

SMF ENERGY CORP
Form 10-Q
February 17, 2009

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

FORM 10-Q

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

For the quarterly period ended December 31, 2008

OR

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

Commission File Number 000-21825

SMF ENERGY CORPORATION
(Exact name of registrant as specified in
its charter)

Delaware
(State of
Incorporation)

65-0707824
(IRS Employer
Identification
Number)

200 West Cypress Creek Road, Suite 400, Fort Lauderdale, Florida
(Address of principal executive offices)

33309
(Zip Code)

(954) 308-4200

(Issuer'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 No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definitions of "accelerated filer and large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Edgar Filing: SMF ENERGY CORP - Form 10-Q

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

As of February 11, 2009 there were 15,187,623 shares of the registrant's common stock outstanding.

SMF ENERGY CORPORATION

FORM 10-Q

INDEX

Form 10-Q Part and Item No.

Part I	Financial Information:	
Item 1.	Condensed Unaudited Consolidated Financial Statements	
	Condensed Consolidated Balance Sheets as of December 31, 2008 (unaudited) and June 30, 2008	3
	Condensed Unaudited Consolidated Statements of Operations for the three and six-months ended December 31, 2008 and 2007	4
	Condensed Unaudited Consolidated Statements of Cash Flows for the six-months ended December 31, 2008 and 2007	5
	Notes to Condensed Unaudited Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	16
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	31
Item 4.	Controls and Procedures	32
Part II	Other Information:	
Item 1.	Legal Proceedings	33
Item 1A.	Risk Factors	33
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	33
Item 3.	Defaults Upon Senior Securities	33
Item 4.	Submission of Matters to a Vote of Security Holders	33
Item 5.	Other Information	35
Item 6.	Exhibits	35
	Signatures	36

SMF ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in 000's, except share and per share data)

	December 31, 2008 (Unaudited)	June 30, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 158	\$ 48
Accounts receivable, net of allowances of \$1,470 and \$1,283	15,000	30,169
Inventories, net of reserve of \$98 and \$99	1,851	2,535
Prepaid expenses and other current assets	690	855
Total current assets	17,699	33,607
Property and equipment, net of accumulated depreciation of \$14,589 and \$13,981	9,353	10,276
Identifiable intangible assets, net of accumulated amortization of \$1,251 and \$1,060	2,201	2,392
Goodwill	228	228
Deferred debt costs, net of accumulated amortization of \$713 and \$556	253	348
Other assets	80	133
Total assets	\$ 29,814	\$ 46,984
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Line of credit payable	\$ 7,884	\$ 19,789
Current portion of long-term debt, net of unamortized debt discount of \$45	8,814	-
Accounts payable	4,973	9,921
Accrued expenses and other liabilities	4,093	4,938
Total current liabilities	25,764	34,648
Long-term liabilities:		
Promissory notes, net of unamortized debt discount of \$0 and \$65	725	8,794
Other long-term liabilities	443	490
Total liabilities	26,932	43,932
Contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value; 10,000 Series A shares authorized, 4,205 and 4,587 issued and outstanding at December 31, 2008 and June 30, 2008, respectively	-	-
Preferred stock, \$0.01 par value; 2,000 Series B shares authorized, 1,985 issued and outstanding at December 31, 2008 and June 30, 2008	-	-
Preferred stock, \$0.01 par value; 2,000 Series C shares authorized, 229 and 0 issued and outstanding at December 31, 2008 and June 30, 2008, respectively	-	-
Common stock, \$.01 par value; 50,000,000 shares authorized; 14,938,295 and 14,556,295 issued and outstanding at December 31, 2008 and June 30, 2008, respectively	149	146
Additional paid-in capital	30,694	30,719

Accumulated deficit	(27,961)	(27,813)
Total shareholders' equity	2,882	3,052
Total liabilities and shareholders' equity	\$ 29,814	\$ 46,984

The accompanying notes to the condensed unaudited financial statements are an integral part of these consolidated balance sheets.

SMF ENERGY CORPORATION AND SUBSIDIARIES

CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(in 000's, except per share data)

	Three Months Ended December		Six Months Ended December	
	2008	31, 2007	2008	31, 2007
Petroleum product sales and service revenues	\$ 39,876	\$ 52,905	\$ 112,838	\$ 102,094
Petroleum product taxes	5,236	6,089	11,545	12,397
Total revenues	45,112	58,994	124,383	114,491
Cost of petroleum product sales and service	36,584	50,340	103,727	96,347
Petroleum product taxes	5,236	6,089	11,545	12,397
Total cost of sales	41,820	56,429	115,272	108,744
Gross profit	3,292	2,565	9,111	5,747
Selling, general and administrative expenses	3,267	3,788	7,899	7,591
Operating income (loss)	25	(1,223)	1,212	(1,844)
Interest expense	(680)	(782)	(1,363)	(1,560)
Interest and other income	3	19	19	40
Loss on extinguishment of promissory notes	-	-	-	(1,641)
Loss before income taxes	(652)	(1,986)	(132)	(5,005)
Income tax expense	(8)	-	(16)	-
Net loss	\$ (660)	\$ (1,986)	\$ (148)	\$ (5,005)
Basic and diluted net loss per share computation:				
Net loss	\$ (660)	\$ (1,986)	\$ (148)	\$ (5,005)
Less: Preferred stock dividends	(132)	-	(328)	-
Net loss attributable to common stockholders	\$ (792)	\$ (1,986)	\$ (476)	\$ (5,005)
Basic and diluted net loss per share attributable to common stockholders	\$ (0.05)	\$ (0.14)	\$ (0.03)	\$ (0.35)
Basic and diluted weighted average common shares outstanding	14,938	14,556	14,792	14,379

The accompanying notes to the condensed unaudited financial statements are an integral part of these consolidated statements of operations.

SMF ENERGY CORPORATION AND SUBSIDIARIES

CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in 000's)

	Six Months Ended December 31,	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (148)	\$ (5,005)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization:		
Cost of sales	584	768
Selling, general and administrative	683	586
Amortization of deferred debt cost	158	130
Amortization of debt discount	20	63
Amortization of stock-based compensation	182	259
Gain from sale of assets	(4)	(11)
Inventory reserve	-	(46)
Provision for doubtful accounts	332	237
Non-cash loss on extinguishment of debt	-	1,371
Changes in operating assets and liabilities:		
Decrease in accounts receivable	14,836	3,815
Decrease in inventories, prepaid expenses and other assets	847	311
Decrease in accounts payable and other liabilities	(5,800)	(216)
Net cash provided by operating activities	11,690	2,262
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(193)	(1,422)
Proceeds from sale of equipment	56	18
Decrease in restricted cash	91	625
Net cash used in investing activities	(46)	(779)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from line of credit	133,375	119,444
Repayments of line of credit	(145,280)	(123,794)
Proceeds from issuance of promissory notes	725	7,690
Proceeds from issuance of preferred stock	149	-
Proceeds from issuance of common stock and warrants	-	1,170
Principal payments on promissory notes	-	(6,359)
Debt issuance costs	(65)	(457)
Common stock, preferred stock, and warrants issuance costs	(22)	(79)
Payment of dividends	(390)	-
Capital lease payments	(26)	(22)
Net cash used in financing activities	(11,534)	(2,407)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	110	(924)
CASH AND CASH EQUIVALENTS, beginning of period	48	987

CASH AND CASH EQUIVALENTS, end of period	\$	158	\$	63
--	----	-----	----	----

(Continued)

5

SMF ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in 000's)

(Continued)	Six Months Ended December 31,	
	2008	2007
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	\$ 1,150	\$ 1,310
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES:		
Accrued dividends related to preferred stock	\$ 132	\$ -
Capital leases	\$ 47	\$ -
Conversion of preferred shares to common shares	\$ 210	\$ -
Refinancing of August 2003, January 2005, and September 2005 notes into August 2007 notes	\$ -	\$ 4,918
Non-cash costs related to issuance of stock, warrants and August 2007 notes	\$ -	\$ 134
Debt discount costs related to issuance of stock, warrants and extension of warrants and August 2007 notes	\$ -	\$ 112

The accompanying notes to condensed unaudited financial statements are an integral part of these consolidated statements of cash flows.

SMF ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

SMF Energy Corporation (the “Company”) is a Delaware corporation formed in 2006. In December 2006, the shareholders of Streicher Mobile Fueling, Inc. (“Streicher”), a Florida corporation formed in 1996, approved changing Streicher’s name to SMF Energy Corporation and the reincorporation of Streicher in Delaware by merger into the Company. The merger was effective February 14, 2007.

The Company provides petroleum product distribution services, transportation logistics and emergency response services to the trucking, manufacturing, construction, shipping, utility, energy, chemical, telecommunications, and government services industries. The Company generates its revenues from commercial mobile and bulk fueling; the packaging, distribution and sale of lubricants; integrated out-sourced fuel management; transportation logistics, and emergency response services. The Company’s fleet of custom specialized tank wagons, tractor-trailer transports, box trucks and customized flatbed vehicles delivers diesel fuel and gasoline to customers’ locations on a regularly scheduled or as needed basis, refueling vehicles and equipment, re-supplying fixed-site and temporary bulk storage tanks, and emergency power generation systems; and distributes a wide variety of specialized petroleum products, lubricants and chemicals to its customers.

At December 31, 2008, the Company was conducting operations through 31 service locations in the eleven states of Alabama, California, Florida, Georgia, Louisiana, Mississippi, Nevada, North Carolina, South Carolina, Tennessee and Texas.

2. BASIS OF PRESENTATION

The condensed unaudited consolidated financial statements include the accounts of SMF Energy Corporation and its wholly owned subsidiaries, SMF Services, Inc., H & W Petroleum Company, Inc., and Streicher Realty, Inc. All significant intercompany balances and transactions have been eliminated in consolidation.

The condensed unaudited consolidated financial statements included herein have been prepared in accordance with the instructions of Form 10-Q, and do not include all the information and footnotes required by generally accepted accounting principles; however, they do include all adjustments of a normal recurring nature that, in the opinion of management, are necessary to present fairly the financial position and results of operations of the Company as of and for the interim periods presented.

Operating results for the three and six months ended December 31, 2008 are not necessarily indicative of the results that may be expected for any subsequent period or the fiscal year ending June 30, 2009. These interim financial statements should be read in conjunction with the Company’s audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended June 30, 2008, as filed with the United States Securities and Exchange Commission (the “2008 Form 10-K”).

SMF ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

3. RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued FAS Statement No. 157, "Fair Value Measurements" ("FAS No. 157"). This standard provides guidance for using fair value to measure assets and liabilities. Under FAS No. 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts. In this standard, the FASB clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing the asset or liability. In support of this principle, FAS No. 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, for example, the reporting entity's own data. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. Certain aspects of this standard were effective for the financial statements issued for the Company since the beginning of fiscal year 2009. The adoption of FAS No. 157 had no impact on the Company's consolidated financial position, results of operations or cash flows. FASB Staff Position (FSP) FAS 157-2, "Effective Date of FASB Statement No. 157," issued in February 2008, provides a one-year deferral of the effective date of FAS No. 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed in financial statements at least annually at fair value on a recurring basis. The Company has not yet determined the impact, if any, that the adoption of FAS No. 157-2 will have on its consolidated financial position, results of operations or cash flows.

In February 2007, FAS Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("FAS No. 159"), was issued. FAS No. 159 enables companies to report selected financial assets and liabilities at their fair value. This statement requires companies to provide additional information to help investors and other users of financial statements understand the effects of a company's election to use fair value on its earnings. FAS No. 159 also requires companies to display the fair value of assets and liabilities on the face of the balance sheet when a company elects to use fair value. FAS No. 159 is effective for the Company since the beginning of fiscal year 2009. The Company's adoption of FAS No. 159 had no impact on the Company's financial condition or results of operations.

In December 2007, the FASB issued FAS Statement No. 141 (revised 2007), "Business Combinations" ("FAS No. 141R"), which replaces FAS No. 141. The statement retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in the purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. FAS No. 141R is effective for the Company beginning July 1, 2009 and will be applied prospectively to business combinations completed on or after that date.

In December 2007, the FASB issued FAS Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB 51," which changes the accounting and reporting for minority interests ("FAS No. 160"). Minority interests will be recharacterized as noncontrolling interests and will be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement and, upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in earnings. FAS No. 160 is effective for the Company beginning July 1, 2009 and will apply prospectively, except for the presentation and disclosure requirements, which will apply retrospectively. The Company is currently assessing the potential impact that adoption of SFAS No. 160 would have on its financial statements.

SMF ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

In March 2008, the FASB issued FAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities — an amendment of FAS Statement No. 133" ("FAS No. 161"). This Standard requires enhanced disclosures regarding derivatives and hedging activities, including: (a) the manner in which an entity uses derivative instruments; (b) the manner in which derivative instruments and related hedged items are accounted for under FAS No. 133, "Accounting for Derivative Instruments and Hedging Activities"; and (c) the effect of derivative instruments and related hedged items on an entity's financial position, financial performance, and cash flows. FAS No. 161 is effective for the Company beginning July 1, 2009. As FAS No. 161 relates specifically to disclosures, the standard will have no impact on our financial condition, results of operations or cash flows.

In May 2008, the FASB issued FAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("FAS No. 162"). This Standard identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. FAS No. 162 directs the hierarchy to the entity, rather than the independent auditors, as the entity is responsible for selecting accounting principles for financial statements that are presented in conformity with generally accepted accounting principles. The Standard is effective 60 days following SEC approval of the Public Company Accounting Oversight Board amendments to remove the hierarchy of generally accepted accounting principles from the auditing standards. FAS No. 162 is not expected to have an impact on our financial condition, results of operations or cash flows.

4. CASH AND CASH EQUIVALENTS

During the six months ended December 31, 2008, the Company paid down \$11.9 million on its line of credit payable. Total cash and cash availability was \$2.0 million and \$1.9 million at December 31, 2008 and June 30, 2008, respectively, and was \$2.5 million at February 11, 2009. Total cash and cash availability includes cash as presented in the Company's balance sheet and cash available to the Company through its line of credit, described in Note 6 - Line of Credit Payable.

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. The Company maintains its cash balances at financial institutions, which at times may exceed federally insured limits. Balances up to \$250,000 are insured by the Federal Deposit Insurance Corporation. The Company has not experienced any losses in such bank accounts.

5. NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing the net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during the period.

Diluted earnings per share is computed by dividing net earnings attributable to common shareholders by the weighted-average number of common shares outstanding, increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Conversion or exercise of the potential common shares is not reflected in diluted earnings unless the effect is dilutive. In determining whether outstanding common share equivalents should be considered for their dilutive effect, the average market price of the Company's common stock for the period has to exceed the exercise price of the outstanding common share equivalent. The dilutive effect, if any, of outstanding common share equivalents would be reflected in diluted earnings per share by application of the if-converted and the treasury stock method, as applicable. The

Company excluded the impact of its common stock equivalents in the computation of diluted net loss per share for the three and six months ended December 31, 2008 and 2007, as their effect is not dilutive.

SMF ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Common stock equivalents outstanding consisted of (in thousands):

	December 31,	
	2008	2007
Stock options	2,008	2,040
Common stock warrants	747	887
Promissory note conversion rights	4,149	3,633
Preferred stock conversion rights	6,419	-
Total common stock equivalents outstanding	13,323	6,560

The following table sets forth the computation of basic and diluted loss per share (in thousands, except per share amounts):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
Net loss	\$ (660)	\$ (1,986)	\$ (148)	\$ (5,005)
Less: Preferred stock dividends	(132)	-	(328)	-
Net loss attributable to common stockholders	\$ (792)	\$ (1,986)	\$ (476)	\$ (5,005)
Net loss per share attributable to common stockholders – basic and diluted	\$ (0.05)	\$ (0.14)	\$ (0.03)	\$ (0.35)
Weighted average shares outstanding:				
Basic and diluted	14,938	14,556	14,792	14,379

6. LINE OF CREDIT PAYABLE

The Company has a \$25.0 million credit facility with a national financial institution, which permits the Company to borrow up to 85% of the total amount of eligible accounts receivable and 65% of eligible inventory, both as defined. Outstanding letters of credit reduce the maximum amount available for borrowing. Interest is payable monthly based on a pricing matrix agreed with the bank. At December 31, 2008 the interest rate was at prime plus 0.75%. At December 31, 2008, the interest rate was 4.00%. Outstanding borrowings under the line are secured by substantially all Company assets other than its transportation fleet and related field equipment.

As of December 31, 2008 and June 30, 2008, the Company had outstanding borrowings of \$7.9 million and \$19.8 million, respectively, under its \$25.0 million line of credit. The line of credit is classified as a current liability in accordance with EIFT 95-22, "Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements". Based on eligible receivables and inventories, and letters of credit outstanding at December 31, 2008 and June 30, 2008, the Company had \$1.8 million and \$1.8 million of cash availability under the line of credit.

SMF ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The Company's line of credit provides for certain affirmative and negative covenants that may limit the total availability based upon the Company's ability to meet these covenants. At December 31, 2008, the financial covenants included a minimum availability of \$750,000, a fixed charge coverage ratio of 1.3 to 1.0, and a capital expenditure limitation for fiscal year 2009 of \$750,000. At December 31, 2008 and June 30, 2008, the Company had a maximum amount of \$1.750 million and \$1.5 million, respectively for which letters of credit could be issued. At December 31, 2008 and June 30, 2008, \$1.6 million and \$1.35 million, respectively, had been issued in letters of credit.

In September 2008, the Company and its line of credit lender entered into the Sixteenth Amendment and also into the Seventeenth Amendment to the loan and security agreement. These amendments allowed for the issuance of unsecured promissory notes, extended the maturity date from December 31, 2008 to July 1, 2009, and modified the variable interest rate to a range of 0.75% to 2.75% over the prime lending rate based on the Company meeting certain fixed charge coverage ratios. Additionally, effective October 31, 2008, the average monthly availability requirement was eliminated and replaced with a required fixed charge coverage ratio of 1.0 to 1.0 through November 2008 and 1.3 to 1.0 thereafter. The termination fee of 0.5% was also eliminated for the period of September 2008 through December 31, 2008.

The line of credit agreement also requires the Company to obtain the consent of the financial institution prior to incurring additional debt, or entering into mergers, consolidations or sales of assets. Failure to comply with one or more of the covenants in the future could affect the amount the Company can borrow and thereby adversely affect the Company's liquidity and financial condition. At December 31, 2008, the Company was in compliance with all the requirements of its covenants under the agreement.

7. LONG-TERM DEBT

Long-term debt consists of the following (in thousands):

	December 31, 2008	June 30, 2008
September 2008 unsecured convertible subordinated promissory notes (the "September 2008 Notes") (12% interest due semi-annually, March 1 and September 1 beginning March 1, 2009); matures September 1, 2010 in its entirety; effective interest rate of 12%. For additional details, see below.	\$ 725	\$ -
August 2007 senior secured convertible subordinated promissory notes (the "August 2007 Notes") (11.5% interest due semi-annually, January 1 and July 1); matures December 31, 2009 in its entirety; effective interest rate of 14.6% including cost of warrants and other debt issue costs.	8,859	8,859
Unamortized debt discount	(45)	(65)
	9,539	8,794
Less: current portion	(8,814)	-

Long-term debt, net	\$	725	\$	8,794
---------------------	----	-----	----	-------

11

SMF ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

On September 2, 2008, we sold \$725,000 in 12% unsecured convertible promissory notes (the "September 2008 Notes") maturing on September 1, 2010 to accredited investors, including a \$250,000 participation by a related party. The Company used the proceeds for working capital purposes, including the enhancement of short-term supplier credit. The September 2008 Notes are unsecured and are expressly subordinated to any amounts owed now or in the future to our primary lender pursuant to a subordination agreement between the note holders and the lender. These promissory notes may be redeemed by us, in whole or in part, without prepayment penalty or premium, except that, if such pre-payment is proposed to be made before September 2, 2009, a 1% prepayment penalty shall be paid. The unpaid principal amount of the September 2008 Notes and the accrued but unpaid interest thereon may be converted into shares of our common stock at \$0.65 per share, which was above the market price of the Company's common stock on the date of the offering. In addition, these promissory notes will be automatically converted into common stock, (A) if the closing price of the common stock is equal to or greater than two times the conversion price then in effect for a period of twenty (20) consecutive business days, or (B) upon the election of the holders of two thirds of the principal outstanding notes, or (C) upon the closing of a firmly underwritten public offering at a price that is two times the conversion price with cash proceeds to the Company of at least \$10,000,000.

Effective January 30, 2008, the holders of the August 2007 Notes agreed to the deferral of the \$520,000 interest payment due on the August 2007 Notes from January 1 to April 15, 2009. As consideration for the deferral, the Company paid a deferral fee equal to 1% of the outstanding principal balance, or \$88,950, 50% of which was paid in cash, with the remainder satisfied through issuance of unregistered shares of the Company's common stock.

Other

In connection with the issuance of certain promissory notes in August 2003, January 2005 and September 2005, which have since been redeemed, the Company had recorded unamortized debt discounts which were being amortized under the effective interest method as non-cash interest expense over the respective term of the debt issued. These were non-cash discounts related to the valuation of the common stock warrants issued to the note holders and the placement agent in the financing transactions that did not reduce the amount of principal cash repayments required to be made by the Company. On August 8, 2007, as a result of the early redemption of these promissory notes, the Company recorded a loss on extinguishment of \$1.6 million, as follows:

	Six Months Ended December 31, 2007
Write offs of costs and gain related to the refinancing of the August 2003, January 2005 and September 2005 Notes:	
Unamortized debt costs	\$ 443
Unamortized debt discounts	978
Cash pre-payment penalty	270
Gain on extinguishment	(50)
Loss on extinguishment of promissory notes, net	\$ 1,641

To the extent that loss on extinguishment of promissory notes constitutes the recognition of previously deferred interest, it is considered interest expense for the calculation of certain interest expense amounts.

SMF ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. SHAREHOLDERS' EQUITY

The following reflects the change in shareholders' equity for the six months ended December 31, 2008 (in thousands, except share data):

	Preferred Stock Series A Shares	Preferred Stock Series B Amount	Preferred Stock Series C Shares	Preferred Stock Series C Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Total		
Balance at June 30, 2008	4,587	\$ -	1,985	\$ -	-	\$ -	14,556,295	\$ 146	\$ 30,719	\$ (27,813)	\$ 3,052
Net loss	-	-	-	-	-	-	-	-	-	(148)	(148)
Issuance of Series C preferred stock, net of issuance costs of \$25	-	-	-	-	229	-	-	-	124	-	124
Conversion of Series A preferred stock to common stock	(382)	-	-	-	-	-	382,000	3	(3)	-	-
Series A preferred stock dividend	-	-	-	-	-	-	-	-	(183)	-	(183)
Series B preferred stock dividend	-	-	-	-	-	-	-	-	(136)	-	(136)
Series C preferred stock dividend	-	-	-	-	-	-	-	-	(9)	-	(9)
Stock-based compensation expense	-	-	-	-	-	-	-	-	182	-	182
Balance at December 31, 2008	4,205	\$ -	1,985	\$ -	229	\$ -	14,938,295	\$ 149	\$ 30,694	\$ (27,961)	\$ 2,882

Issuance of Series C Preferred Stock

On August 15, 2008, the Company issued, in a private offering to accredited investors, \$148,850 in equity securities, consisting of 229 shares of Series C Convertible Preferred Stock, \$0.01 par value, at a price of \$650 per share (the "Series C Preferred Stock"). Each share of Series C Preferred Stock is convertible into 1,000 shares of the Company's common stock at a price per share of \$0.65 per share, which was above the closing market price of the Company's common stock on the date of the offering. The rights and preferences of the Series C Preferred Stock are substantially similar to those of the Series A and Series B Preferred Stock.

The Series C Preferred Stock ranks senior to the common stock, \$0.01 par value (the "Common Stock") of the Company and is on parity with the holders of any other series of preferred stock as to the payment of dividends and distribution of assets, including the currently outstanding shares of Series A Preferred Stock and Series B Preferred Stock. Upon liquidation, dissolution or winding up of the Company, holders of Series C Preferred Stock are entitled to be paid out of the assets of the Company an amount per share of Series C Preferred Stock equal to the greater of: (i) the original issue price of the Series C Preferred Stock, plus all accumulated but unpaid dividends; or (ii) the fair market value of the Series C Preferred Stock on an as-converted to Common Stock basis, plus all accumulated but unpaid dividends. Each holder of Series C Preferred Stock is entitled to one vote per share at each meeting of stockholders of the Company with respect to any and all matters presented to the stockholders of the Company.

Dividends paid on the Series C Preferred Stock when, as and if declared by the Board of Directors, but only out of funds that are legally available, in quarterly cash dividends at the rate of eighteen percent (18%) per annum of the sum of the Original Issue Price of \$650 per share. Since the Company achieved positive Earnings Before Interest, Taxes, Depreciation and Amortization for two consecutive fiscal quarters, the quarterly cash dividend was changed from eighteen percent (18%) of the Original Issue Price per annum to twelve percent (12%) in December 2008.

Each share of Series C Preferred Stock is currently convertible, at the option of the holder, into 1,000 shares of Common Stock based on a conversion price equal to \$0.65 per share of Common Stock (the "Series C Conversion Price"). The Series C Conversion Price is subject to adjustment for stock dividends, stock splits and other similar recapitalization events. In addition, each share of Series C Preferred Stock shall automatically be converted into shares of Common Stock, based on the then-effective Series C Conversion Price, if:

- (A) the closing price of the Common Stock as reported on the Nasdaq Capital Stock Market (or on such other public securities trading market, such as the OTC Bulletin Board, as then constitutes the primary trading market for the Common Stock) is equal to or greater than two times the Series C Conversion Price then in effect (the "Series C Automatic Conversion Price"), for a period of twenty (20) consecutive business days, or
- (B) at any time upon the affirmative election of the holders of at least sixty-six and two-thirds percent (66 2/3%) of the outstanding shares of the Series C Preferred Stock, or
- (C) upon the closing of a firmly underwritten public offering pursuant to an effective registration statement under the Securities Act covering the offer and sale of Common Stock for the account of the Company in which (i) the per share price is at least two times the Series C Automatic Conversion Price and (ii) the cash proceeds to the Company (before underwriting discounts, commissions and fees) are at least ten million dollars (\$10,000,000).

Conversion of Series A Preferred Stock

In September 2008, the holders of an aggregate of 382 shares of the Company's Series A Preferred Stock elected to convert those shares at the 1 to 1000 conversion ratio set by the Certificate of Designation for the Series A into an aggregate of 382,000 shares of the Company's Common Stock.

Preferred Stock Dividends

Cumulative dividends on the Series A, Series B, and Series C Preferred Stock are declared quarterly. During the first six months of fiscal 2009, the Company declared \$328,000 in cumulative dividends on the Series A, Series B, and Series C Preferred Stock, of which \$132,000 remains outstanding as of the date of filing. During the last six months of fiscal 2008, the Company declared dividends of \$249,000 of which \$56,000 was paid during fiscal 2008 and the remainder was paid during fiscal 2009.

Employee Stock Options

During the six months ended December 31, 2008, the Company granted 28,000 stock options under the Employee Stock Options Plan. The weighted average grant date fair value of the options granted was \$0.29.

9. CONTINGENCIES

The Company and its subsidiaries are from time to time parties to legal proceedings, lawsuits and other claims incident to their business activities. Such matters may include, among other things, assertions of contract breach, claims for indemnity arising in the course of the business and claims by persons whose employment with us has been terminated. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, management is unable to ascertain the ultimate aggregate amount of monetary liability, amounts that may be covered by insurance or recoverable from third parties, or the financial impact with respect to these matters as of December 31, 2008, therefore no contingency gains or losses have been recorded as of December 31, 2008. However, based on management's knowledge at the time of this filing, management believes that the final resolution of such matters pending at the time of this report, individually and in the aggregate, will not have a material adverse effect upon the Company's consolidated financial position, results of operations or cash flows.

On October 10, 2006, the Company commenced a civil action in Broward County, Florida Circuit Court against Financial Accounting Solutions Group, Inc. ("FAS"), Kramer Professional Staffing, Inc. ("KPS"), and Mitchell Kramer, an officer, director, shareholder and control person of FAS and KPS ("Kramer"), alleging that Kramer, FAS and KPS (collectively, the "Defendants") induced the Company to engage FAS to provide services with respect to (a) the implementation of certain Information Technology ("IT") functions; (b) the modernization and expansion of the Company's accounting and business technology capabilities, and (c) compliance with public company accounting requirements and the Sarbanes-Oxley Act (the "IT Projects") by making numerous misrepresentations concerning the experience, capabilities and background of FAS and FAS' personnel. FAS subsequently filed a countersuit in the same court seeking payment of additional fees allegedly due from the Company. The court is jointly administering the countersuit with the Company's action. The Company has amended its complaint to add Alex Zaldivar, the managing director and a principal of FAS, as an additional Defendant, and to make new claims for accounting malpractice, negligent training and supervision, negligent placement and breach of fiduciary duty against the Defendants. The case is currently in the discovery stage.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements