COTELLIGENT INC
Form 10-Q
May 14, 2001

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2001

OR

o 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)

DELAWARE	94-3173918
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
44 MONTGOMERY STREET, SUITE 4050 SAN FRANCISCO, CALIFORNIA	94104
(Address of principal executive offices)	(Zip Code)

(415) 439-6400
(Registrant's telephone number, including area code)

101 CALIFORNIA STREET, SUITE 2050
SAN FRANCISCO, CALIFORNIA 94111
(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 X No ----------

At May 10, 2001, there were 15,347,942 shares of common stock outstanding.

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COTELLIGENT, INC.

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PART I - FINANCIAL INFORMATION

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	MARCH 31, 2001 (UNAUDITED)
ASSETS	
Current assets:	
Cash and cash equivalents.................................	$ 26,600
Accounts receivable, including unbilled accounts of $3,520 and $4,043 and net of allowance for doubtful accounts of $2,455 and $2,615, respectively.......	12,657
Deferred income taxes....................................	1,435
Notes receivable from officers and related party...........	1,708
Prepaid expenses and other current assets..................	2,605

Total current assets	45,005
Property and equipment, net	6,246
Note receivable from acquirer of discontinued operation	4,459
Investment	2,086
Other assets	416
Total assets	$ 58,212
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Short-term debt and current maturities of long-term debt	$ 227
Accounts payable	1,962
Accrued compensation and related payroll liabilities	4,788
Income taxes payable	749
Obligations related to acquired/sold businesses	3,508
Restructuring liabilities	1,031
Other accrued liabilities	2,595
Total current liabilities	14,860
Long-term debt	1,000
Deferred tax liabilities	1,435
Other liabilities	37
Total liabilities	17,332
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 authorized, 15,347,942 and 15,349,630 shares issued and outstanding, respectively	153
Additional paid-in capital	86,839
Notes receivable from stockholders	(6,193)
Retained earnings	(39,919)
Total stockholders' equity	40,880
Total liabilities and stockholders' equity	$ 58,212

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

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COTELLIGENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share data)
(Unaudited)

	THR
	2001
Revenues	$ 16,02

Cost of services	11,28
Gross profit	4,74
Selling, general and administrative expenses	8,85
Depreciation and amortization	67
Operating loss	(4,79
Other income(expense):	
Interest expense	(
Interest income	48
Other	4
Total other income (expense)	53
Loss from continuing operations before income Taxes	(4,26
Income tax benefit	
Loss from continuing operations	(4,26
Operating income (loss) from discontinued operations net of income taxes	(
Net loss	$ (4,27
Basic and diluted earnings per share:	
Loss from continuing operations	$ (0.2
Income from discontinued operations	
Net loss	$ (0.2
Basic and diluted weighted average number of shares outstanding	15,349,06

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

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

	THREE MONTHS ENDED M	
	2001	
Cash flows from operating activities:		
Net loss	$(4,271)	
Adjustments to reconcile net loss to net cash used for operating activities:		
Operating (income) loss from discontinued operations	6	
Equity income from investments	(39)	
Depreciation and amortization	676	
Deferred income taxes, net	-	
Provision for doubtful accounts	676	
Changes in current assets and liabilities:		
Accounts receivable, net	5,896	
Prepaid expenses and other current assets	(446)	

Accounts payable and accrued expenses..................	(2,778)	
Income taxes payable..................................	1	
Changes in other assets...............................	-	
Cash used for operating activities...........................	(279)	
Cash flows used for investing activities:		
Purchases of property and equipment..........................	(161)	
Cash used for investing activities...........................	(161)	
Cash flows provided by financing activities:		
Borrowing under Credit Agreement.............................	-	
Borrowing (payments) on capital lease obligations.............	15	
Net proceeds on issuance of stock............................	148	
Repurchase of common stock...................................	-	
Cash provided by financing activities........................	163	
Cash flows provided by discontinued operations:		
Cash provided by discontinued operations......................	377	
Net increase in cash...	100	
Cash at beginning of period..................................	26,500	
Cash at end of period..	$ 26,600	$
Supplemental disclosures of cash flow information:		
Interest paid..	$ 1	$
Income taxes paid (refunded).................................	$ 20	$
Return of shares previously issued to acquire business.........	$ -	$
Adjustment to purchase price of business acquired in prior year..	$ -	$
Fair value of Common Stock issued to employees for notes receivable..	$ -	$

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

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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, was formed to acquire, own and operate software consulting businesses specializing in providing information technology ("IT") consultants on a contract basis and consulting and outsourcing services to businesses with complex IT operations. The Company has acquired 22 IT consulting businesses. These financial statements include the accounts of Cotelligent, Inc. and its subsidiaries.

In July 2000, the Company changed its fiscal year end to December 31 from March 31. Consequently, the three months ended March 31, 2001 is the first quarter of the 2001 fiscal year.

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 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 two fiscal periods as it works through its repositioning in the market, 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, 2000 ("Form 10-K"), and therefore these financial statements should be read in conjunction with the financial statements included on 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 RECEIVABLE	
	SHARES	AMOUNT	PAID-IN CAPITAL	FROM STOCKHOLDERS	RETAINE EARNING
Balance at December 31, 2000..	15,349,630	$153	$86,866	$(6,368)	$(35,64
Issuance of Common Stock......	48,312	1	147	-	
Cancellation of LSPP Note.....	(50,000)	(1)	(174)	175	
Net income....................	-	-	-	-	(4,27
Balance at March 31, 2001.....	15,347,942	$153	$86,839	$(6,193)	$(39,91

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

NOTE 4 - DISCONTINUED OPERATIONS

In accordance with Accounting Principles Board Opinion No. 30, the following financial data reflects a summary of operating results for the Company's discontinued operations for the three months ended March 31, 2001 and 2000.

SUMMARY OF OPERATING RESULTS OF DISCONTINUED OPERATIONS:

	THREE MONTHS ENDED	
	MARCH 31, 2001	MARCH 31, 2000
Revenues	$1,858	$55,963
Cost of services	1,453	40,928
Gross profit	405	15,035
Selling, general and administrative expenses	411	10,679
Depreciation and amortization of goodwill	-	877
Operating income (loss)	(6)	3,479
Other expense	-	(27)
Operating income (loss) before provision for taxes	(6)	3,452
Provision for income taxes	-	1,208
Operating income (loss) from discontinued operations	$ (6)	$ 2,244

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 continued to hold one remaining component of its IT staff augmentation business. The Company anticipates that it will dispose of this remaining component by the end of 2001 at a loss and consequently has written down the value of the net assets, including goodwill of this discontinued business, to zero during the nine month fiscal year ended December 31, 2000.

NOTE 5 - EARNINGS (LOSS) PER SHARE
Earnings (loss) per share were as follows:

	FOR THE THREE MONTHS ENDED MARCH 31		
	INCOME (LOSS)	SHARES	PER AM
Basic and diluted earnings (loss) per share-			
Loss from continuing operations	$(4,265)	15,349,060	$
Loss from discontinued operations	(6)	15,349,060	
Net loss available to common stockholders	$(4,271)	15,349,060	$

	FOR THE THREE MONTHS ENDED MARCH 31		
	INCOME (LOSS)	SHARES	PER AM
Basic and diluted earnings (loss) per share-			

Loss from continuing operations........................	$(3,288)	15,001,429	$
Income from discontinued operations....................	2,244	15,001,429	
Net loss available to common stockholders..............	$(1,044)	15,001,429	$

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

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 change 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, 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 in accordance with Staff Accounting Bulletin No. 100, "Restructuring and Impairment Charges", which resulted in a pre-tax restructuring charge of $4,200 during the nine months ended December 31, 2000. The charge includes 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 following summarizes the activity and balances in each restructuring program for the three months ended March 31, 2001:

	JUNE 1999 RESTRUCTURING PROGRAM		DECEMBER 2000 RESTRUCTURING PROGRAM	
	SEVERANCE	FACILITIES CLOSURE	SEVERANCE	FACILITIES CLOSURE
Balance, December 31, 2000	$ 57	$179	$ 900	$1,000
Spending and write-downs.........	(57)	-	(584)	(464)
Balance, March 31, 2001..........	$ -	$179	$ 316	$ 536

NOTE 7 - INCOME TAXES

The Company did not record an income tax benefit for the three months ended March 31, 2001 due to the uncertainty of its realization. Management will continue to assess the adequacy of and the need for a valuation allowance and to the extent it is determined that such allowance is no longer required, the tax benefit will be recognized in the future.

NOTE 8 - SUBSEQUENT EVENT

On May 3, 2001, the Company announced its plan to repurchase up to 15% of its outstanding shares of common stock. The purchases will be made in the open market or in privately negotiated transactions, depending on market conditions and other factors. The New York Stock Exchange requires that the Company maintain an average closing price, calculated over a 30 consecutive trading day period, of at least $1 per share. The primary reason the Company is undertaking its share repurchase program is to meet this requirement. It is difficult for the Company to predict how many shares it may decide to purchase in order to meet this requirement.

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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, 2000, other filings made with the Securities and Exchange Commission and Cotelligent's press release announcing earnings for the quarter ended March 31, 2001, which was issued on April 24, 2001. 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 was formed in February 1993 to acquire, own and operate IT consulting services businesses. The Company historically operated on an April 1 to March 31 fiscal year. In July 2000, the Company changed its fiscal year end to December 31. Consequently, the Company's most recently completed fiscal period is a nine-month transition period ended December 31, 2000. The three months ended March 31, 2001 is the first quarter of the 2001 fiscal year.

Prior to March 31, 2000, the Company entered into a plan to divest its IT staff augmentation business. Accordingly, the financial statements of Cotelligent has been restated to present as discontinued operations the Company's IT staff augmentation business for all periods presented.

The Company derives substantially all of its revenues from IT consulting and outsourcing service activities. The majority of these activities are provided under time and materials billing arrangements, and 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. In addition, the Company is designing and marketing client server-based, web-enabled mobile management software for industries that have medium to large transient sales, field or delivery personnel. Revenues are directly related to the total number of users of the software and is recognized over the period in which the software is licensed to the client.

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 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 un-utilized time (work activities not chargeable to clients or unrelated to client services) of full-time salaried service professional employees.

Operating income (gross profit less 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. Historically, a majority of the Company's revenues were generated from IT staff augmentation activities. Following the disposition of the IT staff augmentation business, the majority of the Company's revenues has been generated by solutions activities, which require a higher level of selling, general and administrative infrastructure to generate revenues, including research and development related to mobility solutions.

As a service 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.

CONSOLIDATED RESULTS OF OPERATIONS
(In Thousands)

THREE MONTHS ENDED MARCH 31, 2001 COMPARED TO THREE MONTHS ENDED MARCH 31, 2000

REVENUES

Revenues decreased $11,278, or 41%, to $16,022 in the three months ended March 31, 2001 from $27,300 in the three months ended March 31, 2000. The decrease was due to a re-organization of the Company's sales force resulting in significant turnover of sales people and, therefore, associated ramp up time with the new evolving sales force. In addition, the Company experienced a general reduction in demand for its services due a softening in the market, coupled with the discontinuation of three operating locations subsequent to

March 31, 2000 and prior to January 1, 2001.

GROSS PROFIT

Gross profit decreased $3,823, or 45%, to $4,740 in the three months ended March 31, 2001 from $8,563 in the three months ended March 31, 2000. The decrease was due to lower revenues following a re-organization of the Company's sales force and the associated ramp up time with the new evolving sales force, as well as a general reduction in demand for the Company's services due to a softening in the market, coupled with the discontinuation of three operating locations. The gross profit margin decreased to 30% from 31%, due to a drop in utilization of salaried employees and a change in the mix of services delivered, offset by a 7% increase in the average billing rate.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses decreased $2,627, or 23%, to $8,859 in the three months ended March 31, 2001 from $11,486 in the three months ended March 31, 2000. The decrease was primarily due to the closure of three operating locations subsequent to March 31, 2000 and prior to January 1, 2001, a reduction in operating staff following the divestiture of the majority of the IT staff augmentation business, as well as the effects of a reduction-in-force announced on December 20, 2000. These reductions were partially offset by recruiting costs and employee wages paid to newly hired sales people.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased $177, or 21%, to $676 in the three months ended March 31, 2001 from $853 in the three months ended March 31, 2000. The decrease was due to the elimination of amortization related to goodwill following the complete write-off of goodwill in the quarter ended December 31, 2000, offset by increased depreciation on new technology equipment.

OTHER INCOME (EXPENSE)

Other income (expense) primarily consists of net interest income (expense). Net interest income was $484 for the three months ended March 31, 2001 compared to net interest expense of $1,280 for the three months ended March 31, 2000. This change was due to the elimination of all obligations due under the Company's Credit Agreement and an earn-out agreement resulting from the Company's sale of the majority of the IT staff augmentation business on June 30, 2000 which reduced interest expense. The Company also earned additional interest income on the cash proceeds received from the sale on June 30, 2000 of the majority of its IT staff augmentation business during the three months ended March 31, 2001.

BENEFIT FOR INCOME TAXES

The Company did not record an income tax benefit for the three months ended March 31, 2001 due to the uncertainty of its realization. For the quarter ended March 31, 2000, the Company recorded an income tax benefit of $1,770 because the operating losses of that period were available for carry back against taxable income of prior years.

INCOME (LOSS) FROM DISCONTINUED OPERATIONS

Discontinued operations is comprised of the Company's IT staff augmentation business. The loss from discontinued operations of $6 for the three months ended March 31, 2001, compares to income of $2,244 for the three months ended March 31, 2000. The decrease in income from discontinued operations is the result of the sale of the majority of the discontinued operations on June 30, 2000.

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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.

Most recently, the Company 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 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. During the quarter ended March 31, 2001, the Company maintained no credit facility.

Cash used for operating activities was $279 for the three months ended March 31, 2001 and the average cash balance during the quarter was $26,500. Historically, the Company's primary sources of liquidity have been the collection of accounts receivable and borrowings under the credit facility. Total receivables were 71 days of quarterly revenues at March 31, 2001 and 82 days at December 31, 2000.

With the termination of its borrowing arrangements under the Credit Agreement, the Company's primary sources of liquidity going forward will be its existing cash balances, the collection of accounts receivable, and any cash resulting from the sales of the components of the remaining discontinued IT staff augmentation business. The Company believes that the remaining cash from the consummated divestiture transactions, additional proceeds from the potential sale of the remainder of its discontinued IT staff augmentation business and any funds generated from operations will provide adequate cash to fund its anticipated cash working capital needs at least through the next twelve months.

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 the Company to meet its current obligations, primarily accounts payable, capital expenditures and payroll, recognizing that the Company 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

The following reports on Form 8-K were filed during the quarter ended March 31, 2001.

Cotelligent, Inc. filed with the Securities and Exchange Commission on January 3, 2001, Form 8-K regarding the termination of a joint venture between Cotelligent, Inc. and bSmart.to Technologies, Inc.

SIGNATURES

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: MAY 14, 2001	/S/ CURTIS J. PARKER
	Curtis J. Parker Executive Vice President, Chief Financial Officer and Treasurer