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COTELLIGENT INC  
Form 10-Q  
May 15, 2002

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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 March 31, 2002

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-27412

COTELLIGENT, INC.

Delaware  
(State of incorporation)

94-3173918  
(I.R.S. ID)

44 Montgomery Street, Suite 4050 San Francisco, California 94104

(415) 439-6400

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

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

At May 10, 2002, there were 14,900,891 shares of common stock outstanding.

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COTELLIGENT, INC.

FORM 10-Q

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For the Quarterly Period Ended March 31, 2002

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Item 1. Financial Statements

COTELLIGENT, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(In thousands, except share data)  
(Unaudited)

	March 31, 2002 -----
ASSETS	
Current assets:	
Cash and cash equivalents.....	\$ 23,110
Refundable income taxes.....	225
Accounts receivable, including unbilled accounts of \$992 And \$1,627 and net of allowance for doubtful accounts of \$1,668 and \$1,566, respectively.....	2,937
Deferred tax assets.....	7,413
Notes receivable from officers and stockholder.....	1,860

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Current portion of note receivable from acquirer of Discontinued operation.....	642
Prepaid expenses and other current assets.....	960
	-----
Total current assets.....	37,147
Capitalized software costs, net.....	827
Property and equipment, net.....	3,036
Note receivable from acquirer of discontinued operation.....	3,352
Equity investment in alliance partner.....	1,871
Other assets.....	110
	-----
Total assets.....	\$ 46,343
	=====

### LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Current maturities of long-term debt.....	\$ 252
Accounts payable.....	1,084
Accrued compensation and related payroll liabilities.....	1,930
Obligations related to acquired/sold businesses.....	3,085
Restructuring liabilities.....	1,042
Other accrued liabilities.....	2,259
	-----
Total current liabilities.....	9,652
Long-term debt.....	508
Deferred tax liabilities.....	13
Income tax reserves.....	2,368
	-----
Total liabilities.....	12,541
	-----

### Stockholders' equity:

Preferred Stock, \$0.01 par value; 500,000 shares authorized, no shares issued or outstanding.....	-
Common Stock, \$0.01 par value; 100,000,000 shares Respectively authorized, 15,545,491 and 15,514,757 shares issued, respectively.....	155
Additional paid-in capital.....	86,891
Notes receivable from stockholders.....	(6,193)
Retained deficit.....	(46,551)
Treasury Stock.....	(500)
	-----
Total stockholders' equity.....	33,802
	-----
Total liabilities and stockholders' equity.....	\$ 46,343
	=====

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

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	Three Months
	-----
	2002
	-----
Revenues.....	\$ 5,784
Cost of services.....	3,803
	-----
Gross profit.....	1,981
Research and development costs.....	219
Selling, general and administrative expenses.....	4,174
Depreciation and amortization of goodwill.....	400
	-----
Operating loss.....	(2,812)
Other income (expense):	
Interest expense.....	(21)
Interest income.....	186
Other.....	11
	-----
Total other income (expense).....	176
	-----
Loss from continuing operations before income taxes.....	(2,636)
Income tax benefit.....	7,400
	-----
Income (loss) from continuing operations.....	4,764
Loss from discontinued operations net of income taxes Of \$0.....	-
	-----
Net income (loss).....	\$ 4,764
	=====
Earnings (loss) per share:	
Basic.....	\$ 0.32
	=====
Diluted.....	\$ 0.31
	=====
Weighted average number of shares outstanding	
Basic	14,890,646
Diluted	15,556,747

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

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COTELLIGENT, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)  
(Unaudited)

	Three
	-----
	2002
	-----
Cash flows from operating activities:	
Net income (loss).....	\$ 4,7
Adjustments to reconcile net income (loss) to net cash provided by	

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(used in) operating activities:	
Operating (income) loss from discontinued operations.....	(
Equity (income) loss from investments.....	4
Depreciation and amortization.....	(7,4
Deferred income taxes, net.....	)
Provision for doubtful accounts.....	)
Changes in current assets and liabilities:	
Accounts receivable, net.....	1,6
Prepaid expenses and other current assets.....	)
Accounts payable and accrued expenses.....	(1,6
Income taxes payable, refundable.....	6,5
Changes in other assets.....	)
Cash provided by (used for) operating activities.....	4,5
Cash flows from investing activities:	
Payments received on note from acquirer of discontinued operations....	)
Purchases of property and equipment.....	)
Cash provided by (used for) investing activities.....	)
Cash flows from financing activities:	
Payments on capital lease obligations.....	)
Payments on long-term debt.....	(1
Net proceeds on issuance of stock.....	)
Cash provided by (used for) financing activities.....	(1
Cash flows from discontinued operations:	
Cash flow provided (used) by discontinued operations.....	)
Net increase in cash.....	4,3
Cash at beginning of period.....	18,7
Cash at end of period.....	\$ 23,1
Supplemental disclosures of cash flow information:	
Interest paid.....	\$
Income taxes paid (refunded).....	\$ (6,5

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

COTELLIGENT, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollar amounts in thousands)  
(Unaudited)

Note 1 - Business Organization and Basis of Presentation  
Cotelligent, Inc. ("Cotelligent" or the "Company"), a Delaware corporation, provides software consulting services to businesses with complex information technology ("IT") operations and maintenance, support and contract services on software products it licenses. These financial statements include the accounts of Cotelligent, Inc. and its subsidiaries.

During the fiscal year ended March 31, 2000, the Company was organized in two practice groups, Technology Solutions and Professional Services (also known as its IT staff augmentation business), and operated across the United States along with international consultant recruiting offices in Brazil and the Philippines. Prior to March 31, 2000, the Company entered into a plan to divest its IT staff

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augmentation business. Accordingly, the accompanying consolidated financial statements and related footnotes have been prepared to present as discontinued operations the Company's IT staff augmentation business for all periods presented.

The Company has suffered significant operating losses as well as negative operating cash flows in the last three fiscal periods and continues to be subject to certain risks common to companies in this industry. These uncertainties include the availability of financing, the retention of and dependence on key individuals, the affects of intense competition, the ability to develop and successfully market new product and service offerings, and the ability to streamline operations and increase revenues. There can be no assurance the Company will be profitable in the future.

### Note 2 - Summary of Significant Accounting Policies

The accompanying interim financial statements do not include all disclosures included in the financial statements in Cotelligent's Annual Report on Form 10-K for the year ended December 31, 2001 ("Form 10-K"), and therefore these financial statements should be read in conjunction with the financial statements included in Cotelligent's Form 10-K.

In the opinion of management, the interim financial statements filed as part of this Quarterly Report on Form 10-Q reflect all adjustments necessary for a fair presentation of the financial position and the results of operations and of cash flows for the interim periods presented. Certain balances of the prior year have been reclassified to conform to the current presentation.

### Note 3 - Changes in Stockholders' Equity

	Common Stock		Additional	Notes	Retained
	Shares	Amount	Paid-In	Receivable	Deficit
	-----	-----	Capital	From	-----
	-----	-----	-----	Stockholders	-----
Balance at December 31, 2001..	15,514,757	\$155	\$86,888	\$(6,193)	\$(51,315)
Issuance of Common Stock.....	30,734	-	3	-	-
Net income.....	-	-	-	-	4,764
	-----	-----	-----	-----	-----
Balance at March 31, 2002.....	15,545,491	\$155	\$86,891	\$(6,193)	\$(46,551)
	=====	=====	=====	=====	=====

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COTELLIGENT, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollar amounts in thousands)  
(Unaudited)

### Note 4 - Discontinued Operations

The following financial data reflects a summary of operating results for the Company's discontinued operations for the three months ended March 31, 2001.

#### Summary of Operating Results of Discontinued Operations:

Three Months Ended  
March 31, 2001

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Revenues.....	\$ 1,858
Cost of services.....	1,453
<hr/>	
Gross profit.....	405
Selling, general and administrative expenses.....	411
Depreciation and amortization of goodwill.....	-
<hr/>	
Operating loss .....	(6)
<hr/>	
Other expense.....	-
<hr/>	
Operating loss before provision for taxes.....	(6)
Provision for income taxes.....	-
<hr/>	
Operating loss from discontinued operations.....	\$ (6)
<hr/> <hr/>	

On June 30, 2000, the Company sold the majority of its IT staff augmentation business and on July 14, 2000 and October 31, 2000 sold other components of the IT staff augmentation business. During the quarter ended March 31, 2001, the Company held one remaining component in discontinued operations. During the fourth quarter of fiscal 2001, the Company abandoned its plan to divest of this operation and consequently closed this business. Subsequent to the closure of this business, the Company continued to service any residual client contracts and has classified the financial results related to these contracts in continuing operations.

Note 5 - Earnings (loss) Per Share

Earnings (loss) per share were as follows:

	For the Three Months Ended March 31, 2001	
	Income (Loss)	Shares
	-----	-----
Basic earnings (loss) per share-		
Income from continuing operations.....	4,764	14,890,64
Income from discontinued operations.....	-	14,890,64
<hr/>		<hr/>
Net income available to common stockholders.....	4,764	14,890,64
Diluted earnings (loss) per share-		
Income from continuing operations.....	4,764	15,556,74
Income from discontinued operations.....	-	15,556,74
<hr/>		<hr/>
Net income available to common stockholders.....	4,764	15,556,74

Share amounts used in the diluted earnings per share calculation reflect the effect of options issued to directors and employees.

	For the Three Months Ended March 31, 2000	
	Income (Loss)	Shares
	-----	-----

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Basic and diluted earnings (loss) per share-		
Loss from continuing operations.....	\$ (4,265)	15,349
Loss from discontinued operations.....	(6)	15,349
	-----	-----
Net loss available to common stockholders.....	\$ (4,271)	15,349

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COTELLIGENT, INC. AND SUBSIDIARIES  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Dollar amounts in thousands)  
 (Unaudited)

The effect of options issued to directors and employees has not been considered in the diluted earnings per share calculation due to the loss position of the Company's continuing operations for the quarter ended March 31, 2001. As such, there is no difference between the basic and diluted loss per share calculation for the quarter.

Note 6 - Restructuring Programs

In June 1999, as part of the Company's reorganization into practice groups, the Company identified opportunities to align its operating structure by closing certain of its redundant facilities and rationalizing headcount to conform to the Company's new operating structure. Accordingly, the Company adopted a restructuring plan, which resulted in a pre-tax restructuring charge of \$4,920. The charge included provisions for severance of approximately 60 management and operating staff (\$3,510) as well as closure costs related to a plan of consolidating certain operating locations (\$1,410). The charge was originally recorded as an operating expense in June 1999. Upon the Company's decision to discontinue its IT staff augmentation segment the amount was reclassified to discontinued operations, as all charges related to severance or other activities of the discontinued operations.

In December 2000 and September 2001, as part of the Company's efforts to streamline its operations commensurate with its revenue base, the Company identified opportunities to reduce its cost structure by reducing headcount and closing certain operating facilities to conform to the Company's new operating structure. Accordingly, the Company adopted a restructuring plan, which resulted in a pre-tax restructuring charge of \$4,200 during the nine months ended December 31, 2000 and \$3,373 during the nine months ended September 30, 2001. The December 2000 charge included provisions for severance of approximately 90 management and operating staff (\$1,100), as well as closure costs associated with a plan to consolidate or dispose of certain locations including the write-down of associated property and equipment (\$3,100). The September 2001 charge included provisions for severance of approximately 145 management and operating staff (\$1,059) as well as closure costs associated with a plan to consolidate or dispose of certain locations including the write-down of associated property and equipment (\$2,314).

The following summarizes the activity and balances in each restructuring program for the three months ended March 31, 2002:

June 1999 Restructuring Program		December 2000 Restructuring Program		
-----		-----		-----
Severance	Facilities Closure	Severance	Facilities Closure	Sev



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	-----	-----	-----	-----	-----
Balance at December 31, 2001.....	\$	-	\$143	\$	-
Spending and adjustments.....		-	(26)		-
			-----		-----
Balance at March 31, 2002.....	\$	-	\$117	\$	-
			=====		=====
			-----		-----
			-----		-----
			-----		-----

### Note 7 - Income Taxes

On March 9, 2002, Congress approved the Job Creation and Worker Assistance Act of 2002 (the Act) allowing net operating losses for the Company's fiscal tax year ending March 31, 2002 to be carried back five years. In accordance with SFAS No. 109, the effect of this change in tax law was reflected in the March 31, 2002 financial statements as changes in tax law must be reflected in the period of enactment. Consequently, the Company recorded a \$7,400 tax benefit during the quarter ended March 31, 2002, which reflects the release of a valuation allowance against a deferred tax asset previously written down to zero due to the uncertainty of its realization. The Company intends to apply for a refund of taxes estimated to be \$7,400, which it expects to receive late in 2002.

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

Except for statements of historical fact contained herein, any statements contained in this report may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. For example, words such as "may," "will," "should," "estimates," "predicts," "potential," "continue," "strategy," "believes," "anticipates," "plans," "expects," "intends" and similar expressions are intended to identify forward-looking statements. All such forward-looking statements are based upon current expectations that involve risks and uncertainties. Cotelligent's actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those discussed under "Risk Factors" in Cotelligent's Annual Report on Form 10-K for the fiscal year ended December 31, 2001, other filings made with the Securities and Exchange Commission and Cotelligent's press release announcing earnings for the quarter ended March 31, 2002, which was issued on April 30, 2002. The following discussion is qualified in its entirety by, and should be read in conjunction with, the more detailed information set forth in our financial statements and the notes thereto included elsewhere in this filing. All forward-looking statements included in this report are based upon information available to Cotelligent as of the date thereof, and Cotelligent assumes no obligation to update any of such forward-looking statements.

### OVERVIEW

Cotelligent provides IT consulting and maintenance, support and hosting on software products its licenses. These activities are provided under time and materials billing arrangements or on a fixed-fee basis. For time and materials billing arrangements, revenues are recorded as work is performed. Revenues are directly related to the total number of hours billed to clients and the associated hourly billing rates. Hourly billing rates are established for each service provided and are a function of the type of work performed and the related skill level of the consultant. For fixed-fee arrangements, work is performed in line with established deliverables and revenue is calculated on a

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percentage of completion basis. In addition, the Company has developed complete mobile workforce management solutions for industries that have medium to large transient sales, filed or delivery personnel. A component of these solutions may be software that has been developed by the Company. Revenues associated with software licensing, related maintenance and consulting services are recognized once a contract is signed, delivery has been made and collectibility is probable.

The Company's principal costs are professional compensation directly related to the performance of services and related expenses. Gross profits (revenues after professional compensation, related expenses and depreciation of deferred development costs) are primarily a function of hours billed to clients per professional employee or consultant, hourly billing rates of those employees or consultants and employee or consultant compensation relative to those billing rates. Gross profits can be adversely impacted if services provided cannot be billed, if the Company is not effective in managing its service activities, if fixed-fee engagements are not properly priced, if consultant cost increases exceed bill rate increases or if there are high levels of unutilized time (work activities not chargeable to clients or unrelated to client services) of full-time salaried service professional employees.

Operating income (gross profit less depreciation, research and development costs, and selling, general and administrative expenses) can be adversely impacted by increased administrative staff compensation and expenses related to streamlining or expanding the Company's business, which may be incurred before revenues or economies of scale are generated from such investment. Solution development activities require a higher level of selling, general and administrative activities as well as investment in research and development activities.

As a service and software organization, the Company responds to service demands from its clients. Accordingly, the Company has limited control over the timing and circumstances under which its services are provided. Therefore, the Company can experience volatility in its operating results from quarter to quarter. The operating results for any quarter are not necessarily indicative of the results for any future period.

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### CONSOLIDATED RESULTS OF OPERATIONS (In Thousands)

Three Months Ended March 31, 2002 Compared to Three Months Ended March 31, 2001

#### Revenues

Revenues decreased \$10,812, or 65%, to \$5,784 in the three months ended March 31, 2002 from \$16,596 in the three months ended March 31, 2001. The decrease was due to a general reduction in demand for its services due to softening in the market coupled with a shift away from general IT consulting services towards offering mobile workforce management and Web services solutions.

#### Gross Profit

Gross profit decreased \$2,759, or 58%, to \$1,981 in the three months ended March 31, 2002 from \$4,740 in the three months ended March 31, 2001. The decrease was due to lower revenues following a general reduction in demand for its services due to softening in the market coupled with a shift away from general IT consulting services towards offering mobile workforce management and Web services solutions. The gross profit margin increased to 34% from 29%, due to better pricing and a mix shift to higher margin projects, caused in part by the end of some long-term, lower margin, legacy system development engagements.

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### Research and Development Costs

Research and development costs were \$219 for the three months ended March 31, 2002. During the three months ended March 31, 2002, the Company created a dedicated team of people solely focused on research and development activities associated with mobile workforce management and Web services solutions.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased \$4,685, or 53%, to \$4,174 in the three months ended March 31, 2002 from \$8,859 in the three months ended March 31, 2001. The decrease was primarily due to reductions in operating staff and associated spending in order to streamline operations in line with revenues.

### Depreciation and Amortization

Depreciation and amortization decreased \$276, or 41%, to \$400 in the three months ended March 31, 2002 from \$676 in the three months ended March 31, 2001. The decrease was due to the write-off of assets in connection with a restructuring charge in the prior year together with a number of assets becoming fully depreciated towards the end of 2001, resulting in less depreciation going forward.

### Other Income (Expense)

Other income (expense) primarily consists of interest income. Interest income was \$186 for the three months ended March 31, 2002 compared to interest income of \$485 for the three months ended March 31, 2001. The decrease in interest income was due to lower cash and cash equivalents on hand during the three months ended March 31, 2002 and lower interest rates available on cash equivalents.

### Income Tax Benefit

The income tax benefit of \$7,400 for the quarter ended March 31, 2002 was the result of the Job Creation and Worker Assistance Act of 2002, approved by Congress on March 9, 2002, allowing net operating losses for the Company's fiscal tax year ending March 31, 2002 to be carried back five years. In accordance with SFAS No. 109, the effect of this change in tax law was reflected in the March 31, 2002 financial statements as changes in tax law must be reflected in the period of enactment. The Company did not record an income tax benefit for the three months ended March 31, 2001 due to the uncertainty of its realization at the time.

### Loss from Discontinued Operations

Discontinued operations is comprised of the Company's IT staff augmentation business. During the quarter ended March 31, 2001, the Company held one remaining component in discontinued operations which resulted in a loss from discontinued operations of \$6. During the fourth quarter of fiscal 2001, the Company abandoned its plan to divest of this operation and consequently closed this business. Subsequent to the closure of this business, the Company continued to service any residual client contracts and has classified the financial results related to these contracts in continuing operations.

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## LIQUIDITY AND CAPITAL RESOURCES

The Company has financed itself principally through cash flows from operations, periodic borrowing under its credit facilities, net proceeds from its public offerings and net proceeds from the sale of its IT staff augmentation business.

The Company previously maintained a credit facility with a consortium of banks under which it borrowed to fund working capital needs. On June 30, 2000, the Company used a portion of the cash proceeds from the sale of its IT staff

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augmentation business to pay off all obligations under the credit facility and to pay existing earn-out obligations to sellers of an acquired business. Upon settlement of all obligations under the credit facility, the credit facility was terminated. Since June 30, 2000, the Company has not maintained a credit facility.

Cash provided by operating activities was \$4,509 for the three months ended March 31, 2002 and the average cash balance during the quarter was \$20,994. The Company's primary sources of liquidity for the Company going forward include the collection of accounts receivable and refundable federal and state income taxes resulting from the carry-back of net operating losses. In addition, the Company continues to utilize the cash proceeds generated from the sales of its IT staff augmentation businesses. Total receivables were 46 days of quarterly revenues at March 31, 2002 and 56 days at December 31, 2001. In the first quarter of 2002, Congress approved the Job Creation and Worker Assistance Act of 2002, allowing fiscal tax year end March 31, 2002 net operating losses to be carried back five years. The effect of this change in tax law is expected to result in the Company's ability to receive additional tax refunds estimated at \$7,400. The Company intends to apply for these additional tax refunds and expects to receive an estimated \$7,400 refund late in 2002. Shortly after December 31, 2001, the Company completed a detailed forecast of the Company's operations that includes a plan to achieve a positive cash flow and return to profitability prior to December 31, 2002. Based on this forecast and the Company's operations through March 2002, management believes that the remaining cash on hand will provide adequate cash to fund its anticipated cash working capital needs at least through next year.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Cotelligent has invested its existing cash in highly liquid money market accounts and does not use derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions. Accordingly, the Company believes that it is not subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk sensitive instruments. Cotelligent's policy is to invest its cash in a manner that provides Cotelligent with the appropriate level of liquidity to enable it to meet its current obligations, primarily accounts payable, capital expenditures and payroll, recognizing that it does not currently have outside bank funding available.

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## PART II - OTHER INFORMATION

### Item 6. Exhibits and Reports on Form 8-K

#### (a) Exhibits

None.

#### (b) Reports on Form 8-K

None

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## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the

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registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COTELLIGENT, INC.

Date: May 14, 2002

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/s/ Curtis J. Parker

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Curtis J. Parker  
Executive Vice President,  
Chief Financial Officer and Treasurer