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COTELLIGENT INC
Form 10-Q
August 14, 2001

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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 June 30, 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
(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
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At August 9, 2001 there were 14,768,057 shares of common stock outstanding.

COTELLIGENT, INC.

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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)

	JUNE 30, 2001

ASSETS	
Current assets:	
Cash and cash equivalents.....	\$ 22,331
Accounts receivable, including unbilled accounts of \$3,165 and \$4,043 and net of allowance for doubtful accounts of \$2,620 and \$2,615, respectively.....	8,891
Deferred income taxes.....	1,435
Notes receivable from officers and related party.....	1,729
Prepaid expenses and other current assets.....	2,862

Total current assets.....	37,248
Property and equipment, net.....	5,944
Note receivable from acquirer of discontinued operation.....	4,459
Equity investment in alliance partner.....	1,949

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Other assets.....	404

Total assets.....	\$ 50,004
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Short-term debt and current maturities of long-term debt.....	\$ 208
Accounts payable.....	664
Accrued compensation and related payroll liabilities.....	3,920
Income taxes payable.....	740
Obligations related to acquired/sold businesses.....	3,792
Restructuring liabilities.....	1,068
Other accrued liabilities.....	2,845

Total current liabilities.....	13,237
Long-term debt.....	756
Deferred tax liabilities.....	1,435
Other liabilities.....	36

Total liabilities.....	15,464

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, 15,412,657 and 15,349,630 shares issued, respectively.....	154
Additional paid-in capital.....	86,866
Notes receivable from stockholders.....	(6,193)
Retained earnings.....	(45,913)
Common stock held in treasury, at cost (483,000 shares).....	(374)

Total stockholders' equity.....	34,540

Total liabilities and stockholders' equity.....	\$ 50,004
	=====

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

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

	THREE MONTHS ENDED JUNE 30,		SI
	2001	2000	2001
	-----	-----	-----
Revenues.....	\$ 12,073	\$ 23,753	\$ 28
Cost of services.....	9,056	16,500	20
	-----	-----	-----
Gross profit.....	3,017	7,253	7

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Selling, general and administrative expenses..	8,626	12,526	17
Depreciation and amortization of goodwill.....	700	1,042	1
	-----	-----	-----
Operating loss.....	(6,309)	(6,315)	(11)
Other income (expense):			
Interest expense.....	(1)	(1,556)	
Interest income.....	396	49	
Other.....	(103)	49	
	-----	-----	-----
Total other income (expense).....	292	(1,458)	
	-----	-----	-----
Loss from continuing operations before income taxes.....	(6,017)	(7,773)	(10)
Benefit for income taxes.....	-	2,643	
	-----	-----	-----
Loss from continuing operations.....	(6,017)	(5,130)	(10)
	-----	-----	-----
Operating income from discontinued operations, net of income taxes of \$0, \$1,551, \$0 and \$3,707.....	23	1,615	
Gain on sale of discontinued operations, net of income taxes of \$0, \$4,224, \$0 and \$4,224.....	-	4,396	
	-----	-----	-----
Income from discontinued operations.....	23	6,011	
	-----	-----	-----
Net income (loss).....	\$ (5,994)	\$ 881	\$ (10)
	=====	=====	=====
Basic and diluted earnings (loss) per share:			
Loss from continuing operations.....	\$ (0.39)	\$ (0.34)	\$ (
Income from discontinued operations	-	0.40	
	-----	-----	-----
Net income (loss).....	\$ (0.39)	\$0.06	\$ (
	=====	=====	=====
Basic and diluted weighted average number of shares outstanding.....	15,273,716	15,123,639	15,316
	=====	=====	=====

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

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

	SIX MONTHS ENDED JUNE	
	2001	20
	-----	-----
Cash flows from operating activities:		
Net loss.....	\$ (10,265)	\$
Adjustments to reconcile net loss to net cash		

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used for operating activities:		
Operating income from discontinued operations.....	(17)	(3)
Gain on sale of discontinued operations.....	-	(4)
Equity income from investments.....	98	
Depreciation and amortization.....	1,376	1
Deferred income taxes, net.....	-	11
Provision for doubtful accounts.....	1,126	
Changes in current assets and liabilities:		
Accounts receivable, net.....	9,212	(3)
Prepaid expenses and other current assets.....	(724)	(1)
Accounts payable and accrued expenses.....	(4,659)	(6)
Income taxes payable.....	(8)	
Changes in other assets.....	12	
	-----	-----
Cash used for operating activities.....	(3,849)	(5)
Cash flows used for investing activities:		
Proceeds from sale of investment.....	-	
Purchases of property and equipment.....	(559)	(1)
	-----	-----
Cash used for investing activities.....	(559)	(1)
Cash flows provided by financing activities:		
Borrowing under Credit Agreement.....	-	9
Payments on Credit Agreement.....	-	(57)
Payments due sellers of acquired business.....	-	(8)
Payments on capital lease obligations.....	(3)	
Payments long term debt.....	(244)	
Repayments on notes receivable from officers.....	-	
Net proceeds on issuance of stock.....	176	
Purchase of treasury stock.....	(374)	
	-----	-----
Cash used for financing activities.....	(445)	(55)
Cash flows provided by discontinued operations:		
Proceeds on sale of discontinued operations.....	-	111
Cash flow from discontinued operations.....	684	(4)
	-----	-----
Cash flow provided by discontinued operations.....	684	107
	-----	-----
Net increase (decrease) in cash.....	(4,169)	44
Cash at beginning of period.....	26,500	1
	-----	-----
Cash at end of period.....	\$ 22,331	\$ 45
	=====	=====
Supplemental disclosures of cash flow information:		
Interest paid.....	\$ 2	\$ 3
Income taxes paid (refunded).....	\$ 5	\$ (1)
Return of common stock previously issued to acquire business.	\$ -	\$ 2
Adjustment of purchase price of business acquired in prior		
year.....	\$ -	\$ 8
Fair value of common stock issued to employees for notes		
receivable.....	\$ -	\$
Fair value of Common Stock issued to seller of acquired		
Business.....	\$ -	\$
Return of Common Stock previously issued to employee for		
note receivable.....	\$ 175	\$

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, IT consultants on a contract basis 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 three months ended June 30, 2001 is the second 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 Paid-in Capital	Notes Receivable	Retained Earnings
Shares	Amount		from Stockholders	
-----	-----	-----	-----	-----

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Balance at December 31, 2000...	15,349,630	\$153	\$86,866	\$ (6,368)	\$(35,648)
Issuance of Common Stock.....	113,027	2	174	--	--
Cancellation of LSPP Note.....	(50,000)	(1)	\$ (174)	\$ 175	--
Purchase of treasury shares....					
Net loss.....	--	--	--	--	\$(10,265)
	-----	-----	-----	-----	-----
Balance at June 30, 2001.....	15,412,657	\$154	\$86,866	\$ (6,193)	\$(45,913)
	=====	=====	=====	=====	=====

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

NOTE 4 - DISCONTINUED OPERATIONS

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

SUMMARY OF OPERATING RESULTS OF DISCONTINUED OPERATIONS:

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	JUNE 30, 2001	JUNE 30, 2000	JUNE 30, 2001	JUNE 30, 2000
Revenues.....	\$1,272	\$57,368	\$3,130	\$57,368
Cost of services.....	901	42,243	2,354	42,243
Gross profit.....	371	15,125	776	15,125
Selling, general and administrative expenses..	348	11,102	759	11,102
Depreciation and amortization of goodwill.....	-	875	-	875
Operating income	23	3,148	17	3,148
Other income (expense).....	-	18	-	18
Operating income before provision for taxes..	23	3,166	17	3,166
Provision for income taxes.....	-	1,551	-	1,551
Operating income from discontinued operations.....	\$ 23	\$ 1,615	\$ 17	\$ 1,615

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 June 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 December 31, 2000.

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NOTE 5 - EARNINGS (LOSS) PER SHARE

Earnings (loss) per share were as follows:

	FOR THE THREE MONTHS EN	
	INCOME (LOSS)	SH
Basic and diluted earnings (loss) per share-		
Loss from continuing operations.....	\$ (6,017)	1
Income from discontinued operations.....	23	1
Net loss available to common stockholders.....	\$ (5,994)	1

	FOR THE THREE MONTHS END	
	INCOME (LOSS)	SH
Basic and diluted earnings (loss) per share-		
Loss from continuing operations.....	\$ (5,130)	1
Income from discontinued operations.....	6,011	1
Net loss available to common stockholders.....	\$ 811	1

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

	FOR THE SIX MONTHS END	
	INCOME (LOSS)	SH
Basic and diluted earnings (loss) per share-		
Loss from continuing operations.....	\$ (10,282)	1
Income from discontinued operations.....	17	1
Net loss available to common stockholders.....	\$ (10,265)	1

	FOR THE SIX MONTHS ENDE	
	INCOME (LOSS)	SH
Basic and diluted earnings (loss) per share-		
Loss from continuing operations.....	\$ (8,418)	1

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Income from discontinued operations.....	8,255	
Net loss available to common stockholders.....	\$ (163)	

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 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, 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. 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 six months ended June 30, 2001:

	June 1999 Restructuring Program		December 2000 Restructuring Program	
	Severance	Facilities Closure	Severance	Fa
Balance, December 31, 2000	\$ 57	\$179	\$ 900	
Spending and adjustments.....	(57)	23	(900)	
Balance, June 30, 2001.....	\$ -	\$202	\$ -	

NOTE 7 - INCOME TAXES

The Company did not record an income tax benefit for the six months ended June 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.

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

NOTE 8 - 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 are 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 has undertaken 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.

During the three months ended June 30, 2001, the Company purchased 483,000 shares of its common stock for \$374. The purchases are recorded at cost and reported in stockholders' equity as common stock held in treasury.

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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 June 30, 2001, which was issued on July 31, 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 June 30, 2001 is the second quarter of the 2001 fiscal year.

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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 are directly related to the total number of users of the software and is recognized in the period in which the software is licensed to the client, or over the period in which maintenance and support services are provided 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 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 JUNE 30, 2001 COMPARED TO THREE MONTHS ENDED JUNE 30, 2000

REVENUES

Revenues decreased \$11,680, or 49%, to \$12,073 in the three months ended June 30, 2001 from \$23,753 in the three months ended June 30, 2000. The decrease was

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due to a general reduction in demand for its services due to softening in the market coupled with the closure of three operating locations subsequent to March 31, 2000 and prior to January 1, 2001.

GROSS PROFIT

Gross profit decreased \$4,236, or 58%, to \$3,017 in the three months ended June 30, 2001 from \$7,253 in the three months ended June 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 the closure of three operating locations subsequent to March 31, 2000 and prior to January 1, 2001. The gross profit margin decreased to 25% from 31%, 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 \$3,900, or 31%, to \$8,626 in the three months ended June 30, 2001 from \$12,526 in the three months ended June 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, 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.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased \$342, or 33%, to \$700 in the three months ended June 30, 2001 from \$1,042 in the three months ended June 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 net interest income (expense). Net interest income was \$395 for the three months ended June 30, 2001 compared to net interest expense of \$1,507 for the three months ended June 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 three months ended June 30, 2001.

BENEFIT FOR INCOME TAXES

The Company did not record an income tax benefit for the three months ended June 30, 2001 due to the uncertainty of its realization. For the quarter ended June 30, 2000, the Company recorded an income tax benefit of \$2,643 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. Income from discontinued operations of \$23 for the three months ended June 30, 2001 compares to income of \$6,011 for the three months ended June 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)

SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO SIX MONTHS ENDED JUNE 30, 2000

REVENUES

Revenues decreased \$22,958, or 45%, to \$28,095 in the six months ended June 30, 2001 from \$51,053 in the six months ended June 30, 2000. The decrease was due to a general reduction in demand for its services due to softening in the market, the closure of three operating locations subsequent to March 31, 2000 and prior to January 1, 2001 and the associated ramp up time with the new evolving sales force.

GROSS PROFIT

Gross profit decreased \$8,059, or 51%, to \$7,757 in the six months ended June 30, 2001 from \$15,816 in the six months ended June 30, 2000. The decrease was due to a general reduction in demand for its services due to softening in the market, the closure of three operating locations subsequent to March 31, 2000 and prior to January 1, 2001 and the associated ramp up time with the new evolving sales force. The gross profit margin decreased to 28% from 31%, 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 \$6,527, or 27%, to \$17,485 in the six months ended June 30, 2001 from \$24,012 in the six months ended June 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, 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 \$519, or 27%, to \$1,376 in the six months ended June 30, 2001 from \$1,895 in the six months ended June 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 net interest income (expense). Net interest income was \$879 for the six months ended June 30, 2001 compared to net interest expense of \$2,787 for the six months ended June 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 six months ended June 30, 2001.

BENEFIT FOR INCOME TAXES

The Company did not record an income tax benefit for the six months ended June

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30, 2001 due to the uncertainty of its realization. For the six months ended June 30, 2000, the Company recorded an income tax benefit of \$4,413 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. Income from discontinued operations of \$17 for the six months ended June 30, 2001, compares to income of \$8,255 for the six months ended June 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 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 \$5,809 for the six months ended June 30, 2001 and the average cash balance during the quarter was \$24,415. Historically, the Company's primary sources of liquidity have been the collection of accounts receivable and borrowings under the credit facility. Total receivables were 67 days of quarterly revenues at June 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, 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.

PART II - OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

None

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: AUGUST 14, 2001

/S/ CURTIS J. PARKER

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