COTELLIGENT INC
Form 10-Q
August 14, 2003
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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 June 30, 2003

¨ 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 incorporation)	**(I.R.S. ID)**

100 Theory, Suite 200, Irvine, California 92612

(Address of principal executive offices)

(949) 823-1600

(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 ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes ¨ No x

At August 12, 2003 there were 15,068,855 shares of common stock outstanding.

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Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	June 30, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 11,201**	$ 17,683
Refundable income taxes	**150**	197
Accounts receivable, including unbilled accounts of $349 and $261 and net of allowance for doubtful accounts of $77 and $147, respectively	**1,367**	2,399
Notes receivable from officers and stockholder, net of valuation allowance of $1,703 and $1,703, respectively		
Current portion of note receivable from acquirer of discontinued operation	**480**	480
Prepaid expenses and other current assets	**693**	526
Total current assets	**13,891**	21,285
Property and equipment, net	**556**	451
Note receivable from acquirer of discontinued operation	**863**	1,103
Investment in marketable security	**38**	1,543
Equity investment in alliance partner	**72**	335
Other assets	**247**	316
Total assets	**$ 15,667**	$ 25,033
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	**$ 633**	$ 1,353
Accrued compensation and related payroll liabilities	**1,095**	1,435
Restructuring liabilities	**117**	117
Deferred revenue	**84**	247
Other accrued liabilities	**1,850**	2,229
Total current liabilities	**3,779**	5,381
Restructuring liabilities, net of current portion	**738**	805
Other long-term liabilities	**69**	24
Income taxes payable	**2,618**	2,618
Total liabilities	**7,204**	8,828
Commitments and contingencies		
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, 15,713,455 and 15,390,954 shares issued, respectively	**157**	154

Additional paid-in capital	**86,487**	86,374
Notes receivable from stockholders	**(5,940)**	(5,940)
Accumulated deficit	**(71,741)**	(63,883)
Treasury stock	**(500)**	(500)
Total stockholders equity	**8,463**	16,205
Total liabilities and stockholders equity	**$ 15,667**	$ 25,033

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Revenues	$ 2,460	$ 4,302	$ 5,316	$ 10,175
Cost of services	1,785	2,675	3,565	6,443
Gross profit	675	1,627	1,751	3,732
Research and development costs	113	599	493	818
Selling, general and administrative expenses	4,288	5,008	7,641	9,621
Operating loss	(3,726)	(3,980)	(6,383)	(6,707)
Other income (expense):				
Interest expense	(12)	(24)	(28)	(71)
Interest income	30	85	56	161
Other	(493)	(129)	(1,496)	(287)
Total other income (expense)	(475)	(68)	(1,468)	(197)
Loss from continuing operations before income taxes	(4,201)	(4,048)	(7,851)	(6,904)
Income tax expense (benefit)	3	(96)	7	(7,496)
Income (loss) from continuing operations	(4,204)	(3,952)	(7,858)	592
Gain (loss) on sale of discontinued operations, net of income tax expense of $-, $0, $-, $0		82		82
Net income (loss)	$ (4,204)	$ (3,870)	$ (7,858)	$ 674
Earnings (loss) per share:				
Basic				
Income (loss) from continuing operations	$ (0.28)	$ (0.26)	$ (0.53)	$ 0.04
Income (loss) from discontinued operations				0.01
Net income (loss)	$ (0.28)	$ (0.26)	$ (0.53)	$ 0.05
Diluted				
Income (loss) from continuing operations	$ (0.28)	$ (0.26)	$ (0.53)	$ 0.04
Income (loss) from discontinued operations				
Net income (loss)	$ (0.28)	$ (0.26)	$ (0.53)	$ 0.04

Weighted average number of shares outstanding				
Basic	14,955,444	14,901,054	14,851,477	14,895,879
Diluted	14,955,444	14,901,054	14,851,477	17,387,792

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2003	**2002**
Cash flows from operating activities:		
Income (loss) from continuing operations	$ (7,858)	$ 592
Adjustments to reconcile income (loss) from continuing operations to net cash provided by (used for) operating activities:		
Equity loss from investment in alliance partner	263	286
Unrealized loss on investment in marketable security	1,235	
Depreciation	80	3
Compensation expense on change in terms of stock options	54	
Provision for doubtful accounts	70	77
Deferred taxes, net		(7,496)
Changes in current assets and liabilities:		
Accounts receivable	962	2,863
Prepaid expenses and other current assets	(167)	(233)
Income taxes, net	47	6,809
Accounts payable and accrued liabilities	(1,461)	(1,116)
Deferred revenue	(163)	(398)
Other assets	69	49
Cash provided by (used for) operating activities	(6,869)	1,436
Cash flows from investing activities:		
Payments received on note from acquirer of discontinued operations	240	310
Purchases of property and equipment	(185)	(84)
Dividend received from investee	270	
Cash provided by (used for) investing activities	325	226
Cash flows from financing activities:		
Net proceeds on issuance of common stock	62	4
Purchase of treasury stock		
Cash provided by (used for) financing activities	62	4
Cash flows provided by discontinued operations		111
Net increase (decrease) in cash	(6,482)	1,777
Cash at beginning of period	17,683	18,778
Cash at end of period	$ 11,201	$ 20,555
Supplemental disclosures of cash flow information:		
Interest paid	$ 16	$ 47
Income taxes paid (refunded)	$ 7	$ (6,809)

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

Note 1 Accounting Policies

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 also provides maintenance, support and contract services on software products it licenses. These financial statements include the accounts of Cotelligent, Inc. and its subsidiaries.

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.

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, 2002, 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.

Adoption of New Accounting Pronouncements

The Company adopted the provisions of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities , on January 1, 2003. SFAS No. 146 revises the accounting for specified employee and contract terminations that are part of restructuring activities and allows recognition of a liability for the cost associated with an exit or disposal activity only when the liability is incurred and can be measured at fair value. This statement applies on a prospective basis to exit or disposal activities that are initiated after December 31, 2002. The Company believes that the adoption of this interpretation will not have a material impact on its consolidated financial position or results of operations.

The Company adopted the initial recognition and measurement provisions of Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others , on January 1, 2003, which apply on a prospective basis to guarantees issued or modified after December 31, 2002. We adopted the disclosure provisions of FIN No. 45 during the quarter ended December 31, 2002. In the ordinary course of business, we are not subject to potential

obligations under guarantees that fall within the scope of FIN No. 45 except for standard indemnification and warranty provisions that are contained within many of our customer license and service agreements, as well as standard indemnification agreements that we have executed with our executive officers and the statutory indemnification provisions under the laws of the State of Delaware relating to our directors, and give rise to the disclosure requirements prescribed by FIN No. 45. In addition, under previously existing accounting principles generally accepted in the United States of America, we continue to monitor the conditions that are subject to the guarantees and indemnifications to identify whether it is probable that a loss has occurred, and would recognize any such losses under the guarantees and indemnifications when those losses are estimable. Indemnification and warranty provisions contained within our customer license and service agreements are generally consistent with those prevalent in our industry. The duration of our service warranties generally does not exceed 30 days following completion of our services. We have not incurred significant obligations under customer indemnification or warranty provisions historically and do not expect to incur significant obligations in the future. Accordingly, we do not maintain accruals for potential customer indemnification or warranty-related obligations. The indemnification agreements that we have executed with our executive officers and the statutory indemnification provisions under the laws of the State of Delaware relating our directors would require us to indemnify such officers and directors in certain instances. We have not incurred obligations under these indemnification agreements historically and do not expect to incur significant obligations in the future. Accordingly, we do not maintain accruals for potential officer or director indemnification obligations. The maximum potential amount of future payments that we could be required to make is generally limited under the indemnification provisions in our customer license and service agreements, and is unlimited under the indemnification provisions in our executive officer agreements and statutory indemnification provisions under the laws of the State of Delaware relating to our directors.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

The Company adopted the interim disclosure provisions of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure , during our second quarter ended March 31, 2003. Related interim disclosures are included herein.

On January 17, 2003, the FASB issued FASB Financial Interpretation No. 46, Consolidation of Variable Interest Entities, which requires extensive disclosures and will require companies to evaluate variable interest entities created after January 31, 2003 and existing entities to determine whether to apply the Interpretation s consolidation approach to them. Companies must apply the Interpretation to entities with which they are involved if the entity s equity has specified characteristics. If it is reasonably possible that a company will have a significant variable interest in a variable interest entity at the date the Interpretation s consolidation requirements become effective, the company must disclose the nature, purpose, size and activities of the variable interest entity and the consolidated enterprise s maximum exposure to loss resulting from its involvement with the variable interest entity in all financial statements issued after January 31, 2003 regardless of when the variable interest entity was created. Since the Company has no interest in any variable interest entity, the Company believes that the adoption of this interpretation will not have a material impact on its consolidated financial position or results of operations.

Stock-Based Compensation

The Company measures compensation expense for its employee stock-based compensation awards using the intrinsic value method and provide pro forma disclosures of net income (loss) and earnings (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 income (loss) and earnings (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 June 30,		Six Months Ended June 30,	
	2003	**2002**	**2003**	**2002**
Net income (loss), as reported	**$ (4,204)**	$ (3,870)	**$ (7,858)**	$ 674
Add: Stock-based employee compensation expense included in reported net income net of related tax expense, if applicable	**29**		**54**	
Deduct: Total stock-based compensation expense determined under fair value based method for awards net of related tax expense, if applicable	**(26)**	(61)	**(22)**	(183)
Pro forma net income (loss)	$ (4,201)	$ (3,931)	$ (7,826)	$ 491

Earnings (loss) per share, as reported:				
Basic	**$ (0.28)**	$ (0.26)	**$ (0.53)**	$ 0.05
Diluted	**$ (0.28)**	$ (0.26)	**$ (0.53)**	$ 0.04
Pro forma earnings (loss) per share:				
Basic	**$ (0.28)**	$ (0.26)	**$ (0.53)**	$ 0.03
Diluted	**$ (0.28)**	$ (0.26)	**$ (0.53)**	$ 0.03

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

Note 2 Changes in Stockholders Equity

	Common Stock		Additional Paid-In	Notes Receivable From	Accum.	Treasury Stock		Total Stockholders
	Shares	Amount	Capital	Stockholders	Deficit	Shares	Amount	Equity
Balance at December 31, 2002	15,390,954	$ 154	$ 86,374	$ (5,940)	$ (63,883)	644,600	$ (500)	$ 16,205
Issuance of Stock	322,501	3	59					62
Change in terms of stock options granted			54					54
Net loss					(7,858)			(7,858)
Balance at June 30, 2003	15,713,455	$ 157	$ 86,487	$ (5,940)	$ (71,741)	644,600	$ (500)	$ 8,463

Note 3 Investment in Marketable Security

During 2002, the Company acquired 5,316,704 shares of Series C Convertible Redeemable Preferred Stock (Series C) of Bluebook International Holding Company, Inc. (Bluebook), representing an approximately 15% ownership interest (assuming conversion of all outstanding preferred stock) in exchange for $3,000 in cash and contributed services. The value of the Series C Stock was initially recorded at $3,000, the amount of cash paid to Bluebook. The cost of the contributed services was recorded as research and development costs. Under the certificate of designation of the Series C Stock, Bluebook is required, at the Company s option, to either a) convert the shares of Series C Stock to common stock at any time or b) redeem the shares of Series C Stock for cash beginning four years and up through six years after the date of initial issuance.

The Series C Stock meets the definition of a debt security under the provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. In accordance with SFAS No. 115, the Company classified the Series C Stock as a trading security and consequently reports the investment at fair value, with unrealized gains and losses recorded in other income (expense) in the condensed consolidated statements of operations. Accordingly, the investment was reduced by $1,457 during the year ended December 31, 2002 and $1,234 during the six months ended June 30, 2003 due to the decrease in fair value since the acquisition date.

During the six months ended June 30, 2003, the Company delivered software development services to Bluebook for which no revenue was recognized. Payments of $270 were received from Bluebook for the delivery of services during the six months ended June 30, 2003 which were applied against and further reduced the carrying value of the investment. Cost of $230 associated with software development services during the six months ended June 30, 2003 were recorded as research and development costs.

Note 4 Restructuring Program

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 in accordance with EITF 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) and Staff Accounting Bulletin No. 100, Restructuring and Impairment Charges 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 of the aforementioned standards in order to accrue costs as of a commitment date. Therefore, the September 2001 plan costs that did not provide a future benefit were charged to operations when due and payable. The following summarizes the activity and balances in this restructuring program for the six months ended June 30, 2003:

Balance, December 31, 2002	$ 922
Spending	(40)
Adjustments	(27)
Balance, June 30, 2003	$ 855

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands)

Note 5 Weighted Average Number of Shares Outstanding

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Basic weighted average number of shares outstanding	14,955,444	14,901,054	14,851,477	14,895,879
Effect of stock options issued to employees and directors				2,491,913
Diluted weighted average number of shares outstanding	14,955,444	14,901,054	14,851,477	17,387,792

Options to purchase 875,522, 1,131,505 and 2,672,244 shares of common stock were outstanding for the three and six months ended June 30, 2003, and six months ended June 30, 2002, respectively, but were not included in EPS for those relevant periods because the Company reported a loss from continuing operations resulting in an antidilutive effect.

Note 6 Subsequent Event

Subsequent to June 30, 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, which included a re-organization of senior and executive management. As a result, the Company anticipates that it will pay approximately $1,750 of contractual severance costs. One of the executive officers will use a portion of his contractual severance benefits to repay outstanding loans to the Company, resulting in a reversal of a valuation allowance on those loans of approximately $500.

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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, an 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, 2002 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.

OVERVIEW

Cotelligent provides IT consulting and also provides maintenance, support and hosting on software products it licenses. The IT consulting services are either provided under time and materials billing arrangements or on a fixed-fee basis. For time and materials arrangements, revenues are recognized 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. 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. In addition, the Company has developed complete mobile workforce management solutions for industries that have medium to large transient sales, field or delivery personnel. A component of these solutions may be software that has been developed by the Company. For each element in a software arrangement (e.g., license, maintenance, and services), revenue is recognized once there is evidence of an arrangement, delivery has been made, the fee is fixed or determinable, and collectibility is probable. The amount of revenue recognized for each element is based upon vendor specific objective evidence of fair value using the residual method. Maintenance and service revenue is recognized as the Company performs the services.

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, the percentage of effort complete with respect to fixed-fee contracts and employee or consultant compensation. 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 costs increase beyond relative increases in pricing, 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 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, cost savings or economies of scale are generated from such investment. Solution development activities require a higher level of selling, general and administrative activities as well as investment in research and development activities.

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

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CONSOLIDATED RESULTS OF OPERATIONS

(In Thousands)

Three Months Ended June 30, 2003 Compared to Three Months Ended June 30, 2002

Revenues

Revenues decreased $1,842 or 43%, to $2,460 in the three months ended June 30, 2003 from $4,302 in the three months ended June 30, 2002. The decrease was due to a general reduction in demand for the Company s services due to softening in the IT services market coupled with the Company s shift away from general IT consulting services towards offering mobile workforce management solutions and its associated ramp-up time. During the three months ended June 30, 2002 and June 30, 2003, two of our clients individually accounted for more than 10% of our revenues, respectively.

Gross Profit

Gross profit decreased $952, or 59%, to $675 in the three months ended June 30, 2003 from $1,627 in the three months ended June 30, 2002. The decrease was due to lower revenues following a general reduction in demand for the Company s services due to softening in the IT services market coupled with the Company s 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 27% from 38%, due to a lower level of utilization of billable resources.

Research and Development Costs

Research and development costs were $113 for the three months ended June 30, 2003 compared to $599 for the three months ended June 30, 2002. The Company has a dedicated team of people solely focused on research and development activities associated with mobile workforce management and Web services solutions. The higher spending during the three months ended June 30, 2002 was due to research and development costs incurred for the development of a software solution for a business partner.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased $720, or 14%, to $4,288 in the three months ended June 30, 2003 from $5,008 in the three months ended June 30, 2002. The decrease was primarily due to reductions in operating staff and operating locations in order to streamline operations in line with revenues offset by legal, consulting and travel costs associated with due diligence procedures in connection with a potential acquisition, implementation costs associated a new accounting and project reporting system, design costs associated with a changes to the Company s Web site, costs of publishing new collateral materials, and duplicate salary costs during a transition and move of the Company s accounting operations to its headquarter s location.

Other Income (Expense)

Other income (expense) primarily consists of interest income, interest expense, loss on an investment in an alliance partner accounted for under the equity method of accounting and the change in market value associated with an investment in a marketable security. Interest income net of interest expense was $18 for the three months ended June 30, 2003 compared to $61 for the three months ended June 30, 2002. The decrease in net interest income was due primarily to a lower cash balance on hand during the three months ended June 30, 2003. Other expense for the three

months ended June 30, 2003 was $493 principally from the change in market value associated with a preferred stock investment which meets the definition of a debt security under the provisions of SFAS No. 115. In accordance with SFAS No. 115, the Company classified the investment as a trading security and consequently reports the investment at fair value, with unrealized gains and losses recorded in other income (expense) in the consolidated statements of operations. Accordingly, the investment was reduced by a $342 unrealized loss, during the quarter ended June 30, 2003.

Benefit for Income Taxes

The Company did not record an income tax benefit for the three months ended June 30, 2003 or 2002 due to the uncertainty of its realization, except as described below for the three months ended June 30, 2002.

The income tax expense of $3 for the quarter ended June 30, 2003 were minimal state tax payments.

The Company recognized a tax benefit of $96 for the quarter ended June 30, 2002, which represented a true-up of the estimated tax benefit recognized in the quarter ended March 31, 2002. The benefit was based on the carryback claim actually filed in the quarter ended June 30, 2002.

CONSOLIDATED RESULTS OF OPERATIONS

(In Thousands)

Six Months Ended June 30, 2003 Compared to Six Months Ended June 30, 2002

Revenues

Revenues decreased $4,859 or 48%, to $5,316 in the six months ended June 30, 2003 from $10,175 in the six months ended June 30, 2002. The decrease was due to a general reduction in demand for the Company s services due to softening in the IT services market coupled with the Company s shift away from general IT consulting services towards offering mobile workforce management solutions and its associated ramp-up time. During the six months ended June 30, 2002 and June 30, 2003, two of our clients individually accounted for more than 10% of our revenues, respectively.

Gross Profit

Gross profit decreased $1,918, or 53%, to $1,751 in the six months ended June 30, 2003 from $3,732 in the six months ended June 30, 2002. The decrease was due to lower revenues following a general reduction in demand for the Company s services due to softening in the IT services market coupled with the Company s 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 33% from 37%, due to a lower level of utilization of billable resources.

Research and Development Costs

Research and development costs were $493 for the six months ended June 30, 2003 compared to $818 for the six months ended June 30, 2002. The Company has a dedicated team of people solely focused on research and development activities associated with mobile workforce management and Web services solutions. The higher spending during the six months ended June 30, 2002 was due to research and development costs incurred for the development of a software solution for a business partner.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased $1,980, or 21%, to $7,641 in the six months ended June 30, 2003 from $9,621 in the six months ended June 30, 2002. The decrease was primarily due to reductions in operating staff and operating locations in order to streamline operations in line with revenues offset by legal, consulting and travel costs associated with due diligence procedures in connection with a potential acquisition, implementation costs associated a new accounting and project reporting system, design costs associated with a changes to the Company s Web site, costs of publishing new collateral materials, and duplicate salary costs during a transition and move of the Company s accounting operations to its headquarter s location.

Other Income (Expense)

Other income (expense) primarily consists of interest income, interest expense, loss on an investment in an alliance partner accounted for under the equity method of accounting and the change in market value associated with an investment in a marketable security. Interest income net of interest expense was $28 for the six months ended June 30, 2003 compared to $90 for the six months ended June 30, 2002. The decrease in net interest income was due primarily to a lower cash balance on hand during the three months ended June 30, 2003. Other expense for the six

months ended June 30, 2003 was $1,496 principally from the change in market value associated with a preferred stock investment which meets the definition of a debt security under the provisions of SFAS No. 115. In accordance with SFAS No. 115, the Company classified the investment as a trading security and consequently reports the investment at fair value, with unrealized gains and losses recorded in other income (expense) in the consolidated statements of operations. Accordingly, the investment was reduced by a $1,234 unrealized loss, during the six months ended June 30, 2003.

Benefit for Income Taxes

The Company did not record an income tax benefit for the six months ended June 30, 2003 or 2002 due to the uncertainty of its realization, except as described below for the six months ended March 31, 2002.

The income tax expense of $7 for the six months ended June 30, 2003 were minimal state tax payments.

The tax benefit of $7,496 for the six months ended June 30, 2002 was the result of the Job Creation and Worker Assistance Act of 2002, approved by Congress on March 9, 2002, allowing net operating losses for the Company s fiscal tax year ending March 31, 2002 to be carried back five years. In accordance with SFAS No. 109, the effect of this change in tax law was reflected in the March 31, 2002 financial statements as changes in tax law must be reflected in the period of enactment.

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LIQUIDITY AND CAPITAL RESOURCES

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

The Company previously maintained a credit facility with a consortium of banks under which it borrowed to fund working capital needs. On June 30, 2000, the Company used a portion of the cash proceeds from the sale of its IT staff 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 by operating activities was $6,869 for the six months ended June 30, 2003 compared to cash provided by operating activities of $1,436 for the six months ended June 30, 2002. In 2003 the reductions in accounts payable and deferred revenue offset by the add back of non-cash depreciation, equity loss on investment in alliance partner, compensation expense on changes in terms of stock options, provision for doubtful accounts and change in market value associated with an investment in a marketable security together with reductions in accounts receivable, other current assets and income taxes were the primary uses of cash. In 2002 the add back of equity loss on investment in alliance partner and provision for doubtful accounts and reductions in accounts receivable offset by income taxes, accounts payable and deferred revenue were the primary sources of cash. The primary sources of liquidity for the Company going forward are the collection of its accounts receivable and the cash balances at June 30, 2003. Total receivables were 54 and 75 days of quarterly revenue at June 30, 2003 and December 31, 2002, respectively. At December 31, 2002 and June 30, 2003, four clients and two clients, accounted for more than 10% of accounts receivable, respectively. Subsequent to June 30, 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, which included a re-organization of senior and executive management. As a result, the Company anticipates that it will pay approximately $1,750 of contractual severance costs. One of the executive officers will use a portion of his contractual severance benefits to repay approximately $500 of outstanding loans to the Company.

Cash provided by investing activities was $325 for the six months ended June 30, 2003 compared to $226 for the six months ended June 30, 2002. In 2003, the Company received $270 from Bluebook as payment for services provided by the Company for which the Company has not recorded revenue and $240 of payments received on a note from the acquirer of a discontinued operation offset by $185 for the purchase of property and equipment, principally for continuous upgrades to computer software and equipment. In 2002, the Company received $310 of payments received on a note from the acquirer of a discontinued operation offset by $84 for the purchase of property and equipment, principally for continuous upgrades to computer software and equipment.

During the six months ended June 30, 2003, the Company used cash to reduce current liabilities accrued at December 31, 2002 by $1,439. The reduction in current liabilities during the six months ended June 30, 2003 included the payment of some costs incurred in quarters prior to December 31, 2002 which were not repeated in the six months ended June 30, 2003. The Company does not expect a significant portion of these costs to recur in the next year. Management of the Company believes that the remaining cash on hand will provide adequate cash to fund its anticipated cash working capital needs at least through June 30, 2004.

The following table reflects our contractual cash obligations, excluding interest, due over the indicated periods.

	Payments Due by Period

	Total	Less than 1 Year	1 to 3 Years	4 to 5 Years	After 5 Years
Contractual Cash Obligations:					
Obligations due sellers of an acquired business	$ 319	$ 319	$	$	$
Operating leases	$ 3,365	$ 1,261	$ 2,104	$	$
Total contractual obligation	$ 3,684	$ 1,580	$ 2,104	$	$

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CRITICAL ACCOUNTING POLICIES

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 and thorough reviews of aged and known problem 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. Should management have taken another approach to developing its reserve, the allowance for doubtful accounts may have been different than that reported.

Revenue Recognition

The Company accounts for time and materials services revenue under the provisions of SAB 101, Staff Accounting Bulletin No. 101: Revenue Recognition in Financial Statements , which requires revenue to be recorded when there is evidence of an agreement, a fixed or determinable fee, collectibility is reasonably assured, and delivery has occurred. Revenues include reimbursable expenses charged to and collected from clients. Revenues pursuant to fixed-fee services 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 , which shares the basic criteria of SAB No. 101.

Restructuring Liabilities

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 changing operating structure over the prior three fiscal periods. These restructuring obligations were calculated using information known at the date of the respective accruals based on the provisions of EITF 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity and Staff Accounting Bulletin No. 100, Restructuring and Impairment Charges . Management has adjusted these obligations over the payment periods of each restructuring plan as liabilities have been settled and payments have been made.

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 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. In addition, the financial statements have provided reserves for certain tax positions taken by the Company in the March 31, 2002, 2001 and 2000 tax returns based on enacted tax laws during those periods.

New Accounting Pronouncements

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue 00-21, Revenue Arrangements with Multiple Deliverables . EITF Issue No. 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services, and/or rights to use assets. The provisions of EITF Issue No. 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003.

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In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS No. 150). SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. This statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for the Company s quarter beginning July 1, 2003. For financial instruments created before the issuance date of this Statement and still existing at the beginning of the interim period of adoption, transition shall be achieved by reporting the cumulative effect of a change in accounting principle by initially measuring the financial instruments at fair value or other measurement attribute required by this statement. The Company believes the adoption of SFAS No. 150 will not have a material impact on its consolidated financial position or results of operations.

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, recognizing that the Company does not currently have outside bank funding available.

During 2002, the Company invested approximately $3,000 of cash in convertible redeemable preferred stock in Bluebook International Holding Company, a publicly traded company. As the instrument is convertible into a publicly traded security, the investment has market risk which can result in fluctuations in the value. The Company looks to the publicly traded value to determine the fair value of the investment at each reporting date and recognizes unrealized gains or losses in the consolidated statement of operations in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities .

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.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company s management, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness the Company s disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer 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 Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system 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.

(b) 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

We are, from time to time, a party to litigation arising in the normal course of our business. We are not presently subject to any material litigation.

Item 2. Changes in Securities and Use of Proceeds

None

Item 3. Defaults upon Senior Securities

None

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

None

Item 5. Other Information

Not applicable

Item 6. Exhibits and Reports on Form 8-K

(a) 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.

(b) Reports on Form 8-K

None.

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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: August 14, 2003

/s/ Curtis J. Parker

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