

Edgar Filing: CT HOLDINGS INC - Form 10QSB

CT HOLDINGS INC  
Form 10QSB  
November 14, 2003

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

FORM 10-QSB

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER: 0-18718

CT HOLDINGS, INC.  
(EXACT NAME OF SMALL BUSINESS ISSUER AS SPECIFIED IN ITS CHARTER)

DELAWARE  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

75-2432011  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

8750 CENTRAL EXPRESSWAY, SUITE 100, DALLAS, TX 75231  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(214) 520-9292  
(ISSUER'S TELEPHONE NUMBER)

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period 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 check mark whether the registrant is an accelerated filer (as defined in Rule 12b-25 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Class	Outstanding at November 13, 2003
Common Stock, Par value \$.01 per share	57,970,928

Transitional Small Business Disclosure Format Yes  No

CT HOLDINGS, INC.  
FORM 10-QSB  
QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003  
TABLE OF CONTENTS

Edgar Filing: CT HOLDINGS INC - Form 10QSB

Page

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Balance Sheets as of September 30, 2003 (unaudited) and December 31, 2002	3
Unaudited Statements of Operations for the three and nine months ended September 30, 2003 and 2002	4
Unaudited Statements of Cash Flows for the nine months ended September 30, 2003 and 2002	5
Notes to Unaudited Interim Financial Statements	6

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	13
---	----

Item 3. Controls and Procedures	26
---------------------------------	----

PART II. OTHER INFORMATION

Item 1. Legal Proceedings	26
---------------------------	----

Item 2. Recent Sales of Unregistered Securities	27
---	----

Item 3. Defaults Upon Senior Securities	28
---	----

Item 6. Exhibits and Reports on Form 8-K	28
--	----

Signatures	29
------------	----

2

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CT HOLDINGS, INC.  
BALANCE SHEETS

	SEPTEMBER 30, 2003 (unaudited)	DECEMBER 31, 2002
	-----	-----
ASSETS		
-----		
TOTAL ASSETS	\$ -	\$ -
	=====	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT		
-----		
CURRENT LIABILITIES		

Edgar Filing: CT HOLDINGS INC - Form 10QSB

Accounts payable and accrued expenses	\$ 1,283,634	\$ 1,344,051
Demand note payable to Citadel	225,000	-
Payable to Citadel	350,000	150,000
Advances and notes payable to related parties	524,796	524,796
Notes payable to shareholders	9,000	609,000
Accrual for legal settlement	202,000	785,000
	-----	-----
Total current liabilities	2,594,430	3,412,847
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Preferred stock, \$.01 par value per share; 1,000,000 shares authorized; no shares issued or outstanding		
Common stock, \$.01 par value per share; 60,000,000 shares authorized; 57,970,928 and 57,545,928 shares issued and outstanding	579,710	575,460
Common stock pending issuance	600,000	-
Additional paid-in capital	57,052,601	56,950,601
Accumulated deficit	(60,826,741)	(60,938,908)
	-----	-----
Total stockholders' deficit	(2,594,430)	(3,412,847)
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ -	\$ -
	=====	=====

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

3

CT HOLDINGS, INC.  
UNAUDITED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
	-----	-----	-----	-----
Revenue	\$ -	\$ -	\$ -	\$ -
General and administrative expense	86,527	122,007	300,576	897,000
Common stock issued as compensation	-	-	-	1,347,000
Accrual for litigation	202,000	19,000	202,000	785,000
Reversal of litigation accrual	-	-	(560,000)	-
Writedown in investment of affiliate	-	30,000	-	2,233,000
Gain on settlement of liabilities with stock	(132,164)	-	(142,883)	(8,000)
Interest expense	32,034	20,752	88,140	94,000
Other expense	-	-	-	38,000
	-----	-----	-----	-----
Income (loss) from continuing operations	(188,397)	(191,759)	112,167	(5,388)
Costs incurred in connection with spin off of subsidiary	-	-	-	(185,000)
Loss from discontinued operations	-	-	-	(942,000)
	-----	-----	-----	-----
Net income (loss)	\$ (188,397)	\$ (191,759)	\$ 112,167	\$ (6,516)

Edgar Filing: CT HOLDINGS INC - Form 10QSB

Net income (loss) per share - basic and diluted				
Continuing operations	\$ (0.00)	\$ (0.00)	\$ 0.00	\$ (
Discontinued operations	-	-	-	(
	-----	-----	-----	-----
	\$ (0.00)	\$ (0.00)	\$ 0.00	\$ (
	=====	=====	=====	=====
Weighted average shares outstanding				
- basic and diluted	57,970,928	57,545,928	57,700,507	54,246
	=====	=====	=====	=====

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

4

CT HOLDINGS, INC.  
UNAUDITED STATEMENTS OF CASH FLOWS

	NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 112,167	\$ (6,516,565)
Less net loss from discontinued operations	-	942,939
Adjustments to reconcile net loss to net cash used in operating activities:		
Common stock issued as compensation	-	1,347,000
Beneficial conversion feature of convertible debt recognized as interest expense	-	51,300
Writedown of investment in affiliates	-	2,233,975
Accrual for litigation	202,000	785,000
Reversal of accrual for litigation	(560,000)	-
Common stock and options issued in lieu of cash for services	-	4,148
Gain on settlement of liability in exchange for shares of common stock	(142,883)	-
Fair value of conversion right	-	29,951
Changes in operating assets and liabilities		
Accounts payable and accrued expenses	188,716	613,918
Payable to Citadel	200,000	90,000
Accrual for legal settlement	(225,000)	-
	-----	-----
NET CASH USED IN OPERATING ACTIVITIES	(225,000)	(418,334)
NET CASH FROM INVESTING ACTIVITIES	-	-
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from convertible note payable to shareholder	-	600,000
Proceeds from advances and notes payable to related parties	225,000	526,500
Payments on advances and notes payable to related parties	-	(533,034)
Proceeds from sale of common stock	-	25,000

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

NET CASH PROVIDED BY FINANCING ACTIVITIES	225,000	618,466
Net cash provided by continuing operations	-	200,132
Net cash used by discontinued operations	-	(200,132)
Net change in cash	-	-
Cash and cash equivalents at the beginning of the period	-	-
Cash and cash equivalents at the end of the period	\$ -	\$ -
SUPPLEMENTAL CASH FLOW ITEMS		
Fair value of stock issued in settlement of accounts payable	\$ 106,250	\$ 163,125
Conversion of note payable to equity	\$ 600,000	\$ -

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

5

### NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

#### NOTE A - NATURE OF BUSINESS AND CERTAIN SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited interim financial statements reflect, in the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows of CT Holdings. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP") have been condensed or omitted pursuant to rules and regulations promulgated by the Securities and Exchange Commission (the "Commission"). These statements should be read together with the audited financial statements and notes thereto for the years ended December 31, 2002 and 2001, included in CT Holdings' Form 10-KSB for the fiscal year ended December 31, 2002 on file with the Commission. The results of operations for the interim periods shown herein are not necessarily indicative of the results to be expected for any future interim period or for the entire year.

#### NATURE OF BUSINESS

CT Holdings, Inc. (the "Company" or "CT Holdings") has provided management expertise including consulting on operations, marketing and strategic planning and a source of capital to early stage technology companies. The Company was incorporated in Delaware in 1992. The business model is designed to enable the companies with whom the Company acquires or invests to become market leaders in their industries. The strategy over the years has led to the development, acquisition and operation of technology based businesses with compelling valuations and strong business models. The goal is to realize the value of these investments for the Company's shareholders through a subsequent liquidity event such as a sale, merger or initial public offering of the investee companies.

At September 30, 2003 the Company held an investment in Parago Inc. ("Parago"), however there was no carrying value recorded for the investment in Parago on the

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

balance sheets at September 30, 2003 and December 31, 2002. Parago was formed in 1999 as an application service provider ("ASP") and Internet based business process outsourcer that provides an online suite of offerings designed to increase sales, reduce costs, retain customers and increase client profitability. These services include online promotional management, online rebate processing, proactive email, online surveys, and customer data warehousing, analysis and reporting. Parago's comprehensive integrated suite of outsourced customer care solutions are marketed across multiple industry lines.

Prior to December 2001, the investment in Parago had been accounted for under the equity method of accounting. The carrying value of the investment in Parago was reduced to zero due to the recognition of the proportionate share of equity in Parago's losses under the equity method of accounting. In December 2001 Parago entered into an equity financing arrangement for which the Company declined to participate and as a result the Company's ownership percentage fell to less than 1%. Since December 2001 the investment has been accounted for using the cost method of accounting.

At September 30, 2003 the Company holds an investment in River Logic, Inc. ("River Logic") which also has no carrying value recorded on the balance sheets at September 30, 2003 and December 31, 2002. In May 2000, CT Holdings acquired a minority interest in River Logic which develops decision-support applications for corporations across many industries. Using COR Technology, a rapid-application development system, developers at River Logic create applications that enable industry professionals to model complex enterprises and explore financial relationships on a desktop computer or laptop. Embedded analytics allow end-users to understand the financial implications of critical business decisions easily by manipulating graphical icons that model their enterprise. The Company accounted for its investment in River Logic using the cost method. Due to the economic conditions affecting information technology spending in 2002 and River Logic's results of operations in 2002 the Company wrote down the carrying value of the investment in River Logic to zero during the year ended December 31, 2002.

### CITADEL DISTRIBUTION

On May 17, 2002 CT Holdings completed the spin-off of Citadel Security Software Inc. ("Citadel") through the declaration of a pro rata dividend distribution to CT Holdings shareholders (the "Distribution"). The Distribution consisted of one (1) share of Citadel common stock for every four (4) shares of CT Holdings (the Distribution Ratio) held by CT Holdings shareholders as of a May 6,

6

2002, the Record Date. Following the Distribution on May 17, 2002, Citadel became an independent company and CT Holdings retained no ownership interest in Citadel. The Distribution is intended to be a tax free distribution for U.S. federal tax purposes. The results of operations and the cash flows for the period from January 1, 2002 through May 17, 2002 of Citadel are presented as discontinued operations.

On the Distribution Date, CT Holdings and Citadel entered into a series of agreements including a distribution agreement, a transition services agreement, an indemnity agreement and a tax disaffiliation agreement which provides for, among other things, the principal corporate transactions required to effect the Distribution, to provide for an orderly transition to the status of two independent companies and to define the continuing relationship between Citadel and CT Holdings after the Distribution.

### LIQUIDITY

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

The Company received a report from our independent auditors for our year ended December 31, 2002 containing an explanatory paragraph that describes the uncertainty regarding our ability to continue as a going concern due to our recurring operating losses and a significant working capital deficiency. The Company has incurred recurring operating losses and has a significant working capital and stockholders' deficiency at September 30, 2003 of approximately \$2,600,000. The Company had no cash balance or current assets at September 30, 2003 and current liabilities total approximately \$2,600,000. Immediate funding needs of the business are expected to be provided by financings through short-term notes payable and additional investments from related parties although there can be no assurance that such funds will be available. The Company has been and continues to be dependent upon outside financing to perform its business development activities, make investments in new technology companies and to fund operations. However current economic conditions and limited investment opportunities have limited the Company's ability to raise funds. At September 30, 2003 the Company had no plans to raise capital nor had sources of capital been identified.

During the nine months ended September 30, 2003 there were \$225,000 of funds used in operating activities to settle a litigation claim. Net cash provided from financing activities of \$225,000 came from the proceeds of a 12% demand note receivable with Citadel. Future cash may come from the realization of the value of the investments in Parago and River Logic however there can be no assurance that any value will ever be realized from these investments.

The Company's strategy of continuing to support and expand its business development activities is limited due to its current lack of access to near term capital. The implementation of the Company's strategy will not generate positive cash flow in the foreseeable future. Achieving positive cash flow is currently highly dependent upon obtaining liquidity from the Company's investments in unconsolidated affiliates. The Company has no plans at September 30, 2003 to raise additional capital to invest in new business opportunities. The Company estimates it will need to raise up to \$2.6 million to settle liabilities after which it may then support its incubator and business development activities. Historically, the Company has obtained short-term bridge funding from its Chief Executive Officer or Directors of the Company. While this may occur in the future there can be no assurance that such financing will be available or if available with terms that the Company would be willing to accept.

There can be no assurance that management's plans will be successful or what other actions may become necessary. There can be no assurance that the Company will ever achieve liquidity for its investments. Until the Company is able to create liquidity from its investments through sale to a strategic investor, an initial public offering or some other liquidity transaction, the Company will continue to require external sources of working capital to fund its own operating expenses. Although the Company has been successful raising capital in the past, the inability of the Company to raise capital could have a material adverse effect on the Company's business and operations that could be material to the Company's business and results of operations.

### BASIS OF PRESENTATION

The accompanying financial statements of CT Holdings have been prepared in accordance with accounting principles generally accepted in the United States. Accordingly, all material intercompany transactions, if any, with its unconsolidated affiliates have been eliminated pursuant to the applicable accounting principles for consolidation and the equity method of accounting.

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

current period presentation.

### USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates.

### STOCK-BASED COMPENSATION

The Company accounts for stock-based employee compensation arrangements in accordance with provisions of Accounting Principles Board ("APB") Opinion No.25, "Accounting for Stock Issued to Employees," and complies with the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123". Under APB Opinion No. 25, compensation expense for employees is based on the excess, if any, on the date of grant, of the fair value of the Company's stock over the exercise price.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and SFAS No. 148 and Emerging Issues Task Force ("EITF") Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date of the fair value of the equity instrument issued is the earlier of the date on which the counterparty's performance is complete or the date on which it is probable that performance will occur.

If the Company had recognized compensation expense, in accordance with SFAS Nos. 123 and 148, based upon the fair value at the grant date for options granted to employees, officers and directors during the three and nine months ended September 30, 2003 and 2002, the pro forma effect on net income or loss and net income or loss per share would have been as follows:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
Net income (loss) attributable to common stockholders as reported	\$ (188,397)	\$ (191,759)	\$ 112,167	\$ (6,516,565)
Add: Stock-based employee compensation expense included in reported net loss	-	-	-	-
Deduct: Stock-based employee compensation expense determined under fair value based method	-	-	-	(50,000)
Pro forma net income (loss)	\$ (188,397)	\$ (191,759)	\$ 112,167	\$ (6,566,565)

Net earnings (loss) per common share - basic and diluted



Edgar Filing: CT HOLDINGS INC - Form 10QSB

As reported				
Continuing operations	\$	(0.00)	\$	(0.00)
Discontinued operations		-		-
			\$	0.00
			\$	(0.10)
				(0.02)
	\$	(0.00)	\$	(0.00)
			\$	0.00
			\$	(0.12)
Pro forma				
Continuing operations	\$	(0.00)	\$	(0.00)
Discontinued operations		-		-
			\$	0.00
			\$	(0.10)
				(0.02)
	\$	(0.00)	\$	(0.00)
			\$	0.00
			\$	(0.12)

8

NET INCOME (LOSS) PER COMMON SHARE

Basic earnings per share is computed by dividing the net income by the weighted average number of shares common stock outstanding during the period. Total weighted average stock options outstanding of 3,955,850 and warrants outstanding of 2,351,601 for the three and nine month periods ended September 30, 2003 have been excluded from the computation of diluted earnings per share because the exercise price of the options and warrants exceeds the market price of the underlying shares. Therefore basic and diluted earnings per shares are the same.

Basic loss per common share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Basic loss per share excludes any dilutive effects of options and warrants. Total weighted average stock options and warrants outstanding of 3,960,850 and 2,351,601, respectively, have been excluded from the computation of diluted loss per share for the three months ended September 30, 2002, as the effect would be anti-dilutive. Total weighted average stock options and warrants outstanding of 6,976,381 and 2,351,601, respectively, have been excluded from the computation of diluted loss per share for the nine months ended September 30, 2002, as the effect would be anti-dilutive.

NOTE B - DISCONTINUED OPERATIONS

On May 17, 2002 CT Holdings completed the spin-off of Citadel through the declaration of a pro rata dividend distribution to CT Holdings shareholders Citadel. The unaudited results of operations for Citadel for the period from January 1, 2002 through May 17, 2002 are presented as discontinued operations and are as follows:

	Period January 1, 2002 Through May 17, 2002
	-----
Revenue	\$ 130,519
Costs of revenue	
Shipping, supplies and other	3,045
Software amortization	17,511
	-----
Total costs of revenue	20,556

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

Operating expenses	
Selling, general and administrative expense	949,541
Product development expense	83,303
Depreciation expense	20,058
	-----
Total operating expenses	1,052,902
	-----
Operating loss	(942,939)
Provision for income taxes	-
	-----
Net loss	\$ (942,939)
	=====

### NOTE C - ADVANCES AND NOTES TO RELATED PARTIES

At September 30, 2003 and December 31, 2002 the Company held a \$250,000, 8% note payable to a former director that was due April 30, 2002, and is currently in default and bearing interest at 18% per annum. Accrued interest payable of \$80,863 related to this note is included in accounts payable and accrued expenses at September 30, 2003.

At December 31, 2001, the Company had a liability of approximately \$290,000 for cash advances received from its CEO. During the nine months ended September 30, 2002 the Company received cash advances of \$267,500 from its CEO to fund operations and repaid approximately \$327,500 of those and prior advances to its CEO. In May 2002 all outstanding advances owed the Company's CEO of \$225,796

9

were converted into a 5% note payable due July 1, 2002. At September 30, 2003 and December 31, 2002 this note payable was in default and bearing interest at 18% per annum. Accrued interest payable of \$53,981 related to this note is included in accounts payable and accrued expenses at September 30, 2003.

During the nine months ended September 30, 2002 an entity related to an employee of the Company advanced \$199,000 to the Company and the Company repaid \$150,000 of the advances with the remaining \$49,000 converted into an 8% note payable due June 30, 2002. At September 30, 2003 and December 31, 2002 the Company was in default on this note and is accruing interest at 18% per annum. Accrued interest payable of \$12,415 related to this note is included in accounts payable and accrued expenses at September 30, 2003.

### NOTE D - NOTES PAYABLE TO SHAREHOLDERS

During the nine months ended September 30, 2002 a shareholder advanced the Company \$600,000 and the Company entered into a \$600,000 non-interest bearing convertible note payable due April 1, 2003. The note payable was convertible, at the option of the shareholder, into a maximum of 2,700,000 shares of CT Holdings common stock and 675,000 shares of Citadel common stock at a below market conversion price. Interest expense of \$51,300 representing the beneficial conversion feature was recorded with an offset to paid-in-capital during the nine months ended September 30, 2002. During the nine months ended September 30, 2003 the shareholder exercised the conversion feature of the note and because the issuance of all 2,700,000 shares would cause the number of shares outstanding to exceed the number of authorized shares of 60,000,000, the shareholder waived his right to receive these shares until such time as the shares become authorized. As a result of this obligation to issue these shares the Company recorded this conversion as a separate item in stockholders' deficit, in the accompanying balance sheet, labeled common shares pending

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

issuance.

During the nine months ended September 30, 2002 the Company received advances of \$20,000 from a shareholder which were later converted into an 8% note payable due September 30, 2002. At September 30, 2003 and December 31, 2002, a principal balance of \$9,000 remains outstanding, was in default and continues to bear interest at 8% per annum. Accrued interest payable of \$2,355 related to this note is included in accounts payable and accrued expenses at September 30, 2003.

### NOTE E - RELATED PARTY TRANSACTIONS

Pursuant to the terms of the transition services agreement with Citadel, effective January 2002 the Company agreed to pay Citadel a monthly fee of \$20,000 per month for the services of its CEO, CFO and accounting and information management staff, as well as office rent and indirect overhead expenses. At September 30, 2003 the Company has an outstanding balance of \$350,000 payable to Citadel for \$330,000 of these services plus other expenses of \$20,000.

In April 2003 the Company settled a lawsuit for \$225,000 payable in cash. Citadel loaned the Company \$225,000 which is represented by a demand note payable bearing interest at 12% per year. Accrued interest payable of \$13,907 related to this note is included in accounts payable and accrued expenses at September 30, 2003.

### NOTE F - COMMITMENTS AND CONTINGENCIES

In October 2001, Roan-Meyers Associates (formerly Janssen Meyers Associates L.P.) filed suit in the Supreme Court of the State of New York, County of New York against CT Holdings, Inc. to enforce a settlement term sheet arising out of a prior lawsuit alleging breach of a Placement Agency Agreement. This case is styled Roan Meyers Associates v. CT Holdings, Inc. In August 1998, Janssen-Meyers Associates L.P. ("JMA") filed a lawsuit against CT Holdings arising out of an alleged 1995 contract with CT Holdings' predecessor. The suit alleged that this predecessor breached a letter of intent dated September 1995 and/or a Placement Agency Agreement dated November 1995 between JMA and the predecessor. As its damages, JMA claimed that it was entitled to, among other things, the cash value of warrants to purchase 1.8 million shares of CT Holdings common stock at an exercise price of \$0.89 per share, valued during May 1996. According to JMA's valuation of those warrants, potential damages were alleged to exceed \$40 million. CT Holdings vigorously disputes that it breached either the letter of intent or the Placement Agency Agreement or that it is liable to JMA. The lawsuit was styled Janssen-Meyers Associates, L.P. v. Citadel Technology, Inc., and was filed in the Supreme Court of the State of New York, County of New York. CT Holdings removed the case to federal court

10

in the Southern District of New York. Following mediation in July 2000, CT Holdings and JMA entered into a settlement term sheet to attempt to resolve the disputes between it and JMA, pursuant to which CT Holdings and JMA agreed in principle to settle the lawsuit for an aggregate of \$3 million, in a combination of \$1.5 million in cash and 300,000 shares of common stock with a guaranteed value of \$5 per share as of January, April and October 2001 (with respect to 100,000 of the shares for each period). The settlement was subject to execution of definitive settlement documents and approval of the boards of directors of the companies. CT Holdings and JMA were unable to negotiate the final definitive settlement agreement and, as a result, the matter was not settled. The case was dismissed in August 2000 without any resolution of this issue. On March 27, 2001, JMA attempted to reopen this matter, but the Court hearing the JMA lawsuit issued a Summary Order denying JMA's motion to enforce the settlement term sheet

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

and confirmed the prior dismissal of the lawsuit. The Court further ruled that JMA would either have to bring an action on the proposed settlement or move to re-open the dismissed case. The Court stated that it did not express any view with respect to the merits of the proposed settlement that brought about the dismissal of the case. There was no activity on the case from March 2001 through August 2001. On August 27, 2001 JMA refiled its lawsuit with a federal court in New York, and CT Holdings filed a motion to dismiss the case because the plaintiffs lacked the required diversity jurisdiction to pursue the claims in federal court. On October 31, 2001 the case was dismissed in federal court. In December 2001, the plaintiffs refiled the lawsuit in the state court seeking to enforce the settlement term sheet. The case was filed in Supreme Court of New York, that state's trial court, in a case styled Roan Meyers v. CT Holdings. CT Holdings intends to vigorously defend against this lawsuit and has filed a counterclaim to, among other things, recover excess amounts charged by JMA in connection with related bridge loans. Trial has not been set on this matter. At a status conference held November 10, 2003 the plaintiff was given a 30 day extension to file the note of issue, which is due December 5, 2003. The court also ordered CT Holdings to produce additional discovery materials. The Company anticipates that the plaintiff will receive a trial date for sometime in early 2004. The Company cannot reasonably estimate the ultimate liability, if any, and therefore no liability has been recorded in association with this lawsuit. Given these events, including the dismissal of the lawsuit and the failure of the plaintiffs to refile a lawsuit for more than one year after the date of the dismissal, the Company, in the year ended December 31, 2001, reversed the \$1,912,500 nonrecurring charge that the Company had previously recorded related to the settlement of the lawsuit.

In June 2000, CT Holdings was served with a lawsuit filed in the 157th State District Court in Houston, Texas by Michael and Patricia Ferguson for breach of contract, breach of fiduciary duty, tortious interference, violation of the Texas Deceptive Trade Practices Act and negligence. The case was styled Michael and Patricia Ferguson v. CT Holdings, Inc. Specifically, the Fergusons claim that they were damaged when they attempted to exercise warrants during a time when CT Holdings' related registration statement could not be used. In July, 2002, the plaintiffs were awarded damages of \$575,510, pre-judgment interest of \$86,748, attorneys' fees of \$103,818, post-judgment interest at 10% per year, and costs at which time the Company recorded a liability of \$785,000. CT Holdings appealed the judgment in a case styled CT Holdings Inc. v. Michael and Patricia Ferguson in the Fourteenth Court of Appeals in Houston, Texas. In January 2003, the plaintiffs filed a motion to have the District Court appoint a receiver to sell assets to satisfy the judgment. In April 2003 the parties settled the lawsuit for \$225,000 payable in cash, all of which was advanced from Citadel to the Company and is represented by a demand note payable bearing interest at 12% per year. Accordingly, the Company recognized a reversal of the accrued litigation liability of \$560,000 in the Statements of Operations during the quarter ended June 30, 2003.

In June 2000, Tech Data Corporation filed suit against CT Holdings, alleging a breach of a Software Distribution Agreement ("the Agreement") with CT Holdings. The lawsuit is styled Tech Data Corporation v. Citadel Technology, Inc. (now known as CT Holdings), and was filed in Dallas County Court at Law No. 2. Because CT Holdings was not properly served, Tech Data obtained a default judgment for \$101,048. When CT Holdings discovered the default judgment, it filed and won a motion to set aside this judgment. In June 2001, Tech Data properly served CT Holdings. CT Holdings answered and demanded binding arbitration pursuant to the agreement. The parties filed a Joint Motion to Arbitrate in December 2001. The judge granted this motion and abated the lawsuit pending arbitration. The arbitration was held in 2002, and in January 2003, the arbitrator entered a judgment of \$71,655 against CT Holdings in favor of Tech Data, together with pre-judgment interest at the applicable rate under Florida law for the period from January 2, 2000 to January 10, 2003, attorneys' fees of \$3,500, and interest on these amounts in the amount of 10% per year from

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

February 10, 2003 until the amounts are paid. In March 2003, Tech Data filed a motion to revive the abated lawsuit for purposes of entering the arbitration award as a judgment in the case and judgment was entered. Tech Data has filed a motion to appoint a receiver for the Company that is set for November 21, 2003. As part of the Distribution, Citadel assumed responsibility for this lawsuit;

11

and has recorded a liability of approximately \$101,000, although there can be no assurance that CT Holdings will be released from the lawsuit.

In October 2002, S&S Public Relations Inc. filed a lawsuit against CT Holdings and Steven B. Solomon, its CEO, alleging breach of contract and fraud, and seeking damages in the amount of at least \$25,215, along with exemplary damages, attorneys' fees, court costs, and pre- and post-judgment interest. The case is styled S&S Public Relations Inc. v. CT Holdings and Steven B. Solomon, and was filed in the County Court at Law No. 4, Dallas County, Texas. The Company had a liability accrued and in April 2003, the Company settled the liability and this lawsuit by issuing 50,000 shares of CT Holdings common stock along with 12,500 pro rata dividend shares of Citadel common stock that had been reserved for issuance at the Distribution Date.

In August 2002, PriceWaterhouseCoopers, LLP ("PWC") filed a lawsuit against CT Holdings seeking payment of \$131,816 for services performed pursuant to a contract with CT Holdings related to the JMA lawsuit described above. The court ordered that mediation be held by July 2003. The case is styled PriceWaterhouseCoopers, LLP v. CT Holdings, and was filed in the 192nd District Court, Dallas County, Texas. In July 2003, PWC obtained a summary judgment against the Company for damages of \$131,816 plus pre-judgment interest of \$57,615, post-judgment interest at 10% and attorneys' fees in the amount of \$8,605. During the three months ended September 30, 2003 the Company recorded an accrual for legal settlement of \$202,000 in association with this judgment.

In April 2003, Harte Hanks, Inc. filed a lawsuit styled "Harte Hanks, Inc. v. CT Holdings Inc. dba Citadel Computer" seeking payment of \$12,513 for services performed. In July 2003, the plaintiffs filed a motion for receivership held on alternatively to compel discovery in the lawsuit. At a hearing on the matter held September 5, 2003 in the County Court of Law No. 3 of Dallas County, Texas, the court ordered the Company to provide additional discovery by October 20, 2003, which the Company failed to produce. As part of the Distribution, Citadel assumed responsibility for this liability, and has recorded a liability of approximately \$12,500. CT Holdings believes that Citadel will ultimately settle this liability, although there can be no assurance that CT Holdings will be released from the lawsuit.

In June 2003, a vendor asserted claims against Citadel for liabilities properly due from CT Holdings. The lawsuit against Citadel was set aside however, the Company anticipates that a lawsuit may be filed against CT Holdings related to liabilities for services provided to CT Holdings by the vendor during the nine months ended September 30, 2002. The Company had a liability of approximately \$50,000 recorded at December 31, 2002 and at September 30, 2003 for the services performed by the vendor and will vigorously defend the claims.

We may become involved from time to time in litigation on various matters which are routine to the conduct of our business. We believe that none of these actions, individually or in the aggregate, will have a material adverse effect on our financial position or results of operations, though any adverse decision in these cases or the costs of defending or settling such claims could have a material adverse effect on our business.

NOTE G - CERTAIN TRANSACTIONS

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

During the nine months ended September 30, 2002 the Company issued 1,397,500 shares of common stock to employees and directors of the Company pursuant to the exercise of stock options. The aggregate exercise price of these stock options was approximately \$297,000 all of which has been recorded as stock compensation expense.

In May 2002, prior to the record date of the Distribution, the Company entered into negotiations to settle approximately \$860,000 of operating liabilities in exchange for 1,662,500 shares of common stock of the Company. As of September 30, 2002 a gain of approximately \$9,000 on the extinguishment of approximately \$163,000 of these liabilities was recorded in the statement of operations as a result of issuing 612,500 shares of common stock including 100,000 shares for services provided by an independent consultant, 25,000 shares to a consultant for services performed prior to employment as the Company's Chief Financial Officer, 250,000 shares to a shareholder for consulting services, and 250,000 shares to an attorney who is also related to the Company's CEO, for the performance of professional services to the Company. For the purposes of calculating the gain the fair value of the Company's common stock was determined as the closing price (\$0.25) on May 1, 2002, the day before the Citadel ex-dividend date, the last day the Company's common stock was traded and quoted with the value of the distribution dividend included in the value of the Company's stock.

12

During the nine months ended September 30, 2003 the Company completed negotiations to settle approximately \$249,000 of liabilities that had been outstanding prior to the Distribution by issuing 425,000 shares of CT Holdings common stock along with 106,250 pro rata dividend shares of Citadel common stock that had been reserved for issuance at the Distribution Date. The difference between the fair value of the shares and the recorded liabilities of approximately \$143,000 was recognized as a gain in the statement of operations during the nine months ended September 30, 2003. At September 30, 2003 there remains approximately \$448,000 of operating liabilities under negotiation for settlement with shares of the Company's common stock including all dividends and distributions. Approximately 625,000 shares of common stock, are reserved for issuance upon final settlement of these liabilities (See additional discussion in Note H). The Company believes that the negotiations will ultimately be concluded with the issuance of the shares in full settlement of these liabilities however there can be no assurance that such settlement will be finalized or on terms favorable to the Company.

### NOTE H - SUBSEQUENT EVENT

In October 2003, the Company agreed to settle approximately \$416,000 of operating liabilities outstanding prior to the Distribution by issuing 575,000 shares of CT Holdings common stock along with 143,750 pro rata dividend shares of Citadel common stock that had been reserved for issuance at the Distribution Date. The Company continues to reserve 50,000 shares of common stock and 12,500 pro rata dividend shares of Citadel to settle the remaining liabilities of approximately \$32,000 that have been under negotiation since May 1, 2002.

### ITEM 2 -MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### FORWARD-LOOKING STATEMENTS

The following discussion contains forward-looking statements that involve known and unknown risks, uncertainties and other factors that may cause our actual

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among other things, those risk factors set forth in this section and elsewhere in this report. We identify forward-looking statements by words such as may, will, should, could, expects, plans, anticipates, believes, estimates, predicts, potential, or continue or similar terms that refer to the future. We cannot guarantee future results, levels of activity, performance or achievements.

### FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

Investing in our common stock involves a high degree of risk. Any of the following risks could materially adversely affect our business, operating results and financial condition and could result in a complete loss of your investment.

In addition to the other information in this Report, the following factors should be considered carefully in evaluating the Company and its business. This disclosure is for the purpose of qualifying for the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. It contains factors that could cause results to differ materially from such forward-looking statements. These factors are in addition to any other cautionary statements, written or oral, which may be made or referred to in connection with any such forward-looking statement.

The following matters, among other things, may have a material adverse effect on the business, financial condition, liquidity, or results of operations the Company. Reference to these factors in the context of a forward-looking statement or statements shall be deemed to be a statement that any one or more of the following factors may cause actual results to differ materially from those in such forward-looking statement or statements. Before you invest in our common stock, you should be aware of various risks, including those described below. Investing in our common stock involves a high degree of risk. You should carefully consider these risk factors, together with all of the other information included in this Report, before you decide whether to purchase shares of our common stock. Our business and results of operations could be seriously harmed by any of the following risks. The trading price of our common stock could decline due to any of these risks, and you may lose part or all of your investment.

13

### GENERAL RISKS

WE HAVE A HISTORY OF NET LOSSES AND WILL NEED ADDITIONAL FINANCING TO CONTINUE AS A GOING CONCERN.

We received a report from our independent auditors for our year ended December 31, 2002 containing an explanatory paragraph that describes the uncertainty regarding our ability to continue as a going concern due to our recurring operating losses and a significant working capital deficiency. Historically, we have incurred recurring operating losses and have a significant stockholders' deficit at September 30, 2003 of approximately \$2,600,000. We had no cash balance or current assets at September 30, 2003 and current liabilities total approximately \$2,600,000. We have no access to capital at September 30, 2003 and we have no plans to raise capital nor have we identified sources of capital. In the past our funding needs of the business have been provided by financings through short-term notes payable and additional investments from related parties, including our Chief Executive Officer, however there can be no

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

assurance that such funds will be available from these related parties. The Company has been and continues to be dependent upon outside financing to perform its business development activities, make investments in new technology companies and to fund operations.

Our plans to continue to support and expand our business development activities are limited due to a lack of identification of near term capital. As a result, it is unlikely that the implementation of the Company's business strategy will generate positive cash flow in the foreseeable future. Achieving positive cash flow is currently highly dependent upon obtaining liquidity from our investments in unconsolidated affiliates. We have no plans at September 30, 2003 to raise additional capital to invest in new business opportunities. To do so we estimate that we will need to raise up to \$2.6 million to settle liabilities after which we may then support our incubator and business development activities. Historically, we have obtained short-term funding from our Chief Executive Officer or Directors of the Company. While this may occur in the future there can be no assurance that such financing will be available or if available with terms that we would be willing to accept.

We have made investments in entities that we believe may provide liquidity to the Company in the long term and we believe that our investments in Parago and River Logic have been successful. Parago has recently attained profitability. As is expected in early stage companies, River Logic has not been profitable and has had to scale back operations. Historically both companies have experienced cash flow deficiencies. The current private equity and venture capital market conditions have limited the availability of investment capital for investment in early stage private companies. In addition we did not participate in the additional capital infusions made in 2001 and 2002 and as a result, our ownership percentage in both investee companies has been diluted. Our ownership percentage in Parago is less than 1% and approximately 8% in River Logic and the carrying values of both investments have been written down to zero.

While the performance of the investee companies to date has been as expected, there can be no assurance that we will ever achieve liquidity for these investments. In addition, there can be no assurance that our plans will be successful or what other actions may become necessary in the future. Until we are able to create liquidity from our investments through sale to a strategic investor, an initial public offering or some other liquidity transaction, we will continue to require working capital to fund operating expenses. Although we have been successful raising capital in the past, an inability to raise capital may require us to sell assets. Such actions could have a material adverse effect on our business and operations and result in charges that could be material to the Company's business and results of operations. At September 30, 2003 we have not identified sources of capital nor have plans to raise capital to settle liabilities or to fund business development activities.

OUR BUSINESS FOCUS IS THE DEVELOPMENT AND ACQUISITION OF EARLY STAGE COMPANIES; HENCE, WE WILL ENCOUNTER NUMEROUS RISKS ASSOCIATED WITH OUR BUSINESS FOCUS AND OUR PRIOR OPERATING HISTORY MAY NOT BE A MEANINGFUL GUIDE TO EVALUATING OUR FUTURE PERFORMANCE.

Our business model is designed to enable the companies in whom we invest or acquire to become market leaders in their industries. Our strategy over the years has led to the development, acquisition and operation of technology based businesses with strong business models and compelling valuations. We believe that the anticipated growth in technology creates strong opportunities for us to increase shareholder value by investing in early stage ventures well positioned for growth in their respective marketplace. We will attempt to increase the value of each investee by providing



## Edgar Filing: CT HOLDINGS INC - Form 10QSB

management, marketing and financial expertise along with financial capital and then realize this new value through a subsequent liquidity event such as a sale, merger or initial public offering of the investee companies.

In May 2002, we were successful in spinning off Citadel into a standalone company through the pro-rata dividend distribution of Citadel common stock to shareholders of CT Holdings. At September 30, 2003 we held investments in two companies, Parago and River Logic. However the investments have no carrying value on the balance sheet of the Company at September 30, 2003 and December 31, 2002 due to general economic and information technology market conditions, as well as historical performance of the investee companies. During 2002 and 2003 we looked for businesses and technologies in which to invest but economic and stock market conditions along with a general decline in the availability of private and public capital prevented us from making any additional investments and there can be no assurance that these factors will improve so that the Company can continue to execute its business plan.

Other than our formation and development of Citadel, Parago and River Logic, we have a brief history in executing our business strategy. As a consequence, our prior operating history may not provide a meaningful guide to our prospects in emerging markets. Moreover, our business model and prospects must be considered in light of the risk, expense and difficulties frequently encountered by companies in early stages of development, particularly companies in new and rapidly evolving markets. We may be unable to execute our strategy of developing our business due to numerous risks, including the following:

- We may be unable to identify or develop relationships with attractive emerging companies.
- Any companies that we are able to attract may not succeed and the value of our assets and the price of our common stock could consequently decline.
- Our business model is unproven and depends on the willingness of companies to participate in our business development model and collaborate with each other and us.
- Our expenses will increase as we build the infrastructure necessary to implement this model.
- We face competition from incubators, some of which are publicly traded companies, venture capital companies and large corporations; many of these competitors have greater financial resources and brand name recognition than we do, which may make it difficult for us to effectively compete.
- We will require additional capital resources in order to implement our business model and we may not be able to obtain these resources on attractive terms, if at all.

WE HAVE INVESTED IN EARLY STAGE VENTURES; AND THERE CAN BE NO ASSURANCE THAT OUR INVESTMENTS WILL PROVE TO BE FINANCIALLY ATTRACTIVE.

We have developed and invested in Parago and River Logic (our "investees" or "investee companies") and completed the spin-off transaction of Citadel in May 2002. Inasmuch as our investee companies are early stage ventures, it is difficult to judge their future prospects. Economic, governmental, industry and internal company factors outside of our control affect each of our investee companies.

CT HOLDINGS DOES NOT HAVE ACCESS TO THE CASH FLOW OR ASSETS OF CITADEL, AND HAS

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

BEEN UNABLE TO OPERATE PROFITABLY FOLLOWING THE DISTRIBUTION

Historically, since prior to the Distribution the businesses that comprise each of Citadel and CT Holdings have been under one ultimate parent, they were able to rely, to some degree, on the earnings, assets and cash flow of each other for capital requirements. After the Distribution, CT Holdings has not been able to rely on the security software business for such requirements. Following the Distribution, CT Holdings continues to maintain its own credit and banking

15

relationships and perform its own financial and investor relations functions. Because a significant number of key employees of CT Holdings have been employed by Citadel following the Distribution, there can be no assurance that CT Holdings will be able to successfully put in place the financial, administrative and managerial structure necessary to continue to operate as an independent public company, or that the development of such structure will not require a significant amount of management's time and other resources.

WE MAY INCUR SIGNIFICANT COSTS TO AVOID INVESTMENT COMPANY STATUS AND MAY SUFFER OTHER ADVERSE CONSEQUENCES IF WE ARE DEEMED TO BE AN INVESTMENT COMPANY.

We may incur significant costs to avoid investment company status and may suffer other adverse consequences if we are deemed to be an investment company under the Investment Company Act of 1940. Some of our contemplated equity investments in other businesses may constitute investment securities under the 1940 Act. A company may be deemed to be an investment company if it owns investment securities with a value exceeding 40% of its total assets, subject to certain exclusions. Investment companies are subject to registration under, and compliance with, the 1940 Act unless a particular exclusion or Securities and Exchange Commission safe harbor applies. If we were to be deemed an investment company, we would become subject to the requirements of the 1940 Act. As a consequence, we would be prohibited from engaging in some businesses or issuing our securities and might be subject to civil and criminal penalties for noncompliance. In addition, certain of our contracts might be voided, and a court-appointed receiver could take control of us and liquidate our business. Following the Distribution of Citadel, we may be deemed to be an investment company unless we qualify for a safe harbor within the time permitted under the 1940 Act.

Although we have yet to make any investments in the investment securities of companies other than Citadel, Parago, and River Logic, such investments, if and when made, could fluctuate in value, which may cause the value of such securities to exceed 40% of our total assets. Unless an exclusion or safe harbor were available to us, we would have to attempt to reduce our investment securities as a percentage of our total assets. This reduction could be accomplished in a number of ways, including the disposition of investment securities and the acquisition of non-investment security assets. If we were required to sell investment securities, we may sell them sooner than we may otherwise have preferred. These sales may be at depressed prices and we might never realize anticipated benefits from, and may incur losses on, these investments. Some investments may not be sold due to contractual or legal restrictions or the inability to locate a suitable buyer. Moreover, we may incur tax liabilities when we sell assets. We may also be unable to purchase additional investment securities that may be important to our operating strategy. If we decide to acquire non-investment security assets, we may not be able to identify and acquire suitable assets and businesses.

OUR STOCK IS TRADED IN THE OVER THE COUNTER MARKET.

Our common stock was de-listed from the NASDAQ SmallCap Market on May 17, 2001,

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

because we did not meet the NASDAQ's requirements for continued listing. Our common stock now trades on the OTC Bulletin Board maintained by the National Quotation Bureau, Inc. The OTC Bulletin Board is generally considered to be a less efficient market, and our stock price, as well as the liquidity of our common stock, may be adversely impacted as a result.

### WE ARE INVOLVED IN LEGAL PROCEEDINGS THAT COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR BUSINESS

We are involved in legal proceedings as described in PART II Item 1. Legal Proceedings and from time to time, we may be subject to other legal proceedings, including but not limited to claims that we have infringed the intellectual property rights of others, product liability claims, or other claims incidental to our business. While we intend to defend such lawsuits, adverse decisions or settlements, and the costs of defending such suits, could have a material adverse effect on our business.

### OUR EARNINGS AND STOCK PRICE ARE SUBJECT TO SIGNIFICANT FLUCTUATIONS.

Due to the factors noted in this Report, our earnings and stock price have been and may continue to be subject to significant volatility, particularly on a quarterly basis. We have experienced no revenue or earnings which have had an immediate and significant adverse effect on the trading price of our common stock. This may occur again in the future.

16

### FAILURE TO QUALIFY AS A TAX-FREE TRANSACTION COULD RESULT IN SUBSTANTIAL LIABILITY

CT Holdings and Citadel intend for the Distribution to be tax-free for U.S. federal income tax purposes. Neither CT Holdings nor Citadel has requested an advance ruling from the Internal Revenue Service, or any opinion of their tax advisors, as to the tax consequences of the Distribution. No assurance can be given that the Internal Revenue Service or the courts will agree that the Distribution is tax-free.

If the Distribution does not qualify for tax-free treatment, a substantial corporate tax would be payable by the consolidated group of which CT Holdings is the common parent measured by the difference between (1) the aggregate fair market value of the Citadel Shares on the Distribution Date and (2) CT Holdings' adjusted tax basis in the Citadel Shares on the Distribution Date. The corporate level tax would be payable by CT Holdings. However, Citadel has agreed under certain circumstances to indemnify CT Holdings for all or a portion of this tax liability. This indemnification obligation, if triggered, could have a material adverse effect on the results of operations and financial position of Citadel. In addition, under the applicable treasury regulations, each member of CT Holdings' consolidated group (including Citadel) is severally liable for such tax liability.

Furthermore, if the Distribution does not qualify as tax-free, each CT Holdings stockholder who receives Citadel Shares in the Distribution would be taxed as if he had received a cash dividend equal to the fair market value of his Citadel Shares on the Distribution Date.

Even if the Distribution qualifies as tax-free, CT Holdings could nevertheless incur a substantial corporate tax liability under Section 355(e) of the Internal Revenue Code of 1986, as amended (the Internal Revenue Code or the Code), if CT Holdings or Citadel were to undergo a change in control (whether by acquisition, additional share issuance or otherwise) pursuant to a plan or series of related transactions which include the Distribution. Any transaction which occurs within

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

the four-year period beginning two years prior to the Distribution is presumed to be part of a plan or series of related transactions which includes the Distribution unless CT Holdings establishes otherwise. Under certain circumstances, Citadel would be obligated to indemnify CT Holdings for all or a portion of this substantial corporate tax liability under the tax disaffiliation agreement. This indemnification obligation would have a material adverse effect on the results of operations and financial position of Citadel.

### RISKS RELATED TO OUR INVESTEES

The following are some risks related to the business of Parago and River Logic, our investees, and should be considered in addition to the risk factors described in this Report. Any of these factors could have a material adverse effect on us.

### THERE CAN BE NO ASSURANCE THAT OUR INVESTEES WILL COMPLETE AN INITIAL PUBLIC OFFERING OR OTHER LIQUIDITY EVENT.

There can be no assurance that any of our investees will complete an initial public offering, merger, sale or other liquidity event. The failure to complete an offering or other liquidity event such as an acquisition by a third party could have a material adverse effect on our stock price. You cannot be assured that an initial public offering or other liquidity event will occur in the near future or ever at all. In addition, we have agreed to convert the shares of Parago common stock issued in connection with the acquisition of 2-Lane Media by Parago into up to 500,000 of our shares at the option of the 2-Lane Media shareholders, and in May 2002 we exchanged 1,200 Parago shares held by some of the 2-Lane Media shareholders into 139,806 shares of our common stock. Pursuant to the terms of the subscription agreements between Parago and some of its stockholders, we may be required to issue up to 414,000 shares of our common stock based on a conversion price of \$3.75 per share (above the fair market value on the dates of issuance) at the option of such stockholders. In May 2002, the Company exchanged 16,000 shares of the Company's common stock for 40 shares of Parago common stock with one of these shareholders. These provisions could have the effect of diluting our stockholders if the market price for our stock is above that price at the time of conversion.

### WE MAY NOT BE ABLE TO EFFECT THE DISTRIBUTION OF PARAGO SHARES.

We previously announced that we intend to distribute shares of Parago common stock to our shareholders upon compliance with the Securities and Exchange Commission (SEC) requirements

17

applicable in connection with the proposed distribution and upon the expiration of a 180 day lockup agreement between the underwriters of Parago's previously proposed initial public offering and us. If there are problems associated with compliance with SEC requirements or state law, then the distribution of Parago shares may be delayed or may not occur. There can be no assurance that we will complete the distribution on the proposed terms or at all.

### OUR INVESTEES' BUSINESSES AND FUTURE PROSPECTS ARE EXTREMELY DIFFICULT TO EVALUATE BECAUSE THEIR OPERATING HISTORIES ARE VERY LIMITED AND THEIR BUSINESS MODELS ARE NEW, UNPROVEN AND EVOLVING.

Our investees are early stage companies, and therefore each investee has only a limited operating history on which one can base an investment decision. You should consider their prospects in light of the uncertainties and difficulties frequently encountered by companies in their early stages of development.

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

In addition, each investee's business model is new, unproven and evolving. We cannot assure that our investees' business models will be commercially successful, or that their solutions will be accepted by businesses or consumers. If our investees are unable to establish pricing and service models acceptable to manufacturers, retailers and service providers and attractive to their customers, their solutions may not be commercially successful.

EACH INVESTEE HAS A HISTORY OF NET LOSSES AND EXPECTS TO CONTINUE TO INCUR SUBSTANTIAL NET LOSSES IN THE FUTURE.

Each investee had unaudited net losses for the year ended December 31, 2002, and we anticipate that each investee will incur additional losses for the foreseeable future. If our investees' revenues do not grow as they anticipate, our investees may never be profitable.

TO CONTINUE THEIR OPERATIONS AND BUSINESSES, OUR INVESTEES MUST RAISE ADDITIONAL FINANCING.

Our investees' ability to maintain and grow their businesses is dependent on access to sufficient funds to support their working capital and capital expenditure needs. If our investees do not raise additional funds, their businesses and results of operations will be seriously harmed, and our assets and share price would be materially and adversely impacted. This additional financing may not be available to our investees on a timely basis if at all, or, if available, on terms acceptable to our investees. Moreover, additional financing may cause material and immediate dilution to existing stockholders of our investees, including us.

IN THE EVENT OF THE COMPLETION OF AN INITIAL PUBLIC OFFERING BY ANY OF OUR INVESTEES, THEIR STOCK PRICE IS LIKELY TO BE VERY VOLATILE.

Currently, the securities of our investees cannot be bought or sold publicly. There can be no assurance that any of our investees will be able to complete an initial public offering. Although it is anticipated that the initial public offering price (if an initial public offering is completed) would be determined based on several factors, the market price after the offering may vary significantly from the initial offering price. The market price of our investees' common stock is likely to be highly volatile and could be subject to wide fluctuations in response to factors that are beyond its control. A decline in their stock price will adversely affect our stock price.

Domestic and international stock markets often experience extreme price and volume fluctuations. Market fluctuations, as well as general political and economic conditions, such as a recession or interest rate or currency rate fluctuations, could adversely affect the market price of Parago's common stock, if it becomes publicly traded.

Sales of a substantial number of shares of our investees' common stock in the public market after its initial public offering could depress the market price of their common stock and could impair their ability to raise capital through the sale of additional equity securities.

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in conjunction with our audited financial statements for the years ended December 31, 2002 and the related notes in the Company's Form 10-KSB. Our year ends on December 31, and each of our quarters end on the final day of a calendar quarter (each March 31, June 30 and

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

September 30). The following discussion contains forward-looking statements. Please see Forward-Looking Statements for a discussion of uncertainties, risks and assumptions associated with these statements.

### OVERVIEW

CT Holdings, Inc. provides management expertise and capital to early stage companies. At September 30, 2003 and December 31, 2002 we held investments in Parago and River Logic. We were incorporated in Delaware in 1992 and previously operated under the name Citadel Technology Inc. Our business model is designed to enable the companies in whom we invest or acquire to become market leaders in their industries. Our strategy has led to the development, acquisition and operation of primarily technology based businesses with compelling valuations and strong business models. We believe that the anticipated growth in technology creates strong opportunities for us to increase shareholder value by investing in well-positioned early stage ventures. Our goal is to realize the value of our investments for our shareholders through a subsequent liquidity event such as a spin-off, sale, merger or initial public offering of the investee companies.

Recent geopolitical, economic and stock market conditions along with lack of available capital have limited our ability to invest in additional companies and technologies that could offer us and our shareholders a reasonable rate of return on their investment in the foreseeable future. These factors have also affected the businesses of our investee companies and as a result, the carrying values of our investments in Parago and River Logic have been written down to zero. We expect that if and when economic conditions improve that capital may be available to support additional investments in companies that fit into our strategy. Until such time the Company's business activities will be limited to reviewing investment opportunities, filing of compliance documents and defending the lawsuits disclosed in Part II, Item 1 - Legal Proceedings.

### THE CITADEL SECURITY SOFTWARE DISTRIBUTION AND DISCONTINUED OPERATIONS

In November 2001, the board of directors of CT Holdings approved the spin-off of Citadel through the declaration of a pro rata dividend distribution to the holders of record of the outstanding shares of CT Holdings common stock (the "Distribution"). The Distribution consisted of one (1) share of Citadel common stock for every four (4) shares of CT Holdings (the Distribution Ratio) held by CT Holdings shareholders as of May 6, 2002 (the "Record Date"). Following the Distribution on May 17, 2002 (the "Distribution Date"), Citadel became an independent company and CT Holdings has no continuing ownership interest in Citadel. The Distribution is intended to be a tax free distribution for U.S. federal tax purposes although neither we nor Citadel have requested or obtained any opinions as to the tax treatment of the Distribution. On the Distribution Date, CT Holdings and Citadel entered into a series of agreements including a distribution agreement, a transition services agreement and a tax disaffiliation agreement which provide for, among other things, the principal corporate transactions required to effect the Distribution, to provide for an orderly transition to the status of two independent companies and to define the continuing relationship between Citadel and CT Holdings after the Distribution.

After the Distribution, two of five directors of CT Holdings were directors of Citadel and the Chief Executive Officer and the Chief Financial Officer of CT Holdings hold the same positions with Citadel. It is expected that up to 33% of the officers' time could be spent on work related to CT Holdings. All employees of CT Holdings became employees of Citadel following the Distribution. Under the transition services agreement Citadel will provide accounting, administrative, information management and other services, including the services of the two officers, to CT Holdings in return for a payment of a monthly administrative fee initially estimated at \$20,000 per month. The fee may be adjusted quarterly subject to a reallocation of the estimated time devoted to each company.

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

As a result of the Distribution, the financial statements and the results of operations of Citadel are presented as discontinued operations in CT Holdings' financial statements for the period from January 1, 2002 through the Distribution Date of May 17, 2002. Summary financial information with respect to Citadel is provided below:

19

	Period January 1, 2002 through May 17, 2002 -----
Results of operations:	
Revenue	\$ 130,519
Net Loss	(942,939)

### OVERVIEW OF PARAGO

In January 1999 we formed Parago, an application service provider and Internet based business process outsourcer that provides a suite of technology offerings (including PromoCenter, ClickChoice and KnowledgeCenter) designed to increase sales, reduce costs, and retain customers for retailers, manufacturers and service organizations. Parago's continuous customer interaction services include online promotional management (including online rebate processing), proactive email, online surveys, and customer data analysis and reporting.

In connection with an acquisition by Parago in March 1999, we agreed to convert the Parago shares of common stock issued in connection with the merger into a maximum of 500,000 of our shares at the option of the shareholders of the Company acquired by Parago. In May 2002 the Company exchanged 139,806 shares of the Company's common stock for 1,200 shares of Parago common stock with some of these shareholders. In addition, pursuant to the terms of the subscription agreements between Parago and some of its stockholders, we may be required to issue up to 414,000 shares of our common stock to such stockholders based upon a conversion price of \$3.75 per share. In May 2002, the Company exchanged 16,000 shares of the Company's common stock for 40 shares of Parago common stock with one of these shareholders. These provisions could have the effect of diluting our stockholders.

After a 1 for 1000 reverse stock split by Parago in connection with its Series E preferred stock offering in December 2001 to February 2002, in which the Company elected not to participate, the Company holds 20,000 shares of common stock of Parago and warrants to purchase 28.8749 shares of Parago's Series A-3 Preferred Stock (convertible into 2,887 shares of Parago's common stock) at December 31, 2002. In December 2001 Parago completed the first closing (\$13.6 million) of an equity financing of approximately \$15.0 million. Approximately \$1.4 million of equity financing was closed in February 2002. As a result of the equity financing our ownership percentage in Parago was reduced to less than 1%. Our investment in Parago for the period from January 1, 2001 through December 12, 2001 was accounted for under the equity method of accounting for investments and accordingly as a result of our ownership falling below 20%, has been accounted for using the cost method of accounting since December 13, 2001. Under the cost method of accounting, the Company's share of the income or loss from Parago is not included in operations. Under the equity method of accounting, the Company's share of the investee's income or losses is included in the statements of operations. If the carrying value of the Company's net investment falls below

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

zero, the Company discontinues applying the equity method until the carrying value of the net investment rises above zero. In addition, in the event the Company's ownership percentage exceeds 20% and the value of the Company's equity investment rises above zero, the Company will resume applying the equity method and will recognize an investment in Parago after the Company's share of net losses not recognized is recovered through our proportionate share of net income if Parago turns profitable. We believe that our \$50,000 investment in Parago represented by 20,000 shares of Parago's common stock (plus 1,240 shares to be received from the exchanges in May 2002) and warrants to purchase 28.8749 shares of Series A-3 preferred stock (convertible into 2,887 shares of Parago common stock) may ultimately provide an appropriate return.

### OVERVIEW OF RIVER LOGIC

In May 2000, we made an investment in River Logic by acquiring shares of common stock of River Logic from several of its existing shareholders in exchange for 333,333 shares of our common stock. We also acquired shares of Series A Convertible Preferred Stock ("Series A") from River Logic in exchange for the contribution of assets acquired from a third party by the Company through exchange of 666,667 shares of our common stock. In connection with the investment in River Logic, we also made two bridge loans totaling \$600,000 to River Logic that were convertible into shares of capital stock of River Logic. Each of the bridge loans (i) bears interest at a rate of 12% per annum through its first anniversary and at one percent above the prime rate per annum thereafter, (ii) is secured

20

by certain assets of River Logic, (iii) is payable upon the Company's demand and (iv) is repayable by River Logic commencing on its third anniversary date. In addition, we also incurred cash expenses for professional fees related to these transactions and we issued 50,000 shares of our common stock to a consultant for identifying this investment. After the closing of the transaction the consultant became the Chief Operating Officer of River Logic and we granted him 100,000 fully vested options to purchase our common stock at \$5 per share (which was above the fair market value at the date of issuance).

Since the Company's initial investment, River Logic has made progress in executing its strategy through its development and introduction of new products and establishment of new customer relationships. Similar to the investments in Parago, the Company recognized that this investment would be initially illiquid. However during the year ended December 31, 2002 general economic conditions worsened, stock market valuations declined from the values at December 31, 2001 and raising capital at previous historical valuations became difficult. We considered all the facts and circumstances of River Logic's business, marketplace and cost of new capital and based on these considerations we determined that the fair market value of the Company's investment in River Logic had been impaired and that our investment in River Logic may never be realized. Accordingly we wrote down the carrying value of our investment in River Logic by \$2,203,975 during the three months ended September 30, 2002 to its net realizable value at September 30, 2002. Our investment in River Logic is accounted for using the cost method of accounting for investments in common stock therefore no proportionate share of equity in income or loss is recorded.

### CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and



## Edgar Filing: CT HOLDINGS INC - Form 10QSB

expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to our investments in our investee companies and commitments and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies are most important to the presentation of our financial statements and require the most difficult, subjective and complex judgments.

### IMPAIRMENT CHARGES

We periodically evaluate the carrying value of our ownership interests in our investee companies for possible impairment based on achievement of business plan objectives and milestones, the value of each ownership interest in the investee company relative to carrying value, the financial condition and prospects of the investee company, and other relevant factors. The business plan objectives and milestones we consider include, among others, those related to financial performance such as achievement of planned financial results or completion of capital raising activities, and those that are not primarily financial in nature such as obtaining key business relationships or the hiring of key employees. If an indication of impairment exists with respect to the carrying value of an investee company, we perform an evaluation by comparing the estimated fair value of the asset with its carrying value. Fair value is determined by estimating the cash flows related to the asset, including estimated proceeds on disposition, if any. If the fair value is less than the carrying value a loss is recorded.

### COMMITMENTS AND CONTINGENCIES

From time to time, we are a defendant or plaintiff in various legal actions, which arise in the normal course of business. We are also a guarantor of various third-party obligations and commitments. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of reserves required for these contingencies, if any, which would be charged to earnings, is made after careful analysis of each individual issue. The required reserves may change in the future due to new developments in each matter or changes in circumstances, such as a change in settlement strategy.

21

Changes in required reserves could increase or decrease our earnings in the period the changes are made.

### EFFECT OF VARIOUS ACCOUNTING METHODS FOR EQUITY INVESTMENTS

The various interests that we acquire in our investee companies are accounted for under three broad methods: consolidation, equity method and cost method. The applicable accounting method is generally determined based on our percentage ownership in an investee company.

**CONSOLIDATION METHOD:** Investee companies in which we directly or indirectly own more than 50% of the outstanding securities or those where we have effective control are generally accounted for under the consolidation method of accounting. Under this method, an investee company's accounts are consolidated within our financial statements. Participation of other unrelated stockholders in the earnings or losses of a consolidated investee company would be reflected as a minority interest in consolidated financial statements. Minority interest

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

adjusts our consolidated net results of operations to reflect only our share of the earnings or losses of the consolidated investee company. At September 30, 2003 and December 31, 2002, we had no investee company qualified for this accounting method.

**EQUITY METHOD:** Investee companies whose results we do not consolidate, but over whom we exercise significant influence, are generally accounted for under the equity method of accounting. Whether or not we exercise significant influence with respect to an investee company depends on an evaluation of several factors including, among others, representation on the investee company's board of directors and percentage ownership level, which is generally a 20% to 50% interest in the securities of the investee company, including our holdings in common, preferred and other convertible instruments in the investee company where we may have voting rights. Under the equity method of accounting, an investee company's accounts are not reflected within our financial statements; however, our share of the earnings or losses of the investee company is reflected in our statements of operations. At September 30, 2003 and December 31, 2002, we had no investee company qualified for this accounting method.

**COST METHOD:** Investee companies not accounted for under either the consolidation or the equity method of accounting are accounted for under the cost method of accounting. Under this method, our share of the earnings or losses of these companies is not included in our statements of operations. Our investments in Parago and River Logic were accounted for using this method of accounting at September 30, 2003 and December 31, 2002.

### RESULTS OF OPERATIONS

THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003 COMPARED WITH THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2002

Our continuing operations consist of costs and expenses for providing services to our investee companies and the activities to identify additional technologies and companies in which we might invest. We do not generate any direct revenue and because our investee companies are not consolidated, we do not report revenue from investee businesses. Due to the spin-off of Citadel on May 17, 2002 the results of operations of Citadel are presented as discontinued operations in all periods presented prior to the distribution date. Citadel's loss from operations from January 1, 2002 through May 17, 2002 is presented as loss from discontinued operations in the statements of operations. For the periods prior to the distribution date, costs and expenses related to the Citadel business have been allocated to Citadel based on an estimate of the proportion of amounts allocable to Citadel utilizing such factors as revenues, number of employees, and other relevant factors.

### GENERAL AND ADMINISTRATIVE EXPENSES

We had general and administrative expenses for the three months ended September 30, 2003 and 2002 of \$86,527 and \$122,007, respectively, a decrease of \$35,480 or 29%. The decrease in general and administrative expense is primarily a result of the decrease in consulting fees, legal expenses, accounting fees and other professional fees due to the decrease in business development activities in the third quarter of 2003 versus the third quarter of 2002.

During the nine months ended September 30, 2003 general and administrative expenses were \$300,576 representing a decrease of \$597,359 or 67% from the \$897,935 of general and administrative expenses recorded for the nine months ended September 30, 2002. The decrease is primarily due to lower legal, accounting, consulting and other professional fees and expenses resulting from

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

the lower business development activities during the nine months ended September 30, 2003 versus the similar period of 2002.

### COMMON STOCK ISSUED AS COMPENSATION

During the nine months ended September 30, 2002 the Company issued 6,647,500 shares of common stock to employees and directors of the Company pursuant to the exercise of stock options. The aggregate exercise price of these stock options was approximately \$1,347,000. Notes receivable for \$1,312,500 were received for the exercise price and subsequently fully reserved and expensed as stock compensation expense. An additional \$34,500 was recorded as a stock bonus expense.

### LITIGATION ACCRUAL AND REVERSAL

In June 2000, CT Holdings was served with a lawsuit filed in state court in Houston, Texas by Michael and Patricia Ferguson for breach of contract, tortious interference and negligence. Specifically, the Fergusons claimed that they were damaged when they attempted to exercise warrants during a time when CT Holdings' related registration statement could not be used. The trial in this case was held from April 22, 2002 until May 1, 2002, and the Company received the judgment from the trial court in July 2002. The trial court awarded the Fergusons approximately \$766,000 in damages, interest and legal fees. As a result of the judgment, the Company recorded approximately \$766,000 as a nonrecurring charge related to the litigation. An additional accrual for interest expense of \$19,000 was recorded at December 31, 2002 increasing the accrued liability to \$785,000 at December 31, 2002.

In April 2003 the Company settled the lawsuit for \$225,000 payable in cash and accordingly reversed \$560,000 of the accrued liability. Citadel loaned the Company \$225,000 which is represented by a demand note payable bearing interest at 12% per year.

In August 2002, PriceWaterhouseCoopers, LLP ("PWC") filed a lawsuit against CT Holdings seeking payment of \$131,816 for services performed pursuant to a contract with CT Holdings related to the JMA lawsuit described above. The court ordered that mediation be held by July 2003. The case is styled PriceWaterhouseCoopers, LLP v. CT Holdings, and was filed in the 192nd District Court, Dallas County, Texas. In July 2003, PWC obtained a summary judgment against the Company for damages of \$131,816 plus pre-judgment interest of \$57,615, post-judgment interest at 10% and attorneys' fees in the amount of \$8,605. During the three months ended September 30, 2003 the Company recorded an accrual for legal settlement of \$202,000 in association with this judgment.

### WRITEDOWN OF INVESTMENT IN AFFILIATES

During the nine months ended September 30, 2002 general economic conditions worsened, stock market valuations declined from the values at December 31, 2001 and raising capital at previous historical valuations became difficult. We considered these and other facts and circumstances of River Logic's business, marketplace and cost of new capital and based on an this consideration at June 30, 2002 we determined that the fair market value of the Company's investment in River Logic had declined to approximately \$500,000 and accordingly wrote down the investment by \$2,203,975. At December 31, 2002 we determined that the fair value of our investment in River Logic had declined to zero and accordingly wrote down the remaining carrying value to zero at December 31, 2002.

### INTEREST EXPENSE

Interest expense for the three months ended September 30, 2003 was \$32,034 representing interest expense on advances and notes payable to related parties, notes payable to shareholders and the demand note payable to Citadel. Interest

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

expense for the three months ended September 30, 2002 was \$20,752 related to advances and notes payable to related parties and notes payable to shareholders. The increase in interest expense is due to higher average balances of interest bearing debt outstanding during the three months ended September 30, 2003 versus the three month period ended September 30, 2002.

23

Interest expense for the nine months ended September 30, 2003 was \$88,140 representing interest expense on advances and notes payable to related parties, notes payable to shareholders and the demand note payable to Citadel. Interest expense for the nine months ended September 30, 2002 was \$94,334 and includes a charge of \$51,300 related to the beneficial conversion feature of \$600,000 of convertible debt issued in the first nine months of 2002 and \$43,034 of interest expense on advances and notes payable to related parties and notes payable to shareholders. The increase in interest expense, excluding the charge for the beneficial conversion feature, is due to higher average balances of interest bearing debt outstanding during the nine months ended September 30, 2003 versus the nine month period ended September 30, 2002.

### GAIN ON SETTLEMENT OF LIABILITIES WITH STOCK

During the nine months ended September 30, 2003 we completed negotiations to settle approximately \$249,000 of liabilities that had been outstanding prior to the Citadel Distribution by issuing 425,000 shares of CT Holdings common stock along with 106,250 pro rata dividend shares of Citadel common stock that had been reserved for issuance at the Distribution Date. The difference between the fair value of the shares and the recorded liabilities of approximately \$143,000 was recognized as a gain in the statement of operations. At September 30, 2003 there remained approximately \$448,000 of operating liabilities under negotiation for settlement with shares of the Company's common stock including all dividends and distributions. A gain on the settlement of a liability with stock of \$8,501 was recognized in the nine months ended September 30, 2002.

In October 2003, we agreed to settle approximately \$416,000 of the remaining \$448,000 of operating liabilities outstanding prior to the Citadel Distribution by issuing 575,000 shares of CT Holdings common stock along with 143,750 pro rata dividend shares of Citadel common stock that had been reserved for issuance at the Distribution Date. An additional gain of approximately \$272,000 is expected to be recognized in the results of operations for the quarter ending December 31, 2003.

### OTHER (INCOME) EXPENSE

Other expense for the nine months ended September 30, 2002 was \$38,452 representing the fair market value of common stock issued for the exercise of exchange rights granted by the Company.

### NET INCOME (LOSS)

For the three months ended September 30, 2003 we reported a net loss from continuing operations of \$188,397 versus a loss from continuing operations of \$191,759 for the three months ended September 30, 2002.

For the nine months ended September 30, 2003 we reported a net income from continuing operations of \$112,167 versus a loss from continuing operations of \$5,388,195 for the nine months ended September 30, 2002. As a result of the Distribution, the results of operations of Citadel for the nine months ended September 30, 2002 are presented as discontinued operations. The loss from discontinued operations related to Citadel for the nine months ended September 30, 2002 was \$942,939. In addition to the loss from discontinued operations, we

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

recorded transaction costs directly related to the spin-off transaction, primarily, legal and accounting fees, of \$185,431 for the nine months ended September 30, 2002. No transaction costs were recorded during the three and nine months ended September 30, 2003.

### LIQUIDITY AND CAPITAL RESOURCES

We received a report from our independent auditors for our year ended December 31, 2002 containing an explanatory paragraph that describes the uncertainty regarding our ability to continue as a going concern due to our recurring operating losses and a significant working capital deficiency. Historically, we have incurred recurring operating losses and have a significant stockholders' deficit at September 30, 2003 of approximately \$2,600,000. We had no cash balance or current assets at September 30, 2003 and current liabilities total approximately \$2,600,000. We have no access to capital at September 30, 2003 and we have no plans to raise capital nor have we identified sources of capital. In the past our funding needs of the business have been provided by financings through short-term notes payable and additional investments from related parties, including our Chief Executive Officer, however there can be no assurance that such funds will be available from these related parties. The Company has been and continues to be dependent upon outside financing to

24

perform its business development activities, make investments in new technology companies and to fund operations.

Our plans to continue to support and expand our business development activities are limited due to a lack of identification and availability of near term capital. As a result, it is unlikely that the implementation of the Company's business strategy will generate positive cash flow in the foreseeable future. Achieving positive cash flow is currently highly dependent upon obtaining liquidity from our investments in unconsolidated affiliates. We have no plans at September 30, 2003 to raise additional capital to invest in new business opportunities. To do so we estimate that we will need to raise up to \$2.6 million to settle liabilities after which we may then support our incubator and business development activities. Historically, we have obtained short-term funding from our Chief Executive Officer or Directors of the Company. While this may occur in the future there can be no assurance that such financing will be available or if available with terms that we would be willing to accept.

There can be no assurance that management's plans will be successful or what other actions may become necessary. There can be no assurance that the Company will ever achieve liquidity for its investments. Until we are able to create liquidity from an additional inflow of new capital or from our investments through sale to a strategic investor, an initial public offering or some other liquidity transaction, we will continue to require external sources of working capital to fund its own operating expenses. Although we have been successful raising capital in the past, our inability to raise capital could have a material adverse effect on our business and operations that could be material to our results of operations.

The net cash used in operating activities was \$225,000 for the nine months ended September 30, 2003. This is the result of net income of approximately \$112,000 for the nine months ended September 30, 2003 and an accrual for a legal settlement of \$202,000, offset by the reversal of litigation accrual of \$560,000 resulting from the settlement of a legal claim, a gain of approximately \$143,000 recognized upon the settlement of operating liabilities with the issuance of common stock and offset by cash from changes in operating assets and liabilities of approximately \$164,000.

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

The net cash used in operations of approximately \$418,000 for the nine months ended September 30, 2002 is principally a result of the net loss of approximately \$6,517,000 offset by a net loss from discontinued operations of approximately \$943,000, stock compensation expense of \$1,347,000, a writedown of our investment in affiliates of approximately \$2,234,000, a legal settlement accrual of \$785,000 and the changes in operating assets and liabilities of approximately \$704,000.

There was no cash from investing activities for the nine months ended September 30, 2003 or 2002. Cash flows provided from financing activities for the nine months ended September 30, 2003 includes \$225,000 of proceeds from a note payable to Citadel. In April 2003 we settled a lawsuit for \$225,000 payable in cash. Citadel loaned the Company \$225,000 which is represented by a demand note payable bearing interest at 12% per year. Cash flows provided by financing activities was approximately \$618,000 for the nine months ended September 30, 2002, primarily resulting from the proceeds of a convertible note from a shareholder of \$600,000, proceeds of notes and advances payable from related parties of approximately \$526,000 offset by payments on notes payable to related parties of approximately \$533,000 and \$25,000 in proceeds from the sale of common stock.

As a result of the aforementioned factors, there were no net cash flows from continuing operations in the nine months ended September 30, 2003. During the nine months ended September 30, 2002 there were approximately \$200,000 of net cash flows provided by continuing operations and the net contribution by CT Holdings to Citadel was approximately \$200,000 for the same period. The net result in both periods was no cash balance to the Company.

25

### ITEM 3. CONTROLS AND PROCEDURES

The Company's management, including the Company's principal executive officer and principal financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-QSB. Based upon that evaluation, the Company's principal executive officer and principal financial officer have concluded that the disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-QSB.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### PART II. OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

In October 2001, Roan-Meyers Associates (formerly Janssen Meyers Associates L.P.) filed suit in the Supreme Court of the State of New York, County of New York against CT Holdings, Inc. to enforce a settlement term sheet arising out of a prior lawsuit alleging breach of a Placement Agency Agreement. This case is styled Roan Meyers Associates v. CT Holdings, Inc. In August 1998, Janssen-Meyers Associates L.P. ("JMA") filed a lawsuit against CT Holdings arising out of an alleged 1995 contract with CT Holdings' predecessor. The suit alleged that this predecessor breached a letter of intent dated September 1995 and/or a Placement Agency Agreement dated November 1995 between JMA and the predecessor. As its damages, JMA claimed that it was entitled to, among other things, the cash value of warrants to purchase 1.8 million shares of CT Holdings

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

common stock at an exercise price of \$0.89 per share, valued during May 1996. According to JMA's valuation of those warrants, potential damages were alleged to exceed \$40 million. CT Holdings vigorously disputes that it breached either the letter of intent or the Placement Agency Agreement or that it is liable to JMA. The lawsuit was styled Janssen-Meyers Associates, L.P. v. Citadel Technology, Inc., and was filed in the Supreme Court of the State of New York, County of New York. CT Holdings removed the case to federal court in the Southern District of New York. Following mediation in July 2000, CT Holdings and JMA entered into a settlement term sheet to attempt to resolve the disputes between it and JMA, pursuant to which CT Holdings and JMA agreed in principle to settle the lawsuit for an aggregate of \$3 million, in a combination of \$1.5 million in cash and 300,000 shares of common stock with a guaranteed value of \$5 per share as of January, April and October 2001 (with respect to 100,000 of the shares for each period). The settlement was subject to execution of definitive settlement documents and approval of the boards of directors of the companies. CT Holdings and JMA were unable to negotiate the final definitive settlement agreement and, as a result, the matter was not settled. The case was dismissed in August 2000 without any resolution of this issue. On March 27, 2001, JMA attempted to reopen this matter, but the Court hearing the JMA lawsuit issued a Summary Order denying JMA's motion to enforce the settlement term sheet and confirmed the prior dismissal of the lawsuit. The Court further ruled that JMA would either have to bring an action on the proposed settlement or move to re-open the dismissed case. The Court stated that it did not express any view with respect to the merits of the proposed settlement that brought about the dismissal of the case. There was no activity on the case from March 2001 through August 2001. On August 27, 2001 JMA refiled its lawsuit with a federal court in New York, and CT Holdings filed a motion to dismiss the case because the plaintiffs lacked the required diversity jurisdiction to pursue the claims in federal court. On October 31, 2001 the case was dismissed in federal court. In December 2001, the plaintiffs refiled the lawsuit in the state court seeking to enforce the settlement term sheet. The case was filed in Supreme Court of New York, that state's trial court, in a case styled Roan Meyers v. CT Holdings. CT Holdings intends to vigorously defend against this lawsuit and has filed a counterclaim to, among other things, recover excess amounts charged by JMA in connection with related bridge loans. Trial has not been set on this matter. At a status conference held November 10, 2003 the plaintiff was given a 30 day extension to file the note of issue, which is due December 5, 2003. The court also ordered CT Holdings to produce additional discovery materials. The Company anticipates that the plaintiff will receive a trial date for sometime in early 2004. The Company cannot reasonably estimate the ultimate liability, if any, and therefore no liability has been recorded in association with this lawsuit. Given these events, including the dismissal of the lawsuit and the failure of the plaintiffs to refile a lawsuit for more than one year after the date of the dismissal, the Company, in the year ended December 31, 2001, reversed the \$1,912,500 nonrecurring charge that the Company had previously recorded related to the settlement of the lawsuit.

26

In June 2000, CT Holdings was served with a lawsuit filed in the 157th State District Court in n June 2000, Tech Data Corporation filed suit against CT Holdings, alleging a breach of a Software Distribution Agreement ("the Agreement") with CT Holdings. The lawsuit is styled Tech Data Corporation v. Citadel Technology, Inc. (now known as CT Holdings), and was filed in Dallas County Court at Law No. 2. Because CT Holdings was not properly served, Tech Data obtained a default judgment for \$101,048. When CT Holdings discovered the default judgment, it filed and won a motion to set aside this judgment. In June 2001, Tech Data properly served CT Holdings. CT Holdings answered and demanded binding arbitration pursuant to the agreement. The parties filed a Joint Motion to Arbitrate in December 2001. The judge granted this motion and abated the lawsuit pending arbitration. The arbitration was held in 2002, and in January

## Edgar Filing: CT HOLDINGS INC - Form 10QSB

2003, the arbitrator entered a judgment of \$71,655 against CT Holdings in favor of Tech Data, together with pre-judgment interest at the applicable rate under Florida law for the period from January 2, 2000 to January 10, 2003, attorneys' fees of \$3,500, and interest on these amounts in the amount of 10% per year from February 10, 2003 until the amounts are paid. In March 2003, Tech Data filed a motion to revive the abated lawsuit for purposes of entering the arbitration award as a judgment in the case and judgment was entered. Tech Data has filed a motion to appoint a receiver for the Company that is set for November 21, 2003. As part of the Distribution, Citadel assumed responsibility for this lawsuit; and has recorded a liability of approximately \$101,000, although there can be no assurance that CT Holdings will be released from the lawsuit.

In August 2002, PriceWaterhouseCoopers, LLP ("PWC") filed a lawsuit against CT Holdings seeking payment of \$131,816 for services performed pursuant to a contract with CT Holdings related to the JMA lawsuit described above. The court ordered that mediation be held by July 2003. The case is styled PriceWaterhouseCoopers, LLP v. CT Holdings, and was filed in the 192nd District Court, Dallas County, Texas. In July 2003, PWC obtained a summary judgment against the Company for damages of \$131,816 plus pre-judgment interest of \$57,615, post-judgment interest at 10% and attorneys' fees in the amount of \$8,605. During the three months ended September 30, 2003 the Company recorded an accrual for legal settlement of \$202,000 in association with this judgment.

In April 2003, Harte Hanks, Inc. filed a lawsuit styled "Harte Hanks, Inc. v. CT Holdings Inc. dba Citadel Computer" seeking payment of \$12,513 for services performed. In July 2003, the plaintiffs filed a motion for receivership and alternatively to compel discovery in the lawsuit. At a hearing on the matter held on September 5, 2003 in the County Court of Law Number Three of Dallas County, Texas, the court ordered the Company to provide additional discovery by October 20, 2003 which the Company failed to produce. As part of the Distribution, Citadel assumed responsibility for this liability, and has recorded a liability of approximately \$12,500. CT Holdings believes that Citadel will ultimately settle this liability, although there can be no assurance that CT Holdings will be released from the lawsuit.

We may become involved from time to time in litigation on various matters which are routine to the conduct of our business. We believe that none of these actions, individually or in the aggregate, will have a material adverse effect on our financial position or results of operations, though any adverse decision in these cases or the costs of defending or settling such claims could have a material adverse effect on our business.

### ITEM 2 - RECENT SALES OF UNREGISTERED SECURITIES

In April 2003, the Company settled a liability of approximately \$23,000 in exchange for 50,000 shares of CT Holdings common stock and other consideration.

In July 2003, the Company completed negotiations to settle approximately \$226,000 of liabilities that had been outstanding prior to the Distribution by issuing 375,000 shares of CT Holdings common stock.

In October 2003, the Company agreed to settle approximately \$416,000 of operating liabilities outstanding prior to the Distribution by issuing 575,000 shares of CT Holdings common stock.

27

### ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

At September 30, 2003 the Company was in default on the following indebtedness:



## Edgar Filing: CT HOLDINGS INC - Form 10QSB

- \$250,000, 8% note payable due April 30, 2002 to a former director. The note is accruing interest at 18% per year and accrued interest at September 30, 2003 is \$80,863.
- \$225,796, 5% note payable due July 1, 2002 to the Company's CEO. The note is accruing interest at 18% per year and accrued interest at September 30, 2003 is \$53,981.
- \$49,000, 8% note payable due September 30, 2002 to an entity related to an employee of the Company. The note is accruing interest at 18% per year and accrued interest at September 30, 2003 is \$12,415.
- \$9,000, an 8% note payable to a shareholder. The note continues to bear interest at 8% with accrued interest at September 30, 2003 of \$2,355.

### ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

31.1 Certification of Chief Executive Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002

32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002

#### (b) Current Reports on Form 8-K

None

28

### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

CT HOLDINGS, INC.

(REGISTRANT)

Date: November 14, 2003

By: /s/ STEVEN B. SOLOMON

-----  
Steven B. Solomon,  
President and Chief Executive Officer  
(Duly Authorized Signatory and  
Principal Executive Officer)

/s/ RICHARD CONNELLY

-----  
Richard Connelly,  
Chief Financial Officer  
(Duly Authorized Signatory and  
Principal Accounting and Financial Officer)

