incurred. Included in other intangible assets at March 31, 2005 are capitalized course costs of $181,316, net of accumulated amortization of $75,549.

DEFERRED REVENUE

Deferred revenue related to subscription services represents the portion of unearned subscription revenue, which is amortized on a monthly, straight-line basis, as earned. Deferred revenue related to website design and video production services represents that portion of amounts billed by the Company, or cash collected by the Company, for which services have not yet been provided or earned in accordance with the Company's revenue recognition policy.

CAPITAL STOCK

On September 10, 2004, the Company filed an amendment to its Certificate of Incorporation, effecting a reverse stock split in which each issued share of its Common Stock was converted into 0.5169925 new shares. The financial statements reflect this reverse split.

EARNINGS (LOSS) PER SHARE

Basic earnings or loss per common share is net income or loss, as the case may be, divided by the weighted average number of common shares outstanding during the year. Basic earnings or loss per share exclude any dilutive effects of options, warrants and convertible securities. Diluted earnings per common share include the dilutive effect of shares of Common Stock issuable under stock options, warrants and the Company's Series A Convertible Preferred Stock. Diluted earnings per share are computed using the weighted average number of Common Stock and Common Stock equivalent shares outstanding during the period. Common Stock equivalent shares of 34,755 for the period ended March 31, 2005 include the Company's stock options and warrants that are dilutive. At March 31, 2004, all Common Stock equivalents are excluded from the computation because the effect of their inclusion would be anti-dilutive.

STOCK-BASED COMPENSATION

Employee compensation expense under stock options is reported using the intrinsic value method. No stock-based compensation cost is reflected in net income, as all options granted had an exercise price equal to or greater than the market price of the underlying Common Stock at date of grant.

The following table illustrates the effect on net loss and net earnings per share if expense was measured using the fair value recognition provisions of FASB Statement No. 123 "Accounting for Stock-Based Compensation":

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NOTE 2. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

	THREE MONTHS ENDED MARCH 31,	
	2005	2004
Net income (loss) as reported	$ 216,092	$ (7,360)
Add: Stock-based employee compensation expense included in reported net income (loss), net of related tax effects	--	--
Deduct: Stock-based compensation expense determined under fair value-based method	(7,606)	(39,038)
Pro forma net income (loss)	$ 208,486	$ (46,398)
Basic earnings (loss) per share, as reported	$ .04	$ --
Diluted earnings (loss) per share, as reported	$ .04	$ --
Pro forma basic earnings (loss) per share	$ .04	$ --
Pro forma diluted earnings (loss) per share	$ .04	$ --

The fair value of options granted in 2004 were estimated on the date of grant using the Black-Scholes Option Pricing model with an average assumed risk-free interest rate of 4.0%, an average expected life of 10 years, an expected volatility of close to zero and the assumption that no dividends will be paid. The weighted average fair value per option of options granted in 2004 was $1.40. In October 2004, subsequent to the Company's initial public offering, the company granted 22,925 options to employees at an exercise price of $4.27. On May 10, 2005 the Company awarded a grant of 10,000 options to the Chairman of the Audit Committee of which 2,500 vested immediately and 2,500 will vest on each May 10, 2006 - 2008. The options have an exercise price of $4.00 each.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

THE FOLLOWING DISCUSSION OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS SHOULD BE READ IN CONJUNCTION WITH THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES INCLUDED ELSEWHERE IN THIS REPORT. CERTAIN STATEMENTS IN THIS DISCUSSION AND ELSEWHERE IN THIS REPORT CONSTITUTE FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 21E OF THE SECURITIES AND EXCHANGE ACT OF 1934. SEE THE "FORWARD LOOKING STATEMENT" IMMEDIATELY FOLLOWING THE TABLE OF CONTENTS. BECAUSE THIS DISCUSSION INVOLVES RISK AND UNCERTAINTIES, OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS.

We provide learning solutions for accounting/finance and engineering professionals, as well as ethics and compliance training for the general corporate community. We offer "off-the-shelf" courses and custom designed programs with delivery methods suited to the specific needs of our clients. Our customers include approximately half of the Fortune 500 companies and a large

number of midsize and small companies.

Our learning solutions for professionals are designed to meet the initial and ongoing licensing and continuing professional education requirements imposed by state licensing agencies and professional standards organizations. Most of the courses in our accounting/finance library are designed to meet these standards and adhere to the requirements of all state boards of accountancy as well as those of the American Institute of Certified Public Accountants, Institute of Management Accountants, Institute of Internal Auditors, the Association of Finance Professionals, Financial Executives International and the Association of Government Accountants. In the engineering area, most of our courses have been approved for continuing professional development credit by one or more organizations, including the American

Society of Civil Engineers, the National Society of Professional Engineers, the American Council of Engineering Companies, the American Society of Mechanical Engineers and the Project Management Institute. Our corporate ethics and compliance training programs are designed to align corporate behavior with applicable laws and regulations, as well as generally accepted codes of conduct. So, for example, our programs may deal with issues prompted by the Sarbanes-Oxley Act of 2002 and the U.S. Federal Sentencing Guidelines, as well laws addressing workplace misconduct such as harassment.

Our products are available in one or more of the following formats: print, videotapes and digital. Digital format can be delivered on CD-ROM, DVD or over the Internet. The Internet has become our fastest growing delivery channel, attracting new and existing subscribers. This has had a positive effect on our revenue as well as our gross margins since online sales eliminate the cost for materials, i.e., videotapes, packaging and shipping.

We believe that our learning solutions effectively address the needs of professionals and companies seeking comprehensive learning resources for themselves and their employees. Our solutions are flexible, cost-efficient and easy to use. They alleviate many of the inefficiencies associated with traditional classroom training, such as travel costs, scheduling difficulties and opportunity costs. In addition, we also offer our clients a learning content management system, which allows the professionals and their employers to track usage and performance.

Accounting/finance continuing professional education was our original market. This market covers corporate accountants and financial managers as well as accountants in public practice. Initially, our accounting/finance programs were delivered on videotape. In 1998, we recognized that, to remain competitive, we would have to make our products available in digital format for distribution over the Internet and corporate intranets. Towards that end, we hired information technology professionals to build a new media department that, among other things, would convert our programs to digital format for online delivery and who would oversee the development of a learning content management system.

To take advantage of financing opportunities that were then available to technology companies, we were advised to pursue an acquisition strategy that focused on building revenues and diversifying into new markets. Based on assurances we received from a specific financing source, we identified several viable acquisition targets, including Virtual Education Corporation, or VEC, a provider of license preparation and continuing professional development programs for engineers. However, the dynamics of the capital markets changed and our financing source was unable to raise any funds. At that point, we had already consummated our acquisition of VEC.

The acquisition of VEC put a tremendous strain on our internal capital resources. Although our accounting division continued to grow and generate operating profits, overall we began losing money. In the four-year period beginning in 2000 and ending in 2003 we generated over $10 million of losses. In 2001, we hired a new chief executive officer, Allen S. Greene, who had been the chief operating officer of a publicly traded specialty finance company. Mr. Greene successfully refocused on our core competencies, cut overhead, substantially reduced debt and raised additional equity capital. By the end of 2003, we had reduced our annual loss to $315,000 and were EBITDA positive for the second consecutive year. In 2004, we recorded our first annual profit since 1999 and completed our initial public offering.

Since 2001, we have successfully completed two key acquisitions. First, in May 2001, we acquired substantially all of the assets of Pro2Net. In so doing, we acquired a library of "how to" programs, a functional learning content management system that we could market with our programs, customer lists, trade names and computer hardware. As a result, we were able to terminate a contract with a third party to develop a learning content management system, saving us approximately $2 million in development costs. Our ability to provide the value-added services represented by the learning management system is, we believe, key to our recent revenue growth and future success.

Second, in April 2003, we acquired a library of custom-designed integrity-based courses and other assets from Working Values Group Ltd., a company that specialized in building custom-designed learning solutions for the general corporate community using traditional and alternative instructional techniques. As part of the transaction, we also hired the development team from Working Values Group. With the increased focus on corporate governance and ethics and the passage of the Sarbanes-Oxley Act of 2002 along with new rules and regulations adopted by the national stock exchanges and markets, we believe that there is a significant growth opportunity in supplying training that addresses corporate culture as a significant risk factor.

The aggregate purchase price for the Pro2Net and Working Values assets was $1.1 million in cash, stock (based on the value at the time of the acquisition) and assumption of liabilities. In comparison, the sellers of these assets had collectively raised more than $30 million to develop these assets and fund their operations.

We measure our operations using both financial and other metrics. The financial metrics include revenues, gross margins, operating expenses and income from continuing operations. Other key metrics include (i) revenues by sales source, i.e., accounting/finance, engineering, Working Values and video production and e-commerce. (ii) online sales, (iii) cash flows and (iv) EBITDA.

Some of the most significant trends affecting our business are the following:

- The increasing recognition by professionals and corporations that they must continually improve their skills and those of their employees in order to remain competitive.

- The plethora of new laws and regulations affecting the conduct of business and the relationship between a corporation and its employees.

- The increased competition in today's economy for skilled employees and the recognition that effective training can be used to recruit and train employees.

- o The development and acceptance of the Internet as a delivery channel for the types of products and services we offer.

In October 2004 we successfully completed our initial public offering. The net proceeds to us from the offering were $6.0 million of which we have used $500,000 to repay certain indebtedness. We intend to use the balance, $5.5 million, cash from operations and our publicly traded stock to execute our growth strategy, which contemplates acquiring other companies and businesses that provide learning solutions. We intend to focus on acquisitions that will allow us to increase the breadth and depth of our current product offerings, including the general corporate market for compliance, governance and ethics. We will also consider acquisitions that will give us access to new market segments such as insurance, health care and financial services. We prefer acquisitions that are accretive in the short term, as opposed to those that are dilutive, but ultimately the decision will be based on maximizing shareholder value rather than short-term profits. The size of the acquisitions will be determined, in part, by our size, the capital available to us and the liquidity and price of our stock. We may use debt to enhance or augment our ability to consummate larger transactions.

There are many risks involved with acquisitions. These risks include integrating the acquired business into our existing operations and corporate structure, retaining key employees and minimizing disruptions to our existing business. We cannot assure you that we will be able to identify appropriate acquisitions opportunities or negotiate reasonable terms or that any acquired business or assets will deliver the shareholder value that we anticipated at the outset. At the present time, we have no agreements or commitments for any acquisitions. We cannot assure you that we will successfully complete any acquisitions.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements that have been prepared according to accounting principles generally accepted in the United States. In preparing these financial statements, we are required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures of contingent assets and liabilities. We evaluate these estimates on an ongoing basis. We base these estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. We consider the following accounting policies to be the most important to the portrayal of our financial condition.

REVENUES

Most of our revenue is in the form of subscription fees for one of our monthly accounting update programs or our course library. Other sources of revenue include direct sales of programs on a non-subscription basis, fees for various services, including website design, software development, tape duplication, video production, video conversion, course design and development, ongoing maintenance of our clients' online learning content management system and licensing fees. Subscriptions are billed on an annual basis, payable in advance and deferred at the time of billing. Sales made over the Internet are by credit card only. Renewals are usually sent out 60 days before the subscription

period ends. We usually obtain either a signed agreement or purchase orders from our non-subscription customers outlining the terms and conditions of the sale or service to be provided. Larger transactions are usually dealt with by contract, the financial terms of which depend on the services being provided. The contracts may have different billing arrangements resulting in either unbilled or deferred revenue. Contracts for development and production services typically provide for a significant upfront payment and a series of payments based on deliverables specifically identified in the contract.

Revenues from subscription services are recognized as earned, deferred at the time of billing or payment and amortized into revenue on a monthly basis over the term of the subscription. Engineering products are non-subscription based and revenue is recognized upon shipment of the product or, in the case of on-line sales, payment. Revenues from non-subscription services provided to customers, such as website design, video production, consulting services and custom projects, are generally recognized on a proportional performance basis where sufficient information relating to project status and other supporting documentation is avai1able. Otherwise, these services are recognized as revenues after completion and delivery to the customer. Duplication and related services are generally recognized upon shipment or, if later, when our obligations are complete and realization of receivable amounts is assured. Working Values recognizes revenue on a proportional performance basis.

EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Fixed, tangible assets are carried at cost less accumulated depreciation and are depreciated using the straight-line method over the estimated useful lives, which range from 3 years for course content to 10 years for customer lists. Leasehold improvements are amortized over the lesser of their estimated lives or the life of the lease. Major expenditures for renewals and improvements are capitalized and amortized over their useful lives.

IMPAIRMENT OF LONG-LIVED ASSETS

We review long-lived assets and certain intangible assets annually for impairment whenever circumstances and situations change such that there is an indication that the carrying amounts may not be recovered.

STOCK-BASED COMPENSATION

We have adopted the disclosure only requirements of SFAS No. 123. As a result, no compensation costs are recognized for stock options granted to employees. Options and warrants granted to non-employees are recorded as an expense at the date of grant based on the then estimated fair value of the security in question.

RESULTS OF OPERATIONS

COMPARISON OF THREE MONTHS ENDED MARCH 31, 2005 AND 2004

We experienced a significant improvement in operating performance in the first quarter of 2005 compared to the first quarter of 2004. The following table compares our statement of operations data for the three months ended March 31, 2005 and 2004. The trends suggested by this table may not he indicative of future operating results, which will depend on various factors including the relative mix of products sold (accounting/finance, engineering or corporate training) and the method of sale (video or online).

	THREE MONTHS ENDED MARC		
	2004		2005
	AMOUNT	PERCENTAGE	AMOUNT
	(all dollar amounts are in t		
Net revenues	$ 2,218	100.0%	$ 2,849
Cost of revenues	853	38.5%	1,083
Gross profit	1,365	61.5%	1,766
Selling, general and administrative	1,185	53.4%	1,435
Depreciation and amortization	171	7.7%	141
Total operating expenses	1,356	61.1%	1,576
Operating income (loss)	9	.4%	190
Other (expense), net	(16)	(0.7)%	26
Net income (loss)	$ (7)	(.3)%	$ 216

NET REVENUES

Net revenues for the quarter ended March 31, 2005 increased 28.4% compared to net revenues for the three months ended March 31, 2004. Online sales continue to be an important factor contributing to our overall revenue growth, a trend that began in 2003. In the 2005 period, net revenues from online sales accounted for approximately $685,000, or 24%, of net revenues. In the 2004 period, online sales accounted for $560,000, or 25%, of net revenues.

In 2005, net revenues from our accounting/finance and related products were $2.0 million, as compared to $1.6 million in the prior period. This increase is due to various factors, including converting a number of our existing video customers to our online services, partnering with more professional organizations and our continued marketing efforts to increase sales. For 2005, net revenues from accounting/finance products include subscription-based revenue of $1.6 million and direct sales of course material on a non-subscription basis, net revenues from custom work and advertising of $410,000. For 2004, subscription-based revenue was $1.4 million and direct sales of course material on a non-subscription basis, custom work and advertising was $223,000.

Net revenues from sales of our engineering products, which are not subscription-based, were $246,000 in the first quarter of 2005 compared to $202,000 in the first quarter of 2004. This increase is primarily attributable to a growth in the sales of our licensing preparation and project management courses.

Net revenues from video production, duplication, consulting and e-commerce services for the first quarter of 2005 were $483,000 compared to $399,000 for the first quarter of 2004. This increase is primarily attributable to a number of special projects in our technology department and one large video

duplication sale. Under our long-standing policy, revenue is credited to the originating department regardless of the type of service that is performed. For example, a contract to convert videotapes to digital format is credited to the accounting education department if that is where the sale originated, even if the technology group performed all the services necessary to fulfill the terms of that contract.

For the first quarter of 2005 Working Values contributed $70,000 to net revenues compared to $12,000 in the first quarter of 2004.

COST OF REVENUES

Cost of revenues includes production costs - I.E., the salaries, benefits and other costs related to personnel, whether our employees or independent contractors, who are used directly in production, including producing our educational programs; royalties paid to third parties; the cost of materials, such as videotape and packaging supplies; and shipping costs. There are many different types of expenses that are characterized as production costs and many of them vary from period to period depending on many factors.

Compared to the first quarter of 2004, cost of revenues in the first quarter of 2005 increased by $230,000 but decreased slightly - 0.5% -- as a percent of net revenues. The increase was primarily attributable to additional personnel and the cost of sub-contracted labor related to various projects in the technology department. The expenses that showed the greatest variations from 2004 to 2005 and the reasons for those variations were as follows:

- OUTSIDE LABOR AND DIRECT PRODUCTION COSTS. Outside labor includes the cost of hiring actors and production personnel such as directors, producers and cameramen and the out-sourcing of non-video technology. The cost of actors increased minimally; the cost of video production and technology personnel increased by $150,000. Direct production costs, which are costs related to producing videos other than labor costs, such as the cost of renting equipment and locations, decreased $9,000. These variations are related to the type of video production and other projects and do not ref1ect any trends in our business. As our business grows we may be required to hire additional production personnel, increasing our cost of revenues.

- ROYALTIES. Royalty expense decreased in 2005 compared to 2004 by $32,000. We have temporarily reduced royalties to one of our partners until such time as their course material is updated. In addition, we overestimated our expense in the first quarter of 2004, because some of our partners were behind in providing us with information at that time. Assuming the same level of sales in 2005 as in 2004, our royalty payments under these agreements will be constant. However, if volume increases or if we enter into new agreements or modify existing agreements, the actual royalty payments in 2005 under these agreements may be either higher or lower than they were in 2004.

- SALARIES. Overall, payroll and related costs attributable to production personnel increased by $125,000. Most of the increase - I.E., $95,000 - was attributable to our technology group. In addition, compensation paid to our video production and duplication personnel increased by $17,000. The other $13,000 is attributable to salary increases to Working Values personnel.

- TRAVEL AND ENTERTAINMENT; SHIPPING. Travel and entertainment and

shipping expenses increased by only $3,000, reflecting our continuing effort to control costs.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses include corporate overhead such as compensation and benefits for administrative, sales and marketing and finance personnel, rent, insurance, professional fees, travel and entertainment and office expenses. While general and administrative expenses in the first quarter of 2005 were $250,000 higher than they were in 2004, as a percentage of net revenues they decreased by 3%. Part of the increase is attributable to the costs of being a public company such as legal, accounting, investor relations, insurance and regulatory expenses, which we did not have in the first quarter of 2004. The increase in these expenses was $88,000. In addition, personnel costs increased by $56,000. Selling costs, which includes advertising, promotion, travel and entertainment, increased by $50,000. The remaining $56,000 reflects a general increase in operating costs. We anticipate that general and administrative expenses will continue to increase primarily as a result of increased accounting, legal and insurance costs, attributable to the fact that we are now a public company.

DEPRECIATION and AMORTIZATION

Depreciation and amortization expenses decreased in the first quarter of 2005 compared to the first quarter of 2004 as a number of our assets became fully depreciated. We expect our depreciation and amortization expenses on our current assets to decrease in 2005 as many of our older assets are either fully or almost fully depreciated and we do not anticipate replacing them at the same rate.

INCOME/LOSS FROM OPERATIONS

For the three months ended March 31, 2005 net income from operations was $190,000 compared to $9,000 in the comparable period of 2004. This is primarily attributable to the increase innet revenues and gross profit margin without significantly increasing our operating expenses.

OTHER INCOME/EXPENSES

Other income and expense items consist of interest paid on indebtedness and interest earned on deposits. As a result of the successful completion of our initial public offering, we were able to retire all of our debt (other than capital lease obligations), reducing our interest expense. At the same time, since we have not yet used the balance of the net proceeds, our interest income has increased. As a result, for the

first quarter of 2005 we had net interest income compared to a net interest expense for the first quarter of 2004.

NET INCOME AND LOSS

For the three months ended March 31, 2005, we recorded a net profit of $216,000, or $0.04 per share (basic and diluted), compared to a net loss of $7,000 for the three months ended March 31, 2004. The change from a net loss to a net profit is attributable to increased revenue and our continuing efforts to control our costs and expenses.

CONTRACTUAL OBLIGATIONS, COMMITMENTS AND CONTINGENCIES

Historically, we have financed our working capital requirements through internally generated funds, sales of equity and debt securities and proceeds from short-term bank borrowings. In October 2004 we completed our initial public offering, which resulted in net proceeds to us of approximately $6 million.

Our working capital as of March 31, 2005 was approximately $3.7 million compared to $3.4 at December 31, 2004. Our current ratio at March 31, 2005 was 1.84 to 1 compared to 1.75 to 1 at December 31, 2004. The current ratio is derived by dividing current assets by current liabilities and is a measure used by lending sources to assess our ability to repay short-term liabilities. The largest component of our current liabilities, $3.8 million at March 31, 2005 compared to $3.7 million at December 31, 2004, was deferred revenue, which is revenue collected or billed but not yet earned under the principles of revenue recognition. Most of this revenue is in the form of subscription fees and will be earned over the next 12 months. The cost of fulfilling our monthly subscription obligation does not exceed this revenue and is booked to expense as incurred. For some of our products, there are no additional costs, other than shipping costs, required to complete this obligation as the material already exists.

For the three months ended March 31, 2005, net cash generated by operating activities was $248,000 and we had a net cash increase of $1.16 million, which includes a $1 million transfer from investment securities held for sale. Exclusive of that transfer, net cash increased by $160,000 after purchasing $72,000 of fixed assets and debt reduction of $16,000 during the quarter. The primary components of our operating cash flows are net income adjusted for non-cash expenses, such as depreciation and amortization, and the changes in accounts receivable, accounts payable and deferred revenues.

Capital expenditures for the three months ended March 31, 2005 were approximately $72,000, which consisted primarily of computer equipment purchases. Although, we continually upgrade our technology hardware, we do not anticipate any significant capital expenditures relating to equipment purchases over the next 12 months.

At March 31, 2005 our only indebtedness consisted of capital lease obligations, the balance of which was $105,000 compared to $121,000 at December 31, 2004. We have three leases with IDB Leasing, which had an aggregate outstanding balance at March 31, 2005 of $73,000. One lease has a 48-month term that expires in 2007, an imputed interest rate of 7.0% and monthly payments of $2,055. A second lease has a 36-month term that expires in 2006, an imputed interest rate of 7.5% and monthly payments of $996. The third lease has a 36-month term that expires in 2007, an imputed interest rate of 6.05% and a monthly payment of $313. In addition, we have outstanding balances on other capital leases of approximately $10,000. In August 2004 we financed the purchase of a van. The loan is for a term of 36 months, bears interest at 4.99% per annum and requires 35 monthly payments of $358 and a final payment of approximately $13,800 due in August 2007. The lender has agreed to repurchase the vehicle at our option for the amount of the final payment, less any applicable expenses, at the end of the term. At March 31, 2005, the balance on the loan was $22,000.

As of March 31, 2005 we had commitments under operating leases - principally the leases for executive offices in Hawthorne, New York and the Working Values executive offices in Sharon, Massachusetts - aggregating $1.7 million through February 2010. In May 2004 we paid $92,000 in connection with our termination of a sublease in Irvine, California.

We believe that the net proceeds of our initial public offering in October 2004 together with cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements from the next 12

months.

In the future, we may issue additional debt or equity securities to satisfy our cash needs. Any debt incurred or issued may be secured or unsecured, at a fixed or variable interest rates and may contain other terms and conditions that our board of directors deems prudent. Any sales of equity securities may be at or below current market prices. We cannot assure you that we will be successful in generating sufficient capital to adequately fund our liquidity needs.

ITEM 3. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. The Company's management, with the participation of the chief executive officer and the chief financial officer, carried out an evaluation of the effectiveness of the Company's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934, as amended (the "Exchange Act") Rules 13a-15(e) and 15-d-15(e)) as of the end of the period covered by this quarterly report (the "Evaluation Date"). Based upon that evaluation, the chief executive officer and the chief financial officer concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective, providing them with material information relating to the Company as required to be disclosed in the reports the Company files or submits under the Exchange Act on a timely basis.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING. There were no changes in the Company's internal controls over financial reporting, known to the chief executive officer or the chief financial officer that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II
OTHER INFORMATION

ITEM 1: LEGAL PROCEEDINGS.

We are not currently a party to any legal proceeding that we deem material.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

RECENT SALES OF UNREGISTERED SECURITIES

On August 3, 2004, the Board authorized the issuance of 40,000 shares of common stock to Allen S. Greene, our chief executive officer. The shares were issued to Mr. Greene on October 19, 2004. Of the 40,000 shares issued, 10,000 shares vested immediately and 10,000 shares will vest on each of October 19, 2005, 2006 and 2007. Mr. Greene is deemed the owner of these shares as of the date of grant and, as such, will be entitled to vote them on all matters presented to stockholders for a vote and will be entitled to dividends, if any, payable on our common stock with respect to such shares. If Mr. Greene terminates his employment with us voluntarily or we terminate him for "cause," as defined in his employment agreement, any unvested shares will be forfeited and will revert to the company. If Mr. Greene's employment with us is terminated without "cause," or if his employment is terminated as a result of his death or disability (as defined in his employment agreement), or if we experience a

change in control (as defined in his employment agreement) any unvested shares will immediately vest.

In January 2005, we issued 42,539 shares of restricted common stock and 21,269 warrants having an exercise price of $7.125 per share to KS Partners, an affiliate of Morse, Zelnick, Rose & Lander LLP, our corporate and securities attorneys. These securities were issued in connection with our initial public offering and therefore were treated as outstanding at December 31, 2004. This issuance is exempt from registration, as it was made pursuant to Sections 4(2) and 4(6) of the Securities Act of 1933, as amended.

USE OF PROCEEDS

On October 19, 2004, the Company's registration statement on Form SB-2, commission file number 333-115454 (the "Registration Statement") registering the offer and sale of units (each a "Unit" and collectively the "Units"), each Unit consisting of three shares of the Company's common stock, par value $.0001 per share, and one and one-half common stock purchase warrants, was declared effective by the

U.S. Securities and Exchange Commission. The warrants included in the Units have a term of five years and an exercise price of $7.125 per share. The Company sold all 600,000 Units covered by the Registration Statement. Paulson Investment Company, Inc. was the representative of the underwriters of the offering. The gross proceeds to the Company from the offering were $7,650,000 and the net proceeds were $6.0 million. As of the date hereof, we used $490,000 of the net proceeds to repay indebtedness. The remaining $5.5 million will be used for working capital and general corporate purposes, including acquisitions.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

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

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS.

a. Exhibits:

Exhibit No.	Description
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.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SmartPros Ltd.

(Registrant)

Date: May 11, 2005

/s/ Allen S. Greene

Chief Executive Officer

Date: May 11, 2005

/s/ Stanley P. Wirtheim

Chief Financial Officer
(Principal Financial Officer)