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CT HOLDINGS INC
Form 10QSB
May 16, 2005

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 MARCH 31, 2005

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 0-18718

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.)

TWO LINCOLN CENTRE, SUITE 1600, 5420 LYNDON B. JOHNSON FREEWAY
DALLAS, TEXAS 75240
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

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

Indicate by check mark whether the registrant (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 the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Class	Outstanding at May 13, 2005
Common Stock, Par value \$.01 per share	58,545,928

Transitional Small Business Disclosure Format Yes No

CT HOLDINGS, INC.
FORM 10-QSB
QUARTERLY PERIOD ENDED MARCH 31, 2005
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CT HOLDINGS, INC. BALANCE SHEETS

	March 31, 2005 (unaudited)	DECEMBER 31, 2004
	-----	-----
ASSETS		

CURRENT ASSETS		
Cash	\$ 327	\$ 4,168
	-----	-----
TOTAL ASSETS	\$ 327	\$ 4,168
	=====	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT		

CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 337,286	\$ 325,300
Convertible secured note payable to related party, net of deferred debt discount of \$115,000 and \$140,000	85,000	60,000
Demand note payable to Citadel including accrued interest of \$55,774 and \$48,895	280,774	273,895
Payable to Citadel	607,500	585,000

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Note payable to officer	5,000	5,000
Note payable to shareholder	9,000	9,000
Accrual for litigation including accrued interest of \$1,194,345 and \$1,125,738	4,194,345	4,125,738
	-----	-----
Total current liabilities	5,518,905	5,383,933
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; 58,545,928 shares issued and outstanding	585,460	585,460
Common stock pending issuance	600,000	600,000
Additional paid-in capital	57,390,601	57,390,601
Accumulated deficit	(64,094,639)	(63,955,826)
	-----	-----
Total stockholders' deficit	(5,518,578)	(5,379,765)
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	\$ 327	\$ 4,168
	=====	=====

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

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CT HOLDINGS, INC.
STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended	
	March 31,	
	2005	2004
	-----	-----
Revenue	\$ -	\$ -
General and administrative expense	33,838	65,470
Interest expense	104,975	7,556
Write off of affiliate shares acquired through exercise of warrants	-	30,000
	-----	-----
Loss before income taxes	(138,813)	(103,026)
Provision for income taxes	-	-
	-----	-----
Net loss	\$ (138,813)	\$ (103,026)
	=====	=====
Net loss per share - basic and diluted	\$ -	\$ -
	=====	=====
Weighted average shares outstanding - basic and diluted	67,245,928	63,487,686

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

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CT HOLDINGS, INC.
STATEMENTS OF CASH FLOWS
(unaudited)

	Three Months Ended March 31,	
	2005	2004
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (138,813)	\$ (103,026)
Adjustments to reconcile net loss to net cash used in operating activities		
Amortization of deferred debt discount recorded as interest expense	25,000	-
Accrual for litigation and related interest expense	68,607	-
Write off of affiliate shares acquired through exercise of warrants	-	30,000
Changes in operating assets and liabilities		
Accounts payable and accrued expenses	18,865	13,026
Payable to Citadel	22,500	60,000
	-----	-----
NET CASH USED IN OPERATING ACTIVITIES	(3,841)	-
NET CASH FROM INVESTING ACTIVITIES		
Exercise of warrants to acquire an affiliate's Series-A preferred stock	-	(30,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from note payable to related party	-	30,000
	-----	-----
Net change in cash	(3,841)	-
Cash and cash equivalents at the beginning of the period	4,168	-
	-----	-----
Cash and cash equivalents at the end of the period	\$ 327	\$ -
	=====	=====

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

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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

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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, 2004 and 2003, included in CT Holdings' Form 10-KSB for the year ended December 31, 2004 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") provides management expertise including consulting on operations, marketing and strategic planning and a single 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 March 31, 2005 the Company held investments in two companies, Parago, Inc. ("Parago") and River Logic, Inc. ("River Logic"). The Company owns 25,000 shares of Parago common stock and 28.8749 shares of Series A-3 convertible preferred stock (convertible into 2,887 shares of Parago common stock) and approximately 8% of River Logic.

Parago is a marketing services company that brings transaction processing capabilities together with information-based marketing in a way that transforms the way companies interact with customers. Through web-enabled products, processes and resources, Parago creates solutions that meet their client's marketing objectives. Parago provides a proprietary, promotional marketing technology platform that helps their clients reduce promotional program costs, increase sales, and enhance customer relationships. The Company accounts for the investment in Parago using the cost method of accounting. In prior periods due to continuing operating losses and other factors the Company wrote down the carrying value of the investment in Parago to zero. The investment has no carrying value at March 31, 2005 and December 31, 2004.

In May 2000, CT Holdings acquired a minority interest in River Logic which develops decision-support applications for industry. River Logic's applications 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 by manipulating graphical icons that model their enterprise. The Company accounts for the investment in River Logic using the cost method of accounting. In prior periods due to continuing operating losses and other factors the Company wrote

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down the carrying value of the investment in River Logic to zero. The investment has no carrying value at March 31, 2005 and December 31, 2004.

LIQUIDITY

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The Company has incurred recurring operating losses and has a significant working capital and stockholders' deficiency at March 31, 2005 of approximately \$5.5 million. There is a cash balance of \$327 at March 31, 2005 and current liabilities total approximately \$5.5 million. The Company has limited access to capital at March 31, 2005, no plans to raise capital, and management has not identified sources of capital at March 31, 2005.

The Company has made investments in entities that it believes may provide liquidity to the Company in the long term and management believes that Parago and River Logic may ultimately be successful. Both Parago and River Logic are privately held companies and because the Company holds minority interests in these companies, the Company has received only limited information regarding their results of operations and financial condition. The Company has not participated in the additional capital infusions since the initial investments and as a result, the ownership percentage in both investee companies has been significantly diluted. The Company's ownership in Parago consists of 25,000 shares of common stock and 28.8749 shares of Series A-3 convertible preferred stock (convertible to 2,887 shares of Parago common stock), and approximately 8% of River Logic.

While management believes that the performance of the investee companies to date has been as expected, there can be no assurance that the Company will ever achieve liquidity from these investments. In addition, there can be no assurance that the Company's plans will be successful or what other actions may become necessary in the future. Until the Company is able to create liquidity from the investments through sale to a strategic investor, an initial public offering or some other liquidity transaction, the Company will continue to require working capital to fund operating expenses. Although the Company has 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 the Company's business and results of operations. At March 31, 2005 the Company has not identified sources of capital nor does the Company have any plans to raise sufficient amounts of capital to settle liabilities or to fund business development activities.

BASIS OF PRESENTATION

The accompanying financial statements of CT Holdings have been prepared in accordance with accounting principles generally accepted in the United States.

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.

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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 months ended March 31, 2005 and 2004, the pro forma effect on net loss and net loss per share would have been as follows:

	THREE MONTHS ENDED	
	MARCH 31,	
	2005	2004
Net loss as reported	\$ (138,813)	\$ (103,026)
Add: Stock-based employee compensation expense included in reported net loss	-	-
Deduct: Stock-based employee compensation expense determined under fair value based method	-	-
Pro forma net loss	\$ (138,813)	\$ (103,026)
Net loss per share - basic and diluted		
As reported	\$ (0.00)	\$ (0.00)
Pro forma	\$ (0.00)	\$ (0.00)

NET LOSS PER SHARE

Net loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Included in the weighted average number of common shares outstanding for the three months ended March 31, 2005 and 2004 are 2,700,000 shares that would have been issued when a shareholder exercised his right to convert a note payable to common stock and 6,000,000 shares that would have been issued to the Company's CEO when he exercised his right to exchange Parago shares for CT Holdings shares if the Company had the available authorized shares. These shares have been included in the computation from the date that they would have been issued. Basic loss per

share excludes any dilutive effects of stock options. Stock options to purchase

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2,917,500 shares of common stock at March 31, 2005 and March 31, 2004, have been excluded from the computation of diluted loss per share, as the effect would be anti-dilutive. At March 31, 2005, the Company does not have any outstanding stock options or warrants that have an exercise price below market value.

RECENT ACCOUNTING PRONOUNCEMENTS

On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued FASB Statement No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123R"), which is a revision of FASB Statement No. 123, Accounting for Stock-Based Compensation. SFAS No. 123R supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends FASB Statement No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123R is similar to the approach described in SFAS No. 123. However, SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The Company expects to adopt SFAS No. 123R on January 1, 2006.

The Company is evaluating the impact of adopting SFAS 123R and expects that it may record non-cash stock compensation expenses. The adoption of SFAS 123R is not expected to have a significant effect on the Company's financial condition or cash flows but may have a significant effect on the Company's results of operations. The future impact of the adoption of SFAS 123R cannot be predicted at this time because it will depend on the levels of share-based payments granted by the Company in the future. However, had the Company adopted SFAS 123R in prior periods, the impact of the standard would have approximated the impact of SFAS 123 as described in the pro forma net loss included in the Stock-Based Compensation policy footnote.

NOTE B - NOTE PAYABLE TO CITADEL

During 2003, CT Holdings received an advance of \$225,000 from Citadel Security Software Inc. ("Citadel"), the Company's formerly wholly-owned subsidiary, to pay a legal settlement in return for an unsecured Note Payable to Citadel due on demand and bearing interest at 12% per year. The accrued interest on the note payable at March 31, 2005, was approximately \$56,000 and approximately \$49,000 at December 31, 2004.

Pursuant to the amended terms of the transition services agreement with Citadel, the Company has agreed to pay Citadel a monthly fee of \$7,500 per month (reduced in May 2004 from \$20,000 per month) for the services of its CEO, CFO and accounting and information management staff, as well as its pro rata share of office rent and indirect overhead expenses. The Company has a liability recorded for \$572,500 and \$550,000 for amounts payable to Citadel under this agreement at March 31, 2005 and December 31, 2004, respectively. The transition services agreement between Citadel and CT Holdings has been amended and extended to May 2005 by approval of the independent members of each company's board of directors.

NOTE C - NOTES PAYABLE TO SHAREHOLDER

At March 31, 2005 and December 31, 2004, the principal balance of a \$9,000, 8% note payable to a shareholder originally due June 30, 2002 was in default and continues to bear interest at 8% per annum. Accrued interest payable of approximately \$4,900 and \$4,500 related to this note is included in accounts

payable and accrued expenses at March 31, 2005 and December 31, 2004, respectively.

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NOTE E - RELATED PARTY TRANSACTIONS

On May 24, 2004, the Company was advanced \$200,000 by CITN Investment Inc. ("CII") pursuant to the Loan Agreement and evidenced by a Secured Convertible Promissory Note (the "Note"). The note accrues interest at 8% per annum and is due the earlier of May 24, 2006 or on demand by CII. This Note is convertible in whole or in part, at the option of CII, into up to 23,666,667 shares of the Company's common stock (approximately 25% of the Company's common stock on a fully diluted basis), and is secured by a pledge of all of the Company's assets. The note is presented on the accompanying unaudited balance sheets net of deferred debt discount of \$115,000 and \$140,000 at March 31, 2005 and December 31, 2004, respectively.

In October 2004, the Company obtained a \$5,000 90-day note, bearing interest at 5% per year, from the CEO of the Company. This note is outstanding at March 31, 2005 and December 31, 2004. This note is past due and is currently due on demand.

NOTE F - COMMITMENTS AND CONTINGENCIES

In August 1998, Janssen-Meyers Associates L.P. (JMA) filed a lawsuit against the Company arising out of an alleged 1995 contract with the Company's predecessor (Old Citadel). The suit alleged that Old Citadel breached a letter of intent dated September 1995 and/or a Placement Agency Agreement dated November 1995 between JMA and Old Citadel. 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. The Company 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. The Company removed the case to federal court in the Southern District of New York.

Following mediation in July 2000, the Company entered into a settlement term sheet, to attempt to resolve the disputes between it and JMA, pursuant to which the Company 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 the Company's 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 both parties.

However, the Company and JMA were unable to negotiate the final definitive settlement agreement. 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 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 the Company filed its 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 proposed

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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 has filed counterclaims for breach of the term sheet as well as breach of the placement agency agreement. Cross motions for partial summary judgments have been argued but on June 9, 2004 the court entered judgment in favor of Roan-Meyers in the amount of \$3,000,000 and granted interest at the rate of 9% from October 31, 2000 through the date of final judgment, and thereafter at the statutory rate allowed by law. The amount for the judgment as well as the interest from October 2000 through March 31, 2005 of \$1,194,345 has been accrued. The Company has appealed the final judgment. The Company intends to vigorously defend this case.

On April 8, 2005, Meyers Associates, L.P. f/k/a Roan/Meyers Associates, L.P. and f/k/a Janssen-Meyers Associates, L.P. ("Meyers") filed a lawsuit in the Court of Chancery of the State of Delaware, in New Castle County, against the Company, Citadel Security Software, Inc. (Citadel) including Steven B. Solomon, the Chief Executive and a Director of the Company, Chris A. Economou, a Director of the Company, Lawrence Lacerte, a former Director of the Company, and Phillip J. Romano, a former Director of the Company (the "Individual Defendants"). The suit alleges that in connection with an action filed in the Supreme Court of New York, New York County, to enforce a Settlement Term Sheet executed on July 7, 2000 by Meyers and CT Holdings, Meyers was awarded a judgment against CT Holdings in the amount of \$3 million plus interest on the judgment at the rate of 9% from October 31, 2000 until the date of entry of that judgment and thereafter at the statutory rate (the "Judgment"). CT Holdings has appealed the Judgment and that appeal is pending. The suit alleges that CT Holdings' May 2002 spin-off of its interests in Citadel to CT Holdings' shareholders rendered CT Holdings insolvent and constituted a fraudulent conveyance to defraud CT Holdings' creditors, including Meyers. The suit asserts fraudulent conveyance claims against Citadel and CT Holdings pursuant to Delaware statutory and common law. The suit also asserts a claim against Citadel for successor liability as the alleged successor in interest or alter ego of CT Holdings. The suit alleges that the Individual Defendants who were officers and/or directors of CT Holdings at the time of the spin-off breached fiduciary duties allegedly owed to creditors of CT Holdings, including Meyers, by approving and allowing the spin-off transaction. The suit seeks to void the spin-off transaction or alternatively to hold Citadel liable for the Judgment including interest, to recover damages against the Individual Defendants in an amount not less than the Judgment including interest, plus an unspecified amount of punitive, consequential and incidental damages, as well as attorneys' fees and costs. The Company believes that this suit is without merit and intends to vigorously defend this action. The ultimate outcome is not currently predictable. Currently the Company is unable to estimate the ultimate liability, if any, related to this suit, and therefore has not recorded a liability for this suit at March 31, 2005.

The Company may become involved from time to time in litigation on various matters which are routine to the conduct of our business. The Company believes 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 - 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

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and unknown risks, uncertainties and other factors that may cause our actual 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, 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.

GENERAL RISKS

WE HAVE RECEIVED A GOING CONCERN REPORT FROM OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM, HAVE A HISTORY OF NET LOSSES AND WILL NEED ADDITIONAL FINANCING TO CONTINUE AS A GOING CONCERN.

We received a report from our independent registered public accounting firm for our year ended December 31, 2004 containing an explanatory paragraph that

describes the uncertainty regarding our ability to continue as a going concern due to our recurring operating losses and our significant working capital deficiency. Historically, we have incurred recurring operating losses and have a significant stockholders' deficit at March 31, 2005 of approximately \$5.5 million. We had a cash balance of \$327 at March 31, 2005 and current liabilities total approximately \$5.5 million. We have limited access to capital at March 31, 2005, no plans to raise capital, and we have not identified sources of capital

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at March 31, 2005. During the year ended December 31, 2004, we received \$200,000 from CITN Investment Inc. ("CII") as part of an interest bearing Promissory Note. CII is an entity owned 50% by our CEO and 50% by a shareholder. Our past funding needs of the business have been provided by financings through short-term notes payable and additional investments from related parties, including our CEO and CII, however there can be no assurance that such funds will be available from these related parties in the future. 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.

We have made investments in entities that we believe may provide liquidity to the Company in the long term and we believe that Parago and River Logic may ultimately be successful. Both Parago and River Logic are privately held companies and because we hold minority interests in these companies, we have received only limited information regarding their results of operations and financial condition. We have not participated in the additional capital infusions since our initial investments and as a result, our ownership percentage in both investee companies has been significantly diluted. Our ownership in Parago consists of 25,000 shares of common stock and 28.8749 shares of Series A-3 convertible preferred stock (convertible to 2,887 shares of Parago common stock), and approximately 8% of River Logic. There is no carrying value in these investments on the balance sheet.

While we believe that the performance of the investee companies to date has been as expected, there can be no assurance that we will ever achieve liquidity from 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 operations and result in charges that could be material to the Company's business and results of operations. At March 31, 2005 we have not identified sources of capital nor do we have any plans to raise sufficient amounts of capital to settle liabilities or to fund business development activities.

OUR CONVERTIBLE NOTE MAY ADVERSELY IMPACT THE COMPANY AND OUR COMMON STOCKHOLDERS OR HAVE A MATERIAL ADVERSE EFFECT ON THE COMPANY.

We have issued a \$200,000 convertible secured promissory note (the "Note") payable to CII, an entity owned 50% by Steven B. Solomon, our CEO and Chairman of the Board, and 50% by Lawrence Lacerte, a shareholder and former director of our Company. Pursuant to the terms of the note and the related Loan and Security Agreement (the "Agreement"), the Note is secured by a pledge of all of our assets and the Note is convertible into approximately 23.7 million shares of our common stock, at the option of CII. CT Holdings has the option to borrow up to \$600,000 under the Agreement (at the sole discretion of CII). In the event the entire \$600,000 is advanced, the notes would be convertible into 51% of our

common stock. We have also agreed to use our best efforts to amend our certificate of incorporation or undertake a reverse stock split to permit conversion if CII elects to convert the notes. The terms of the Note and the Agreement will make it more difficult or impossible for us to raise additional funds in the future and may have a material adverse effect on us and our financial condition and results of operations. The Note is senior to our common stock on any liquidation or sale of our Company, so the Note must be paid before

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common stockholders would receive funds in the event of a liquidation or sale. In addition, the Note is due and payable on the earlier to occur of May 24, 2006 or demand by CII. In the event of a default to CT Holdings under the Note or Agreement or demand for payment by CII, CII could foreclose on the loans and obtain all of our assets or force us into bankruptcy, in which case our common stock would most likely be worthless. These terms and conditions could have a material adverse effect on us and our financial condition and results of operations.

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 which 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 marketplaces. Our business strategy seeks to increase the value of each investee by providing 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. However, the impact of any advice and expertise may be limited due to a lack of a significant ownership percentage in any of our investees and the lack of available capital.

In May 2002, we were successful in spinning off of Citadel Security Software Inc. ("Citadel") into a standalone company through the pro-rata dividend distribution of Citadel common stock to shareholders of CT Holdings. At the time of the spin-off, which was first considered in November 2001, Citadel was losing substantial amounts of money and the investee assets of CT Holdings were more valuable than the assets in Citadel. At March 31, 2005 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 March 31, 2005 and December 31, 2004. The lack of availability of private and public capital available to us has prevented us from making any additional investments and there can be no assurance that the availability of capital will improve so that the Company can execute its business plan.

We have a limited 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 emerging companies.

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- 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.

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- Our expenses may increase as we build the infrastructure necessary to implement this model.
- We face competition from other 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"). 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 may materially and adversely affect each of our investee companies. These investee companies have had losses in the past and may have substantial losses in the future. To continue in business, the investee companies may need to raise capital and may not be able to do so on reasonable terms or at all. In addition, if the investee companies are able to raise capital, our ownership stake in these companies would be diluted. Our investee companies may also never be able to complete an initial public offering of stock, or successfully close a sale, merger or other liquidity event whereby we would realize a return on our investment.

WE HAVE LIMITED ACCESS TO FINANCIAL AND OPERATING REPORTS OF OUR INVESTEE COMPANIES.

Both Parago and River Logic are privately held entities and as such are not required to provide financial information to its minority shareholders. Consequently we have limited access to financial operating reports on performance measures. As a result, we cannot measure or estimate the long-term prospects of these investments and while we believe that both Parago and River Logic have been successful, we cannot assure you that because of the limited financial reporting that they may be successful in the future or that they will provide an appropriate return on our investment.

CT HOLDINGS DOES NOT HAVE ACCESS TO THE CASH FLOW OR ASSETS OF ITS INVESTEE COMPANIES AND HAS BEEN UNABLE TO OPERATE PROFITABLY.

Historically, businesses and technologies in which we have invested are not controlled by us and as such we have been unable to rely on the investee company businesses for a source of cash flow, earnings, assets or capital. There can be no assurance that CT Holdings will be able to successfully put in place the

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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.

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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 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, because we did not meet the NASDAQ's requirements for continued listing. Our common stock now trades on the OTC Bulletin Board. 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

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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

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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.

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

In May 2002, CT Holdings effected a pro rata distribution of the common stock of Citadel to Stockholders of CT Holdings in a ratio of one (1) share of Citadel common stock for every four (4) shares of CT Holdings common stock. 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. 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 received 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 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.

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

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You should read the following discussion in conjunction with our audited financial statements for the years ended December 31, 2004 and 2003 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 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.

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OVERVIEW

CT Holdings, Inc. provides management expertise and sources of capital to early stage companies. At March 31, 2005 and 2004 we held investments in Parago and River Logic. We were incorporated in Delaware in 1992. Our business model is designed to enable the companies in which we invest or acquire to become market leaders in their industries. Our strategy is expected to lead to the development, acquisition and operation of 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.

At March 31, 2005 the lack of available capital has limited our ability to raise sufficient capital 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. We expect that if and when capital becomes available to us, we may continue our business development and investment activities, however there can be no assurance that any capital will be available to us. Until such time as capital becomes available 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.

OVERVIEW OF PARAGO

We formed Parago in 1999 through the contribution of some technology assets acquired in the late 1990's during the growth period of Internet electronic commerce industry.

At March 31, 2005, the Company holds 25,000 shares of Parago common stock and 28.8749 shares of Series A-3 convertible preferred stock (convertible into 2,887 shares of Parago common stock). In February 2004, our CEO loaned us \$30,000 in order for us to exercise our warrants to purchase the shares of Series A-3 convertible preferred stock, pursuant to a promissory note secured by a pledge of the preferred stock. Our CEO also elected to exercise an exchange right whereby he exchanged 5,000,000 (before a 1:1000 reverse stock split that occurred in 2001) shares of Parago, Inc. common stock for 6,000,000 shares of CT Holdings common stock. Our CEO has waived his right to receive these shares until such time as the shares become authorized. Our investment in Parago has no carrying value on our balance sheet at March 31, 2005 and December 31, 2004 as a result of the write down of the carrying value to zero in prior periods. We believe that our initial \$50,000 investment along with the \$30,000 to purchase warrants in Parago, represented by 20,000 shares of common stock, 28.8749 shares of Series A-3 convertible preferred stock (convertible into 2,887 shares of Parago common stock) and an additional 5,000 shares (5,000,000 pre reverse split shares) received in February 2004 may ultimately provide an appropriate return on our investment.

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OVERVIEW OF RIVER LOGIC

In May 2000, CT Holdings acquired a minority ownership interest in River Logic. River Logic develops and markets enterprise optimization technologies and decision support applications. Recognizing a need in the marketplace, River Logic created strategic-level, process modeling tools and approaches for helping senior managers suggest, evaluate, and understand the impact of business decisions as they relate to the overall profitability of their organizations. River Logic's optimization tools integrate several technologies such as mixed

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integer optimization, visual process modeling, accounting, and constraint theory to bring together the best active financial planning and profitability tools on the market.

The Company holds an ownership interest in River Logic of approximately 8% at March 31, 2005. Since our initial investment in May 2000, River Logic has raised additional capital through the issuance of preferred stock and other equity securities. In a prior period, we wrote down the carrying value of our investment in River Logic to zero. While we believe that our investment in River Logic will be successful there can be no assurance that our investment in River Logic may ultimately provide an appropriate return on our investment.

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 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.

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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

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circumstances, such as a change in settlement strategy.

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 adjusts our consolidated net results of operations to reflect only our share of the earnings or losses of the consolidated investee company. At March 31, 2005 and December 31, 2004 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 March 31, 2005 and December 31, 2004 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 March 31, 2005 and December 31, 2004.

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RESULTS OF OPERATIONS

THE QUARTER ENDED MARCH 31, 2005 COMPARED WITH THE QUARTER ENDED MARCH 31, 2004

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.

GENERAL AND ADMINISTRATIVE EXPENSES

During the quarter ended March 31, 2005 general and administrative expenses were \$33,838 representing a decrease of approximately \$31,632 or 48.3% \$65,470 of

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general and administrative expenses recorded for the quarter ended March 31, 2004. The decrease is primarily due to lower legal, accounting, consulting and other professional fees and expenses resulting from the lower business development activities during the quarter and the decrease in management fees from Citadel ended March 31, 2005 versus the similar period of 2004.

INTEREST EXPENSE

Interest expense for the quarter ended March 31, 2005 was \$104,975 representing interest expense on litigation accrual, advances and notes payable to shareholders and the demand note payable to Citadel. Interest expense for the quarter ended March 31, 2004 was approximately \$7,556. The increase in interest expense is due to the interest being accrued for litigation and the amortization of the debt discount on the convertible note payable to a related party.

WRITE-OFF OF AFFILIATES SHARES ACQUIRED THROUGH EXERCISE OF WARRANT

The \$30,000 write off of investment in affiliates in the quarter ending March 31, 2004 is related to the warrant exercised by the Company to obtain Series-A Parago preferred Stock, which was determined by the Company to have no fair market value and was immediately written off.

NET LOSS

For the quarter ended March 31, 2005 we reported a net loss of approximately \$139,000 versus a net loss of approximately \$103,000 for the quarter ended March 31, 2004.

LIQUIDITY AND CAPITAL RESOURCES

We received a report from our independent registered public accounting firm for our year ended December 31, 2004 containing an explanatory paragraph that describes the uncertainty regarding our ability to continue as a going concern due to our recurring operating losses and our significant working capital deficiency. Historically, we have incurred recurring operating losses and have a significant stockholders' deficit at March 31, 2005 of approximately \$5.5 million. We had a cash balance of \$327 at March 31, 2005 and current liabilities total approximately \$5.5 million. We have limited access to capital at March 31, 2005, no plans to raise capital, and we have not identified sources of capital at March 31, 2005. Our past funding needs of the business have been provided by financings through short-term notes payable and additional investments from related parties, including our CEO and CII, however there can be no assurance that such funds will be available from these related parties in the future. The

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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 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 March 31, 2005 to raise additional capital to invest in new business opportunities. To do so we estimate that we will need to raise up to \$5.5 million to settle recorded liabilities at March 31, 2005 after which we may then need to raise additional funds to support our incubator and business development activities. However there can be no assurance that we will raise additional

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funds needed to settle our liabilities.

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 our operating expenses. 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.

CASH FLOW ACTIVITIES

The net cash used in operating activities was \$3,841 for the quarter ended March 31, 2005. This is the result of a net loss of approximately \$139,000 for the quarter ended March 31, 2005 and non-cash adjustments for the amortization of debt discount of \$25,000 recorded as interest expense and an accrual for interest related to litigation of \$68,607. An increase in accounts payable and accrued expenses of approximately \$19,000 and a \$22,500 increase in the payable to Citadel partially offset the net loss in addition to the non-cash adjustments noted above.

There was no cash from investing or financing activities for the quarter ended March 31, 2005.

There was no net cash used in operations for the quarter ended March 31, 2004 which is principally a result of the net loss of approximately \$103,000 offset by the changes in operating assets and liabilities of approximately \$103,000.

Net cash provided from financing activities during the quarter ended March 31, 2004 included \$30,000 from the CEO through a note payable secured by Parago's Series-A preferred stock.

Net cash used in investing activities during the quarter ended March 31, 2004, included \$30,000 to exercise warrants to acquire Parago's Series-A preferred stock.

CONTRACTUAL OBLIGATIONS

At March 31, 2005 no long term debt obligations, capital lease obligations, operating lease obligations or long term capital purchase commitments. However at March 31, 2005 we have accrued obligations for estimated payments of legal

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judgments against us and for payments to Citadel under the transition services agreement and demand note payable, none of which may be paid until such time as the Company has sufficient cash to pay these obligations.

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.

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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

Set forth below are litigation matters to which we are a party. We believe that we have meritorious defenses and will vigorously defend ourselves. However, an unfavorable resolution of, settlement, or defense costs related to one or more of these lawsuits could have a material adverse effect on our business, results of operations or financial condition.

In August 1998, Janssen-Meyers Associates L.P. (JMA) filed a lawsuit against the Company arising out of an alleged 1995 contract with the Company's predecessor (Old Citadel). The suit alleged that Old Citadel breached a letter of intent dated September 1995 and/or a Placement Agency Agreement dated November 1995 between JMA and Old Citadel. 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. The Company 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. The Company removed the case to federal court in the Southern District of New York.

Following mediation in July 2000, the Company entered into a settlement term sheet, to attempt to resolve the disputes between it and JMA, pursuant to which the Company 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 the Company's 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 both parties.

However, the Company and JMA were unable to negotiate the final definitive settlement agreement. 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 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 the Company filed its 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 proposed 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 has filed counterclaims for breach of the term sheet as well as breach of the placement agency agreement. Cross motions for partial summary judgments have

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been argued but the court entered judgment in favor of Roan-Meyers in the amount of \$3,000,000 and granted interest at the rate of 9% from October 31, 2000 through the date of final judgment, and thereafter at the statutory rate allowed by law. The amount for the judgment as well as the interest through March 31, 2005 has been accrued. The Company has appealed the final judgment. The Company intends to vigorously defend this case.

On April 8, 2005, Meyers Associates, L.P. f/k/a Roan/Meyers Associates, L.P. and f/k/a Janssen-Meyers Associates, L.P. ("Meyers") filed a lawsuit in the Court of Chancery of the State of Delaware, in New Castle County, against the Company, Citadel Security Software, Inc. (Citadel) and certain current and former officers and directors of the Company and/or CT Holdings, including Steven B. Solomon, the Chief Executive and a Director of the Company, Chris A. Economou, a Director of the Company, Lawrence Lacerte, a former Director of the Company, and Phillip J. Romano, a former Director of the Company (the "Individual Defendants"). The suit alleges that in connection with an action filed in the Supreme Court of New York, New York County, to enforce a Settlement Term Sheet executed on July 7, 2000 by Meyers and CT Holdings, Meyers was awarded a judgment against CT Holdings in the amount of \$3 million plus interest on the judgment at the rate of 9% from October 31, 2000 until the date of entry of that judgment and thereafter at the statutory rate (the "Judgment"). CT Holdings has appealed the Judgment and that appeal is pending. The suit alleges that CT Holdings' May 2002 spin-off of its interests in Citadel to CT Holdings' shareholders rendered CT Holdings insolvent and constituted a fraudulent conveyance to defraud CT Holdings' creditors, including Meyers. The suit asserts fraudulent conveyance claims against Citadel and CT Holdings pursuant to Delaware statutory and common law. The suit also asserts a claim against Citadel for successor liability as the alleged successor in interest or alter ego of CT Holdings. The suit alleges that the Individual Defendants who were officers and/or directors of CT Holdings at the time of the spin-off breached fiduciary duties allegedly owed to creditors of CT Holdings, including Meyers, by approving and allowing the spin-off transaction. The suit seeks to void the spin-off transaction or alternatively to hold Citadel liable for the Judgment including interest, to recover damages against the Individual Defendants in an amount not less than the Judgment including interest, plus an unspecified amount of punitive, consequential and incidental damages, as well as attorneys' fees and costs. The Company believes that this suit is without merit and intends to vigorously defend this action. The ultimate outcome is not currently predictable.

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ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

At March 31, 2005, and December 31, 2004 the Company was in default on the following indebtedness:

- \$9,000, an 8% note payable to a shareholder. The note continues to bear interest at 8% with accrued interest at March 31, 2005 of approximately \$4,900.

ITEM 6 - EXHIBITS

(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

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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

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: May 16, 2005

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)