

COTELLIGENT INC  
Form 10-Q  
November 14, 2005  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

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**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 September 30, 2005**

**“ 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.**

**(Exact name of registrant as specified in its charter)**

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**Delaware**  
(State of incorporation)

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

**655 Montgomery Street, Suite 1000, San Francisco, California 94111**

(Address of principal executive offices)

**(415) 477-9900**

(Registrant's telephone number, including area code)

(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 by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b2 of the Exchange Act). Yes ☐ No ☒

At November 11, 2005, there were 28,723,629 shares of common stock outstanding.

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**Table of Contents****Item 1. Financial Statements****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)

(Unaudited)

	September 30, 2005	December 31, 2004
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 151	\$ 526
Refundable income taxes	13	16
Accounts receivable, including unbilled accounts of \$0 and \$2, net of allowance for doubtful accounts of \$53 and \$60, and \$119 and \$590 pledged as collateral security, respectively	66	530
Prepaid expenses and other current assets	150	133
Current assets of discontinued operations held for sale		160
	<hr/>	<hr/>
Total current assets	380	1,365
Property and equipment, net	243	259
Goodwill	2,592	2,592
Other intangibles, net of \$223 and \$118 of accumulated amortization	779	748
Other assets	180	239
Non-current assets of the discontinued operations held for sale		170
	<hr/>	<hr/>
Total assets	\$ 4,174	\$ 5,373
	<hr/>	<hr/>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Secured borrowings	\$ 38	\$ 386
Accounts payable	506	247
Accrued compensation and related payroll liabilities	200	264
Restructuring liabilities	599	425
Other accrued liabilities	187	198
Current liabilities of the discontinued operations held for sale		898
	<hr/>	<hr/>
Total current liabilities	1,530	2,418
Restructuring liabilities, net of current portion		268
Lease deposit on sublet property		13
Income taxes payable		69
	<hr/>	<hr/>
Total liabilities	1,530	2,768
	<hr/>	<hr/>
Commitments and contingencies		
	<hr/>	<hr/>
Stockholders' equity:		
Preferred Stock, \$0.01 par value; 500,000 shares authorized, no shares issued or outstanding		

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Common Stock, \$0.01 par value; 100,000,000 shares authorized, 28,868,229 and 24,984,792 shares issued, respectively	289	250
Additional paid-in capital	82,785	82,801
Accumulated deficit	(80,317)	(79,946)
Treasury stock	(113)	(500)
	<hr/>	<hr/>
Total stockholders' equity	2,644	2,605
	<hr/>	<hr/>
Total liabilities and stockholders' equity	\$ 4,174	\$ 5,373
	<hr/>	<hr/>

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenues	\$ 379	\$ 254	\$ 1,243	\$ 564
Cost of services	225	114	570	253
Gross profit	154	140	673	311
Selling, general and administrative expenses	1,035	642	2,279	1,422
Operating loss	(881)	(502)	(1,606)	(1,111)
Other income (expense):				
Interest expense	(14)		(34)	
Interest income	1	2	2	89
Other	115		141	
Total other income (expense)	102	2	109	89
Loss from continuing operations before income taxes	(779)	(500)	(1,497)	(1,022)
Income tax expense (benefit)	(5)	(6)	(72)	(2)
Loss from continuing operations	(774)	(494)	(1,425)	(1,020)
Discontinued operations:				
Operating income (loss) from discontinued operations, net of income tax expense of \$0, \$0, \$0, \$0	485	(545)	(466)	(2,460)
Gain on sale of discontinued operations, net of income tax expense of \$0, \$0, \$0, \$0	1,520		1,520	
Income (loss) from discontinued operations	2,005	(545)	1,054	(2,460)
Net income (loss)	\$ 1,231	\$ (1,039)	\$ (371)	\$ (3,480)
Earnings per share:				
Basic and diluted				
Loss from continuing operations	\$ (0.03)	\$ (0.02)	\$ (0.05)	\$ (0.05)
Income (loss) from discontinued operations	0.07	\$ (0.02)	\$ 0.04	\$ (0.11)
Net income (loss)	\$ 0.04	\$ (0.04)	\$ (0.01)	\$ (0.16)
Weighted average number of shares outstanding:				
Basic and diluted	28,556,208	24,111,621	27,319,695	21,734,044

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See accompanying notes to condensed consolidated financial statements.

**Table of Contents****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
Cash flows from operating activities:		
Net loss	\$ (371)	\$ (3,480)
Adjustments to reconcile net loss from operations to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	86	180
Amortization of identifiable intangible assets	105	
Restricted shares issued in connection with director compensation	17	
Gain on sale of discontinued operation	(1,520)	
Gain on sale of investment in common stock	(141)	
Provision for doubtful accounts	(11)	(11)
Changes in current assets and liabilities:		
Accounts receivable	472	411
Prepaid expenses and other current assets	133	135
Accounts payable and accrued liabilities	(94)	(1,540)
Deferred revenue	(600)	(39)
Income taxes, net	(66)	85
Other assets		(44)
Net cash used in operating activities	(1,990)	(4,303)
Cash flows from investing activities:		
Payments received on note from acquirer of previously sold business		200
Proceeds on sale of discontinued operation, net of selling expenses of \$732 and \$0	1,568	
Proceeds on sale of investment in common stock	124	
Purchases of property and equipment	(70)	(278)
Cash paid for purchase of business	(66)	(605)
Net cash provided by (used in) investing activities	1,556	(683)
Cash flows from financing activities:		
Repayments of secured borrowings, net	(348)	
Cost of issuing of Common Stock and warrants	(13)	(195)
Net proceeds from issuance of Common Stock and warrants	420	
Net cash provided by (used in) financing activities	59	(195)
Net decrease in cash and cash equivalents	(375)	(5,181)
Cash and cash equivalents at beginning of period	526	5,688
Cash and cash equivalents at end of period	\$ 151	\$ 507



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See accompanying notes to condensed consolidated financial statements.

**Table of Contents****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
Supplemental disclosures of cash flow information:		
Interest paid	\$ 34	\$
Income taxes paid (refunded)	\$ 6	\$ (2)
Significant non-cash financing and investing activities:		
Repayment of officer notes receivable with severance and bonus compensation	\$	\$ 364
Revaluation of note receivable from stockholder	\$	\$ 403
Detail of acquisition:		
Cash	\$	\$ (36)
Accounts receivable		(50)
Prepaid expenses and other current assets		(2)
Property and equipment		(3)
Other assets		(5)
Goodwill		(2,592)
Other intangibles	(136)	(866)
Accounts payable		106
Accrued compensation		50
Other accrued liabilities		91
Common stock issued to sellers of acquired business	40	1,815
Warrants issued to sellers of acquired business		676
Consideration due sellers of acquired business	30	
Cash paid in prior period		175
Cash paid in current period	(66)	(641)
Cash acquired in acquisition		36
Cash used for purchase of business	\$ (66)	\$ (605)

See accompanying notes to condensed consolidated financial statements.

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**COTELLIGENT, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Dollar amounts in thousands)

**Note 1 Summary of Significant Accounting Policies and Practices**

*Description of Business*

Cotelligent, Inc. ( Cotelligent or the Company ), a Delaware corporation, provides narrowcasting services which include digital technologies and production services for video content, distribution, scripting and playback on digital display channels. The Company also provides software consulting services to businesses with complex information technology ( IT ) operations, but as discussed below, this business component is classified as a part of the Company s discontinued operations.

In 2004, the Company was organized into two reportable segments, IT services and narrowcasting (which became effective with the acquisition of OnSite Media, Inc. on March 2, 2004). Prior to December 31, 2004, the Company entered into a plan to divest its IT services segment. Accordingly, the accompanying consolidated financial statements and related footnotes have been prepared to present as discontinued operations the Company s IT services segment for all periods presented.

These financial statements include the accounts of Cotelligent, Inc. and its subsidiaries. The results of acquisitions have been included in the Company s results from its acquisition date.

*Liquidity*

The Company has had operating losses and negative operating cash flows for the past several fiscal periods. This has been due to declining demand for IT services and solutions and investments the Company has made in Watchit Media, Inc., its new narrowcasting business. As a result, the Company is exposed to certain risks which include the availability of financing, the retention of and dependence on key individuals, the effects of intense competition, the ability to develop and successfully market new product and service offerings, and the ability to streamline operations and increase revenues. While the Company is now focused on executing a growth strategy in the narrowcasting market, there can be no assurance the Company will be profitable in the future.

During the past and in 2005, management has taken action in response to the continued softness in IT services in order to preserve cash, including but not limited to significant reductions in headcount, outsourcing certain administrative functions, changing benefit plan insurance carriers, relocating the headquarters office resulting in lower lease obligations, acquiring a business in an industry with more near term growth prospects than IT services, securing a line of credit agreement against its accounts receivable and announcing the plan to divest its IT services segment. Between February 1, 2005 and April 27, 2005, the Company entered into Stock and Warrant Purchase Agreements with certain accredited investors pursuant to which the Company sold shares of Common Stock and warrants to purchase additional shares of Common Stock resulting in a cash infusion to the Company of approximately \$420. In addition, on July 15, 2005 the Company sold its remaining IT services business to FastTech Integrated Solutions LLC, an affiliate of Beverly Hills, California-based private equity firm Skyview Capital, LLC, resulting in cash of approximately \$2,300. Management has carefully forecasted its results of operations and financial position through September 30, 2006, and has determined that the remaining cash on hand, together with cash available from the line of credit, proceeds from the sales of Common Stock to accredited investors, proceeds from the sale of the IT services segment, will provide adequate cash to fund its anticipated working capital needs. In the event circumstances arise that are not factored into the forecast, management will take further action to

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streamline operations and seek financing alternatives.

### *Basis of Presentation*

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, 2004, 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, results of operations and cash flows for the interim periods and dates presented.

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### Stock-Based Compensation

The Company has adopted the interim disclosure provisions of SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*. Related interim disclosures are as follows.

The Company measures compensation expense for its employee stock-based compensation awards using the intrinsic value method and provides pro forma disclosures of net loss and loss per share as if a fair value method had been applied. Therefore, compensation cost for employee stock awards is measured as the excess, if any, of the fair value of our common stock at the grant date or re-measurement date over the amount an employee must pay to acquire the stock and is amortized over the related service periods using the straight-line method. Compensation expense previously recorded for unvested employee stock-based compensation awards that are forfeited upon employee termination is reversed in the period of forfeiture.

The following table compares net loss and loss per share as reported, to the pro forma amounts that would be reported had compensation expense been recognized for our stock-based compensation plans in accordance with the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss), as reported	\$ 1,231	\$ (1,039)	\$ (371)	\$ (3,480)
Deduct: Stock-based compensation expense determined under fair value based method for awards net of related tax expense, if applicable	18	5	59	165
Pro forma net loss	\$ 1,213	\$ (1,044)	\$ (430)	\$ (3,645)
Income (loss) per share, as reported:				
Basic and diluted	\$ 0.04	\$ (0.04)	\$ (0.01)	\$ (0.16)
Pro forma income (loss) per share:				
Basic and diluted	\$ 0.04	\$ (0.04)	\$ (0.02)	\$ (0.17)

On December 16, 2004, the Financial Accounting Standards Board issued Statement No. 123 (revised 2004), Share-Based Payment (FAS 123R), which replaces FAS 123 and supercedes APB 25. Securities and Exchange Commission ( SEC ) registrants were originally required to adopt FAS 123R's provisions at the beginning of this first interim period after June 15, 2005. On April 14, 2005, the SEC announced the registrants could delay adoption of FAS 123R's provisions until the beginning of their next fiscal year. We currently expect to adopt FAS 123R on January 1, 2006, which will require us to measure the cost of employee services received in exchange for an award of equity instruments, such as stock options, based on the fair value of an award on the grant date. This cost must be recognized in the statement of operations over the vesting period of the award.

### Reclassifications

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Certain reclassifications have been made in the prior year's financial statements to conform to the presentation in the current period.

**Table of Contents****Note 2 Changes in Stockholders' Equity**

	Common Stock		Additional Paid-In Capital	Accum. Deficit	Treasury Stock		Total Stockholders Equity
	Shares	Amount			Shares	Amount	
Balance at December 31, 2004	24,984,792	\$ 250	\$ 82,801	\$ (79,946)	644,600	\$ (500)	\$ 2,605
Issuance of Common Stock in connection with private placement	3,550,000	35	168				203
Issuance of Warrants in connection with private placement			217				217
Cost of registering and issuing securities in connection with private placement			(57)				(57)
Issuance of Common Stock from treasury stock			(387)		(500,000)	387	
Issuance of Common Stock in connection with acquisition of business	202,667	3	27				30
Issuance of Common Stock in connection with director compensation	130,770	1	16				17
Net loss				(371)			(371)
Balance at September 30, 2005	28,868,229	\$ 289	\$ 82,785	\$ (80,317)	144,600	\$ (113)	\$ 2,644

**Note 3 Acquisitions***Onsite Media, Inc.*

Cotelligent acquired OnSite Media, Inc, a Nevada corporation, on March 2, 2004. In the acquisition, OnSite was merged with and into Watchit Media USA, Inc. a wholly owned subsidiary of Cotelligent, or Watchit. OnSite was a ten year old company that developed enabling digital technologies and production services aimed at providing complete solutions for video content creation, distribution, scripting and playback for companies with digital display channels and networks. OnSite historically provided this software and service offerings to the hospitality and gambling industries. This is called narrowcasting.

Narrowcasting technology presents dynamic, compelling motion media that influences the actions of captive audiences. Promotional messages for hotel in-room channels, presenting commercial messages to casino entertainment facilities and outdoor signage had been the primary business of OnSite. In addition, OnSite developed a unique Internet media creation software application which we believe will give the newly formed Watchit a competitive advantage. Cotelligent intends to leverage its marketing expertise, resources and infrastructure to enhance Watchit's current services, launch new proprietary television programs, add greater value to current client relationships, add clients in the hospitality market, and expand to new markets.

The Company believes the convergence of Internet, wireless and video media will soon become a major part of the technology landscape. The Company believes Cotelligent's infrastructure, experience in developing wireless and Internet business applications and its system integration expertise are an excellent fit with the rapidly evolving narrowcasting market.

The aggregate consideration paid for the acquisition was \$3,307 (10,679,608 shares of the Company's Common Stock issued at fair value of \$1,815 and based on the average closing price of the Company's Common Stock for a few days prior to and after the signing of the definitive

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agreement and related public announcement to purchase the business on November 25, 2003, warrants to purchase 5,339,803 shares of the Company's common stock value using the Black-Scholes with the following assumptions: (1) risk-free interest rate of 1.95%, (2) a dividend yield of 0%, (3) volatility factor of the expected market price of the Company's Common Stock of 175%, and (4) a weighted average expected life of 2 years, that resulted in a valuation of \$676, cash consideration of \$505 and transaction costs of \$501). Transaction costs of \$501 include \$195 paid for registration of securities in connection with the acquisition which were netted against the issuance of the shares. Liabilities assumed were approximately \$247, and tangible assets acquired were approximately \$96. The Company recognized total intangible assets of \$3,458 resulting from the acquisition.



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The Company has obtained an independent valuation for the aggregate consideration paid for the acquisition of OnSite as follows.

Total liabilities assumed	\$ (247)
Total tangible assets acquired	96
Identifiable intangible assets:	
Software	73
Customer contracts	98
Archived content video library	695
Goodwill	2,592
	<hr/>
Total aggregate consideration paid	3,307
	<hr/>

The changes in carrying amounts of goodwill and other intangibles related to the acquisition of OnSite for the nine months ended September 30, 2005 were as follows.

	<u>Goodwill</u>	<u>Other Intangibles</u>
Balance at December 31, 2004	\$ 2,592	\$ 748
Amortization expense		(105)
	<hr/>	<hr/>
Balance at September 30, 2005	<b>\$ 2,592</b>	<b>\$ 643</b>
	<hr/>	<hr/>

The Company has ascribed useful lives to the identifiable intangible assets that range from 2 to 20 years.

Immediately following the close of the transaction, with the issuance of 10,679,608 shares of Cotelligent Common Stock, the former OnSite stockholders owned 43% of the total shares of Cotelligent Common Stock then outstanding.

### *California Visitors Network*

Watchit Media, Inc. acquired California Visitors Network on September 15, 2005. California Visitors Network, a California based narrowcaster, presents point of interest television programming with embedded advertising to hotels. Pursuant to the Asset Purchase Agreement, dated September 15, 2005, at closing Watchit paid \$50 in cash to the seller and issued 246,667 unregistered shares of Cotelligent's common stock having a fair market value of \$40. In addition, the Asset Purchase Agreement requires Watchit to deliver an additional \$30 in cash six months after the date of acquisition. The Company incurred \$16 of expenses in connection with the acquisition.

Subsequent to September 15, 2005, the Company reduced the number of unregistered shares issued in connection with the acquisition of California Visitors Network by 44,000 in order to satisfy obligations of the predecessor owner.

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Because the acquisition was completed on September 15, 2005, the Company has not been able to complete a valuation of the net assets acquired. The Company intends to obtain a valuation of the net assets in the near term from which it may derive an allocation between identifiable assets and goodwill. At September 30, 2005 the Company included the total investment in California Visitors Network of \$136 in other intangibles.

The results of acquired businesses were included in the Company's results of operations from the respective acquisition dates.

In accordance with SFAS No. 141, *Business Combinations*, the following unaudited pro forma information for the three and nine months ended September 30, 2005 and 2004, gives effect to the acquisitions of OnSite Media, Inc., and California Visitors Network as if the acquisitions were completed as of the beginning of the periods reported below.

	(Unaudited)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Pro forma revenues	\$ 394	\$ 269	\$ 1,288	\$ 818
Pro forma loss from continuing operations before income taxes	\$ (770)	\$ (491)	\$ (1,470)	\$ (900)
Pro forma loss from continuing operations	\$ (765)	\$ (485)	\$ (1,398)	\$ (901)
Pro forma loss per share, basic and diluted	\$ (0.03)	\$ (0.02)	\$ (0.05)	\$ (0.04)

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### Note 4 Restructuring Programs

In 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. Accordingly, the Company adopted an exit plan which resulted in a restructuring charge of \$2,436 during the year ended December 31, 2001. The September 2001 plan included provisions for severance of approximately 145 management and operating staff (\$1,034) as well as closure costs associated with a plan to consolidate or dispose of certain locations (\$1,402). The September 2001 plan did not meet the requirements in order to accrue employee severance costs as of a commitment date, and these severance costs that did not provide a future benefit were charged to operations when due and payable. Only the obligations for one facility closure remained payable at December 31, 2004.

In August 2003, 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. The Company terminated approximately 33 management and operating staff between August 2003 and December 2003 and recorded a restructuring charge related to the severance and extended medical coverage ( COBRA ) benefits provided to the terminated employees of \$2,531. Only the COBRA benefits remained payable at December 31, 2004.

In October of 2004, as part of the Company's efforts to streamline its operations commensurate with its revenue base, the Company identified additional opportunities to reduce its cost structure and decided to close its software development operation in southern California. Accordingly, the Company adopted an exit plan which resulted in a reduction of approximately 14 management and operating staff (\$93) as well as closure costs associated with a plan to dispose of the southern California location (\$24). The Company accounted for the plan in line with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities .

The following summarizes the activity and balances for these restructuring programs for the nine months ended September 30, 2005.

	September 2001	August 2003	October 2004		
	Facilities Closure	Severance & Benefits	Severance	Facilities Closure	Total
Balance at December 31, 2004	\$ 616	\$ 9	\$ 44	\$ 24	\$ 693
Spending, net of sublease receipts on facilities	(28)	(9)	(33)	(24)	(94)
Balance at September 30, 2005	\$ 588	\$	\$ 11	\$	\$ 599

### Note 5 Discontinued Operations

Prior to December 31, 2004, the Company entered into a plan to divest its IT services segment. The following financial data reflects the total assets and total liabilities of the discontinued operations as of September 30, 2005 and December 31, 2004 and summary of operating results for the three and nine months ended September 30, 2005 and 2004.

#### Assets and Liabilities of Discontinued Operations:

	September 30, 2005	December 31, 2004
<b>Assets</b>		
Prepaid expenses and other	\$	\$ 160
Total current assets of discontinued operations held for sale		160
Property and equipment, net of accumulated depreciation of \$0 and \$156		170
Total non-current assets of discontinued operations held for sale		170
Total assets of discontinued operations held for sale		330
<b>Liabilities</b>		
Accounts payable		36
Accrued compensation		262
Deferred revenue		600
Total current liabilities of discontinued operations		898
Net liabilities of discontinued operations held for sale	\$	\$ 568

**Table of Contents****Summary of Operating Income (Loss) from Discontinued Operations:**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Revenues	\$ 730	\$ 1,571	\$ 2,664	\$ 5,339
Cost of services	60	892	1,044	2,937
Gross profit	670	679	1,620	2,402
Selling, general and administrative expenses	185	1,282	2,086	4,920
Restructuring benefit		(58)		(58)
Operating income (loss)	485	(545)	(466)	(2,460)
Total other income				
Income (loss) from operations before income taxes	485	(545)	(466)	(2,460)
Income tax expense				
Income (loss) from operations	485	(545)	(466)	(2,460)
Gain on sale of discontinued operations	1,520		1,520	
Income (loss) from discontinued operations	\$ 2,005	\$ (545)	\$ 1,054	\$ (2,460)

On July 13, 2005, the Company's stockholders approved the sale of the IT services business located at Broomall, Pennsylvania, the remaining component of the discontinued operations, pursuant to an Asset Purchase Agreement, dated as of April 1, 2005, as amended on June 27, 2005 (the "Asset Purchase Agreement") by and among the Company and certain of its subsidiaries and FastTech Integrated Solutions, LLC, an affiliate of Beverly Hills, California-based private equity firm Skyview Capital, LLC. The sale was completed July 15, 2005. Under terms of the Asset Purchase Agreement, aggregate consideration for the business included: cash at closing of \$2,300, subject to closing date adjustments and an earn-out of up to \$1,450 if certain future revenue targets are attained over the three years following completion of the sale.

**Note 6 Weighted Average Number of Shares Outstanding**

There were no reconciling items between the numerator and denominator used to compute basic and diluted loss per share for the periods presented in the condensed consolidated statements of operations. The Company had outstanding stock options, and warrants of 12,691,511 and 7,683,291 at September 30, 2005 and 2004 respectively, that were not included in EPS for those relevant periods because the Company reported a loss from continuing operations resulting in an antidilutive effect.

**Note 7 Segment Information**

Prior to March 2, 2004, Cotelligent was organized into one reportable segment, IT services. Effective with the acquisition of OnSite Media, Inc. on March 2, 2004, the Company became organized into the following two reportable segments, to align internal management with current service offerings:

*IT services.* IT software and consulting services to businesses with complex IT operations in addition to maintenance, support and hosting on software products it has licensed.

*Narrowcasting.* Creative media development, private venue video programming, installation and integration of Internet protocol (IP) digital technology, presenting video content, distribution, scripting and playback via Broadband to private video networks.

Prior to December 31, 2004, the Company committed to a plan to discontinue its IT services segment. Accordingly, these accompanying consolidated financial statements have been prepared on a discontinued operations basis effectively reporting the Narrowcasting segment as continuing operations (see accompanying condensed consolidated statements of operations), and the IT services segment as discontinued operations (see Note 5).

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### **Note 8 Lawsuit**

In June 2005, Advance at Branchburg, LLC ( "Advance" ) filed a lawsuit against the Company in the Superior Court of New Jersey, Law Division, Somerset County. The lawsuit arises out of a commercial lease agreement between Advance as landlord and Cotelligent as tenant. Specifically, Advance alleges that Cotelligent breached the lease agreement by failing to make base and additional rent payments for the months of March 2005 to the present. Advance seeks payment of all amounts allegedly due under the lease, including base rent, late charges, interest and attorneys fees and costs. Advance also seeks "loss of bargain" damages, consisting of all rent due through the end of the lease term, reduced to present value using an interest rate of 6% per annum. The lawsuit does not specify the specific amount of damages sought. Advance initially obtained an entry of default against the Company but the default was vacated in September 2005 by Advance's consent. The Company then filed an answer to Advance's complaint, along with a counterclaim for the return of its security deposit. At September 30, 2005, the Company has accrued \$588 related to the lease obligation, which is classified as part of restructuring liabilities. The accrual covers obligations for base and additional rent and late charges, offset by estimated potential rent from the sublet of the facility. In addition, the Company maintains a \$180 security deposit with Advance in connection with the lease, classified as part of other long term assets.

### **Note 9 Subsequent Event**

On October 7, 2005, the Company's Board of Directors approved the issuance of 2,275,000 fully vested stock options under the Company's 2000 Long-Term Incentive Plan to five senior and executive managers of the Company. Total stock options outstanding after the October 7, 2005 grant were 6,075,000.

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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, and 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, 2004 and other filings made with the Securities and Exchange Commission. 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.

Cotelligent was formed in February 1993 to acquire, own and operate IT services businesses. Cotelligent was a non-operating entity until 1996 when it first began to acquire businesses. The Company historically operated on an April 1 to March 31, fiscal year. In July 2000, the Company changed its fiscal year to December 31, resulting in a nine-month transition period from April 1, 2000 through December 31, 2000. In 2004, the Company was organized into two reportable segments, IT services and narrowcasting (which became effective with the acquisition of OnSite Media, Inc. on March 2, 2004). The results of OnSite Media, Inc. have been included in the Company's results from its acquisition date. Prior to December 31, 2004, the Company entered into a plan to divest its IT services segment. Accordingly, the financial information on the Quarterly Report has been restated to present as discontinued operations the Company's IT services segment for all periods presented.

On a continuing operations basis, Cotelligent provides narrowcasting services which includes Internet protocol (IP) technologies and production services for video content, distribution, scripting and playback on digital display video channels and networks, as well as maintenance, support and contract services on software and hardware products it licenses. The Company provides these services primarily to gaming and hospitality businesses. Narrowcasting, maintenance and support services are provided under term contracts of which most are one year or longer. These contracts are renewable at the discretion of our clients.

The Company recognizes revenue for the subscription of maintenance, support and contract services on software and hardware products it licenses to its narrowcasting clients as the Company performs the services. Revenues earned for software license sales and service contracts are recorded based on the provisions of AICPA SOP 97-2, *Software Revenue Recognition*, as amended, which shares the basic criteria described above. For each element in a software arrangement (e.g. license, maintenance, and services), the amount of revenue recognized is based upon vendor specific objective evidence of fair value using the residual method. Revenue for production services for video content, distribution, scripting and playback on digital display video channels and networks on either a time and materials basis, when services are provided or where pursuant to fixed-fee contract, the revenue is generally recognized as services are rendered on the percentage-of-completion method of accounting based on hours incurred to total estimated labor hours to complete. Revenues include reimbursable expenses charged to and collected from clients.

The Company's principal costs are professional compensation directly related to the performance of services and related expenses. Gross profits (revenues after professional compensation and related expenses) are primarily a function of the number of gaming and hospitality properties that subscribe to the narrowcasting services as well as the number of channels for different narrowcasting services each property elects to subscribe to and the level of video production service purchased by the client. Gross profits can be adversely impacted if clients do not renew contracts, if the Company is not effective in managing its service activities, or if fixed-fee engagements for production services are not properly priced.



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Operating income 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.

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### **OVERVIEW OF 2005 AND 2004**

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In the years leading up to 2004, we strategically shifted from providing general IT services and solutions to a targeted approach to offering mobile workforce management and Web services. We changed our go-to-market strategy to better focus our resources and leverage our experience and solid client base in these areas. Our decision to do this was reinforced at the time by market research, financial research and our own research and analysis indicating that mobile workforce management and Web services were the next emerging growth markets. Our solutions utilized broadly accepted as well as cutting edge technologies. We spent considerable time on the development of these core competencies after divesting the majority of our IT staffing business in 2000. In addition, the Company carefully assessed and exited a number of solutions and service offerings that were not core to the principal service offerings outlined above.

While executing this strategy we believed we were focused on offering services that would help us increase revenue in the near term. From 2001 through the third quarter of 2003 the Company continued to invest heavily in a large scale sales, marketing and business development organization working to capture new business. In September 2002, the Company hired a marketing executive to develop and implement a more formalized and systematic marketing program for the Company because of the difficulty we were having in selling new business to new clients. Marketing programs re-designed and put in place by early 2003 offered promising results when measured against prior year sales opportunity pipeline and business backlog. By the second quarter of 2003, the Company gained more confidence in its marketing program and saw an unprecedented number of prospect and client proposals. Nevertheless, throughout 2003 we continued to be disappointed by prospects and clients either delaying decisions to initiate projects or pursuing lower cost off-shore technical resource to executing their projects. In spite of the Company's investments in its selling organization, we were not successful in signing new business with companies we had not done business with before. We did, however, continue to sign new contracts with existing clients.

In August of 2003, it became clear to us that a number of opportunities that only a few months before looked promising were not going to close. The Company performed an in-depth review of each opportunity and concluded that businesses were reticent to use discretionary expenditures to invest in mobile workforce and Web service technologies (or other new projects) given the fact that their current IT environments operated satisfactorily. In addition, fearful of continuing poor economic conditions and market pressures, we observed that many of the prospects that decided to pursue projects did so with larger, better capitalized firms than Cotelligent.

It became evident to us that the outlook for spending in IT services would continue to be uncertain without any clear indication of when a turnaround could be expected. Accordingly, in August 2003, the Company terminated the majority of its senior executive staff along with most of the sales and business development organization. At the same time we aggressively engaged our existing clients and committed ourselves to supporting their project requirements. In some cases we have been successful in securing longer term commitments. By scaling back expenses and focusing intensely on generating business from our long term clients we began to stabilize our revenue trend allowing us to move forward in our attempt to restore profitability and positive cash flow.

Throughout the remainder of 2003, the Company continued to reduce headcount and looked closely at expense activity to scale back and streamline operating costs in line with revenue. The Philadelphia-based operation that supports Cotelligent's sales force automation application FastTrack achieved stable revenue over the past several years and our clients continued to give us high marks for performance and client service. In addition, the core team responsible for our custom software development activities helped us to take advantage of recurring projects with existing clients. By keeping only the top sales account executives and account managers, we lowered our selling cost and improved our client relationships and retention.

In April 2003, our Chief Executive Officer, James Lavelle, sent a letter to our stockholders indicating the Company's intention to engage in merger and acquisition activities in order to help improve Cotelligent's prospects for the future and increase our scale. As a matter of course since we started our Company in 1996 and successfully executed an aggressive merger and acquisition strategy through early 1999, we believed this strategy would help us improve our prospects. We researched and analyzed a variety of vertical markets that could provide new growth opportunities for us through merger or acquisition. In mid-2003 Cotelligent signed a letter of intent to acquire a field force automation firm.

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After 90 days of due diligence, we decided not to consummate the transaction.

In September 2003, Cotelligent engaged in a dialog with a Las Vegas based narrowcasting company, OnSite Media, Inc. The combination of Cotelligent's deep history in Internet, media and wireless technologies and OnSite's strength in driving video content to high growth venues in the gaming and hospitality industries looked promising. Cotelligent entered into a definitive agreement to acquire OnSite Media, Inc. on November 24, 2003, and closed the acquisition transaction on March 2, 2004. By integrating OnSite's business with Cotelligent's infrastructure, and by utilizing our public company know how to position us for the future, we have set about executing a strategy that we believe will allow us to play an important role in the convergence of Internet, video and mobile technology. This is a growing, fast paced market in which we believe the ability to integrate these technologies will help us to differentiate us from many other companies.

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Upon completion of the acquisition, OnSite Media was renamed Watchit Media USA, Inc., and is now a wholly-owned subsidiary of Cotelligent, Inc. The newly acquired business was immediately integrated into the Cotelligent infrastructure from March through October 2004. Our Board of Directors carefully followed and evaluated the financial and operating performance of our Company's two business segments. While the IT services and solutions business continued to struggle, Watchit Media performed well and experienced significant revenue growth, together with stable to increasing gross margin performance. In addition, Watchit's near and longer term business opportunities appeared to indicate the strong possibility of future revenue growth.

In November 2004, we announced our plan to divest our entire IT services and solutions business and change our name to Watchit Media, Inc. allowing us to focus all of our attention on narrowcasting. On July 13, 2005, the Company's stockholders approved the sale of the IT services business located at Broomall, Pennsylvania, the remaining component of our discontinued operations, pursuant to an Asset Purchase Agreement, dated as of April 1, 2005, as amended on June 27, 2005 (the "Asset Purchase Agreement") entered into between the Company and certain of its subsidiaries and FastTech Integrated Solutions, LLC, an affiliate of Beverly Hills, California-based private equity firm Skyview Capital, LLC. The transaction was completed on July 15, 2005. Pursuant to the Asset Purchase Agreement, aggregate consideration for the business included: cash at closing of \$2,300, subject to closing date adjustments, and an earn-out of up to \$1,450 if certain future revenue targets are attained over the three years following completion of the sale.

### **Three Months Ended September 30, 2005 Compared to Three Months Ended September 30, 2004**

The Company has two reportable segments: IT services and narrowcasting. Prior to December 31, 2004, the Company entered into a plan to divest its IT services segment. Accordingly, the financial information presented in this Quarterly Report has been prepared to present as discontinued operations the Company's IT services business. The Company's continuing operations consist of the narrowcasting segment. The Company commenced reporting revenues for its narrowcasting segment following the acquisition of On-Site Media, Inc. on March 2, 2004. As a result, on a continuing operations basis, the Company had no revenue, gross profit or selling, general and administrative expenses to report prior to March 2, 2004.

#### ***Revenues***

Revenues increased \$125, or 49%, to \$379 in the three months ended September 30, 2005, from \$254 in the three months ended September 30, 2004. The increase in revenues resulted from marketing efforts and a corresponding expansion of business.

Our narrowcasting clients retain us to manage a part of their television system infrastructure, produce video content pertinent to their brand, marketing communications and hotel property amenities, and present this content on their Private Video Networks. We have annual renewable contracts with our clients for managing the computer hardware that interfaces with their television systems and, in some cases, their information system infrastructure. Watchit Media charges a base monthly subscription fee for these services.

Clients also pay us on a time and materials basis for the production of video content. In the gaming and hospitality industry, our clients tend to require frequent changes to the content we produce for them. Video content pertaining to their entertainment, casino games, cross promotions, and activities are among the dynamic video content we produce.

In addition, Watchit Media provides the service of securing hardware, software and installation and training services from third parties. Clients re-imburse Watchit for hardware and software and are charged an installation and training service fee in connection with these installations.

***Gross Profit***

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Gross profit increased \$14, or 10%, to \$154 in the three months ended September 30, 2005, from \$140 in the three months ended September 30, 2004. The increase in gross profit resulted from marketing efforts and a corresponding expansion of business.

As a percentage of revenues, the gross margin decreased to 41% in the three months ended September 30, 2005, from 55% in the three months ended September 30, 2004. The decrease in gross margin was the result of increased revenues related to hardware and software expenses passed through to clients with a nominal mark-up.

***Selling, General and Administrative Expenses***

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Selling, general and administrative expenses increased \$393, or 61%, to \$1,035 in the three months ended September 30, 2005, from \$642 in the three months ended September 30, 2004. The increase in selling, general and administrative expenses was the result of increased staff and associated expenses. In addition, corporate selling, general and administrative expense was allocated between the narrowcasting and IT services segment. Upon completion of the divestiture of the remaining component of the IT services segment on July 15, 2005, corporate selling, general and administrative expenses were allocated solely to the narrowcasting segment.

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***Other Income (Expense)***

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Other income (expense) consists of interest income, interest expense and other income.

Interest expense, net of interest income, was \$13 for the three months ended September 30, 2005 compared to interest income, net of interest expense of \$2 for the three months ended September 30, 2004. The decrease in net interest income was the result of lower cash balances on hand coupled with interest expense on secured borrowings that commenced in October of 2004.

Other income of \$115 was the result of gains on the sales of common stock of Bluebook International Holding Company, Inc., which previously had been written down to a zero book value.

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***Income Tax Benefit***

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The Company recognized income tax benefits of \$5 for the three months ended September 30, 2005, and \$6 for the three months ended September 30, 2004, which represented refunds of state income taxes.

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***Discontinued Operations***

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Discontinued operations comprised the IT services segment and included the operating results of businesses placed into discontinued operations and the gain on the sale of the remaining component of the discontinued operations.

The income from discontinued operations of \$485 for the three months ended September 30, 2005 compared to the loss from discontinued operations of \$545 for the three months ended September 30, 2004 and consisted of the operating results of the discontinued operations. The improvement in operating performance in 2005 was the result of recognizing previously deferred revenues of \$600 on the sale of software licenses, coupled with the effect of only operating the remaining component of discontinued operations through July 15, 2005, the date upon which it was sold, compared to three months in the prior year.

The gain on the sale of the discontinued operations of \$1,520 for the three months ended September 30, 2005, was the result of the gain on the sale of the remaining component of discontinued operations on July 15, 2005.

**Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004**

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***Revenues***

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Revenues increased \$679, or 120%, to \$1,243 in the nine months ended September 30, 2005, from \$564 in the nine months ended September 30, 2004. Effective with the acquisition of OnSite Media, Inc. on March 2, 2004, the Company commenced reporting revenues under its narrowcasting segment. The increase in revenues resulted from marketing efforts and a corresponding expansion of business together with the full nine months effect of including revenue resulting from the March 2, 2004 acquisition.

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Our narrowcasting clients retain us to manage a part of their television system infrastructure, produce video content pertinent to their brand, marketing communications and hotel property amenities, and present this content on their Private Video Networks. We have annual renewable contracts with our clients for managing the computer hardware that interfaces with their television systems and, in some cases, their information system infrastructure. Watchit Media charges a base monthly subscription fee for these services.

Clients also pay us on a time and materials basis for the production of video content. In the gaming and hospitality industry, our clients tend to require frequent changes to the content we produce for them. Video content pertaining to their entertainment, casino games, cross promotions, and activities are among the dynamic video content we produce.

In addition, Watchit Media provides the service of securing hardware, software and installation and training services from third parties. Clients re-imburse Watchit for hardware and software, and are charged an installation and training service fee in connection with these in installations.

### *Gross Profit*

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Gross profit increased \$362, or 116%, to \$673 in the nine months ended September 30, 2005, from \$311 in the nine months ended September 30, 2004. Effective with the acquisition of OnSite Media, Inc. on March 2, 2004, the Company commenced reporting revenues under its narrowcasting segment. The increase in gross profit resulted from marketing efforts and a corresponding expansion of business, together with the full nine months effect of including revenue resulting from the March 2, 2004 acquisition.

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As a percentage of revenues, the gross margin decreased to 54% in the nine months ended September 30, 2005, from 55% in the nine months ended September 30, 2004. The decrease in gross margin was the result of increased revenues related to hardware and software expenses passed through to clients with a nominal mark-up.

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***Selling, General and Administrative Expenses***

Selling, general and administrative expenses increased \$857, or 60%, to \$2,279 in the nine months ended September 30, 2005, from \$1,422 in the nine months ended September 30, 2004. The increase in selling, general and administrative expenses was the result of increased staff, marketing programs and development of new proprietary video programming not yet introduced to clients. In addition, corporate selling, general and administrative expense was allocated between the narrowcasting and IT services segment. Upon completion of the divestiture of the remaining component of the IT services segment on July 15, 2005, corporate selling, general and administrative expenses were allocated solely to the narrowcasting segment.

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***Other Income (Expense)***

Other income (expense) consists of interest income and interest expense.

Interest expense, net of interest income, was \$32 for the nine months ended September 30, 2005 compared to interest income, net of interest expense of \$89 for the nine months ended September 30, 2004. The decrease in net interest income was the result of lower cash balances on hand coupled with interest expense on secured borrowings that commenced in October of 2004.

Other income of \$141 was the result of gains on the sales of common stock of Bluebook International Holding Company, Inc., which had previously been written down to a zero book value.

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***Income Tax Benefit***

The Company recognized an income tax benefit of \$72 for the nine months ended September 30, 2005 which resulted from the reversal of an accrual for income tax contingencies of \$69 and state tax refunds of \$3.

The Company recognized an income tax benefit of \$2 for the nine months ended September 30, 2004 which represented state tax refunds.

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***Discontinued Operations***

Discontinued operations comprised the IT services segment and included the operating results of businesses placed into discontinued operations and the gain on the sale of the remaining component of discontinued operations.

The loss from discontinued operations of \$466 for the nine months ended September 30, 2005 compared to a loss from discontinued operations of \$2,460 for the nine months ended September 30, 2004 and consisted of the operating results of the discontinued operations. The improvement in operating performance in 2005 was the result of recognizing previously deferred revenues of \$600 on the sale of software licenses, coupled



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with the effect of only operating the remaining component of discontinued operations through July 15, 2005, the date upon which it was sold, compared to nine months in the prior year.

The gain on the sale of the discontinued operations of \$1,520 for the nine months ended September 30, 2005 was the result of the gain on the sale of the remaining component of discontinued operations on July 15, 2005.

### LIQUIDITY AND CAPITAL RESOURCES

In recent years, the Company has financed its operations principally through its own cash resources.

Cash used in operating activities was \$1,990 for the nine months ended September 30, 2005, compared to cash used in operating activities of \$4,303 for the nine months ended September 30, 2004. In the nine months ended September 30, 2005, the primary uses of cash in operating activities were \$1,520 of gain recognized on sale of discontinued operations, \$600 decrease in deferred revenue and \$371 net loss, offset by \$472 decrease in accounts receivable, \$133 decrease in prepaid expenses and other current assets and \$191 of amortization of identifiable assets and depreciation of property and equipment. In the nine months ended September 30, 2004, the primary uses of cash in operating activities were \$3,480 net loss and \$1,540 decrease in accounts payable and accrued liabilities, offset by \$411 decrease in accounts receivable.

Cash provided by investing activities was \$1,556 for the nine months ended September 30, 2005, compared to \$683 used for the nine months ended September 30, 2004. In the nine months ended September 30, 2005, the primary source from investing activities was \$1,568 of net proceeds on the sale of a discontinued operation. In the nine months ended September 30, 2004 the primary sources

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from investing activities were \$200 of payments received on a note from the acquirer of a previously sold business offset by \$605 used to purchase a business and \$278 used to acquire property and equipment.

Cash provided by financing activities was \$59 in the nine months ended September 30, 2005, which consisted of \$420 of cash provided by financing activities from the issuance of common stock and warrants, offset by \$348 of net repayments of advances against secured borrowings and \$13 of expenses incurred for the issuance of common stock and warrants. Cash used by financing activities was \$195 for the nine months ended September 30, 2004 which comprised the cost of issuing common stock and warrants.

The primary sources of liquidity for the Company going forward are the collection of its accounts receivable and existing cash balances at September 30, 2005. Accounts receivables of the continuing operations were 25 and 36 days of quarterly revenues of the continuing operations at September 30, 2005 and December 31, 2004, respectively.

During the past and in 2004, management has taken action in response to the continued softness in IT services in order to preserve cash, including but not limited to significant reductions in headcount, outsourcing certain administrative functions, changing benefit plan insurance carriers, relocating the headquarters office resulting in lower lease obligations, acquiring a business in an industry with more near term growth prospects than IT services, securing a line of credit agreement against its accounts receivable and announcing the plan to divest its IT services segment. Between February 1, 2005 and April 27, 2005, the Company entered into Stock and Warrant Purchase Agreements with certain accredited investors pursuant to which the Company sold shares of Common Stock and warrants to purchase additional shares of Common Stock resulting in a cash infusion to the Company of approximately \$420. In addition, on July 15, 2005 the Company sold its remaining IT services business to FastTech Integrated Solutions LLC, an affiliate of Beverly Hills, California-based private equity firm Skyview Capital, LLC, resulting in cash of approximately \$2,300. Management has carefully forecasted its results of operations and financial position through September 30, 2006, and has determined that the remaining cash on hand, together with cash available from the line of credit, proceeds from the sales of Common Stock to accredited investors, proceeds from the sale of the IT services segment, will provide adequate cash to fund its anticipated working capital needs. In the event circumstances arise that are not factored into the forecast, management will take further action to streamline operations and seek financing alternatives.

The following table reflects our contractual cash obligations as of September 30, 2005, excluding interest, due over the indicated periods.

	Payments Due by Period			
	Less than 1 Year	1 to 3 Years	4 to 5 Years	After 5 Years
Total				
Contractual Cash Obligations:				
Operating leases	\$ 1,422	\$ 1,422	\$	\$

**CRITICAL ACCOUNTING ESTIMATES****Allowance for Doubtful Accounts**

The Company provides an allowance for potentially uncollectible accounts receivable under the provisions of SFAS No. 5, Accounting for Contingencies, in the ordinary course of business. The allowance is derived as the result of periodic reviews of aged and known problem

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accounts during each quarter. In addition, the Company reserves for unknown issues in its receivables at the balance sheet date using a formula consistent from quarter to quarter. Management believes that its approach is appropriate to reserve for potentially uncollectible receivables. If management had taken another approach to developing its reserve, the allowance for doubtful accounts may have been different than that reported.

### **Revenue Recognition**

The Company recognizes revenue for time and materials contracts when there is evidence of an agreement, a fixed or determinable fee, its ability to collect is reasonably assured, and delivery has occurred. Revenues exclude reimbursable expenses charged to and collected from clients. Revenues pursuant to fixed-fee contracts are generally recognized as services are rendered on the percentage-of-completion method of accounting based on hours incurred to total estimated labor hours to complete. Revenues earned for software license sales and service contracts are recorded based on the provisions of AICPA SOP 97-2, *Software Revenue Recognition*, as amended, which shares the basic criteria described above, except its ability to collect is probable rather than reasonably assured.

### **Accounting for Income Taxes**

The Company accounts for income taxes under SFAS No. 109, *Accounting for Income Taxes*. This pronouncement requires using an asset and liability approach to recognize deferred tax assets and liabilities for the tax consequences of temporary differences by applying enacted statutory tax rates to differences between the financial statement carrying amounts and the tax basis of existing assets

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and liabilities. The Company has not given benefit to any deferred tax assets or net operating losses in the previous three fiscal years due to uncertainty of realizing these assets in future periods.

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

Cotelligent's policy is to invest its cash in a manner that provides Cotelligent with the appropriate level of liquidity to enable the Company to meet its current obligations, primarily accounts payable, capital expenditures and payroll.

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.

On August 19, 2002, the Company acquired Convertible Redeemable Preferred Stock in Bluebook International Holding Company (Bluebook). The Company accounted for the preferred stock as a trading security with changes in fair value recorded in the consolidated statements of operations. On May 4, 2004, the Preferred Stock was fully converted to common stock of Bluebook. The Company continues to account for the investment at fair value. Accordingly, subsequent to August 19, 2002, the Company was exposed to market risk related to changes in the market price of the common stock in Bluebook.

### **Item 4. Controls and Procedures**

#### *Evaluation of Disclosure Controls and Procedures*

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report was carried out by the Company under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures as of the end of the period covered by this report, were designed and were functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in reports filed under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. A controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls systems are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

#### *Change in Internal Control over Financial Reporting*

No change in the Company's internal control over financial reporting occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

In June 2005, Advance at Branchburg, LLC ( "Advance" ) filed a lawsuit against the Company in the Superior Court of New Jersey, Law Division, Somerset County. The lawsuit arises out of a commercial lease agreement between Advance as landlord and Cotelligent as tenant. Specifically, Advance alleges that Cotelligent breached the lease agreement by failing to make base and additional rent payments for the months of March 2005 to the present. Advance seeks payment of all amounts allegedly due under the lease, including base rent, late charges, interest and attorneys fees and costs. Advance also seeks loss of bargain damages, consisting of all rent due through the end of the lease term, reduced to present value using an interest rate of 6% per annum. The lawsuit does not specify the specific amount of damages sought. Advance initially obtained an entry of default against the Company but the default was vacated in September 2005 by Advance's consent. The Company then filed an answer to Advance's complaint, along with a counterclaim for the return of its security deposit. At September 30, 2005, the Company has accrued \$588 related to the lease obligation, which is classified as part of restructuring liabilities. The accrual covers obligations for base and additional rent and late charges, offset by estimated potential rent from the sublet of the facility. In addition, the Company maintains a \$180 security deposit with Advance in connection with the lease, classified as part of other long term assets. At this time, we do not believe this matter will have a material impact on our consolidated financial position, results of operations or cash flows other than the amounts already recorded on our financial statements.

**Item 2. Unregistered Sale of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults upon Senior Securities**

None

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

- (a) We held a Special Meeting of Stockholders of Cotelligent, Inc. on July 13, 2005. At the meeting, the stockholders approved the sale of substantially all of the assets used in the operation of Cotelligent's sales force automation software and services solutions business (the "Transaction") pursuant to an Asset Purchase Agreement, dated April 1, 2005, as amended, among Fast Track, LLC, Cotelligent, Inc. and certain of Cotelligent, Inc.'s subsidiaries.
- (b) Set forth below is a description of the matters voted upon at the Special Meeting of Stockholders of Cotelligent, Inc., including the number of votes cast for, as well as the number of votes withheld and broker non-votes, as to the Transaction.

Proposal I

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To approve the Transaction pursuant to an Asset Purchase Agreement, dated April 1, 2005, as amended, among Fast Track LLC, Cotelligent, Inc. and certain of Cotelligent, Inc.'s subsidiaries.

For 15,538,079

Withheld 18,040

### Proposal II

To adjourn or postpone the special meeting on one or more occasions if a quorum is not present or if sufficient votes in favor of the Transaction are not received by the time scheduled for the special meeting or any adjournment or postponement thereof.

For 14,915,259

Withheld 440,322

### Item 5. Other Information

Not applicable

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

Exhibits

- 31.1 Rule 13a-14(a) Certification of Chief Executive Officer
- 31.2 Rule 13a-14(a) Certification of Chief Financial Officer
- 32.1 Certification pursuant to 18 U.S.C. as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Chief Executive Officer. Section 1350.
- 32.2 Certification pursuant to 18 U.S.C. as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Chief Financial Officer. Section 1350.

Reports on Form 8-K

Current Report on Form 8-K, dated July 15, 2005, with the Securities and Exchange Commission in connection with the sale of substantially all of the assets related to the Company's sales force automation software and solution business.

Current Report on Form 8-K, dated September 15, 2006, with the Securities and Exchange Commission in connections with the acquisition of California Visitors Network.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**COTELLIGENT, INC.**

Date: November 14, 2005

**/s/ Curtis J. Parker**  
**Curtis J. Parker**

**Executive Vice President,**

**Chief Financial Officer and Treasurer**