

COTELLIGENT INC  
Form 10-Q  
May 13, 2005  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

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

**For The Quarterly Period Ended March 31, 2005**

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

**For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 0-27412**

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**COTELLIGENT, INC.**

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

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**Delaware**

**94-3173918**

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(State of incorporation)

(I.R.S. ID)

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

(Address of principal executive offices)

**(415) 477-9900**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

At May 12, 2005, there were 28,520,962 shares of common stock outstanding.

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

(In thousands, except share data)

(Unaudited)

	March 31, 2005	December 31, 2004
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 107	\$ 526
Refundable income taxes	10	16
Accounts receivable, including unbilled accounts of \$- and \$2, net of allowance for doubtful accounts of \$51 and \$60, and \$502 and \$588 pledged as collateral security, respectively	451	530
Prepaid expenses and other current assets	126	133
Current assets of discontinued operations held for sale	159	160
Total current assets	853	1,365
Property and equipment, net	271	259
Goodwill	2,592	2,592
Other intangibles, net of \$153 and \$118 of accumulated amortization	713	748
Other assets	239	239
Non-current assets of the discontinued operations held for sale	170	170
Total assets	\$ 4,838	\$ 5,373
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Secured borrowings	\$ 322	\$ 386
Accounts payable	728	247
Accrued compensation and related payroll liabilities	205	264
Restructuring liabilities	465	425
Other accrued liabilities	277	198
Current liabilities of the discontinued operations held for sale	859	898
Total current liabilities	2,856	2,418
Restructuring liabilities, net of current portion	214	268
Lease deposits on sublet properties	13	13
Income taxes payable		69
Total liabilities	3,083	2,768
Commitments and contingencies		

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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, 26,665,562 and 24,984,792 shares issued, respectively		
	<b>266</b>	250
Additional paid-in capital	<b>82,910</b>	82,801
Accumulated deficit	<b>(80,921)</b>	(79,946)
Treasury stock	<b>(500)</b>	(500)
	<hr/>	<hr/>
Total stockholders' equity	<b>1,755</b>	2,605
	<hr/>	<hr/>
Total liabilities and stockholders' equity	<b>\$ 4,838</b>	\$ 5,373
	<hr/>	<hr/>

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**COTELLIGENT, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except share and per share data)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
Revenues	<b>\$ 255</b>	<b>\$ 77</b>
Cost of revenues	<b>113</b>	<b>29</b>
Gross profit	<b>142</b>	<b>48</b>
Selling, general and administrative expenses	<b>504</b>	<b>282</b>
Operating loss	<b>(362)</b>	<b>(234)</b>
Other income (expense):		
Interest expense	<b>(9)</b>	
Interest income	<b>1</b>	<b>84</b>
Total other income (expense)	<b>(8)</b>	<b>84</b>
Loss from continuing operations before income tax	<b>(370)</b>	<b>(150)</b>
Income tax benefit (expense)	<b>67</b>	<b>(3)</b>
Loss from continuing operations	<b>(303)</b>	<b>(153)</b>
Loss from discontinued operations, net of income tax benefit of \$- and \$-	<b>(672)</b>	<b>(1,387)</b>
Net loss	<b>\$ (975)</b>	<b>\$ (1,540)</b>
Earnings per share:		
Basic and diluted		
Loss from continuing operations	<b>\$ (0.01)</b>	<b>\$ (0.01)</b>
Loss from discontinued operations	<b>(0.03)</b>	<b>(0.08)</b>
Net loss	<b>\$ (0.04)</b>	<b>\$ (0.09)</b>
Basic and diluted weighted average number of shares outstanding	<b>25,357,756</b>	<b>16,952,763</b>

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****COTELLIGENT, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
Cash flows from operating activities:		
Loss from continuing operations	\$ (303)	\$ (153)
Adjustments to reconcile net loss from continuing operations to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	26	
Amortization of identifiable intangible assets	35	
Restricted shares issued in connection with director compensation	17	
Provision for doubtful accounts	(9)	
Changes in current assets and liabilities:		
Accounts receivable	88	(18)
Prepaid expenses and other current assets	7	85
Accounts payable and accrued liabilities	487	716
Deferred revenue		(18)
Income taxes, net	(63)	54
Other assets		(1)
Net cash provided by operating activities	285	665
Cash flows from investing activities:		
Payments received on note from acquirer of previously sold business		200
Purchases of property and equipment	(38)	(25)
Cash paid for purchase of business		(81)
Net cash provided by (used in) investing activities	(38)	94
Cash flows from financing activities:		
Repayment of secured borrowings	(64)	
Cost of issuing of Common Stock and warrants	(47)	(183)
Net proceeds from issuance of Common Stock and warrants	155	
Net cash provided by (used in) financing activities	44	(183)
Cash flows from discontinued operations:		
Cash used in discontinued operations	(710)	(1,995)
Net decrease in cash and cash equivalents	(419)	(1,419)
Cash and cash equivalents at beginning of period	526	5,688
Cash and cash equivalents at end of period	\$ 107	\$ 4,269

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See accompanying notes to condensed consolidated financial statements.



**Table of Contents****COTELLIGENT, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands, except share data)

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
Supplemental disclosures of cash flow information:		
Interest paid	\$ 9	\$
Income taxes paid	\$ 2	\$ 3
Income taxes refunded	\$ 6	\$
Significant non-cash financing and investing activities:		
Repayment of officer notes receivable with severance and bonus compensation	\$	\$ 364
Deferred acquisition costs	\$ 8	\$ -
Detail of acquisition:		
Cash	\$	\$ (36)
Accounts receivable		(50)
Prepaid expenses and other current assets		(2)
Property and equipment		(3)
Other assets		(5)
Goodwill		(2,592)
Other intangibles		(847)
Accounts payable		106
Accrued compensation		50
Other accrued liabilities		91
Common stock issued to sellers of acquired business		1,815
Warrants issued to sellers of acquired business		676
Consideration due sellers of acquired business		505
Cash paid in 2003		175
Cash paid in 2004		(117)
Cash acquired in acquisition		36
Cash used for purchase of business	\$	\$ (81)

See accompanying notes to condensed consolidated financial statements.

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**COTELLIGENT, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Dollar amounts in thousands)

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

*Description of Business*

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

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

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

*Liquidity*

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

During the past and in 2004, management has taken action in response to the continued softness in IT services in order to preserve cash, including but not limited to significant reductions in headcount, outsourcing certain administrative functions, changing benefit plan insurance carriers, relocating the headquarters office resulting in lower lease obligations, acquiring a business in an industry with more near term growth prospects than IT services, securing a line of credit agreement against its accounts receivable and announcing the plan to divest its IT services segment. Between February 1, 2005 and April 27, 2005, the Company entered into Stock and Warrant Purchase Agreements with certain accredited investors pursuant to which the Company sold Common Stock and warrants resulting in a cash infusion to the Company. In addition, on April 1, 2005 the Company signed a definitive agreement with FastTrack, LLC, an affiliate of Beverly Hills, California-based private equity

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firm Skyview Capital, LLC, for the sale of its remaining IT services business. Management has carefully forecasted its results of operations and financial position through March 31, 2006, and has determined that the remaining cash on hand, together with cash available from the line of credit, proceeds from the sales of Common Stock to accredited investors, and proceeds from the sale of the IT services segment, will provide adequate cash to fund its anticipated working capital needs. In the event circumstances arise that are not factored into the forecast, management will take further action to streamline operations and seek financing alternatives.

### *Basis of Presentation*

The accompanying interim financial statements do not include all disclosures included in the financial statements in Cotelligent's Annual Report on Form 10-K for the year ended December 31, 2004, and therefore these financial statements should be read in conjunction with the financial statements included in Cotelligent's Form 10-K.

In the opinion of management, the interim financial statements filed as part of this Quarterly Report on Form 10-Q, reflect all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods and dates presented.

### *Stock-Based Compensation*

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

The Company measures compensation expense for its employee stock-based compensation awards using the intrinsic value method and provides pro forma disclosures of net loss and loss per share as if a fair value method had been applied. Therefore, compensation cost for employee stock awards is measured as the excess, if any, of the fair value of our common stock at the grant date or re-measurement

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date over the amount an employee must pay to acquire the stock and is amortized over the related service periods using the straight-line method. Compensation expense previously recorded for unvested employee stock-based compensation awards that are forfeited upon employee termination is reversed in the period of forfeiture.

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

	Three Months Ended March 31,	
	2005	2004
Net loss, as reported	\$ (975)	\$ (1,540)
Deduct: Stock-based compensation expense determined under fair value based method for awards net of related tax expense, if applicable	21	155
Pro forma net loss	\$ (996)	\$ (1,695)
Loss per share, as reported:		
Basic and diluted	\$ (0.04)	\$ (0.09)
Pro forma loss per share:		
Basic and diluted	\$ (0.04)	\$ (0.10)

## Note 2 - Changes in Stockholders' Equity

	Common Stock		Additional	Accum.	Treasury Stock		Total
	Shares	Amount	Paid-In Capital		Shares	Amount	Stockholders' Equity
Balance at December 31, 2004	24,984,792	\$ 250	\$ 82,801	\$ (79,946)	644,600	\$ (500)	\$ 2,605
Issuance of Common Stock in connection with private placement	1,550,000	15	53				68
Issuance of Warrants in connection with private placement			87				87
Cost of registering and issuing securities in connection with private placement			(47)				(47)
Restricted shares issued in connection with director compensation	130,770	1	16				17
Net loss				(975)			(975)
Balance at March 31, 2005	26,665,562	\$ 266	\$ 82,910	\$ (80,921)	644,600	\$ (500)	\$ 1,755



**Table of Contents****Note 3 Acquisition**

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

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

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

The aggregate consideration paid for the acquisition was \$3,307 (10,679,608 shares of the Company's Common Stock issued at fair value of \$1,815 and based on the average closing price of the Company's Common Stock for a few days prior to and after the signing of the definitive agreement and related public announcement to purchase the business on November 25, 2003, warrants to purchase 5,339,803 shares of the Company's common stock value using the Black-Scholes with the following assumptions: (1) risk-free interest rate of 1.95%, (2) a dividend yield of 0%, (3) volatility factor of the expected market price of the Company's Common Stock of 175%, and (4) a weighted average expected life of 2 years, that resulted in a valuation of \$676, cash consideration of \$505 and transaction costs of \$501). Transaction costs of \$501 include \$195 paid for registration of securities in connection with the acquisition which were netted against the issuance of the shares. Liabilities assumed were approximately \$247, and tangible assets acquired were approximately \$96. The Company recognized total intangible assets of \$3,458 resulting from the acquisition.

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

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

The changes in carrying amounts of goodwill and other intangibles for the three months ended March 31, 2005 were as follows.

	<u>Goodwill</u>	<u>Other Intangibles</u>
Balance at December 31, 2004	\$ 2,592	\$ 748
Amortization expense		(35)
Balance at March 31, 2005	<u>\$ 2,592</u>	<u>\$ 713</u>

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

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

The results of the acquired business were included in the Company's results of operations from its acquisition date, March 2, 2004.

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In accordance with SFAS No. 141, *Business Combinations*, the following unaudited pro forma information for the three months ended March 31, 2004, gives effect to the acquisition of OnSite Media, Inc., as if the acquisition was completed as of the beginning of the periods reported below.

	(Unaudited) Three Months  Ended March 31,  2004
Pro forma revenues	\$ 316
Pro forma loss from continuing operations before income tax expense	\$ (104)
Pro forma loss from continuing operations	\$ (110)
Pro forma loss per share:	
Basic and diluted	\$

**Note 4 Restructuring Programs**

In September 2001, as part of the Company's efforts to streamline its operations commensurate with its revenue base, the Company identified opportunities to reduce its cost structure. Accordingly, the Company adopted an exit plan which resulted in a restructuring charge of \$2,436 during the year ended December 31, 2001. The September 2001 plan included provisions for severance of approximately 145 management and operating staff (\$1,034) as well as closure costs associated with a plan to consolidate or dispose of certain locations (\$1,402). The September 2001 plan did not meet the requirements in order to accrue employee severance costs as of a commitment date, and these severance costs that did not provide a future benefit were charged to operations when due and payable.

In August 2003, as part of the Company's efforts to streamline its operations commensurate with its revenue base, the Company identified opportunities to reduce its cost structure by reducing headcount. The Company terminated approximately 33 management and operating staff between August 2003 and December 2003 and recorded a restructuring charge related to the severance and extended medical coverage ( COBRA ) benefits provided to the terminated employees of \$2,531. Only the COBRA benefits remained payable at September 30, 2004.

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

The following summarizes the activity and balances for these restructuring programs for the three months ended March 31, 2005.



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	September 2001	August 2003	October 2004		
	<u>Facilities Closure</u>	<u>Severance &amp; Benefits</u>	<u>Severance</u>	<u>Facilities Closure</u>	<u>Total</u>
Balance at December 31, 2004	\$ 616	\$ 9	\$ 44	\$ 24	\$ 693
Spending, net of sublease receipts on facilities	17	(9)	(10)	\$ (12)	(14)
Balance at March 31, 2005	<u>\$ 633</u>	<u>\$</u>	<u>\$ 34</u>	<u>\$ 12</u>	<u>\$ 679</u>

**Table of Contents****Note 5 Discontinued Operations**

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

**Assets and Liabilities of Discontinued Operations:**

	March 31, 2005	December 31, 2004
<b>Assets</b>		
Prepaid expenses and other	\$ 159	\$ 160
Total current assets of discontinued operations held for sale	159	160
Property and equipment, net of accumulated depreciation of \$156 and \$156	170	170
Total non-current assets of discontinued operations held for sale	170	170
Total assets of discontinued operations held for sale	329	330
<b>Liabilities</b>		
Accounts payable	67	36
Accrued compensation	191	262
Deferred revenue	601	600
Total current liabilities of discontinued operations	859	898
Net liabilities of discontinued operations held for sale	\$ 530	\$ 568

**Summary of Operating Loss from Discontinued Operations:**

	For the Three Months Ended March 31,	
	2005	2004
Revenues	\$ 937	\$ 1,936
Cost of revenues	514	1,146
Gross profit	423	790
Selling, general and administrative expenses	1,095	2,177

Operating loss	(672)	(1,387)
Total other income		
Loss before income tax	(672)	(1,387)
Income tax		
Net loss	\$ (672)	\$ (1,387)

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

There were no reconciling items between the numerator and denominator used to compute basic and diluted loss per share for the periods presented in the condensed consolidated statements of operations. The Company had outstanding stock options, and warrants of 10,310,805 and 7,878,115 at March 31, 2005 and 2004 respectively, that were not included in EPS for those relevant periods because the Company reported a loss from continuing operations resulting in an antidilutive effect.

#### Note 7 Segment Information

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

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

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

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

### **Note 8 Subsequent Events**

#### *Issuances of Common Stock*

On April 11, 2005, the Company entered into a Stock and Warrant Purchase Agreement with an accredited investor pursuant to which the Company sold an aggregate of 1,000,000 shares of Common Stock at an offering price of \$0.10 per share and warrants to purchase up to an additional 1,000,000 shares of Common Stock. On April 27, 2005, the Company entered into a Stock and Warrant Purchase Agreement with the Company's Chief Executive Officer pursuant to which the company sold an aggregate of 1,000,000 shares of Common stock at an offering price of \$0.10 per shares and warrants to purchase up to an additional 1,000,000 shares of Common Stock. Each warrant is exercisable for the purchase of one share of the Company's Common Stock at an exercise price of \$0.30 per share. The warrants are immediately exercisable and expire three years from their date of issuance. The Company has the right to redeem all or any portion of the warrants at any time at a price of \$0.05 per share.

The Company further agreed to use its commercially reasonable efforts to file a registration statement with the Securities and Exchange Commission as promptly as reasonably practicable after the first anniversary of the above agreements and to use its commercially reasonable efforts to have such registration statement declared effective in order to comply with the provisions of the Securities Act of 1933, as amended, so as to permit (i) the registered resale of the warrants and the exercise of the warrants for shares of Common Stock by persons to whom the warrants are resold pursuant to such resale registration and (ii) the registered resale of the Common Stock and the shares of Common Stock issuable upon exercise of the warrants for a period of one year following the date on which the registration statement is declared effective by the holder of the Common Stock and warrants sold pursuant to the agreements who desires to register the resale of their shares of Common Stock and warrants.

#### *Sale of IT Services Business*

On April 1, 2005, the Company and certain of its subsidiaries entered into an Asset Purchase Agreement with FastTrack, LLC, an affiliate of Beverly Hills, California-based private equity firm Skyview Capital, LLC, for the sale of its IT services business located at Broomall, Pennsylvania. Aggregate consideration for the business includes: cash at closing of \$2,800 and an earn-out of up to \$950 if certain future revenue targets are attained over the three years following completion of the sale. The purchaser will be entitled to a post-closing refund of up to \$700 in the event certain specified business conditions are not satisfied. The transaction is subject to stockholder approval and is expected to close by the end of the second quarter of 2005.

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Except for statements of historical fact contained herein, any statements contained in this report may be deemed to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. For example, words such as may, will, should, estimates, predicts, potential, continue, strategy, believes, and expects, intends and similar expressions are intended to identify forward-looking statements. All such forward-looking statements are based upon current expectations that involve risks and uncertainties. Cotelligent's actual results and the timing of certain events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those discussed under Risk Factors in Cotelligent's Annual Report on Form 10-K for the fiscal year ended December 31, 2004 and other filings made with the Securities and Exchange Commission. The following discussion is qualified in its entirety by, and should be read in conjunction with, the more detailed information set forth in our financial statements and the notes thereto included elsewhere in this filing. All forward-looking statements included in this report are based upon information available to Cotelligent as of the date thereof, and Cotelligent assumes no obligation to update any of such forward-looking statements.

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

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

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

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

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Operating income can be adversely impacted by increased administrative staff compensation and expenses related to streamlining or expanding the Company's business, which may be incurred before revenues or economies of scale are generated from such investment.

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

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

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

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

It became evident that the outlook for spending in IT services would continue to be uncertain without any clear indication of when a turnaround could be expected. Accordingly, in August 2003, the Company terminated the majority of its senior executive staff along with most of the sales and business development organization. At the same time we aggressively engaged our existing clients and committed ourselves to supporting their project requirements. In some cases we have been successful in securing longer term commitments. By scaling back expenses and focusing intensely on generating business from our long term clients we began to stabilize our revenue trend allowing us to move forward in our attempt to restore profitability and positive cash flow. Throughout the remainder of 2003, the Company continued to reduce headcount and looked closely at expense activity to scale back and streamline operating costs in line with revenue. The Philadelphia-based operation that supports Cotelligent's sales force automation application FastTrack has achieved stable revenue over the past several years and our clients continue to give us high marks for performance and client service. In addition, the core team responsible for our custom software development activities is helping us to take advantage of recurring projects with existing clients. By keeping only the top sales account executives and account managers, we have lowered our selling cost and improved our client relationships and retention.

In April 2003, our Chief Executive Officer, James Lavelle, sent a letter to our stockholders indicating the Company's intention to engage in merger and acquisition activities in order to help improve Cotelligent's prospects for the future and increase our scale. As a matter of course since we started our Company in 1996 and successfully executed an aggressive merger and acquisition strategy through early 1999, we believed this strategy would help us improve our prospects. We researched and analyzed a variety of vertical markets that could provide new growth opportunities for us through merger or acquisition. In mid-2003 Cotelligent signed a letter of intent to acquire a field force automation firm. After 90 days of due diligence, we decided not to consummate the transaction.

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



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

In November 2004, we announced our plan to divest our entire IT services and solutions business and change our name to Watchit Media, Inc. allowing us to focus all of our attention on narrowcasting. On April 1, 2005, we signed a definitive agreement to divest our IT services and solutions business to Fast Track LLC, an affiliate of Beverly Hills, California-based private equity firm Skyview Capital, LLC, for aggregate consideration of \$2,800 in cash at closing and an earn-out of up to \$950 if certain revenue targets are attained over the three years following completion of the sale. The purchaser will be entitled to a post-closing refund of up to \$700 if certain specified business conditions are not satisfied. The divestiture is subject to stockholder approval and is expected to close by the end of the second quarter of 2005.

### **Three Months Ended March 31, 2005 Compared to Three Months Ended March 31, 2004**

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

### ***Revenues***

Revenues increased \$178 or 231%, to \$255 in the three months ended March 31, 2005, from \$77 in the three months ended March 31, 2004. Effective with the acquisition of OnSite Media, Inc, March 2, 2004, the Company commenced reporting revenues under its narrowcasting segment. The increase in revenues resulted from the full quarter effect of including revenue resulting from the 2004 acquisition.

Our narrowcasting clients retain us to manage a part of their television system infrastructure, produce video content pertinent to their brand, marketing communications and hotel property amenities, and present this content on their Private Video Networks. We have annual renewable contracts with our clients for managing the computer hardware that interfaces with their television systems and, in some cases, their information system infrastructure. Watchit Media charges a base monthly subscription fee for these services. Currently, Watchit derives over 95% of its revenue from base monthly subscription fees under these recurring revenue contracts.

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

### ***Gross Profit***

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Gross profit increased \$94 or 196%, to \$142 in the three months ended March 31, 2005, from \$48 in the three months ended March 31, 2004. Effective with the acquisition of OnSite Media, Inc, March 2, 2004, the Company commenced reporting revenues under its narrowcasting segment. The increase in gross profit resulted from the full quarter effect of including revenue resulting from the 2004 acquisition.

As a percentage of revenues, the gross margin decreased to 56% in the three months ended March 31, 2005, from 62% in the three months ended March 31, 2004. The decrease in gross margin was the result of the hiring of additional staff to support client services in anticipation of revenue growth.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased \$222 or 79%, to \$504 in the three months ended March 31, 2005, from \$282 in the three months ended March 31, 2004. Effective with the acquisition of OnSite Media, Inc, March 2, 2004, the Company commenced reporting revenues under its narrowcasting segment. The increase in selling, general and administrative expenses resulted from the full quarter effect of including of revenue resulting from the 2004 acquisition.

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### ***Other Income (Expense)***

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

Interest expense, net of interest income, was \$8 for the three months ended March 31, 2005 compared to interest income, net of interest expense of \$84 for the three months ended March 31, 2004. The decrease in net interest income was the result of lower cash balances on hand coupled with interest expense on secured borrowings that commenced in October of 2004.

### ***Income Tax Benefit***

The Company recognized an income tax benefit of \$67 for the three months ended March 31, 2005 which resulted from the reversal of an accrual for income tax contingencies of \$69, offset by state tax payments of \$2.

The Company recognized an income tax expense of \$3 for the three months ended March 31, 2004 which represented state tax payments.

### ***Loss from Discontinued Operations***

Discontinued operations comprised operations associated with the IT services segment. Loss from discontinued operations was \$672 for the three months ended March 31, 2005 compared to \$1,387 for the three months ended March 31, 2004. The reduction in loss was the result of improvements to the utilization of billable staff due to the elimination of a number of underutilized billable people and reductions in selling, general and administrative expenses.

## **LIQUIDITY AND CAPITAL RESOURCES**

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

Cash provided by operating activities was \$285 and \$665 for the three months ended March 31, 2005 and March 31, 2004, respectively. In the three months ended March 31, 2005, the primary sources of cash provided by operating activities were \$487 increase in accounts payable, \$88 reduction in accounts receivable and \$61 of depreciation and amortization, offset by \$303 net loss from continuing operations and \$63 of income taxes. In the three months ended March 31, 2004 the primary sources of cash provided by operating activities were \$716 increase in accounts payable, \$85 in prepaid expenses and other current assets and \$54 in income taxes, offset by \$153 net loss from continuing operations

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Cash used by investing activities was \$38 for the three months ended March 31, 2005, compared to cash provided by investing activities of \$94 for the three months ended March 31, 2004. In the three months ended March 31, 2005, \$38 was used to acquire property and equipment. In the three months ended March 31, 2004 the primary sources from investing activities was \$200 of payments received on a note from the acquirer of a previously sold business offset by \$81 used to purchase a business and \$25 used to acquire property and equipment.

Cash provided by financing activities was \$44 in the three months ended March 31, 2005 compared to \$183 used for financing activities in the three months ended March 31, 2004. In the three months ended March 31, 2005, \$155 was provided from the issuance of common stock and warrants, offset by \$64 of repayments of secured borrowings and \$47 of cost incurred in connection with the issuance of common stock and warrants. In the three months ended March 31, 2004, \$183 was used for costs incurred in connection with the issuance of stock and warrants.

The primary sources of liquidity for the Company going forward are the collection of its accounts receivable and existing cash balances at March 31, 2005. Total receivables were 38 and 33 days of quarterly revenue at March 31, 2005 and December 31, 2004, respectively.

In the past and during the three months ended March 31, 2005, management has taken action in response to the continued softness in IT services in order to preserve cash, including but not limited to significant reductions in headcount, outsourcing certain administrative functions, changing benefit plan insurance carriers and acquiring a business in an industry with more near term growth prospects than IT services. Management has carefully forecasted its results of operations and financial position through September 30,

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2005 and has determined the Company may not have adequate cash to fund its anticipated working capital needs. Beginning in October 2004, management continued to take further action, including salary reductions for the executive officers and vice presidents of the Company, further reductions in headcount, securing a line of credit against its trade accounts receivable. We are also considering other alternatives for attracting other financing. The Company cannot be sure, however, that its results of operations will be sufficient to meet its cash needs through March 31, 2006, or that it will be able to take additional actions to make up for any cash shortfall.

The following table reflects our contractual cash obligations as of March 31, 2005, excluding interest, due over the indicated periods.

	Payments Due by Period				
		Less than	1 to 3	4 to 5	After 5
Contractual Cash Obligations:	Total	1 Year	Years	Years	Years
Operating leases, net of sublet arrangements	\$ 1,590	\$ 817	\$ 773	\$	\$

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

The Company provides an allowance for potentially uncollectible accounts receivable under the provisions of SFAS No. 5, *Accounting for Contingencies*, in the ordinary course of business. The allowance is derived as the result of periodic reviews of aged and known problem accounts during each quarter. In addition, the Company reserves for unknown issues in its receivables at the balance sheet date using a formula consistent from quarter to quarter. Management believes that its approach is appropriate to reserve for potentially uncollectible receivables. If management had taken another approach to developing its reserve, the allowance for doubtful accounts may have been different than that reported.

**Revenue Recognition**

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

**Accounting for Income Taxes**

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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 for certain tax positions taken by the Company in certain tax periods where the statute of limitations still applies.

### RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, Statement No. 123R. Statement No. 123R supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance and it establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. Statement No. 123R also requires that the benefits associated with the tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the effective date. The effective date of Statement No. 123R is the first reporting period beginning after June 15, 2005, which is third quarter 2005 for calendar year companies, although early adoption is allowed. However, in April 2005, the Securities and Exchange Commission ( SEC ) announced that the effective date of Statement No. 123R will be deferred until January 1, 2006 for calendar year companies. The Company has not yet determined the method of adoption or the effect that the adoption will have on its financial position or results of operations.

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In March 2005, the SEC staff issued guidance on Statement No. 123R. Staff Accounting Bulletin No. 107 ( SAB No. 107 ) was issued to assist preparers by simplifying some of the implementation challenges of Statement No. 123R while enhancing the information that investors receive. SAB No. 107 creates a framework that is premised on (a) considerable judgment will be required by preparers to successfully implement Statement No. 123R, specifically when valuing employee stock options; and (b) reasonable individuals, acting in good faith, may conclude differently on the fair value of employee stock options. Key topics covered by SAB No. 107 include (a) valuation models (SAB No. 107 reinforces the flexibility allowed by Statement No. 123R to choose an option-pricing model that meets the standard's fair value measurement objective), (b) expected volatility (the SAB provides guidance on when it would be appropriate to rely exclusively on either historical or implied volatility in estimating expected volatility) and (c) expected term (the new guidance includes examples and some simplified approaches to determining the expected term under certain circumstances). The Company will apply the principles of SAB No. 107 in conjunction with its adoption of Statement No. 123R.

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

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

Cotelligent has invested its existing cash in highly liquid money market accounts and does not use derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions. Accordingly, the Company believes that it is not subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk sensitive instruments.

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

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

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

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

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### *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. Unregistered Sale of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults upon Senior Securities**

None

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

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

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### 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

Form 8-K, dated February 1, 2005, with the Securities and Exchange Commission in connection with the entry into a material definitive agreement for the sale of unregistered securities.

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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: May 13, 2005

**/s/ Curtis J. Parker**

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