V ONE CORP/ DE
Form 10-Q
August 16, 2004

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

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2004

OR

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

For the transition period from ______________ to ______________

Commission File Number 0-21511

V-ONE CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	52-1953278
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20300 Century Blvd., Suite 200, Germantown, Maryland 20874
(Address of principal executive offices) (Zip Code)

(301) 515-5200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ].

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X].

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 1, 2004
Common Stock, $0.001 par value per share	15,642,555

V-ONE Corporation
Quarterly Report on Form 10-Q

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

V-ONE CORPORATION
CONDENSED BALANCE SHEETS

ASSETS	June 30, 2004 (Unaudited)	Dece
Current assets:		
Cash and cash equivalents	$ 238,842	
Certificate of deposit - restricted	-	
Accounts receivable, less allowances of $20,000 and $15,500 respectively	134,735	
Finished goods inventory, less allowances of $9,226 and $8,901 respectively	821	
Prepaid expenses and other assets	105,260	
Total current assets	479,658	
Property and equipment, net	72,958	
Deferred financing costs, net	342,305	
Deferred costs of business combination	154,346	
Deposits	95,141	
Total assets	$ 1,144,408	
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable and accrued expenses	$ 1,369,224	
Deferred revenue	687,241	
Convertible notes payable	-	
Notes payable, other	110,460	
Total current liabilities	2,166,925	
Convertible notes payable, noncurrent, net of debt discount of $1,118,302	81,698	
Notes payable, other - noncurrent	-	
Deferred rent	41,601	
Total liabilities	2,290,224	
Commitments and contingencies		
Shareholders' deficiency:		
Preferred stock, $.001 par value,13,333,333 shares authorized:		
Series C redeemable preferred stock, 500,000 designated; 42,904 shares issued and outstanding (liquidation preference of $1,126,000)	43	
Series D convertible preferred stock 3,675,000 shares designated, 3,021,000 shares issued and outstanding	3,021	
(liquidation preference of $5,770,110)		
Common stock, $0.001 par value; 75,000,000 shares authorized; 15,642,555 and 13,950,284 shares issued and outstanding, respectively	15,643	
Accrued dividends payable	2,974,346	
Additional paid-in capital	64,482,233	
Accumulated deficit	(68,621,102)	
Total shareholders' deficiency	(1,145,816)	
Total liabilities and shareholders' deficiency	$ 1,144,408	

The accompanying notes are an integral part of these financial statements.

V-ONE CORPORATION
CONDENSED 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)
Revenues:				
Products	$ 141,626	$ 771,117	$ 400,257	$ 1,412,219
Consulting and services	377,386	384,103	767,474	748,272
Total revenues	519,012	1,155,220	1,167,731	2,160,491
Cost of revenues:				
Products	7,295	127,695	13,858	143,100
Consulting and services	21,249	14,651	48,793	40,426
Total cost of revenues	28,544	142,346	62,651	183,526
Gross profit	490,468	1,012,874	1,105,080	1,976,965
Operating expenses:				
Research and development	243,265	272,326	465,601	594,439
Sales and marketing	433,217	364,265	807,860	747,853
General and administrative	395,470	373,611	828,329	847,930
Total operating expenses	1,071,952	1,010,202	2,101,790	2,190,222
Operating profit (loss)	(581,484)	2,672	(996,710)	(213,257)
Other (expense) income:				
Interest expense	(137,616)	(28,744)	(656,077)	(161,475)
Interest income	1,416	20	2,003	5,052
Other (expense) income	(52)	(183)	207	(9,153)
Total other (expense) income	(136,252)	(28,907)	(653,867)	(165,576)
Net loss	(717,736)	(26,235)	(1,650,577)	(378,833)
Dividends on preferred stock	232,595	171,936	456,581	341,983
Loss attributable to holders of common stock	$ (950,331)	$ (198,171)	$(2,107,158)	$ (720,816)
Basic and diluted loss per share attributable to holders of common stock	$ (0.06)	$ (0.01)	$ (0.14)	$ (0.05)
Weighted average number of				

common shares outstanding	15,567,350	13,479,425	15,264,324	13,419,627

The accompanying notes are an integral part of these financial statements.

V-ONE CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS

	Six months ended June 30, 2004 (unaudited)	Six months ended June 30, 2003 (unaudited)
Cash flows from operating activities:		
Net loss	$ (1,650,577)	$ (378,833)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	26,303	189,032
Amortization of debt discount	81,698	11,758
Interest expense-beneficial conversion feature	434,888	22,000
Interest expense on repricing of warrants	-	23,890
Amortization of deferred financing costs	85,692	68,974
Noncash charge related to issuance of warrants, options and stock as compensation	2,088	21,193
Changes in operating assets and liabilities:		
Accounts receivable	471,691	(329,524)
Inventory	2,815	2,952
Prepaid expenses and other assets	(43,385)	43,910
Payments of business combination costs	(154,346)	-
Accounts payable and accrued expenses	17,474	392,391
Accrued interest on note payable related to financing costs		
Deferred revenue	(5,673)	(145,502)
Deferred rent	1,066	4,524
Net cash used in operating activities	(730,266)	(73,235)
Cash flows from investing activities:		
Net purchase of property and equipment	(35,124)	6,586
Certificate of deposit redemption	26,500	8,500
Net cash provided by (used in) investing activities	(8,624)	15,086
Cash flows from financing activities:		
Exercise of options and warrants	900	-
Payment of fractional shares	(9)	-
Issuance of common stock under employee stock plans	4,072	2,869
Proceeds of notes payable	1,200,000	-
Payments of deferred financing costs	(200,301)	-
Payments on notes payable-other	(24,068)	-
Payments of notes payable	(30,617)	-
Net cash provided by financing activities	949,977	2,869

Net increase (decrease) in cash and cash equivalents	211,087	(55,280)
Cash and cash equivalents at beginning of period	27,755	93,985
Cash and cash equivalents at end of period	$ 238,842	$ 38,705

The accompanying notes are an integral part of these financial statements.

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V-ONE CORPORATION
NOTES TO THE CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of the Business

V-ONE Corporation ("Company" or "V-ONE") develops, markets and licenses a comprehensive suite of network security products that enables organizations to conduct secured electronic transactions and information exchange using private enterprise networks and public networks, such as the Internet. The Company's principal market is the United States, with headquarters in Maryland, with secondary markets in Europe and Asia.

2. Basis of Presentation

The condensed financial statements for the three and six months ended June 30, 2004 and June 30, 2003 are unaudited and reflect all adjustments, consisting of normal recurring adjustments, which are, in the opinion of management, necessary to present fairly the results for the interim periods. The balance sheet at December 31, 2003 is as presented in the financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with the audited financial statements as of December 31, 2003 and 2002 and for the three years ended December 31, 2003, which are included in the Company's 2003 Annual Report on Form 10-K ("Form 10-K").

The preparation of financial statements to be in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and would affect future results of operations and cash flows.

The results of operations for the three-month and six month period ended June 30, 2004 are not necessarily indicative of the results expected for the full year ending December 31, 2004.

Certain prior year amounts have been reclassified to conform to the 2004 presentation. These changes had no impact on previously reported results of operations.

3. Common and Preferred Stock

On June 30, 2004, the Company sold 8,426 shares of common stock at a price of

$.22015 per share as part of its Employee Stock Purchase Plan.

As of March 31, 2004 holders had converted $1,038,000 or 87% of the 8% Secured Convertible Notes ("8% Notes) into shares of common stock. In April 2004, holders converted the remaining $150,000 or 13% of the 8% Notes into shares of Common Stock.

4. Management's Plans

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company reported a net loss of $449,650, $5,635,191 and $6,237,278 for the years ended December 31, 2003, 2002 and 2001, respectively, and further net losses of $717,736 and $1,650,577 for the three and six months ended June 30, 2004, respectively. Notwithstanding acceptance of the Company's security concepts and critical acclaim for its products, there can be no assurance that the consummation of sales of the Company's products to existing customers or proposed agreements with potential customers will generate timely or sufficient revenue for the Company to cover its costs of operations and meet its cash flow requirements. Accordingly, the Company may not have the funds needed to sustain operations during 2004.

For the immediate future, V-ONE will focus on existing and potential customers in the government sector, targeted marketing operations to commercial accounts and continued minimization of general and administrative expenditures. V-ONE may not be successful in further reducing operating levels without jeopardizing the ability to serve existing customers or grow its business base. In February 2004, the Company completed a private placement of 7% Subordinated Convertible Notes with detachable warrants for an aggregate of $1,200,000, which resulted in net proceeds to the Company of $1,065,690. The Company believes that to maintain

operations for any extended period of time it must generate revenue from existing and new customers, raise additional capital or undergo a significant strategic transformative event. The Company's ability to reach sustainable profitability is dependent on its ability to generate sufficient cash flow to meet its obligations and needs on a timely basis or to obtain additional funding.

The Company expanded its banking relationships to explore alternatives to preserve its operations and maximize shareholder value, including potential strategic partnering relationships, a business combination with a strategically placed partner, or a sale of the Company. On May 19, 2004, the Company signed a letter of intent with SteelCloud Inc. ("SteelCloud"), for SteelCloud to acquire V-ONE in an all stock transaction. On August 11, 2004, the parties signed a definitive agreement for the transaction. For further information, refer to Part II, Item 5 of this Quarterly Report on Form 10-Q and V-ONE's Current Report on Form 8-K filed with the SEC on August 11, 2004.

5. 8% Secured Convertible Notes with Detachable Warrants

In July and August 2002, the Company closed on approximately $1,188,000 in a private placement of 8% Secured Convertible Notes with detachable warrants, due 180 days after issuance with an additional 180-day extension available at the option of the Company or the holders. Detachable five year warrants, exercisable at $0.50 per share, are included to provide one warrant share for every dollar invested as warrant coverage to the note holders. In January 2003, the Company elected to extend the 8% Notes for an additional 180 days, paid the interest accrued under the initial term of the 8% Notes and agreed to adjust the exercise price of the warrants from $0.50 per share to $0.15 per share. In July 2003, the Company requested and received an extension of the 8% Notes for an additional

180 days and agreed to an increase in the interest rate from 10% to 12% during the extension period. In connection with a restructuring of the 8% Notes, the Company agreed in January 2004 to adjust the conversion price of certain 8% Notes constituting $150,000 in principal to $.18 per share in exchange for an extension of the term of such 8% Notes to July 15, 2004 at an interest rate of 10%. Also in connection with the January 2004 restructuring, the Company adjusted the conversion price of the remaining 8% Notes outstanding, which constituted $343,000 in principal, to $.15 per share and granted warrants to purchase a total of 250,000 shares of Common Stock at an exercise price of $0.18 per share to Joseph Gunnar & Co., LLC, placement agent for the 8% Notes offering. In the three months ended June 30, 2004, 8% Note holders exercised warrants to purchase 130,106 shares of Common Stock.

As of June 30, 2004, holders had converted $1,188,000 or 100% of the 8% notes into shares of Common Stock.

The Company recorded $2,600 in accrued interest expense for the second quarter of 2004. The accrued interest was paid upon conversion of the outstanding 8% Notes.

6. 7% Subordinated Convertible Notes

In a closing on February 27, 2004, V-ONE issued 7% Subordinated Convertible Notes ("7% Notes") with warrants for an aggregate principal amount of $1,200,000, resulting in net proceeds to V-ONE of $1,065,690. The 7% Notes mature on February 27, 2009. Interest at the rate of 7% per annum is payable semi-annually at the option of V-ONE in cash or in shares of Common Stock. The 7% Notes rank senior to the Common Stock and junior to the Series C Shares and Series D Shares as to the payment of dividends and as to distribution of assets upon liquidation, dissolution or winding up of V-ONE. So long as at least $500,000 of the principal amount of the 7% Notes is outstanding, the affirmative vote of the holders of at least 75% of the principal amount of the 7% Notes outstanding is required to issue any securities that rank senior to or on parity with the 7% Notes.

Under the original terms of the 7% Notes, the holders could convert the principal amount of their 7% Notes, in whole or in part, at any time into shares of Common Stock at a conversion price of $0.20 per share. On May 14, 2004, V-ONE effected a 1:2 reverse stock split modifying the original conversion price of the 7% Notes to $0.40 per share. In addition, subject to certain terms, the principal amount of the 7% Notes plus all accrued and unpaid interest shall automatically convert into shares of Common Stock at the then current conversion price on the earlier of (i) February 27, 2009 and (ii) the first date which is at least 180 days following the effective date of the Registration Statement providing for the resale of the shares of Common Stock issuable upon conversion of the 7% Notes that the closing bid price of V-ONE Common Stock exceeds $1.00 for a period of 20 consecutive trading days. On May 14, 2004, V-ONE effected a 1:2 reverse stock split modifying the closing bid to $2.00 per share.

An event of default will occur if V-ONE fails to make any principal payment under the 7% Notes, V-ONE fails to make any interest payment for a period of five days after such payment is due, V-ONE fails to timely file the Registration Statement providing for the resale of the shares of Common Stock issuable upon conversion of the 7% Notes or the Registration Statement is not declared effective by the SEC within 180 days of February 27, 2004, the effectiveness of

the Registration Statement lapses for a period of 20 consecutive trading days, or upon the occurrence of other default events, including, but not limited to, an assignment for the benefit of creditors, an application for the appointment of a trustee or receiver or the commencement of a bankruptcy proceeding. If an event of default occurs, the Notes will bear interest at the lesser of 12% and the maximum applicable legal rate per annum from the date of the event of default until such default is cured.

Upon the occurrence of certain events of default and other triggering events, a 7% Note holder shall have the right to require V-ONE to prepay in cash all or a portion of the holder's 7% Note at 120% of the aggregate principal amount of the 7% Note, plus all accrued and unpaid interest. Similar provisions apply if V-ONE cannot fully convert a 7% Note into shares of registered Common Stock upon the receipt of a proper conversion notice from the holder. In addition, in the event of a major corporate transaction such as the consolidation, merger or other business combination of V-ONE into another entity or a sale or transfer of more than 50% of V-ONE's assets, the 7% Note holder shall have the right to require V-ONE to prepay in cash all or a portion of the holder's 7% Note at 100% of the aggregate principal amount of the 7% Note, plus all accrued and unpaid interest. If the major corporate transaction is consummated within six months of the issuance of the 7% Note, then the prepayment shall be at 110% of the aggregate principal amount of the 7% Note, plus all accrued and unpaid interest. Also, beginning one year after the issuance of the 7% Notes, V-ONE may prepay any portion or all of the outstanding principal balance of the 7% Notes together with all accrued and unpaid interest at 110% of the aggregate principal amount of the 7% Notes plus any accrued and unpaid interest.

For twelve months after the issuance of the 7% Notes, each holder shall have a right of first refusal to purchase its pro rata portion of V-ONE Common Stock (or any securities convertible, exercisable or exchangeable into Common Stock) offered to a third party in a private transaction on the same terms as those offered to the third party, other than in certain permitted financings. If a holder elects not to exercise its right of first refusal, the other holders may participate on a pro rata basis. If the holders do not participate, V-ONE may proceed with the transaction with the third party.

In connection with the 7% Notes offering, V-ONE issued detachable warrants to purchase 6,000,000 shares of Common Stock to the holders of the 7% Notes. The warrants are exercisable beginning on August 27, 2004 at an exercise price of $0.25 per share and expire on August 27, 2008. On May 14, 2004, V-ONE effected a 1:2 reverse stock split reducing the number of shares purchasable under the warrants to 3,000,000 and increasing the exercise price to $0.50. Beginning 180 days after the effective date of a Registration Statement providing for the resale of the shares of Common Stock issuable upon conversion of the 7% Notes and exercise of the warrants, V-ONE may call up to 100% of the warrants if the per share market value of its Common Stock has been greater than $0.75 for a period of 20 consecutive trading days by issuing a call notice to the warrant holders. On May 14, 2004, V-ONE effected a 1:2 reverse stock split modifying the per share market value required for a call of the warrants to $1.50. The rights and privileges granted to a warrant holder with respect to the shares subject to the call notice shall expire on the twentieth day after the holder receives the call notice if the holder does not exercise the warrant. If the holder does not exercise the warrant, V-ONE shall remit to the warrant holder (i) $0.01 per share subject to the call notice and (ii) a new warrant representing the number of shares of Common Stock, if any, which were not subject to the call notice.

The exercise price and number of shares of Common Stock to be issued upon conversion of the 7% Notes and exercise of the warrants are subject to equitable adjustment in the event of stock dividends, stock splits and similar events affecting the Common Stock. In addition, if V-ONE issues any shares of Common Stock or equivalents at a purchase price less than the then current conversion price for the 7% Notes or warrant exercise price, the conversion price and warrant exercise price will be equitably reduced, and number of shares of Common Stock to be issued upon conversion of the 7% Notes and exercise of the warrants adjusted accordingly. However, in no event shall the conversion price, or exercise price in the event of the issuance of V-ONE securities at less than the current warrant exercise price, be less than $0.15 per share. On May 14, 2004, V-ONE effected a 1:2 reverse stock split modifying the minimum warrant exercise price to $0.30 per share.

In connection with the 7% Notes offering, V-ONE granted warrants to purchase up to a total of 1,260,000 shares of Common Stock to H.C. Wainwright & Co., Inc., placement agent for the 7% Notes offering. As a result of the stock split effected in May 2004, the shares that may be purchased under warrants issued to H.C. Wainwright & Co., Inc. have been reduced to 630,000. The placement agent warrants include a cashless exercise provision. The remaining terms of the placement agent warrants mirror those of the warrants granted in connection with the 7% Notes offering.

Upon issuance of the 7% Notes, the Company recorded a debt discount of approximately $1,200,000 in accordance with the accounting requirements for a beneficial conversion feature on the 7% Notes. The debt discount will be amortized over the 5 year term of the notes. During the three and six months ended June 30, 2004, the Company amortized $21,698 and $60,000 of the discount to interest expense, respectively. Additionally, the Company recorded $21,233 in accrued interest expense for the second quarter of 2004.

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7. Stock-Based Compensation

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), allows companies to account for stock-based compensation either under the provisions of SFAS 123 or under the provisions of Accounting Principles Bulletin No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), as amended by FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation (an Interpretation of APB Opinion No. 25)," but requires pro forma disclosure in the footnotes to the financial statements as if the measurement provisions of SFAS 123 had been adopted. The Company has elected to account for its stock-based compensation in accordance with the provisions of APB 25. The following table illustrates the effect on net income (loss) and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123:

	Three months ended June 30,		Six months ended
	2004	2003	2004
Net Loss, as reported	$ (717,736)	$ (26,235)	$ (1,650,577)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects			
Deduct: Total stock-based employee compensation income (expense) determined under fair value based method for all awards, net of related tax effects	$ 49,557	$ (66,407)	$ (19,081)
Pro forma net loss	$ (668,179)	$ (92,642)	$ (1,669,658)
Earnings per share:			
Basic - as reported	$ (0.05)	$ (0.00)	$ (0.11)

Basic - pro forma	$ (0.04)	$ (0.01)	$ (0.11)
Diluted - as reported	$ (0.06)	$ (0.00)	$ (0.11)
Diluted - pro forma	$ (0.05)	$ (0.01)	$ (0.11)
Denominator for basic and diluted net loss per share-adjusted weighted average shares	15,567,350	13,479,425(1)	15,264,324

(1) reflects 1:2 reverse stock split effected May 14, 2004

This disclosure is in accordance with Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," that the Company has adopted in these financial statements.

Stock options and warrants granted to non-employees are accounted for in accordance with SFAS 123 and the Emerging Issues Task Force Consensus No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," which requires the value of the options to be periodically re-measured as they vest over a performance period. The fair value of the options and warrants is determined using the Black-Scholes model.

8. Net Loss Per Share

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

	Three Months ended June 30,		Six
	2004	2003	2004
Numerator:			
Net Loss	$ (717,736)	$ (26,235)	$ (1,650
Less: Dividend on preferred stock	(232,595)	(171,936)	(456
Net loss attributable to holders of common stock	$ (950,331)	$ (198,171)	$ (2,107
Denominator:			
Denominator for basic and diluted net loss per share-weighted average shares	15,567,350	13,479,425	15,264
Effect of dilutive securities:			
Preferred Stock	-	-	
Stock Options	-	-	
Warrants	-	-	
Dilutive potential common shares	-	-	

Denominator for diluted net loss per share-adjusted weighted average shares	15,567,350	13,479,425(1)	15,264
Net loss attributable to holders of common stock	$ (0.06)	$ (0.01)	$ (

(1) reflects 1:2 reverse stock split effected May 14, 2004

The following equity instruments were not included in the diluted net loss per share calculation anti-dilutive:

	Six Months ended June 30 2004	2003
Preferred stock:		
Series D	1,510,500	1,510,500 (1)
Stock options	2,458,699	2,569,479 (1)
Warrants	4,693,662	1,153,352 (1)

(1) reflects 1:2 reverse stock split effected May 14, 2004

9. Supplemental Cash Flow Disclosure

	Three Months Ended June 30, 2004	June 30, 2003	Six Months Ended June 30, 2004	June 3
Cash paid for interest	14,818	1,194	52,299	
Non-cash investing and financing activities:				
Debt discount on 7% Convertible Notes	0	0	1,200,000	
Issuance of warrants for financing costs	0	0	227,696	
Debt converted to common stock	150,000	50,000	343,000	

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Item 2.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These statements may differ in a material way from actual future events. For instance, factors that could cause results to differ from future events include rapid rates of technological change and intense competition, among others. The Company's total revenues and operating results have varied substantially from quarter to quarter and should not be relied upon as an indication of future results. Several factors may affect the ability to forecast the Company's quarterly operating results, including the size and timing of individual software and hardware sales; the length of the Company's sales cycle; the level of sales and marketing, research and development and administrative expenses; and general economic conditions.

Operating results for a given period could be disproportionately affected by any shortfall in expected revenues. In addition, fluctuation in revenues from quarter to quarter will likely have an increasingly significant impact on the Company's results of operations. The Company's performance in recent periods may not be an accurate indication of future results of operations in light of the evolving nature of the network security market and the uncertainty of the demand for Internet and intranet products in general and the Company's products in particular. Because the Company's operating expenses are based on anticipated revenue levels, a small variation in the timing of recognition of revenues can cause significant variations in operating results from quarter to quarter.

Readers are also referred to the documents filed by the Company with the SEC, specifically the Company's latest Annual Report on Form 10-K that identifies important risk factors for the Company.

RESULTS OF OPERATIONS

REVENUES

Total revenues decreased from approximately $1,155,000 and $2,160,000 for the three and six months ended June 30, 2003, respectively, to approximately $519,000 and $1,168,000 for the three and six months ended June 30, 2004, respectively. This decrease of approximately $636,000 or 55% and $993,000 or 46% is due primarily to a decrease in product revenue of $629,000 and $1,012,000 for the three and six months ended June 30, 2004, respectively. Product revenues are derived principally from software licenses and the sale of hardware products. Product revenues decreased from approximately $771,000 and $1,412,000 for the three and six months ended June 30, 2003, respectively, to approximately $142,000 and $400,000 for the three and six months ended June 30, 2004, respectively. Consulting and services revenues are derived principally from fees for services complementary to the Company's products, including consulting, maintenance, installation and training. Consulting and services revenues decreased from approximately $384,000 for the three months ended June 30, 2003 to approximately $377,000 for the three months ended June 30, 2004. Consulting and services revenues increased from approximately $748,000 for the six months ended June 30, 2003 to approximately $767,000 for the six months ended June 30, 2004. This was due principally to an increase in the number of renewing maintenance contracts provided to customers in the first quarter of fiscal 2004.

The Company cannot be certain that revenue will, in fact, become more predictable or certain of the relative levels of software, hardware, consulting and services revenues to be generated in future periods.

COST OF REVENUES

Total cost of revenues as a percentage of total revenues decreased from approximately 12% and 9% for the three and six months ended June 30, 2003, respectively, to approximately 6% and 5% for the three and six months ended June 30, 2004, respectively. The percentage decrease was primarily due to lower sales of software licenses and SmartGuard appliances sales in the current year. Total cost of revenues is comprised of cost of product revenues and cost of consulting and services revenues.

Cost of product revenues consists principally of the costs of computer hardware, licensed technology, manuals and labor associated with the distribution and support of the Company's products. Cost of product revenues decreased from approximately $128,000 and $143,000 or the three and six months ended June 30, 2003, respectively to approximately $7,000 and $14,000 for the three and six

months ended June 30, 2004, respectively. The decrease in cost of product revenues for the three and six months ended June 30, 2004 was primarily attributable to lower sales of SmartGuard appliances and turnkey hardware solutions in the current year. Cost of product revenues as a percentage of product revenues was approximately 11% and 7% for the three and six months ended June 30, 2003, respectively and approximately 1% for the three and six month periods ended June 30, 2004.

Cost of consulting and services revenue consists principally of personnel and related costs incurred in providing consulting, support and training services to customers and costs of third-party product support. Cost of consulting and services revenues increased from approximately $15,000 and $40,000 for the three and six months ended June 30, 2003, respectively, to approximately $21,000 and $49,000 for the three and six months ended June 30, 2004, respectively. Cost of consulting and services revenues as a percentage of consulting and services revenue was approximately 1% and 2% for the three and six months ended June 30, 2003, respectively, and 4% for the three and six month periods ended June 30, 2004.

OPERATING EXPENSES

Research and Development -- Research and development expense consists principally of the costs of research and development personnel and other expenses associated with the development of new products and enhancement of existing products. Research and development expenses decreased from approximately $272,000 and $594,000 for the three and six months ended June 30, 2003, respectively, to approximately $243,000 and $466,000 for the three and six months ended June 30, 2004, respectively. The dollar decrease of approximately $29,000 and $128,000, was primarily due to lower consulting expense of $13,000 and $21,000, lower depreciation expense of $30,000 and $80,000 and lower rent expense of $13,000 and $25,000 partially offset by higher salary expense of $32,000 and $1,000, respectively. Research and development expense as a percentage of total revenue was approximately 24% and 28% for the three and six months ended June 30, 2003, respectively, and approximately 47% and 40% for the three and six months ended June 30, 2004, respectively. The percentage increase was primarily due to lower revenues for the three and six months ended June 30, 2004.

Sales and Marketing -- Sales and marketing expense consists principally of the costs of sales and marketing personnel, advertising, promotions and trade shows. Sales and marketing expenses increased from approximately $364,000 and $748,000 for the three and six months ended June 30, 2003, respectively, to approximately $433,000 and $808,000 for the three and six months ended June 30, 2004, respectively. The dollar increase of $69,000 and $60,000 for the three and six months ended June 30, 2004, respectively, relates primarily to higher salary expense of $55,000 and $79,000, higher marketing expense of $35,000 and $43,000, higher consulting expense of $22,000 and $22,000, higher travel expense of $20,000 and $16,000 and higher public relations expense of $30,000 and $21,000 partially offset by lower commission expense of $77,000 and $66,000, lower telephone expense of $5,000 and $10,000 and lower depreciation expense of $16,000 and $57,000, respectively. Sales and marketing expenses as a percentage of total revenues were approximately 32% and 35% for the three and six months ended June 30, 2003, respectively, and approximately 84% and 69% for the three and six months ended June 30, 2004, respectively. The percentage increase is due primarily to lower revenue for fiscal 2004 when compared to the same period for fiscal 2003.

General and Administrative -- General and administrative expense consists principally of the costs of accounting and finance, legal and human resources management, administrative personnel and facilities expenses. General and administrative expenses increased from approximately $374,000 for the three months ended June 30, 2003 to approximately $395,000 for the three months ended June 30, 2004 and decreased from approximately $848,000 for the six months ended June 30, 2003 to approximately $828,000 for the six months ended June 30, 2004. The increase in expense of approximately $22,000 for the three months ended June 30, 2004 was due principally to higher salary expense of $26,000, higher consulting expense of $20,000, higher annual report expense of $12,000, higher travel expense of $3,000, higher membership expenses of $18,000 and higher accounting and audit fees of $2,000 partially offset by lower depreciation expense of $6,000, lower commission expense of $16,000 and a decrease in legal expense of $33,000. The decrease in expense of approximately $19,000 for the six months ended June 30, 2004 is primarily due to a decrease in commission expense of $20,000, a decrease in accounting and audit fees of $79,000, a decrease in miscellaneous expense of $16,000 and a decrease in depreciation expense of $25,000, partially offset by an increase in salary expense of $26,000, an increase in legal expense of $30,000, an increase in consulting expense of $63,000 and an increase an annual report expense of $13,000. General and administrative expenses as a percentage of total revenues were approximately 32% and 39% for the three and six months ended June 30, 2003 and 76% and 71% for the three and six months ended June 30, 2004.

Other (Expense) Income -- Other (expense) income represents the income or expense resulting from non-operational activities that are of an infrequently occurring nature. Other (expense) income increased from approximately zero and $(9,000) for the three and six months ended June 30, 2003, respectively, to approximately zero for the three and six months ended June 30, 2004. The expense

in 2003 was due primarily to early retirement of certain fixed assets.

Interest Income and Expense -- Interest income represents interest earned on cash and cash equivalents. Interest income decreased from approximately zero and $5,000 for the three and six months ended June 30, 2003, respectively, to approximately $1,000 and $2,000 for the three and six months ended June 30, 2004, respectively. The increase was attributable to higher levels of cash and cash equivalents in the current period. Interest expense represents interest paid or payable on loans and capitalized lease obligations. Interest expense increased from approximately $29,000 and $161,000 for the three and six months ended June 30, 2003, respectively, to approximately $138,000 and $656,000 for the three and six months ended June 30, 2004, respectively, substantially all of which was for recognition of a beneficial conversion feature on the 7% Subordinated Convertible Notes.

Income Taxes -- The Company did not incur income tax expenses as a result of the net loss incurred during the three and six months ended June 30, 2003 and 2004.

Dividend on Preferred Stock -- The Company provided for dividends on preferred stock of approximately $233,000 and $457,000 during the three and six months ended June 30, 2004, respectively, and approximately $172,000 and $342,000 for the three and six months ended June 30, 2003, respectively. Under the terms of the purchase agreements for the Series C and Series D Preferred Stock, the Company may elect to pay these dividends in cash or stock.

LIQUIDITY AND CAPITAL RESOURCES

The Company's operating activities used cash of approximately $73,000 for the six months ended June 30, 2003 and used cash of approximately $730,000 for the six months ended June 30, 2004. Cash used in operating activities resulted principally from net operating losses in the periods offset in part by an increase in accounts payable in 2003 and interest expense and accounts receivable in 2004. The increase in cash used in operating activities of approximately $657,000 in the first six months of 2004 was attributable primarily to an increase in net operating loss of $1,426,000.

The Company's investing activities provided cash of approximately $15,000 in the six months ended June 30, 2003 and used approximately $9,000 in the six months ended June 30, 2004. Net capital expenditures for property and equipment were approximately $7,000 and ($35,000) during the six months ended June 30, 2003 and 2004, respectively. These expenditures have generally been for computer workstations and personal computers, office furniture and equipment, and leasehold additions and improvements.

The Company's financing activities provided cash of approximately $3,000 during the six months ended June 30, 2003 and provided cash of approximately $950,000 during the six months ended June 30, 2004. In fiscal 2004, the cash was provided primarily by the 7% Notes.

The Company had a working capital deficiency of ($1,931,000) and ($1,638,000) at December 31, 2003 and June 30, 2004, respectively. As of June 30, 2004, the Company had an accumulated deficit of approximately $68,621,000.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. The Company reported a net loss of $449,650, $5,635,191 and $6,237,278 for the years ended December 31, 2003, 2002 and 2001, respectively, and a further net losses of $717,736 and $1,650,577 for the three and six months ended June 30, 2004, respectively. Notwithstanding acceptance of the Company's security concepts and critical acclaim for its products, there can be no assurance that the consummation of sales of the Company's products to existing customers or proposed agreements with potential customers will generate timely or sufficient revenue for the Company to cover its costs of operations and meet its cash flow requirements. Accordingly, the Company may not have the funds needed to sustain operations during 2004.

For the immediate future, V-ONE will focus on existing and potential customers in the government sector, targeted marketing operations to commercial accounts and continued minimization of general and administrative expenditures. V-ONE may not be successful in further reducing operating levels without jeopardizing the ability to serve existing customers or grow its business base. In February 2004, the Company completed a private placement of 7% Subordinated Convertible Notes with detachable warrants for an aggregate of $1,200,000, which resulted in net proceeds to the Company of $1,065,690. The Company believes that to maintain operations for any extended period of time it must generate revenue from existing and new customers, raise additional capital or undergo a significant strategic transformative event. The Company's ability to reach sustainable profitability is dependent on its ability to generate sufficient cash flow to meet its obligations and needs on a timely basis or to obtain additional funding.

The Company expanded its banking relationships to explore alternatives to preserve its operations and maximize shareholder value, including potential strategic partnering relationships, a business combination with a strategically placed partner, or a sale of the Company. On May 19, 2004, the Company signed a letter of intent with SteelCloud Inc. ("SteelCloud"), for SteelCloud to acquire V-ONE in an all stock transaction. On August 11, 2004, the parties signed a definitive agreement for the transaction. For further information, refer to Part II, Item 5 of this Quarterly Report on Form 10-Q and V-ONE's Current Report on

Form 8-K filed with the SEC on August 11, 2004.

CONTRACTUAL OBLIGATIONS

The following table discloses aggregate information about the Company's contractual obligations as of June 30, 2004 and the periods in which payments are due:

	Payments Due By Period				
	Remainder of 2004	2005 and 2006	2007 and 2008	Thereafter	Total
Long-term debt obligations	$69,351	$46,234	$0	$0	$115,585
Convertible debt	0	0	0	1,200,000	1,200,000
Operating leases	116,064	465,069	296,275	0	877,408
	$185,415	$511,303	$296,275	$1,200,000	$2,192,993

OFF-BALANCE SHEET ARRANGEMENTS

The Company had no material off-balance sheet arrangements during the first three and six months of fiscal 2004 or 2003.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is not materially exposed to fluctuations in currency exchange rates as all of its products are invoiced in U.S. dollars. The Company does not hold any derivatives or marketable securities. However, the Company is exposed to interest rate risk. The Company believes that the market risk arising from holdings of its financial instruments is not material.

Item 4. Controls and Procedures

The Company carried out an evaluation under the supervision and with participation of the Company's management, including the Company's President, Chief Executive Officer and Principal Financial Officer, of the effectiveness of the Company's disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of the period covered by this report. Based on that evaluation, the Company's President, Chief Executive Officer and Principal Financial Officer have concluded that disclosure controls and procedures were effective as of the end of the period covered by this report to ensure that information required to be disclosed by the Company in its reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commissions rules and forms. There was no change in the Company's internal controls over financial reporting 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

On March 20, 2003, BSA Sales, Inc. d/b/a BSA ("BSA") filed a complaint against the Company in the Court of Common Pleas in the County of Greenville, South Carolina, alleging breach of contract for failure to pay disputed fees and seeking damages of a maximum of $75,000. The fees relate to the early termination of a contract by the Company for BSA's non-performance under the contract. The parties proceeded to arbitration as required by the state of North Carolina, but were unsuccessful in settling the matter. The Company agreed to a $20,000 settlement in the matter in April 2004 and the complaint was dismissed with prejudice.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

In a closing on February 27, 2004, V-ONE issued 7% Subordinated Convertible Notes with warrants to certain accredited investors for an aggregate principal amount of $1,200,000, resulting in net proceeds to V-ONE of $1,065,690, which will be used for general working capital purposes. The 7% Notes mature on February 27, 2009 and were sold pursuant to Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended. Interest at the rate of 7% per annum is payable semi-annually at the option of V-ONE in cash or in shares of Common Stock. The holders may convert the principal amount of their 7% Notes, in whole or in part, at any time into shares of Common Stock at a conversion price of $0.20 per share. On May 14, 2004, V-ONE effected a 1:2 reverse stock split modifying the original conversion price of the 7% Notes to $0.40 per share. In addition, subject to certain terms, the principal amount of the 7% Notes plus all accrued and unpaid interest shall automatically convert into shares of Common Stock at the then current conversion price on the earlier of (i) February 27, 2009 and (ii) the first date which is at least 180 days following the effective date of the Registration Statement providing for the resale of the shares of Common Stock issuable upon conversion of the 7% Notes that the closing bid price of V-ONE Common Stock exceeds $1.00 for a period of 20 consecutive trading days. On May 14, 2004, V-ONE effected a 1:2 reverse stock split modifying the closing bid to $2.00 per share.

In connection with the 7% Notes offering, V-ONE issued detachable warrants to purchase 6,000,000 shares of Common Stock to the holders of the 7% Notes. The warrants are exercisable beginning on August 27, 2004 at an exercise price of $0.25 per share and expire on August 27, 2008. On May 14, 2004, V-ONE effected a 1:2 reverse stock split reducing the number of shares purchasable under the warrants to 3,000,000 and increasing the exercise price to $.50. Beginning 180 days after the effective date of a Registration Statement providing for the resale of the shares of Common Stock issuable upon conversion of the 7% Notes and exercise of the warrants, V-ONE may call up to 100% of the warrants if the per share market value of its Common Stock has been greater than $.75 for a period of 20 consecutive trading days by issuing a call notice to the warrant holders. The rights and privileges granted to a warrant holder with respect to the shares subject to the call notice shall expire on the twentieth day after the holder receives the call notice if the holder does not exercise the warrant. If the holder does not exercise the warrant, V-ONE shall remit to the warrant holder (i) $0.01 per share subject to the call notice and (ii) a new warrant representing the number of shares of Common Stock, if any, which were not subject to the call notice. Also in connection with the 7% Notes offering, V-ONE granted warrants to purchase up to a total of 1,260,000 shares of Common Stock to H.C. Wainwright & Co., Inc., placement agent for the 7% Notes offering. As a result of the May 2004 1:2 reverse stock split, such shares have been reduced to 630,000. The placement agent warrants contain a cashless exercise provision. The other terms of the placement agent warrants mirror those of the warrants granted in connection with the 7% Notes offering.

For the terms and conditions of the 7% Notes and warrants, refer to V-ONE's Form

8-K filed with the SEC on March 5, 2004 and note 6 to the financial statements contained herein.

Item 3. Defaults Upon Senior Securities

None.

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

On May 13, 2004, the following items were voted on at the Annual Meeting of Shareholders:

	Reelection of Directors	For	Withheld	Abstain	Broker Non-Vote
Proposal 1*:	Molly G. Bayley	24,796,147	198,874	0	18,791,123

Proposal 2*: Amendment to the Company's certificate of incorporation, as amended and restated, to effect a 1:2 reverse stock split of Company common stock.

For	Against	Abstain	Broker Non-Votes
23,459,243	1,504,146	21,632	18,791,123

Proposal 3: Amendment to the Company's 1998 Amended Incentive Stock Plan increasing the number of shares of common stock authorized and reserved for issuance under the plan from 5,000,000 to 6,000,000.

For	Against	Abstain	Broker Non-Votes
5,647,854	502,267	50,777	0

Proposal 4*: Ratification of appointment of Aronson & Company as the auditors of the Company for the year ending December 31, 2004.

For	Against	Abstain	Broker Non-Votes
24,694,306	94,581	206,134	18,791,123

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* Broker non-votes are included in "For" votes on this proposal.

Item 5. Other Information

On May 19, 2004, the Company signed a letter of intent with SteelCloud Inc. ("SteelCloud"), for SteelCloud to acquire V-ONE in an all stock transaction. The letter of intent contemplated that V-ONE common shareholders would receive one share of SteelCloud Common Stock in exchange for approximately 8.5 shares of V-ONE Common Stock. Because of continuing delays in the governmental programs underlying V-ONE's revenue plan and the resulting adverse effect on V-ONE's financial position, the parties renegotiated the transaction valuation, taking into consideration the risks associated with possible additional delays in V-ONE's government programs. The parties have signed a definitive agreement, a copy of which was filed with the Securities and Exchange Commission on August 11, 2004 as an exhibit to V-ONE's Current Report on Form 8-K. The definitive agreement contemplates that V-ONE common shareholders will receive one share of SteelCloud Common Stock in exchange for approximately 21 shares of V-ONE Common Stock, plus warrants to purchase an aggregate of 750,000 shares of SteelCloud Common Stock. The management and respective Boards of Directors of SteelCloud and V-ONE have approved this transaction subject to shareholder approval and other customary closing conditions.

Item 6. Exhibits and Reports on Form 8-K

(a) The following exhibits are filed as part of this quarterly report on Form 10-Q for the period ended June 30, 2004:

Exhibit	Description
3.1	Certificate of Amendment to Amended and Restated Certificate of Incorporation dated May 13, 2004
31	Certification of Chief Executive Officer and Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Principal Financial Officer Pursuant to Title 18, United States Code, Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

Form 8-K filed May 20, 2004, reporting under Items 5 and 7.

SIGNATURE

Pursuant to the requirements 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.

V-ONE CORPORATION
Registrant

Date: August 16, 2004

By: /s/ Margaret E. Grayson

Name: Margaret E. Grayson
Title: President, Chief Executive Officer and Principal Financial Officer