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COTELLIGENT INC
Form 10-Q
November 13, 2001

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2001

OR

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

For the transition period from _____ to _____

Commission File Number 0-27412

COTELLIGENT, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State of other jurisdiction of
incorporation or organization)

94-3173918
(I.R.S. Employer
Identification No.)

44 MONTGOMERY STREET, SUITE 4050
SAN FRANCISCO, CALIFORNIA
(Address of principal executive offices)

94104
(Zip Code)

(415) 439-6400
(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 X No
----- -----

At November 9, 2001 there were 14,815,475 shares of common stock outstanding.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

SEPTEMBER 30,
2001

ASSETS

Current assets:

| | |
|--|-----------|
| Cash and cash equivalents..... | \$ 20,186 |
| Accounts receivable, including unbilled accounts of \$1,709 and \$4,043 and net of allowance for doubtful accounts of \$2,166 and \$2,615, respectively..... | 6,739 |
| Deferred income taxes..... | 1,435 |
| Notes receivable from officers and related party..... | 1,761 |
| Current portion of note receivable from acquirer of..... | |

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| | |
|---|-----------|
| discontinued operation..... | 411 |
| Prepaid expenses and other current assets..... | 1,578 |
| | ----- |
| Total current assets..... | 32,110 |
| Property and equipment, net..... | 4,593 |
| Note receivable from acquirer of discontinued operation..... | 3,685 |
| Equity investment in alliance partner..... | 1,863 |
| Other assets..... | 172 |
| | ----- |
| Total assets..... | \$ 42,423 |
| | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| Current liabilities: | |
| Short-term debt and current maturities of long-term debt..... | \$ 250 |
| Accounts payable..... | 1,364 |
| Accrued compensation and related payroll liabilities..... | 3,073 |
| Income taxes payable..... | 735 |
| Obligations related to acquired/sold businesses..... | 3,619 |
| Restructuring liabilities..... | 2,086 |
| Other accrued liabilities..... | 2,682 |
| | ----- |
| Total current liabilities..... | 13,809 |
| Long-term debt..... | 657 |
| Deferred tax liabilities..... | 1,435 |
| Other liabilities..... | 48 |
| | ----- |
| Total liabilities..... | 15,949 |
| | ----- |
| 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, 15,460,075 and 15,349,630 shares issued, respectively..... | 155 |
| Additional paid-in capital..... | 86,879 |
| Notes receivable from stockholders..... | (6,193) |
| Retained earnings..... | (53,867) |
| Common stock held in treasury, at cost (644,600 shares)..... | (500) |
| | ----- |
| Total stockholders' equity..... | 26,474 |
| | ----- |
| Total liabilities and stockholders' equity..... | \$ 42,423 |
| | ===== |

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

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

THREE MONTHS ENDED
SEPTEMBER 30,

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| | 2001 | 2000 |
|---|------------|------------|
| | ----- | ----- |
| Revenues..... | \$ 10,187 | \$ 22,475 |
| Cost of services..... | 7,035 | 14,904 |
| | ----- | ----- |
| Gross profit..... | 3,152 | 7,571 |
| Selling, general and administrative expenses..... | 7,221 | 11,440 |
| Depreciation and amortization of goodwill..... | 689 | 987 |
| Restructuring charge..... | 3,373 | - |
| | ----- | ----- |
| Operating loss..... | (8,131) | (4,856) |
| Other income (expense): | | |
| Interest expense..... | - | (8) |
| Interest income..... | 312 | 543 |
| Other..... | (86) | (7) |
| | ----- | ----- |
| Total other income (expense)..... | 226 | 528 |
| | ----- | ----- |
| Loss from continuing operations before income taxes..... | (7,905) | (4,328) |
| Benefit for income taxes..... | - | 1,472 |
| | ----- | ----- |
| Loss from continuing operations..... | (7,905) | (2,856) |
| | ----- | ----- |
| Operating income (loss) from discontinued operations, net of income taxes of \$0, \$142, \$0 and \$2,901..... | (49) | 148 |
| Gain on sale of discontinued operations, net of income taxes of \$0 and \$4,224..... | - | - |
| | ----- | ----- |
| Income (loss) from discontinued operations..... | (49) | 148 |
| | ----- | ----- |
| Net loss..... | \$ (7,954) | \$ (2,708) |
| | ===== | ===== |
| Basic and diluted earnings (loss) per share: | | |
| Loss from continuing operations..... | \$ (0.54) | \$ (0.19) |
| Income from discontinued operations..... | - | 0.01 |
| | ----- | ----- |
| Net loss..... | \$ (0.54) | \$ (0.18) |
| | ===== | ===== |
| Basic and diluted weighted average number of shares outstanding..... | 14,824,310 | 15,235,827 |
| | ===== | ===== |

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

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| | |
|---|-------------|
| Cash flows from operating activities: | |
| Net loss..... | \$ (18,219) |
| Adjustments to reconcile net loss to net cash used for operating activities: | |
| Operating income from discontinued operations..... | 32 |
| Gain on sale of discontinued operations..... | - |
| Equity loss from investments..... | 166 |
| Depreciation and amortization..... | 2,065 |
| Deferred income taxes, net..... | - |
| Loss on disposal of property and equipment..... | - |
| Provision for doubtful accounts..... | 1,552 |
| Changes in current assets and liabilities: | |
| Accounts receivable, net..... | 10,938 |
| Prepaid expenses and other current assets..... | 537 |
| Accounts payable and accrued expenses..... | (2,511) |
| Income taxes payable..... | (13) |
| Changes in other assets..... | 12 |
| Cash used for operating activities..... | (5,441) |
| Cash flows used for investing activities: | |
| Proceeds from sale of investment..... | - |
| Purchases of property and equipment..... | (1,029) |
| Cash used for investing activities..... | (1,029) |
| Cash flows provided by financing activities: | |
| Borrowing under Credit Agreement..... | - |
| Payments on Credit Agreement..... | - |
| Payments due sellers of acquired business..... | (600) |
| Payments on capital lease obligations..... | (44) |
| Payments long term debt..... | (293) |
| Repayments on notes receivable from officers..... | - |
| Net proceeds on issuance of stock..... | 190 |
| Repurchase of common stock..... | - |
| Purchase of treasury stock..... | (500) |
| Cash used for financing activities..... | (1,247) |
| Cash flows provided by discontinued operations: | |
| Proceeds on sale of discontinued operations..... | - |
| Cash flow from discontinued operations..... | 1,403 |
| Cash flow provided by discontinued operations..... | 1,403 |
| Net increase (decrease) in cash..... | (6,314) |
| Cash at beginning of period..... | 26,500 |
| Cash at end of period..... | \$ 20,186 |
| Supplemental disclosures of cash flow information: | |
| Interest paid..... | \$ 2 |
| Income taxes paid (refunded)..... | \$ 14 |
| Return of common stock previously issued to acquire business..... | \$ - |
| Adjustment of purchase price of business acquired in prior year..... | \$ - |
| Fair value of Common Stock issued for notes receivable..... | \$ - |
| Adjustment of note receivable from acquirer of discontinued operation..... | \$ 400 |
| Fair value of Common Stock issued to seller of acquired Business..... | \$ - |
| Return of Common Stock previously issued to employee for note receivable..... | \$ 175 |

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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, provides software consulting services to businesses with complex information technology ("IT") operations and maintenance, support and contract services on software products it licenses. These financial statements include the accounts of Cotelligent, Inc. and its subsidiaries.

In July 2000, the Company changed its fiscal year end to December 31 from March 31. Consequently, the nine months ended September 30, 2001 is the third quarter of the 2001 fiscal year.

During the fiscal year ended March 31, 2000, the Company was organized into 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 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. 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

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| | COMMON STOCK | | ADDITIONAL | NOTES |
|-----------------------------------|----------------|----------|---------------|--------------|
| | ----- | | PAID-IN | RECEIVABLE |
| | SHARES | AMOUNT | CAPITAL | FROM |
| | ----- | ----- | ----- | STOCKHOLDERS |
| | | | | ----- |
| Balance at December 31, 2000..... | 15,349,630 | \$153 | \$86,866 | \$ (6,368) |
| Issuance of Common Stock..... | 160,445 | 3 | 187 | - |
| Cancellation of LSPP Note | (50,000) | (1) | \$ (174) | \$ 175 |
| Purchase of treasury shares | | | | |
| Net loss..... | - | - | - | - |
| | ----- | ----- | ----- | ----- |
| Balance at September 30, 2001.... | 15,460,075 | \$155 | \$86,879 | \$ (6,193) |
| | ===== | ===== | ===== | ===== |
| | TREASURY STOCK | | TOTAL | |
| | ----- | | STOCKHOLDERS' | |
| | SHARES | AMOUNT | EQUITY | |
| | ----- | ----- | ----- | |
| Balance at December 31, 2000..... | | | \$ 45,003 | |
| Issuance of Common Stock..... | | | 190 | |
| Cancellation of LSPP Note | | | - | |
| Purchase of treasury shares | 644,600 | \$ (500) | (500) | |
| Net loss..... | | | \$ (18,219) | |
| | ----- | ----- | ----- | |
| Balance at September 30, 2001.... | 644,600 | \$ (500) | \$ 26,474 | |
| | ===== | ===== | ===== | |

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

NOTE 4 - PRO FORMA STATEMENT OF OPERATIONS

During the quarter ended September 30, 2001, the Company took action to streamline operations in line with revenues. The following pro forma statement of operations for the quarter ended September 30, 2001 excludes the one-time restructuring charge, salary expense for non-billable staff terminated during the quarter, salary expense for billable staff terminated during the quarter (for the portion of time these billable people did not generate revenues), and occupancy expense for locations included in the restructuring charge.

| | |
|---|-------|
| Revenues..... | |
| Cost of services..... | |
| Gross profit..... | |
| Selling, general and administrative expenses..... | |
| Depreciation and amortization of goodwill..... | |

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| | |
|---|--|
| Operating loss..... | |
| Other income, net..... | |
| | |
| Loss from continuing operations before income taxes..... | |
| Income tax benefit..... | |
| | |
| Loss from continuing operations..... | |
| | |
| Operating income (loss) from discontinued operations, net of income tax (benefit) of \$0..... | |
| | |
| Net loss..... | |
| | |
| Basic and diluted earnings (loss) per share: | |
| Loss from continuing operations..... | |
| Income from discontinued operations..... | |
| | |
| Net loss..... | |
| | |
| Basic and diluted weighted average number of shares outstanding..... | |

NOTE 5 - DISCONTINUED OPERATIONS

The following financial data reflects a summary of operating results for the Company's discontinued operations for the three and nine months ended September 30, 2001 and 2000.

SUMMARY OF OPERATING RESULTS OF DISCONTINUED OPERATIONS:

| | THREE MONTHS ENDED | | |
|---|-----------------------|-----------------------|--|
| | SEPTEMBER 30, 2001 | SEPTEMBER 30, 2000 | |
| Revenues..... | \$ 323 | \$7,688 | |
| Cost of services..... | 339 | 5,974 | |
| | ----- | ----- | |
| Gross profit..... | (16) | 1,714 | |
| Selling, general and administrative expenses. | 33 | 1,424 | |
| Depreciation and amortization of goodwill..... | - | - | |
| | ----- | ----- | |
| Operating income | (49) | 290 | |
| Other expense..... | - | - | |
| | ----- | ----- | |
| Operating income before provision for taxes... | (49) | 290 | |
| Provision for income taxes..... | - | 142 | |
| | ----- | ----- | |
| Operating income from discontinued operations.... | \$ (49) | \$ 148 | |
| | ===== | ===== | |

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 September 30, 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 to zero during the nine month fiscal year ended

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December 31, 2000.

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

NOTE 6 - EARNINGS (LOSS) PER SHARE

Earnings (loss) per share were as follows:

| | FOR THE THREE MONTHS ----- | |
|--|-------------------------------|---|
| | INCOME (LOSS) ----- | |
| Basic and diluted earnings (loss) per share- | | |
| Loss from continuing operations..... | \$ (7,905) | 1 |
| Loss from discontinued operations..... | (49) | 1 |
| | ----- | |
| Net loss available to common stockholders..... | \$ (7,954) | 1 |

| | FOR THE THREE MONTHS ----- | |
|--|-------------------------------|---|
| | INCOME (LOSS) ----- | |
| Basic and diluted earnings (loss) per share- | | |
| Loss from continuing operations..... | \$ (2,856) | 1 |
| Income from discontinued operations..... | 148 | 1 |
| | ----- | |
| Net loss available to common stockholders..... | \$ (2,708) | 1 |

| | FOR THE NINE MONTHS ----- | |
|--|------------------------------|----|
| | INCOME (LOSS) ----- | |
| Basic and diluted earnings (loss) per share- | | |
| Loss from continuing operations..... | \$ (18,187) | 15 |
| Loss from discontinued operations..... | (32) | 15 |
| | ----- | |
| Net loss available to common stockholders..... | \$ (18,219) | 15 |

| | FOR THE NINE MONTHS ----- | |
|--|------------------------------|----|
| | INCOME (LOSS) ----- | |
| Basic and diluted earnings (loss) per share- | | |
| Loss from continuing operations..... | \$ (11,274) | 15 |
| Income from discontinued operations..... | 8,403 | 15 |
| | ----- | |
| Net loss available to common stockholders..... | \$ (2,871) | 15 |

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

NOTE 7 - RESTRUCTURING PROGRAMS

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

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

The following summarizes the activity and balances in each restructuring program for the nine months ended September 30, 2001:

| | JUNE 1999 RESTRUCTURING PROGRAM | | DECEMBER 2000 RESTRUCTURING PROGRAM | | |
|----------------------------------|------------------------------------|-----------------------|--|-----------------------|----|
| | SEVERANCE | FACILITIES CLOSURE | SEVERANCE | FACILITIES CLOSURE | |
| Balance at December 31, 2000.... | \$ 57 | \$179 | \$ 900 | \$1,000 | |
| Restructuring charge..... | - | - | - | - | \$ |
| Spending and adjustments..... | (57) | (10) | (900) | (463) | |
| Balance at June 30, 2001..... | \$ - | \$169 | \$ - | \$ 537 | \$ |
| | ===== | ===== | ===== | ===== | |

NOTE 8 - INCOME TAXES

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The Company did not record an income tax benefit for the nine months ended September 30, 2001 due to the uncertainty of its realization. Management will continue to assess the adequacy of and the need for a valuation allowance. To the extent it is determined that such allowance is no longer required, principally by achieving sustained profitability, a tax benefit may be recognized in the future.

NOTE 9 - COMMON STOCK REPURCHASE PROGRAM

On May 3, 2001, the Company announced its plan to repurchase up to 15% of its then outstanding shares of common stock. Purchases under the program were made in the open market or in privately negotiated transactions, depending on market conditions and other factors. The New York Stock Exchange, the exchange the Company's Common Stock traded on at the time required that the Company maintain a certain average closing price of its Common Stock, calculated over a 30 consecutive trading day period. The primary reason the Company undertook its share repurchase program was to meet this requirement. On September 27, 2001, the Company announced it would no longer purchase any additional shares under the program.

Between May 3, 2001 and September 27, 2001, the Company purchased 644,600 shares of its common stock for \$500. The purchases were recorded at cost and reported in stockholders' equity as common stock held in treasury.

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

NOTE 10 - LONG-TERM INCENTIVE PLAN

On March 9, 2001 the Company notified all option holders under the Long-Term Incentive Plan of a stock option exchange program. The exchange program was developed as a way to bring the option exercise prices back in line with the market price for the Company's Common Stock. Completely voluntary on the part of the option holder, the program allowed the option holder to exchange existing stock option grants for a new option grant. On March 16, 2001, the date by which option holders were required to elect to participate in the program, 1,399,638 options were cancelled. On September 21, 2001, 1,169,446 new option grants were issued, based on that day's closing price of the Company's Common Stock. The number of new option grants were less than the number of options initially cancelled, due to option holders who were terminated from the Company between March 16, 2001 and September 21, 2001. On September 30, 2001, the total number of options issued or approved by the Board of Directors for issuance was 4,403,251.

NOTE 11 - SUBSEQUENT EVENT

On October 11, 2001, the Company announced that it began trading its Common Stock on the OTC Bulletin Board under the symbol "CGZT". The Company had previously traded its Common Stock on the New York Stock Exchange under the symbol "CGZ" and announced on September 27, 2001, that the New York Stock Exchange had determined that trading in the Company's Common Stock would be suspended after close of market on October 10, 2001, and that the issue would be removed from the New York Stock Exchange's trading list as a result of failing to meet the New York Stock Exchange's continued listing requirements.

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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 September 30, 2001, which was issued on October 30, 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 provides IT consulting and maintenance and support on software product it licenses. 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 September 30, 2001 is the third 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 have been restated to present as discontinued operations the Company's IT staff augmentation business for all periods presented.

Cotelligent provides IT consulting and maintenance and support on software product it licenses. 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 associated with software licensing and the related maintenance and consulting services are recognized once a contract is signed, delivery has been made and collectibility is probable.

The Company's principal costs are professional compensation directly related to the performance of services and related expenses. Gross profits (revenues after professional compensation 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

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its service activities, if fixed-fee engagements are not properly priced, if consultant cost increases exceed increases in revenue or if there are high levels of unutilized time (work activities not chargeable to clients or unrelated to client services) of full-time salaried service professional employees.

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

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CONSOLIDATED RESULTS OF OPERATIONS (In Thousands)

THREE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THREE MONTHS ENDED
SEPTEMBER 30, 2000

REVENUES

Revenues decreased \$12,288, or 55%, to \$10,187 in the three months ended September 30, 2001 from \$22,475 in the three months ended September 30, 2000. The decrease was due to a general reduction in demand for its services due to softening in the market coupled with a shift away from general IT consulting services towards offering mobile workforce management solutions and its associated ramp-up time.

GROSS PROFIT

Gross profit decreased \$4,419, or 58%, to \$3,152 in the three months ended September 30, 2001 from \$7,571 in the three months ended September 30, 2000. The decrease was due to lower revenues following a general reduction in demand for its services due to softening in the market coupled with a shift away from general IT consulting services towards offering mobile workforce management solutions and its associated ramp-up time. The gross profit margin decreased to 31% from 34%, due to a drop in utilization of salaried employees during a period of declining revenues.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses decreased \$4,219, or 37%, to \$7,221 in the three months ended September 30, 2001 from \$11,440 in the three months ended September 30, 2000. The decrease was primarily due to the closure of three operating locations subsequent to March 31, 2000 and prior to January 1, 2001, and reductions in operating staff following the divestiture of the majority of the IT staff augmentation business, as well as the effects of other

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reductions in staff to streamline operations in line with revenues.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased \$298, or 30%, to \$689 in the three months ended September 30, 2001 from \$987 in the three months ended September 30, 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 interest income. Interest income was \$312 for the three months ended September 30, 2001 compared to interest income of \$543 for the three months ended September 30, 2000. The decrease in interest income was due to a lower cash balance on hand during the three months ended September 30, 2001.

BENEFIT FOR INCOME TAXES

The Company did not record an income tax benefit for the three months ended September 30, 2001 due to the uncertainty of its realization. For the quarter ended September 30, 2000, the Company recorded an income tax benefit of \$1,472 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 \$49 for the three months ended September 30, 2001 compares to income of \$148 for the three months ended September 30, 2000. The decrease in income from discontinued operations is the result of the sale of all components of discontinued operations, except one component, by October 31, 2000.

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CONSOLIDATED RESULTS OF OPERATIONS (IN THOUSANDS)

NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2000

REVENUES

Revenues decreased \$35,246, or 48%, to \$38,282 in the nine months ended September 30, 2001 from \$73,528 in the nine months ended September 30, 2000. The decrease was due to a general reduction in demand for its services due to softening in the market coupled with a shift away from general IT consulting services towards offering mobile workforce management solutions and its associated ramp-up time.

GROSS PROFIT

Gross profit decreased \$12,478, or 53%, to \$10,909 in the nine months ended September 30, 2001 from \$23,387 in the nine months ended September 30, 2000. The decrease was due to a general reduction in demand for its services due to softening in the market coupled with a shift away from general IT consulting services toward offering mobile workforce management solutions and its associated ramp-up time. The gross profit margin decreased to 28% from 32%, due

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to a drop in utilization of salaried employees during a period of declining revenues.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses decreased \$10,746, or 30%, to \$24,706 in the nine months ended September 30, 2001 from \$35,452 in the nine months ended September 30, 2000. The decrease was primarily due to the closure of three operating locations subsequent to March 31, 2000 and prior to January 1, 2001, and reductions in operating staff following the divestiture of the majority of the IT staff augmentation business, as well as the effects of other reductions in staff to streamline operations in line with revenue.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased \$817, or 28%, to \$2,065 in the nine months ended September 30, 2001 from \$2,882 in the nine months ended September 30, 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.

OTHER INCOME (EXPENSE)

Other income (expense) primarily consists of net interest income (expense). Net interest income was \$1,191 for the nine months ended September 30, 2001 compared to net interest expense of \$2,252 for the nine months ended September 30, 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 nine months ended September 30, 2001.

BENEFIT FOR INCOME TAXES

The Company did not record an income tax benefit for the nine months ended September 30, 2001 due to the uncertainty of its realization. For the nine months ended September 30, 2000, the Company recorded an income tax benefit of \$5,885 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 \$32 for the nine months ended September 30, 2001, compares to income of \$8,403 for the nine months ended September 30, 2000. The decrease in income from discontinued operations is the result of the sale of all components of discontinued operations, except one component, by October 31, 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

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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. Since June 30, 2000, the Company has not maintained a credit facility.

Cash used for operating activities was \$5,441 for the nine months ended September 30, 2001 and the average cash balance during the quarter was \$21,259. Historically, the Company's primary sources of liquidity have been the collection of accounts receivable and borrowings under the credit facility. Total receivables were 61 days of quarterly revenues at September 30, 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 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

None

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SIGNATURES

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THE

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REGISTRANT HAS DULY CAUSED THIS REPORT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED, THEREUNTO DULY AUTHORIZED.

COTELLIGENT, INC.

DATE: NOVEMBER 13, 2001

/S/ CURTIS J. PARKER

CURTIS J. PARKER
EXECUTIVE VICE PRESIDENT,
CHIEF FINANCIAL OFFICER AND TREASURER