NETZEE INC
Form 10-Q
August 14, 2001
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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 JUNE 30, 2001

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ________________________ to ________________________, 20___.

Commission file number: 0-27925

Netzee, Inc.
(Exact name of registrant as specified in its charter)

Georgia	**58-2488883**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

6190 Powers Ferry Road, Suite 400, Atlanta, Georgia 30339
(Address of principal executive offices)

(770) 850-4000
(Registrant s telephone number including area code)

N/A
(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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of August 1, 2001, there were 3,335,713 shares of the Registrant s Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

NETZEE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2000	June 30, 2001
		(Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$960,231	$136,069
Short-term investments	135,000	506,378
Accounts receivable, net of allowance for doubtful accounts of $641,447 and $596,255, at December 31, 2000 and June 30, 2001, respectively	5,836,904	4,257,515
Leases receivable, current	671,580	649,847
Prepaid and other current assets	1,130,294	769,500
Total current assets	8,734,009	6,319,309
Property and equipment, net of accumulated depreciation of $3,552,971 and $2,219,311, at December 31, 2000 and June 30, 2001, respectively	6,616,804	4,796,746
Intangible assets, net of accumulated amortization of $47,824,555 and $52,718,701, at December 31, 2000 and June 30, 2001, respectively	89,950,659	49,617,409
Leases receivable, net of current portion	1,202,606	892,983

Other non-current assets	210,942	256,029
Total assets	$106,715,020	$61,882,476

LIABILITIES AND SHAREHOLDERS EQUITY

Current liabilities:		
Accounts payable	$1,784,480	$1,607,174
Accrued liabilities	4,372,821	2,825,292
Deferred revenue	7,263,099	2,844,923
Note payable, current portion	134,231	
Other current liabilities	668,151	779,994
Total current liabilities	14,222,782	8,057,383
Related-party borrowings	20,000,000	11,497,474
Note payable, net of current portion	1,465,590	
Deferred revenue, net of current portion	1,436,576	1,466,055
Total liabilities	37,124,948	21,020,912
Commitments and contingencies		

Redeemable preferred stock, no par value; 5,000,000 shares authorized:

8% convertible preferred stock, $13 stated value; 500,000 shares authorized, issued and outstanding at December 31,

2000 and June 30, 2001	6,500,000	6,500,000
Shareholders equity:		
Common stock, no par value; 70,000,000 shares authorized at December 31, 2000 and June 30, 2001, respectively; 3,358,495 and 3,335,713 shares issued and outstanding at December 31, 2000 June 30, 2001, respectively	192,304,886	191,267,277
Notes receivable from shareholders	(1,525,467)	(561,840)
Deferred stock compensation	(3,595,682)	(1,945,692)
Accumulated deficit	(124,093,665)	(154,398,181)
Total shareholders equity	63,090,072	34,361,564
Total liabilities and shareholders equity	$106,715,020	$61,882,476

The accompanying notes are an integral part of these consolidated balance sheets.

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NETZEE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	June 30, 2000	June 30, 2001	June 30, 2000	June 30, 2001
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenues:				

Monthly maintenance and service
$4,001,173 $5,874,522 $6,781,490 $12,795,573
License, hardware, implementation and other
301,643 475,018 336,675 1,022,433

Total revenues
4,302,816 6,349,540 7,118,165 13,818,006
Operating expenses:

Cost of services, license, hardware, implementation and maintenance
2,121,606 3,747,239 3,712,508 8,131,204
Selling and marketing
2,773,335 1,068,110 5,015,410 2,369,704 General and administrative, excluding amortization of stock-based compensation and restructuring costs 2,595,255 3,334,233 4,424,077 6,837,365 Amortization of stock-based compensation 789,563 248,054 1,582,322 728,187
Restructuring costs
(323,452) 1,535,193
(Gain)/loss on sale of assets
(1,213,458) 4,548,750
Depreciation
414,278 484,620 689,556 979,691
Amortization
13,163,594 8,595,580 24,897,392 18,252,861

Total operating expenses
21,857,631 15,940,926 40,321,265 43,382,955

Operating loss
(17,554,815) (9,591,386) (33,203,100) (29,564,949)
Interest expense, net
(228,113) (182,713) (296,840) (479,567)

Net loss before preferred dividends and cumulative effect of change in accounting principle
(17,782,928) (9,774,099) (33,499,940) (30,044,516)
Preferred stock dividends
(130,000) (130,000) (260,000) (260,000)

Net loss attributable to common shareholders before cumulative effect of change in accounting principle
(17,912,928) (9,904,099) (33,759,940) (30,304,516)
Cumulative effect of change in accounting principle
(351,980)

Net loss attributable to common shareholders
$(17,912,928) $(9,904,099) $(34,111,920) $(30,304,516)

Basic and diluted net loss per share before cumulative effect of change in accounting principle
$(6.60) $(2.96) $(12.71) $(9.05)
Loss per share from cumulative effect of change in accounting principle
(0.13)

Basic and diluted net loss per share
$(6.60) $(2.96) $(12.85) $(9.05)

Weighted average common shares outstanding
2,713,238 3,342,204 2,655,427 3,349,625

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

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NETZEE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended	
	June 30, 2000	**June 30, 2001**
	(Unaudited)	**(Unaudited)**
Cash flows from operating activities:		
Net loss attributable to common shareholders	$(34,100,796)	$(30,304,516)

Adjustments to reconcile net loss to net cash used in operating activities:		
Cumulative effect of change in accounting principle	351,980	
Restructuring costs		1,535,193
Depreciation and amortization	25,586,948	19,232,552
Stock-based compensation expense	1,582,322	728,187
Loss on sale of assets		4,548,750
Provision for bad debt	202,260	141,174
Interest income on shareholder notes	(112,115)	(31,552)
Changes in assets and liabilities, net of effect of acquisitions and dispositions:		
Accounts receivable	74,454	1,049,288
Leases receivable	(450,011)	331,356
Prepaid and other current assets	(343,652)	32,996
Accounts payable	(1,875,945)	(177,306)
Accrued liabilities	197,372	(2,788,208)
Deferred revenue	2,687,874	(1,249,242)
Other	(20,190)	(44,154)
Net cash used in operating activities	(6,219,499)	(6,995,482)
Cash flows from investing activities:		
Acquisitions, net of cash acquired		(420,954)
Purchase of short-term investments		(475,000)
Proceeds from sales of short-term investments		100,000
Proceeds from sales of assets		15,511,441

Purchase of property, equipment and capitalized software	(2,303,964)	(1,145,674)
Net cash (used in) provided by investing activities	(2,303,964)	13,569,813
Cash flows from financing activities:		
Related party borrowings	13,605,078	6,475,335
Payments on related party borrowings	(9,611,500)	(14,846,706)
Payments of notes payable	(3,172,891)	(22,372)
Repayment of shareholder notes	360,000	995,179
Payments of preferred stock dividends	(24,200)	
Proceeds from exercise of warrants	1,501,097	
Proceeds from exercise of options for common stock	17,500	71
Net cash provided by (used in) financing activities	2,675,084	(7,398,493)
Net decrease in cash and cash equivalents	(5,848,379)	(824,162)
Cash and cash equivalents, beginning of period	11,255,099	960,231

Cash and equivalents, end of period
$5,406,720 $136,069

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid for interest
$186,793 $871,336

SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

Stock issued for acquisitions
$19,446,037 $

Stock issued for the exercise of warrants, net of cash received
$4,618,760 $

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

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NETZEE, INC. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND NATURE OF BUSINESS

Overview

We are a provider of integrated Internet banking products and services to financial institutions and their customers. We provide a suite of integrated Internet banking products and services and Internet commerce solutions to financial institutions. The suite provides cost-effective, outsourced, secure and scalable Internet banking and Internet commerce products that enable financial institutions to offer to their customers a wide array of financial products and services over the Internet. Included in the suite are full-service Internet banking, bill payment, cash management, Internet commerce services, custom web site design and hosting, branded portal design, access to brokerage services, implementation and marketing services, as well as financial analytic and financial information tools.

Formation and Acquisitions

Direct Access Interactive, Inc. (Direct Access or the Predecessor) was incorporated on October 10, 1996. On March 9, 1999, Direct Access was purchased by The InterCept Group, Inc. (InterCept). Direct Access was operated as a separate subsidiary of InterCept. On August 6, 1999, Direct Access purchased the remote banking operations of SBS Corporation (SBS). SBS provided automated technology products and services to community financial institutions nationwide. Direct Access was later merged with and into Netzee. On September 3, 1999, we purchased the Internet banking divisions of TIB The Independent BankersBank (TIB) and The Bankers Bank, and we acquired Dyad Corporation and subsidiaries (Dyad) and Call Me Bill, LLC (Call Me Bill). Call Me Bill provided 24-hour electronic bill payment services to financial institutions customers. On December 15, 1999, we purchased DPSC Software, Inc. (DPSC) which provided regulatory reporting and related software to community financial institutions.

On March 7, 2000, we purchased Digital Visions, Inc. (DVI) which provided Internet-based information and analytic tools to financial institutions. In July 2000, we acquired Card Plus, Inc., (Card Plus), which provided outsourced software and systems development as well as related consulting services. In November 2000, we acquired the Internet banking and bill payment businesses of John H. Harland Company (Harland). In March 2001, we acquired the Internet banking assets of HomeCom Communications, Inc., (HomeCom). We collectively refer to Call Me Bill, DPSC, Dyad, the remote banking operations of SBS, the Internet banking divisions of the two bankers banks, DVI, Card Plus, the Internet banking and bill payment businesses of Harland and the Internet banking assets of HomeCom as the Acquired Operations.

Dispositions

On February 2, 2001, we sold to InterCept certain assets related to the regulatory reporting business acquired from DPSC in 1999, and InterCept assumed certain of the related operating liabilities (see Note 2).

On May 8, 2001, we sold to iPay, LLC (iPay), a related party, certain assets related to our bill payment operations formerly located in Elizabethtown, Kentucky, and iPay assumed certain of the related operating liabilities (see Note 2).

Basis of Presentation

The accompanying statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements reflect all adjustments, which are of a normal recurring nature, to present fairly our financial position, results of operations and cash flows at the dates and for the periods presented. Interim results of operations are not necessarily indicative of results to be expected for a 12-month period. The interim financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2000.

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The unaudited consolidated financial statements include the accounts of Netzee and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

All share and per share figures in this filing have been restated to reflect our one-for-eight reverse stock split effected on May 16, 2001.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) approved Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations. SFAS No. 141 prospectively prohibits the pooling of interest method of accounting for business combinations initiated after June 30, 2001. Additionally, SFAS No. 141 requires additional disclosure regarding the reasons for a business combination and the allocation of the purchase price for business combinations accounted for as a purchase subsequent to June 30, 2001.

In June 2001, the FASB also approved SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 requires companies to cease the amortization of goodwill that existed at June 30, 2001. SFAS No. 142 established a new method of testing goodwill for impairment on an annual basis or on an interim basis if an event occurs or circumstances change that would change the fair value of goodwill from its carrying value. SFAS No. 142 also creates additional criteria for allocating the purchase price of acquired business to additional identifiable intangible assets. SFAS No. 142 becomes effective for our fiscal year beginning January 1, 2002. We are currently assessing the impact of adopting SFAS No. 142 as amortization of goodwill will cease for our fiscal year beginning January 1, 2002 and periodic impairment gains or losses will be recognized. Since we have historically allocated the excess of purchase price over net tangible assets to identifiable intangible assets, we do not expect the adoption of SFAS No. 142 to have a material impact on our results of operations. The cumulative impact of adopting SFAS No. 142 will be reported as a change in accounting principle in our fiscal 2002 consolidated financial statements.

In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 established accounting and reporting standards for derivative instruments, including instruments embedded in other contracts. SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities measured based on their fair values. SFAS becomes effective for our fiscal year ended December 31, 2001. We adopted SFAS No. 133 on January 1, 2001. Since we do not utilize these instruments or participate in these activities, SFAS No. 133 had no impact on our consolidated financial statements for the six months ended June 30, 2001.

In the fourth quarter of fiscal 2000, we adopted Staff Accounting Bulleting (SAB) No. 101, Revenue Recognition , which establishes guidelines for revenue recognition and enhances revenue recognition disclosure requirements. Pursuant to this guideline, up-front fees associated with certain product implementations are now being recognized over the term of the underlying agreement, rather than upon the completion of product implementation. The cumulative impact of adopting SAB No. 101 was recorded as of January 1, 2000 and is reported as a cumulative effect of change in accounting principle for the six months ended June 30, 2000.

2. ACQUISITION AND DISPOSITIONS

Acquisition of HomeCom

During March 2001, we purchased certain assets of HomeCom s Internet banking businesses and assumed certain of HomeCom s operating liabilities related to the businesses. The purchase price was approximately $420,000 in cash and related acquisition expenses. The transaction was accounted for as a purchase. The excess of purchase price over the net tangible assets acquired was allocated to acquired technology and is being amortized over three years. The results of operations of HomeCom have been included in the consolidated financial statements from the effective date of the acquisition and are not material to the results of our operations.

Disposition of DPSC Assets

On February 2, 2001, we sold to InterCept certain of the regulatory reporting assets acquired from DPSC in 1999 and InterCept assumed certain of the related operating liabilities, for total consideration of approximately $16.5 million, including liabilities assumed of approximately $2.4 million. We received cash proceeds of approximately $14.1 million, of which $250,000 was placed in escrow for indemnification and other purposes.

In connection with the sale of these assets, we recorded a non-cash loss of approximately $5.7 million. This non-cash loss is included in the loss on sales of assets in our Consolidated Statement of Operations.

Disposition of Certain Bill Payment Assets

On May 8, 2001, we sold certain assets related to a portion of our bill payment operations formerly located in Elizabethtown, Kentucky to iPay, a related party, and iPay, assumed certain of the related operating liabilities. Net proceeds from the sale were approximately $1.3 million in cash, of which $50,000 was placed in escrow for indemnification and other purposes.

In connection with the sale of these assets, we recorded a gain of approximately $1.2 million. This gain is included in the gain on sales of assets in our Consolidated Statement of Operations.

Pro Forma Results of Operations

The following summary presents unaudited pro forma results of operations assuming that each of the acquisitions of the Acquired Operations as discussed in Note 1, and th