SMF ENERGY CORP
Form 10-Q
February 14, 2008

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

FORM 10-Q

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

For the quarterly period ended December 31, 2007

OR

o 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	**65-0707824**
(State of Incorporation)	(IRS Employer Identification Number)

200 West Cypress Creek Road, Suite 400, Fort Lauderdale, Florida	**33309**
(Address of principal executive offices)	(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 x. No o.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

As of February 12, 2008 there were 14,556,295 shares of the registrant’s common stock outstanding.

SMF ENERGY CORPORATION

FORM 10-Q

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SMF ENERGY CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

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

	December 31, 2007 (unaudited)	June 30, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 63	$ 987
Accounts receivable, net of allowances of $1,381 and $1,401	21,390	25,442
Inventories, net of reserve of $192 and $238	2,142	2,283
Prepaid expenses and other current assets	347	471
Total current assets	23,942	29,183
Restricted cash	520	1,145
Property and equipment, net of accumulated depreciation of $12,942 and $11,807	10,266	10,017
Identifiable intangible assets, net of accumulated amortization of $870 and $681	2,583	2,771
Goodwill	228	228
Deferred debt costs, net of accumulated amortization of $402 and $1,197 and other assets	579	581
Total assets	$ 38,118	$ 43,925
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Line of credit payable	$ 12,947	$ 17,297
Promissory notes	2,000	-
Accounts payable	6,821	7,887
Accrued expenses and other liabilities	4,713	3,831
Total current liabilities	26,481	29,015
Long-term liabilities:		
Promissory notes, net of unamortized debt discount of $98 and $1,027	10,511	10,250
Other long-term liabilities	491	546
Total liabilities	37,483	39,811
Contingencies		
Shareholders' equity:		
Common stock, par value $.01 per share; 50,000,000 shares authorized; 14,556,295 and 13,702,426 issued and outstanding at December 31, 2007 and June 30, 2007, respectively	146	137
Additional paid-in capital	26,538	25,021
Accumulated deficit	(26,049)	(21,044)
Total shareholders' equity	635	4,114
Total liabilities and shareholders' equity	$ 38,118	$ 43,925

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 31, 2007	2006	Six Months Ended December 31, 2007	2006
Petroleum product sales and service revenues	$ 52,905	$ 48,276	$ 102,094	$ 106,920
Petroleum product taxes	6,089	6,522	12,397	13,506
Total revenues	58,994	54,798	114,491	120,426
Cost of petroleum product sales and service	50,340	45,176	96,347	99,699
Petroleum product taxes	6,089	6,522	12,397	13,506
Total cost of sales	56,429	51,698	108,744	113,205
Gross profit	2,565	3,100	5,747	7,221
Selling, general and administrative expenses	3,788	4,149	7,591	7,799
Operating loss	(1,223)	(1,049)	(1,844)	(578)
Interest expense	(782)	(835)	(1,560)	(1,785)
Interest and other income	19	(11)	40	6
Loss on extinguishment of promissory notes	-	-	(1,641)	-
Loss before income taxes	(1,986)	(1,895)	(5,005)	(2,357)
Income tax expense	-	-	-	-
Net loss	$ (1,986)	$ (1,895)	$ (5,005)	$ (2,357)
Basic and diluted net loss per share	$ (0.14)	$ (0.18)	$ (0.35)	$ (0.22)
Basic and diluted weighted average common shares outstanding	14,556	10,523	14,379	10,509

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, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (5,005)	$ (2,357)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization:		
Cost of sales	768	880
Selling, general and administrative	398	265
Amortization of deferred debt cost	130	156
Amortization of debt discount	63	294
Amortization of intangible assets	188	187
Stock-based compensation expense	259	151
Gain from sale of assets	(11)	-
Inventory reserve	(46)	-
Provision for doubtful accounts	237	219
Non-cash loss on extinguishment of debt	1,371	-
Changes in operating assets and liabilities:		
Decrease in accounts receivable	3,815	2,530
Decrease in prepaid expenses and other assets	124	354
Decrease in inventories	187	-
Decrease in accounts payable and other liabilities	(216)	(2,665)
Net cash provided by operating activities	2,262	14
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchases of property and equipment	(1,422)	(365)
Proceeds from sale of equipment	18	-
Decrease in restricted cash	625	-
Net cash used in investing activities	(779)	(365)
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Proceeds from line of credit	119,444	126,766
Repayments of line of credit	(123,794)	(129,509)
Proceeds from issuance of promissory notes	7,690	-
Proceeds from issuance of common stock	1,170	-
Principal payments on promissory notes	(6,359)	(452)
Debt issuance costs	(457)	(44)
Common stock issuance costs	(79)	-
Capital lease payments	(22)	(83)
Net proceeds from exercise of common stock options and warrants	-	31
Net cash used in financing activities	(2,407)	(3,291)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(924)	(3,642)
CASH AND CASH EQUIVALENTS, beginning of period	987	4,103

CASH AND CASH EQUIVALENTS, end of period	$	63	$	461

(Continued)

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

SMF ENERGY CORPORATION AND SUBSIDIARIES

CONDENSED UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in 000's)

(Continued)	**Six Months Ended December 31, 2007**		**2006**	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest	$	1,310	$	1,091
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES:				
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 August 2007 notes	$	112	$	-

The accompanying notes to consolidated 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. In addition, the Company's fleet of special duty tractor-trailer units provides heavy haul transportation services over short and long distances to customers requiring the movement of over-sized or over-weight equipment and manufactured products.

At December 31, 2007, the Company was conducting operations in ten states: Alabama, California, Florida, Georgia, Louisiana, Mississippi, 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. Certain prior period amounts have been reclassified to conform to the current period presentation, see Note 3, Reclassifications.

Operating results for the three and six months ended December 31, 2007 are not necessarily indicative of the results that may be expected for any subsequent period or the fiscal year ending June 30, 2008. 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, 2007, as filed with the United States Securities and Exchange Commission.

3. RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the current period presentation. These changes had no impact on previously reported results of operations or shareholders' equity. In accordance with EITF Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty", the Company has reclassified its treatment of reporting for sales of inventory to one of the Company's vendors from a gross basis to a net basis (net of service charges). Revenue and cost of sales were reduced by $364,000 and $701,000 from amounts previously reported for the three and six months ended December 31, 2006, respectively, to reflect this reclassification.

SMF ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

4. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board ("FASB") issued Financial Accounting Standard ("FAS") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FAS Statement No. 109" ("FIN No. 48"). FIN No. 48 clarifies the accounting for uncertainty in income taxes by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Application of FIN No. 48 was effective for the Company during this first quarter of fiscal 2008. The Company discloses its conclusions with respect to the effect of the application of FIN No. 48 in Note 14 – Income Taxes.

In September 2006, the FASB issued FAS Statement No. 157, "Fair Value Measurements" ("FAS No. 157"). This new 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. The application of FAS No. 157 is effective for financial statements issued for the Company's first quarter of fiscal year 2009. The Company has not yet determined the impact, if any, that the adoption of FAS No. 157 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's first quarter of fiscal year 2009. The Company has not yet determined the impact, if any, that the adoption of FAS No. 159 will have on its financial condition or results of operations.

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141 (revised 2007), *Business Combinations*, which replaces SFAS 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. SFAS No. 141R is effective for the Company beginning July 1, 2009 and will apply prospectively to business combinations completed on or after that date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB 51*, which changes the accounting and reporting for minority interests. 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. SFAS 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 currently assessing the potential impact that adoption of SFAS No. 160 would have on its financial statements.

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SMF ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

5. CASH AND CASH EQUIVALENTS

During the six months ended December 31, 2007, the Company paid down $4.4 million on its line of credit payable. Total cash and cash availability was $1.8 million and $2.8 million at December 31, 2007 and June 30, 2007, respectively, and was $2.0 million at February 12, 2008. 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 7 – Line of Credit Payable.

6. RESTRICTED CASH

In May 2007, the Company sold 29 pieces of equipment for an aggregate amount of $1.1 million. The proceeds of the sale were collateral for the August 2007 Notes, and therefore, were designated for the purchase of replacement equipment. At June 30, 2007, these proceeds were held by the indenture trustee, and recorded as restricted cash.

In August 2007, the Company entered into commitments to purchase $1.1 million in trucks and field equipment. Eight pieces of equipment for an aggregate amount of $654,000 were delivered in the six months ended December 31, 2007. The remaining proceeds of $520,000 remain in restricted cash and continue to be held by the indenture trustee at December 31, 2007 pending the delivery of the remaining new equipment.

7. 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. Letters of credit reduce the maximum amount available for borrowing. Interest is payable monthly at prime plus 0.75% (8.0% at December 31, 2007) and 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, 2007 and June 30, 2007, the Company had outstanding borrowings of $12.9 million and $17.3 million, respectively, under its $25.0 million line of credit. The line of credit is classified as a current liability since it expires on June 30, 2008. Based on eligible receivables and inventories, and letters of credit outstanding at December 31, 2007, the Company had $1.8 million of cash availability under the line of credit compared to $1.8 million availability at June 30, 2007.

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 September 30, 2007, the financial covenants included a minimum availability of $750,000 and an average monthly availability of $2.5 million, covenant which, if not maintained, would trigger a fixed charge coverage ratio of 1.0 to 1.0. Additionally, the Company had a current fiscal year capital expenditure limitation of $750,000 without approval from the line of credit lender. During the second quarter 2008, the Company and its line of credit lender amended the loan and security agreement to amend its average availability requirements from $2.5 million to $800,000 through January 31, 2008, increasing thereafter to $1.8 million in February 2008 and to increase the maximum amount for which letters of credit could be issued from $300,000 to $1,000,000. The line of credit agreement was subsequently amended to increase the maximum for letters of credit from $1,000,000 to $1,500,000 of which $1.0 million have been issued as of the date hereof. Additionally, the capital expenditure limitation without lender approval was increased to $1.3 million for fiscal 2008.

The line of credit agreement also requires the Company to obtain the consent of the financial institution prior to incurring additional debt, or mergers, consolidations or sales. 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, 2007, the Company was in compliance with the requirements of these covenants.

SMF ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

8. CURRENT PROMISSORY NOTES

On November 19, 2007, the Company obtained an aggregate of $2.0 million in short-term notes from a small group of individual and institutional investors (the "November 2007 Notes"). The proceeds were used for general working capital purposes. The Company's obligations under the November 2007 Notes are unsecured. While the November 2007 Notes have a six-month term originally maturing in May 2008, now extended until July 2008, they must be repaid earlier if and to the extent that the Company conducts an offering of its equity securities and the aggregate net proceeds of the equity offering, together with the net proceeds of the November 2007 Notes, exceed $3.5 million. The Company incurred $30,000 in issuance costs which are being amortized over the term of the notes. Interest on the unpaid principal balance of the November 2007 Notes will be paid monthly at an interest rate of 1.5% per month. The effective yield of these notes is 21.0%.

Each of the investors of the November 2007 Notes also entered into a subordination agreement with the Company and its principal lender, Wachovia Bank, N.A. (the "Bank"), subordinating their rights under the notes to the Bank. The subordination agreements were required by the terms of the amendment to the loan and security agreement between the Company and its line of credit lender, dated November 21, 2007.

9. LONG-TERM DEBT

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

	December 31, 2007	June 30, 2007
August 2007 senior secured convertible subordinated promissory notes (the "August 2007 Notes") (11.5% interest due semi-annually, December 31 and June 30); matures December 31, 2009 in its entirety; effective interest rate of 14.4% including cost of warrants and other debt issue costs.	$ 10,609	$ -
September 2005 promissory notes (the "September 2005 Notes"). The notes were refinanced on August 8, 2007.	-	3,000
January 2005 promissory notes (the "January 2005 Notes"). The notes were refinanced on August 8, 2007.	-	4,860
August 2003 promissory notes (the "August 2003 Notes"). The notes were refinanced on August 8, 2007.	-	3,417
Various capital leases	4	26
Unamortized debt discount	(98)	(1,027)
	10,515	10,276
Less: current portion (included in accrued expenses and other current liabilities)	(4)	(26)

Long-term debt, net	$	10,511	$	10,250

SMF ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

On August 8, 2007, the Company sold $11.8 million in debt and equity securities (the "Offering"). The Company used a portion of the proceeds to satisfy the balance of its outstanding secured promissory notes issued on August 29, 2003, January 25, 2005 and September 1, 2005 (the "Satisfied Notes"), respectively, and to lower the Company's total senior secured convertible subordinated debt from $11.2 million to $10.6 million on August 8, 2007. As a result of this transaction, the Company wrote-off approximately $978,000 and $443,000 of unamortized debt discount and debt costs, respectively.

In the Offering, the Company sold $10.6 million in 11½% senior secured convertible subordinated promissory notes maturing in their entirety on December 31, 2009, including $5.7 million sold to new institutional and private investors and $4.9 million to then current holders of the Company's secured debt. The Company paid a total commission of $400,000 to the placement agent, $94,000 of which was paid through the issuance of 63,327 shares of the Company's common stock at the offering price of $1.48 per share. For information on the equity securities sold, see Note 12 – Stockholders' Equity.

The August 2007 Notes are secured by specified vehicles and field equipment of the Company and its subsidiaries and are senior to all other existing debt of the Company other than any amounts owed now or in the future to the Company's primary lender, Wachovia Bank, N.A, to which the August 2007 Notes are expressly subordinated. The amounts due under the August 2007 Notes will become due and payable immediately upon the occurrence of customary events of default. The Notes are redeemable by the Company, in whole or in part, without pre-payment penalty or premium, except that, if such pre-payment is made before the first anniversary of the issuance of the August 2007 Notes, a pre-payment penalty equal to 3% of the principal amount being redeemed, together with accrued but unpaid interest shall be paid.

The noteholders have the right to convert up to fifty percent (50%) of the principal amount of the August 2007 Notes into shares of the Company's common stock at $1.46 per share. The Company may elect, in its discretion, to grant additional conversion rights for some or all of the remaining principal amount of the August 2007 Notes at a price not less than the higher of $1.46, or the most recent closing price for the Company's common stock on the Nasdaq Stock Market at the time of such grant. The Company registered the resale of the shares under the Securities Act of 1933, as amended, including the shares into which the August 2007 Notes may be converted and the shares obtained upon exercise of the warrants. As a result of the conversion feature, the Company recorded $37,000 as a beneficial conversion feature which is being amortized under the effective interest method as a non-cash discount over the respective term of the debt. Through December 31, 2007, neither the Company nor the noteholders have granted additional conversion rights or exercised any of their existing conversion rights, respectively.

The August 2007 Notes have cross-default provisions contained in the debt agreement. Accordingly, an event of default under the line of credit facility, described in Note 7, could also cause a default under the August 2007 Notes. As of December 31, 2007, the Company was in compliance with the requirements of these covenants.

In accordance with FAS No. 6, "Classification of Short-term Obligations Expected to be Refinanced", at June 30, 2007, the Company classified all of the then outstanding balances related to the secured promissory notes as long-term debt, since they were refinanced with the proceeds from the August 2007 Notes, which mature on December 31, 2009.

SMF ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Other

In connection with the August 2003, January 2005 and September 2005 Notes, the Company recorded at issuance 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, there were unamortized debt discounts of $978,000 which were written-off when the Satisfied Notes were redeemed. As a result of the early satisfaction of the notes, the Company incurred $270,000 as a pre-payment penalty. The unamortized debt discounts of $978,000 and the pre-payment penalty of $270,000, along with deferred debt costs of $443,000, were recorded as losses on extinguishment of debt in our unaudited condensed consolidated results of operations. Partially offsetting the losses on extinguishment of debt was a gain on extinguishment of debt of $50,000 as a result of the excess of the carrying value of the Satisfied Notes over the extinguishment price.

In connection with the August 2007 Notes, the Company recorded unamortized debt discounts of $112,000, to be amortized as non-cash interest expense over the term of the notes, related to the valuation of the common stock warrants issued to noteholders. Total amortization expense related to all debt discounts were $13,000 and $144,000 for the three months ended December 31, 2007 and 2006, respectively, and $63,000, and $294,000 for the six months ended December 31, 2007 and 2006, respectively.

10. WARRANTS

In conjunction with the issuance of the August 2003, January 2005 and September 2005 Notes described in Note 9 - Long Term Debt, the Company issued detachable common stock purchase warrants, described below as the August 2003, January 2005, and September 2005 Warrants, respectively. In addition, in June 2006, the Company issued non-detachable warrants to certain note holders (the “Conversion Warrants”). In conjunction with a private offering of its common stock in February 2007, the Company issued warrants described below as the February 2007 warrants. In August 2007, in conjunction with the sale of promissory notes and equity, the company issued warrants described below as the August 2007 warrants. As of June 30, 2007, all of the Conversion Warrants had been exercised.

There was no exercise of warrants in the six months ended December 31, 2007.

August 2003 Warrants

On August 29, 2003, the Company raised $6.9 million and issued 2,008,250 five-year detachable warrants to purchase the Company’s common stock at $1.00 per share. At December 31, 2007, the warrant holders had a balance of 140,000 warrants available to exercise into common shares.

January 2005 Warrants

On January 25, 2005, the Company raised $6.1 million and issued 1,006,500 four-year detachable warrants to purchase the Company’s common stock at an exercise price of $1.60 per share. At December 31, 2007, the warrant holders had a balance of 37,292 warrants available to exercise into common shares.

September 2005 Warrants

On September 1, 2005, the Company raised $3.0 million and issued 360,000 four-year detachable warrants to purchase the Company’s common stock at an exercise price of $2.28 per share. At December 31, 2007, the warrant holders had a balance of 75,840 warrants available to exercise into common shares.

SMF ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Conversion Warrants

On June 30, 2006, the Company issued 1,057,283 non-detachable warrants (the “Conversion Warrants”), exercisable for 90 days to certain note holders of the August 2003 Notes and the January 2005 Promissory Notes, by which those note holders could exchange up to $2.6 million of existing August 2003 and January 2005 Notes for the purchase of shares of the Company’s common stock at an exercise price of $2.54 per share, the closing market price on the date of the agreement. Included in these warrants were 25,787 warrants, valued at $65,500, issued to pay 50% of the 5% call penalty, or a 2.5% penalty. As of June 30, 2007, the note holders had exercised all of the Conversion Warrants.

February 2007 Warrants

In conjunction with the February 15, 2007 private placement offering, the Company issued detachable warrants to purchase 423,800 of the Company’s common stock at an exercise price of $1.52 per share. In addition, the placement agent received additional warrants to purchase 130,955 shares of the Company’s common stock at an exercise price of $1.90 per share. As of December 31, 2007, these warrants remain outstanding.

August 2007 Warrants

In conjunction with the August 8, 2007 promissory notes and equity offering, further described in Note 9 - Long-Term Debt and Note 12 – Shareholders’ Equity, the Company issued detachable warrants to the noteholders to purchase 39,528 shares of the Company’s common stock at an exercise price of $1.752 per share. In addition, the placement agent received additional warrants to purchase 39,526 shares of the Company’s common stock at an exercise price of $1.752 per share. The August 2007 warrants will terminate on the fourth anniversary of the offering closing date. The August 2007 warrants also have customary anti-dilution and underlying stock registration rights. As of December 31, 2007, these warrants remain outstanding.

11. NET INCOME (LOSS) PER SHARE

Basic net income per share is computed by dividing the net income attributable to common shareholders by the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income attributable to common shareholders by the weighted-average number of common shares outstanding during the period, increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. The dilutive effect of outstanding stock options and warrants is reflected in diluted earnings per share by application of the treasury stock method.

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The net loss per share computations for the three months and six months ended December 31, 2007 and 2006 do not include common stock equivalents that the Company had outstanding during those periods as they were antidilutive due to the net loss incurred. At December 31, 2007, these common stock equivalents outstanding consisted of 2,040,202 stock options, 886,941 common stock warrants, and 3,633,296 promissory note conversion rights, at prices ranging from $.67 to $7.63 per share. At December 31, 2006, the common stock equivalents outstanding consisted of 1,844,502 stock options and 1,310,415 common stock warrants, at prices ranging from $.92 to $7.63 per share.

12. SHAREHOLDERS' EQUITY

As discussed in Note 9 – Long-term Debt, on August 8, 2007, the Company sold $11.8 million in debt and equity securities (the "Offering"). The Company used a portion of the proceeds to satisfy the balance of its outstanding secured promissory notes issued on August 29, 2003, January 25, 2005 and September 1, 2005, respectively, and to lower the Company's total senior secured convertible subordinated debt from $11.2 millionto $10.6 million on August 8, 2007.

In the Offering, the Company sold 790,542 shares of common stock (the "Shares") and 39,528 four year warrants to purchase common stock at $1.752 per share (the "Warrants"). The Shares and Warrants were sold at $1.48 per Share and one twentieth of a Warrant, or $29.60 for twenty (20) Shares and one (1) Warrant, for equity proceeds of $1.2 million. The Company incurred transaction costs of $592,000 which were allocated on a percentage basis to equity and debt. Included in these transaction costs were commissions of $400,000 paid to the placement agent for the offering, $94,000 of which was paid through the issuance of 63,327 shares of our common stock at the offering price of $1.48 per share, along with 39,528 warrants with the same terms as the Warrants sold to investors.

The following reflects the change in shareholders' equity for the six months ended December 31, 2007 (in thousands):

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total Shareholders' Equity
Balance at June 30, 2007	$ 137	$ 25,021	$ (21,044)	$ 4,114
Issuance of common stock and warrants from August 2007 offering, net of issuance costs of $99,000	9	1,258	-	1,267
Stock-based compensation expense	-	259	-	259
Net loss	-	-	(5,005)	(5,005)
Balance at December 31, 2007	$ 146	$ 26,538	$ (26,049)	$ 635

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During the six months ended December 31, 2007, the Company granted 253,000 and 18,000 stock options under the Employee Stock Options and Director Stock Options plans, respectively. The weighted average grant date fair value of the options granted was $1.12. For the six months ended December 31, 2007, there were no stock options exercised.

13. CONTINGENCIES

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. On January 25, 2007, the Company filed an amended complaint in its lawsuit by which Alex Zaldivar, the managing director and a principal of FAS, was added as an additional Defendant. In the amended complaint, the Company also made new claims for accounting malpractice, negligent training and supervision, and breach of fiduciary duty against the Defendants. The case is currently in the discovery stage.

The amount of damages recoverable from the Defendants in this action will depend on a number of factors, including but not limited to the costs incurred by the Company in completing the IT Projects, the amount of consequential damages suffered by the Company as a result of the delays and poor performance by FAS in implementing the IT projects, potential counterclaims or countersuit by FAS for amounts billed to the Company which the Company has refused to pay, and the assessment by the Company, based on input from the new vendor engaged by the Company to replace FAS, of the estimated costs to complete the IT Projects. The Company believes that, based on all available information, the likelihood of FAS prevailing in any litigation against the Company is remote and the chance of recovery by FAS against the Company is slight.

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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 which may be covered by insurance or recoverable from third parties, or the financial impact with respect to these matters as of December 31, 2007. However, based on management's knowledge at December 31, 2007, 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.

14. INCOME TAXES

On July 1, 2007, the Company adopted the provisions of Financial Accounting Standards ("FAS") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN No. 48"). The Company previously had accounted for tax contingencies in accordance with FAS No. 5, "Accounting for Contingencies". As required by FIN No. 48, which clarifies FAS No. 109, "Accounting for Income Taxes", the Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, the Company applied FIN No. 48 to tax positions for all open tax years. The adoption of FIN No. 48 resulted in a decrease to deferred tax assets and the related valuation allowance of approximately $352,000 as of July 1, 2007. There was no impact on the previously reported accumulated deficit.

At July 1, 2007, the amount of unrecognized tax benefits was approximately $847,000, of which approximately $352,000 would, if recognized, affect the Company's effective tax rate. There have been no material changes in unrecognized tax benefits since July 1, 2007.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income taxes. No interest and penalties were accrued upon the adoption of FIN No. 48 due to the existence of net operating loss carryforwards benefits that would exceed any interest and penalties expense related to uncertain tax positions.

The Company or its subsidiaries file income tax returns in the U.S. federal jurisdiction and various states and other local jurisdictions. The Company's federal income tax returns for years prior to June 30, 2004 are no longer subject to examination. Returns for some state and local jurisdictions prior to that date remain subject to examination but are not individually considered material.

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

<u>Forward Looking Statements</u>

This report, including but not limited to this Item 2 and the footnotes to the financial statements in Item 1, contains "forward looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements concern expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. Statements preceded by, followed by, or that include the words "believes," "expects," "anticipates," or similar expressions are generally considered to be forward-looking statements.

The forward-looking statements include, but are not limited, to the following:

- Our beliefs regarding our position in the market for commercial mobile fueling and bulk fueling; lubricant and chemical packaging, distribution and sales; integrated out-sourced fuel management services; and transportation logistics;

- Our strategies, plan, objectives and expectations concerning our future operations, cash flows, margins, revenues, profitability, liquidity and capital resources;

- Our efforts to improve operational, financial and management controls and reporting systems and procedures; and

- Our plans to expand and diversify our business through acquisitions of existing companies or their operations and customer bases.

The forward-looking statements reflect our current view about future events and are subject to risks, uncertainties and assumptions. We caution readers of this report that certain important factors may have affected and could in the future affect our actual results and could cause actual results to differ significantly from those expressed in any forward-looking statement. In addition to the Risk Factors included in Part II, Item 1A, of this report, the inaccuracy of any of the following assumptions could prevent us from achieving our goals, and cause the assumptions underlying the forward-looking statements and the actual results to differ materially from those expressed in or implied by those forward-looking statements:

- The avoidance of future net losses;

- The avoidance of adverse consequences relating to our outstanding debt;

- Our continuing ability to pay interest and principal on our debt instruments, and to pay our accounts payable and other liabilities when due;

- Our continuing ability to comply with financial covenants contained in our credit agreements;

- Our continuing ability to obtain all necessary waivers of covenant violations, if any, in our debt agreements;

- The avoidance of significant provisions for bad debt reserves on our accounts receivable;

- The continuing demand for our products and services at competitive prices and acceptable margins;

- The avoidance of negative customer reactions to new or existing marketing strategies;

- The avoidance of significant inventory reserves for slow moving products;

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- Our continuing ability to acquire sufficient trade credit from fuel and lubricants suppliers and other vendors;
- The successful integration of acquired companies into our existing operations, and enhancing the profitability of the integrated businesses;
- The successful execution of our acquisition and diversification strategy, including the availability of sufficient capital to acquire additional businesses and to support the infrastructure requirements of a larger combined company;
- The success in responding to competition from other providers of similar services;
- The impact of generally positive economic and market conditions; and
- The ability to retire or convert debt to equity.

OVERVIEW

Our Business

We are a provider of petroleum product distribution services, transportation logistics and emergency response services to the trucking, manufacturing, construction, shipping, utility, energy, chemical, telecommunications and government services industries. At December 31, 2007, we were conducting operations through 26 locations in the ten states of Alabama, California, Florida, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee and Texas.

We provide commercial mobile and bulk fueling, integrated out-sourced fuel management, packaging, distribution and sale of lubricants and chemicals, transportation logistics, and emergency response services. Our fleet delivers diesel fuel and gasoline to customer locations on a regularly scheduled or as needed basis, refueling vehicles and equipment, re-supplying bulk storage tanks, and providing fuel for emergency power generation systems. We also distribute a wide variety of specialized petroleum products, lubricants and chemicals primarily to our customers in Texas. Our fleet of special duty tractor-trailer units provides heavy haul transportation logistics services over short and long distances to customers requiring the movement of over-sized and/or over-weight equipment and heavy manufactured products.

We compete with several large and numerous small distributors, jobbers and other companies offering services and products in the same markets in which we operate. We believe that the industry and these markets offer us opportunities for consolidation, as customers increasingly demand one-stop shopping for their petroleum based needs and seek reliable supply deliveries particularly to prevent business interruptions during emergencies. We believe that certain factors, such as our ability to provide a range of services and petroleum based products and services, create advantages for us when compared to our competitors.

An objective of our business strategy is to become the leading “single source” provider of petroleum products and services in the markets we currently operate in, as well as expanding into additional contiguous markets. To achieve this objective we plan to focus on increasing revenues in our core operations and in expanding through selective acquisitions.

The following is a summary discussion of our financial results for the three months ended December 31, 2007 (the "second quarter of fiscal 2008") and our execution on several core strategies that impacted results of operations:

- In the second quarter of fiscal 2008, we had a net loss of $1.986 million. These results include $963,000 in non-cash charges, such as depreciation and amortization of assets, debt costs, debt discounts, stock based compensation, and provision for doubtful accounts. Additionally the results include stated interest expense associated with servicing of our debt of $686,000, legal expenses of $179,000, and non-legal public company costs of $256,000**,** including audit, director, filing, and other fees .

- On November 19, 2007, we obtained an aggregate of $2.0 million in short-term notes from a small group of individual and institutional investors (the "November 2007 Notes"). The proceeds were used for general working capital purposes.

- Escalating fuel prices resulting in decreased demand from our existing customers have continued to impact our results of operations. While fuel price fluctuations affect our revenues, our gross profits are generally not affected by such fluctuations since we were able to pass the increased cost of the product on to our customers. However, these historically high fuel prices are damping the demand for the services and goods provided by most of the transportation, manufacturing, services and other industries that comprise the majority of our customer base and are also raising the fuel running costs of our delivery fleet. In addition to negatively impacting our profitability, these higher fuel prices have substantially increased the amount of short term credit that we need to obtain to cover the time between our receipt of fuel from the suppliers and our receipt of payment from our customers. Our higher demand for credit has led to limitations on the availability of supplier credit and has increased our borrowing cost.

We initially addressed the limitations on supplier credit by obtaining $2.0 million in short-term notes from a limited number of investors in November 2007, including an agreement to repay the notes with the proceeds of a planned equity offering. The recent downturn in the equity markets and the tightening of the credit markets from the sub prime debt crisis have significantly delayed our efforts to obtain new equity financing in order to pay the November 2007 investors and provide additional working capital for our operations. As a result we have obtained an extension of the maturity date of this debt from May 18, 2008 until July 18, 2008 while we continue to seek replacement financing, which may be obtained as part of the financing of one or more new acquisitions. While we believe that we will be able to obtain such replacement financing or a further extension of the short-term notes, if needed, failure to do so or to make timely payment of the short-term notes could result in a default that could trigger a default in our other debt agreements because of cross-default provisions in those agreements.

- Increasing the overall size of the Company while diversifying the services and products we offer to the industry are integral to the execution of our strategic business plan and critical to the utilization of the infrastructure and systems which we now have in place. We believe that this infrastructure and these systems are today unique in the industry and give us the ability to rapidly and effectively integrate operations and gain efficiencies. To this end, we are actively pursuing merger and acquisition opportunities and are in discussions with key targets which we believe would meet our goals. While there can be no assurance that we will be able to acquire or merge with these targets, we do believe that, notwithstanding the current conditions in the credit markets, the capital necessary to execute this strategy will be available to us, including the opportunity to raise additional working capital in conjunction with these transactions.

Key financial and operating measures during the second quarter of fiscal 2008 include:

- The net loss from operations for the second quarter of fiscal 2008 was $1.986 million compared to a net loss of $1.895 million for the same period in the prior year. The primary reasons for the $91,000 increase in the net loss were a $535,000 decrease in gross profit as a result of the decrease in demand in the industries and geographic locations we serve, a reduction in business with net margin contributions below acceptable levels and lower emergency response revenue. The $535,000 decrease in gross profit was partially offset by a decrease of $361,000 in selling, general and administrative costs, primarily due to the integration of the H&W and Shank acquisitions and lower personnel costs stemming from efficiencies of our new Enterprise Resource Planning ("ERP") system.

- For the second quarter of fiscal 2008, the net margin was 16.3 cents per gallon compared to 16.6 cents per gallon for the same period in the prior year, primarily due to higher margin emergency response revenue in fiscal 2007.

- Earnings before interest, taxes, depreciation, amortization, stock-based compensation expense, and loss on extinguishment of debt ("EBITDA"), a non-GAAP measure, for the second quarter of fiscal 2008 was a loss of $387,000 compared to a loss of $258,000 for the same period in the prior year. The primary reason for the $129,000 increase in the EBITDA loss was the decrease in gross profit offset by the decrease in selling, general and administrative costs, as discussed above.

- Financial results from our commercial mobile and bulk fueling services business continue to be largely dependent on the number of gallons of fuel sold and the net margin per gallon achieved. We experienced a 15.5% gallon reduction in the second quarter of fiscal 2008 when compared to the same period in the prior year. This volume reduction was primarily due to lower volume demanded by our existing customers, which we believe stems from the general economic conditions in the industries and geographic locations we serve, our customers' efforts to reduce fuel consumption in light of increased fuel prices, and the reduction in business with net margin contributions below acceptable levels.

RESULTS OF OPERATIONS:

To monitor our results of operations, we review key financial information, including net revenues, gross profit, selling, general and administrative expense, net income or losses, and non-GAAP measures such as EBITDA and Proforma EBITDA. We continue to seek ways to more efficiently manage and monitor our business performance. We also review other key operating metrics, such as the number of gallons sold and net margins per gallon sold. As our business is dependent on the supply of fuel and lubricants, we closely monitor pricing and fuel availability from our suppliers in order to purchase the most cost effective products.

Net margin per gallon is calculated by adding gross profit and the depreciation and amortization components of cost of sales, and dividing that sum by the number of gallons sold.

Comparison of Three Months Ended December 31, 2007 ("second quarter of fiscal 2008") to Three Months Ended December 31, 2006 ("second quarter of fiscal 2007")

Revenues

Revenues were $59.0 million in the second quarter of fiscal 2008, as compared to $54.8 million in the same period of the prior year, an increase of $4.2 million, or 8%, as a result of the increases in prices per gallon of petroleum products. Price variances resulted in an increase of $12.6 million in revenues partially offset by a $8.4 million decrease in revenues due to a 15% reduction in gallons sold during the second quarter of fiscal 2008 when compared to the prior year. We believe that the lower volume is the result of the contraction of the national economy, particularly as it is impacting the industries and geographic locations we serve, and our customers' efforts to reduce fuel consumption in light of substantially higher fuel prices. A portion of the decrease in volume is due to our decision to reduce the business with net margin contributions below acceptable levels as well as lower emergency response services this year.

Gross Profit

Gross profit was $2.6 million in the second quarter of fiscal 2008, as compared to $3.1 million in the same period of the prior year, a decrease of $535,000, or 17%. The decrease was primarily due to the decrease in industry demand stemming from the contraction of the national economy, reduction in business with net margin contributions below acceptable levels, the decrease in emergency response business earned in the second quarter of fiscal 2007, all described above. The net margin per gallon for the second quarters of fiscals 2008 and 2007 was 16.3 cents and 16.6 cents, respectively. The decrease in net margin per gallon was due to the decrease in higher margin emergency response revenue since the demand for these services was greater in fiscal 2007.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $3.8 million in the second quarter of fiscal 2008, as compared to $4.1 million in the same period of the prior year, a decrease of $361,000, or 9%. The decrease is attributable to the following (in thousands):

Reduction in acquired SG&A costs associated with H & W and Shank and certain personnel cost, as system efficiencies are gained	$	(202)
Non-legal public company compliance expense		(58)
Reduction in facilities expenses related to the integration of certain Texas locations		(35)
Increase in SG&A depreciation primarily related to ERP system implementation		75
Reduction due to disaster recovery relocation of systems incurred in prior year		(70)
Other, net		(71)
Total decrease	$	(361)

Interest Expense

Interest expense was $782,000 in the second quarter of fiscal 2008, as compared to $835,000 in the same period of the prior year, a decrease of $53,000, or 6%. The decrease was primarily due to lower non-cash interest amortization as a result of the refinancing of our long-term debt, since the outstanding secured promissory notes issued on August 2003, January 2005 and September 2005 were refinanced in August 2007 with new senior secured convertible subordinated notes.

The components of interest expense were as follows (in thousands):

	Three Months Ended December 31,	
	2007	**2006**
Stated Rate Interest Expense:		
Line of credit	$ 318	$ 269
Long term debt	354	319
Other	14	27
Total stated rate interest expense	686	615
Non-Cash Interest Amortization:		