CT HOLDINGS INC
Form 10QSB
November 19, 2001

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

FORM 10-QSB

(MARK ONE)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

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

FOR THE TRANSITION PERIOD FROM _________ TO _________

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

DELAWARE	75-2432011
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

3811 TURTLE CREEK BLVD., SUITE 770, DALLAS, TX 75219
(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[X] 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 19, 2001

Common Stock, Par value $.01 per share 49,829,608

Transitional Small Business Disclosure Format Yes [_] No [X]

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PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CT HOLDINGS, INC.
BALANCE SHEETS

	September 30, 2001 (unaudited)	December 31, 2000
CURRENT ASSETS		
Cash and cash equivalents	$ 12,352	$ 21,647
Accounts receivable-trade, less allowance of $20,000 and $28,754	76,872	54,794
Accounts receivable, other	16,854	45,250
Accounts receivable from affiliate, less allowance of $40,000	41,337	--
Notes receivable from related parties	--	588,559

Notes receivable from affiliates	130,000	730,000
Inventory	39,868	42,077
Prepaid expenses	48,854	94,217
Total current assets	366,137	1,576,544
INVESTMENT IN UNCONSOLIDATED AFFILIATES	3,063,975	2,613,976
PROPERTY AND EQUIPMENT, net	23,472	94,054
PURCHASED SOFTWARE, net of accumulated amortization of $1,152,398 and $1,045,696	--	106,704
CAPITALIZED SOFTWARE DEVELOPMENT COSTS, net of accumulated amortization of $1,302,470 and $851,204	177,443	485,221
OTHER ASSETS	57,586	42,095
TOTAL ASSETS	$ 3,688,613	$ 4,918,594

The accompanying notes are an integral part of these statements.

CT HOLDINGS, INC.
BALANCE SHEETS - CONTINUED

	September 30, 2001 (unaudited)	December 31, 2000
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 1,685,096	$ 922,113
Accrual for legal settlement	--	1,912,500
Guarantee to equity method subsidiary	1,406,472	--
Payable to affiliate	--	126,028
Current maturities of long-term debt	150,000	150,000
Notes payable	--	98,425
Notes payable to related parties	692,482	--
Total current liabilities	3,934,050	3,209,066
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIT)		
Common stock, $.01 par value per share; authorized 60,000,000 Shares; 53,994,221 and 53,825,317 shares issued	539,942	538,253
Preferred stock, $.01 par value per share;		

authorized 1,000,000 shares; 50 shares of Series B convertible issued and outstanding (liquidation value $50,000)	1	1
Additional paid-in capital	56,429,100	56,383,496
Accumulated deficit	(54,714,241)	(52,711,983)
Treasury stock, at cost (4,164,613 shares)	(2,500,239)	(2,500,239)
Total stockholders' equity (deficit)	(245,437)	1,709,528
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)	$ 3,688,613	$ 4,918,594

The accompanying notes are an integral part of these statements.

CT HOLDINGS, INC.
UNAUDITED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
Net sales	$ 141,028	$ 200,614
Cost of sales, excluding depreciation and amortization	20,043	2,316
Operating expenses		
Selling, general and administrative expense	491,102	458,378
Research and development expenses	--	--
Accrual for legal settlement	--	--
Reversal of accrual for legal settlement	--	--
Write-off of capitalized software costs	--	--
Depreciation and amortization expense	154,740	269,335
Total operating expenses	645,842	727,713
Operating income (loss)	(524,857)	(529,415)
Other income (expense)		
Interest expense/income, net	26,944	(9,584)
Other income	34,242	15,000
Equity in loss of unconsolidated affiliate	--	(105,734)
	61,186	(100,318)
Net loss	$ (463,671)	$(629,733)

Net loss per share - basic and diluted	$ (0.01)	$ (0.01)
Weighted average shares outstanding - basic and diluted	49,829,608	48,252,675

The accompanying notes are an integral part of these statements.

CT HOLDINGS, INC.
UNAUDITED STATEMENTS OF CASH FLOWS

	NINE MONTHS ENDED SEPTEMBER 30, 2001	2000
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(2,002,258)	$(10,500,238)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	574,105	883,420
Provision for loss on account receivable from affiliate	40,000	--
Equity in loss of unconsolidated affiliate	2,099,211	4,658,781
Write-down of software development costs	--	625,336
Common stock and options issued as payment of expenses	--	50,001
Noncash employee severance expense	--	1,163,392
Changes in operating assets and liabilities		
Accounts receivable	6,318	529,557
Accounts receivable from affiliate	(81,337)	--
Prepaid expenses	45,363	64,501
Inventory	2,209	67,259
Accounts payable and accrued expenses	762,983	(50,385)
Accrual for legal settlement	(1,912,500)	1,912,500
Payable to affiliate	(126,028)	28,085
Other assets	(17,793)	166,423
NET CASH USED IN OPERATING ACTIVITIES	(609,727)	(401,368)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net payments on notes receivable from related parties	588,559	(357,451)
Capital contributions due to deconsolidation of Parago, Inc.	--	(3,167,975)
Participation in Parago, Inc. guarantee	(692,739)	--
Software development costs	--	(239,086)
Notes receivable	206,750	--
Purchase of property and equipment	(143,489)	--
NET CASH USED IN INVESTING ACTIVITIES	(40,919)	(3,291,450)
CASH FLOW FROM FINANCING ACTIVITIES		

Payments on notes payable	(98,425)	(699,113)
Proceeds from notes payable	--	--
Proceeds from sale of common stock	47,293	6,161,755
Notes payable to related party	692,483	--
NET CASH PROVIDED BY FINANCING ACTIVITIES	641,351	5,462,642
Net decrease in cash and cash equivalents	(9,295)	1,296,943
Cash and cash equivalents at the beginning of the period	21,647	14,078
Cash and cash equivalents at the end of the period	$ 12,352	$ 1,310,840

The accompanying notes are an integral part of these statements.

CT HOLDINGS, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION AND DESCRIPTION OF BUSINESS

DESCRIPTION OF BUSINESS

CT Holdings, Inc. (CT Holdings), develops and markets its Citadel Technology line of security software, and also acts as a developer of early stage companies, including Parago and River Logic. CT Holdings' Citadel Technology Security Software division develops and markets computer security and privacy software designed to address the need for security inside the firewall. CT Holdings announced in November 2001 its intention to spin off its Citadel Security Software division to its shareholders upon effectiveness of required Securities and Exchange Commission filings and final approval by the Board of Directors of the terms and conditions of the distribution, including the assets and liabilities to be distributed and the desirability or requirement of any shareholder approval.

These products, WinShield SecurePC and NetOff, enable companies to enforce security policies from a single point of control across multiple operating systems and platforms. Citadel's software products provide the flexibility and scalability that security administrators are demanding for managing security policies within their computing environments. These security policies operate inside the firewall and are designed to secure computers against unauthorized configuration changes and software installations, which cause the majority of system vulnerabilities. Additionally, SecurePC provides hardening of system files that deliver the first line of defense against viruses, malicious code and unauthorized access or theft of confidential information. The products specifically enforce policies recently mandated by the Health Insurance Portability and Accountability Act (HIPAA) and Gramm-Leach-Bliley legislation, which impose strict new security and privacy requirements on the health care and financial industries, respectively. Citadel Technology Security Software clients include IBM Global Services, Washington Mutual Bank, Merrill Lynch, the U.S. Navy, and numerous health care, education and corporate clients.

In addition to its current product offerings, CT is also developing additional

security products, including its new "Hercules" vulnerability remediation software, that it anticipates launching in the fourth quarter of 2001 with commercial sales beginning in the first quarter of 2002.

CT Holdings has developed technology-based companies and provided early stage ventures with a single source of management capital, as well as consulting on operations, marketing and strategic planning. The Company is currently reviewing strategic alternatives with respect to the addition of operating companies following the spinoff of the software business to its shareholders.

CT Holdings began its business development activities in 1999 with the formation of Parago, Inc. (Parago), an application service provider (ASP) and Internet based business process outsourcer (BPO) 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.

In May 2000, CT Holdings acquired a minority interest in River Logic, Inc. (River Logic). River Logic develops decision-support applications for industry. Using its open and rapid-application development (ORAD) 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. Headquartered in Beverly, Massachusetts, with offices in Austin, Dallas, and Portland, River Logic is a privately held corporation receiving venture capital support from Cardinal Investment, Inc., CT Holdings, EBSCO CASIAS, eMed Ventures, the Intel 64 Fund, and Mercury Ventures. River Logic's solutions incorporate several patented technologies and leverages research originally conducted at University of Massachusetts and the Russian Academy of Sciences.

Liquidity

The Company has incurred recurring operating losses and has a working capital deficiency. The Company has used cash in operations of approximately $609,727 during the nine months ended September 30, 2001. The Company has a cash balance of approximately $12,352 at September 30, 2001 and current liabilities exceed current assets by approximately $3.6 million. As outlined below, these assets do not reflect the value that may be realized from our investments in Parago and River Logic. The Company has been and continues to be dependent upon outside financing to develop its software products, perform its business development activities, invest in unconsolidated affiliates and provide for ongoing working capital requirements.

The Company expects to generate cash from the sale of the Company's software and will incur costs relating to such operations that may result in a cash deficiency. Following the spinoff of the Company's software business, revenues and expenses related to the software business will be recognized by the new entity. The Company will also continue to incur expenses relating to corporate overhead and activities related to managing the Company's investments and considering additional opportunities. The Company may require cash from financing activities to fund the deficits expected over the next year.

The Company's strategy of continuing to support and expand its business development activities, in addition to its software activities, requires the Company to obtain additional capital. The complete implementation of this element of our strategy will not generate positive cashflow in the foreseeable future. Achieving positive cashflow is currently highly dependent upon obtaining liquidity from the Company's investments in unconsolidated affiliates. The Company estimates it will need to raise additional capital to fund the plan through the remainder of 2001 and substantially greater funds if the Company expects to continue to acquire investments, if amounts become due to settle contingent liabilities, or if the Company is required to fund the balance of its participation in the Parago guaranty. CT was required to pay $692,740 to participate in the bridge loan guarantee related to its investment in Parago. These funds were obtained in part through the repayment of $365,017 owed to CT Holdings by its Chief Executive Officer and in part by an advance to the Company of $489,983 from the Chief Executive Officer. In addition, in the event Parago is unsuccessful in repaying the bridge loan by December 2001, CT Holdings would be required to advance up to an additional $1,406,472 to pay for its participation in the bridge loan guarantee participation described below under Note 2 - Investment in Unconsolidated Subsidiary and Part II -- Item 5 - Other Information - Parago Bridge Financing. Historically, the Company has obtained short-term bridge funding from its Chief Executive Officer or Directors of the Company. One of the Company's directors loaned $250,000 to the company in the third quarter. The loan bears interest at 8% and is payable on demand. While this may occur in the future there can be no assurance that such financing will be available or if available based on terms that the Company would be willing to accept.

Since 1999, we have made investments in two companies that we believe may provide liquidity to the Company in the long term. Our first investment in Parago we believe has been successful in that it has grown from the original $50,000 of equity provided by the Company and no revenue, to net revenue of approximately $7.6 million for the three months ended September 30, 2001 (unaudited). As expected in an early stage company, Parago has not been profitable and has experienced cash flow deficiencies as it implements its business plan. We believe, however, that our Parago investment of 20,000,000 common shares, and warrants to purchase 28,874.90 shares of Series A-3 Preferred Stock, convertible into 2,887,490 shares common stock at an exercise price of $0.01 per share, may ultimately provide an appropriate return. These warrants only become exercisable in the event the Company fulfills all of its obligations under the Participation Agreement or Parago repays the bridge loan. Until we are able to create liquidity from the Company's investments through sale to a strategic investor, an initial public offering or some other activity, or sufficient revenues from its operating activities, the Company will continue to require working capital to fund its own operating expenses.

Similarly, the Company's investment in River Logic we believe has also been successful. Since our initial investment, River Logic has made substantial progress in executing its strategy through its development and introduction of new products and establishment of new customer relationships. In addition, during April 2001 River Logic obtained a significant strategic investment from a subsidiary of Intel, Cardinal Investments, eMed Ventures, and Mercury Ventures. As part of that round, the Company converted $450,000 of demand notes receivable into River Logic Series C Preferred Stock, the same equity instruments purchased by the other investees. The remainder of our note receivable totaling approximately $200,000 was paid in April 2001. Similar to the investments into Parago, the Company recognized that these investments would be initially illiquid. While we are pleased with the performance of Parago and River Logic to date, there can be no assurance that the Company will ever achieve liquidity for its investments.

There can be no assurance that management's plans will be successful or what other actions may become necessary. Although the Company has been successful

raising capital in the past, if the Company is unable to raise capital, it may be required to sell assets or reduce the level of its operations. Such actions could have a material adverse effect on the Company's business and operations and result in charges that could be material to the Company's business and results of operations.

BASIS OF PRESENTATION

The accompanying condensed financial statements of CT Holdings have been prepared in accordance with accounting

principles generally accepted in the United States for interim financial information. The condensed financial statements of CT Holdings as of September 30, 2001 and for the three and nine month periods ended September 30, 2001 and 2000 are unaudited and, in the opinion of management, contain all adjustments necessary for the fair presentation of the financial position and results of operations for the interim period. These condensed financial statements should be read in conjunction with the Financial Statements and notes thereto included in CT Holdings' Form 10-KSB for the ten months ended December 31, 2000. The results of operations for the three and nine month periods ended September 30, 2001 are not necessarily indicative of the results to be expected for the entire year (see Part I. Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition - Risk Factors). The condensed balance sheet as of December 31, 2000 has been derived from the Company's audited financial statements as of that date and does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements.

Principles of Accounting for Ownership Interests in Investees / Investment in Unconsolidated Affiliates

For the three and nine months ended September 30, 2001 and the year ended December 31, 2000, the ownership interests that the Company holds in Parago and River Logic have been accounted for under the equity method for Parago and the cost method for River Logic. The Company records its investments in equity-method and cost- method investees on its balance sheets as Investment in Unconsolidated Affiliates and its share of the equity-method investee's losses in Equity in Loss of Unconsolidated Affiliate. All significant intercompany accounts and transactions have been eliminated.

For the three and nine months ended September 30, 2001 and the year ended December 31, 2000, the Company's investment in Parago is presented under the equity method of accounting. Under the equity method of accounting, the Company's share of the investee's income or losses is included in the statements of operations. Under the equity method, when Parago sells its common stock to unrelated parties at a price in excess of its book value, the Company's net investment in that affiliate increases. If the carrying value of the Company's net investment falls below 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 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 during the period the equity method was suspended of approximately $18.9 million (unaudited) are recovered by income or an increase in equity. In the quarter ended June 30, 2001, the Company participated in the Parago bridge loan guaranty and as a result was required under the equity method to recognize equity in losses equal to its participation of $692,739 and an additional $1,406,472 as a

result of the participation in the bridge loan guarantee. The total equity in losses of unconsolidated affiliate of $2,099,211 recorded for the nine months ended September 30, 2001 reduces the amount of net losses not recognized during the periods the equity method was suspended. The Company continues to hold 20,000,000 shares of common stock of Parago at September 30, 2001, representing approximately 45% of Parago's outstanding common stock at September 30, 2001, as well as warrants to purchase 28,874.90 shares of Series A-3 Preferred Stock, convertible into 2,887,490 shares of Parago common stock, acquired in connection with the guarantee participation. These warrants only become exercisable in the event the Company fulfills all of its obligations under the Participation Agreement or Parago repays the bridge loan.

Because the Company owned less than 20% of the ownership interest in River Logic at September 30, 2001, the investment has been accounted for under the cost method of accounting, and the carrying value of the investment is recorded at the original acquisition costs. Under this method, the Company's share of the income or losses of River Logic is not included in the Company's statements of operations. The investment in unconsolidated affiliate at September 30, 2001 of approximately $3.1 million represents the investment in River Logic as the investment in Parago was reduced to zero as discussed above.

The Company periodically evaluates the investment in River Logic for impairment based upon the prospects of the entity and the value of the investment when compared to other investments in the entity from other unrelated parties. If these two factors indicate that an other than temporary impairment exists, then the Company will write down the value of the investment to its realizable value. However, no such indications were identified at September 30, 2001 and the investment in River Logic is stated at its original acquisition cost.

Net Loss Per Common Share

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. Diluted loss per common share includes the dilutive effect of options and warrants calculated using the treasury stock method, and, includes the effect of convertible preferred stock using the if-converted method. Stock options and warrants to purchase 11,947,000 shares of common stock have been excluded from the computation of diluted loss per share, as the effect would be anti-dilutive. In addition, approximately 9,400 shares (based on the price per share for the Company's common stock on September 30, 2001), which would be issued upon the conversion of Series B preferred stock, have been excluded from the computation of loss per share.

NOTE 2. INVESTMENT IN UNCONSOLIDATED AFFILIATE

Parago Investment

In the quarter ending May 31, 1999, the Company accounted for its investment in Parago under the consolidation method. Through subsequent sale and distribution by Parago of shares of its common stock, the Company's ownership was reduced below 50% beginning in July 1999. As a result, beginning July 1999, the Company began accounting for its remaining investment in Parago under the equity method of accounting. Prior to these events, the operating results of Parago were consolidated in the Company's consolidated financial statements. At September 30, 2001, the Company owns 20,000,000 of Parago's outstanding shares of common stock, and warrants to purchase 28,874.90 shares of Series A-3 Preferred Stock, convertible into 2,887,490 shares of Parago common stock. These warrants only

become exercisable in the event the Company fulfills all of its obligations under the Participation Agreement or Parago repays the bridge loan. The Company believes that any additional financing by Parago in the current market environment will materially dilute the equity ownership interest held by the Company.

From January to March 2000, Parago raised an aggregate of $36,500,000, including $21,500,000 through the issuance of 430,000 shares of Series C Convertible Preferred Stock to THLee.Putnam Internet Partners LP, Dain Rauscher Wessels Investors LLC and Watershed Capital I, L.P. At the time of issuance, the Series C preferred stock is convertible into 4,300,000 shares of Parago common stock. In addition, in September 2000, Parago sold an additional $15,000,000 in Series D Preferred Stock to THLee.Putnam and Watershed Capital. In connection with the Series A, B, C, and D preferred stock financings, the preferred stockholders were issued approximately 5,618,000 warrants to purchase common stock. The warrants vest immediately and have a weighted average exercise price of $1.25.

The following is the unaudited condensed financial information of Parago at September 30, 2001 and December 31, 2000 and for the three and nine months ended September 30, 2001 and 2000.

SUMMARIZED BALANCE SHEET	SEPTEMBER 30, 2001	DECEMBER 31, 2000
Current assets	$27,476,521	$29,369,901
Noncurrent assets	23,316,748	27,988,337
Total assets	$50,793,269	$57,358,238
Current liabilities	$37,006,116	$31,002,400
Long-term debt and capital lease obligations	2,231,065	3,490,910
Total liabilities	39,237,181	34,493,310
Redeemable common stock	--	2,000,000
Shareholders' equity	11,556,088	20,864,928
	$50,793,269	$57,358,238

SUMMARIZED STATEMENT OF OPERATIONS	THREE MONTHS ENDED SEPTEMBER 30, 2001	NINE MONTHS ENDED SEPTEMBER 30, 2001
Revenues	$ 7,640,087	$ 19,767,098
Cost of revenues	1,940,765	5,833,477
Operating expenses	10,391,710	32,403,974
Loss on sale of assets	(12,498)	2005
Operating loss EBITDA	(368,634)	(5,480,727)
Net loss	(4,612,180)	(15,280,620)

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Parago has incurred recurring operating losses and has a working capital deficiency. Parago had a net operating loss, before interest, taxes, depreciation and amortization, of approximately $368,634 and $5.5 million during

the three and nine months ended September 30, 2001, respectively, and a working capital deficiency of $11.5 million as of September 30, 2001. Consequently, Parago is seeking to raise additional capital to repay the bridge loan described below and to execute its business plans. The Parago financial information does not include any adjustments that might result from the outcome of this uncertainty regarding Parago's liquidity and capital resources.

In May 2001, Parago obtained a Term Loan from Comerica Bank--Texas (Comerica) in the principal amount of $8.0 million. The funds derived from the Term Loan were necessary to enable Parago to continue operations, as Parago's cash resources were depleted. Parago intends to repay the Term Loan with proceeds from a contemplated sale of shares of a new series of preferred stock, the terms of which have not yet been established (the Series E Stock). As a condition to the extension of the Term Loan, Comerica required a guarantee of Parago's obligations under the Term Loan from certain affiliates of TH Lee.Putnam Internet Partners, L.P. (collectively, TH Lee), which own shares of Parago's Series C Convertible Preferred Stock (Series C Stock) and Series D Convertible Preferred Stock (Series D Stock), common stock and certain warrants.

TH Lee executed the Guaranty in consideration of its receipt of 110,000 warrants to purchase shares of Parago's Series A-3 Preferred Stock, convertible into 11,000,000 shares of Parago common stock, a new series of preferred stock that was created in connection with the bridge loan and guaranty transaction, and, in the event that TH Lee is called upon to make payment under the Guaranty, its receipt of shares of Series A-1 Stock and Series A-2 Stock, two new series of preferred stock the issuance of which could have the effect of substantially diluting Parago's existing stockholders, including CT Holdings, in the event such holders do not participate in the guaranty as described below.

Parago securityholders (including CT Holdings) who met the required suitability criteria were offered the opportunity to participate in the Guaranty through a Pro Rata Participation Interest. In the event that TH Lee is required to pay all or a portion of the Term Loan under the Guaranty, those offerees who have participated in the offering and pay their pro rata portion of the Guaranty when it is due will maintain their percentage equity ownership in Parago, while those offerees who do not participate in the offering, and those participants who fail to make their Guaranty payments when due, will be substantially diluted. If offerees holding a significant portion of Parago's current equity ownership fail to make their Guaranty payments when due, if they become due, then TH Lee may gain a controlling interest in Parago as a result of the transactions. See Risk Factors--The issuance of the securities will result in dilution of existing Parago stockholders and possibly a change in control of Parago. The terms of the participation offering are described in greater detail under Part II--Item 5--Other Information--Parago Bridge Financing. CT Holdings has participated in this offering, although there can be no assurance that CT Holdings will be able to make the remaining guaranty payments when due, in the event Parago is unable to repay the bridge loan.

The Company has also agreed to convert shares of Parago common stock issued in connection with a 1999 acquisition by Parago into up to 500,000 of the Company's common shares at the option of the acquired entity's shareholders. Pursuant to the terms of the subscription agreements between Parago and some of its stockholders, the Company may be required at the option of such stockholders to issue up to 414,000 shares of the Company's common stock. In consideration of certain of its directors' funding of the Company's participation in the Parago bridge loan, the Company has agreed to permit the directors to exchange up to 5,000,000 Parago shares into up to 6,000,000 shares of the Company's common stock.

RIVER LOGIC INVESTMENT

In May 2000, the Company acquired approximately 1.19 million, or 5.9%, shares of

common stock of River Logic from several of its existing shareholders in exchange for 333,333 shares of the Company's common stock. The Company also acquired shares of Series A Convertible Preferred Stock 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 the Company's common stock. The acquired shares of River Logic's preferred stock are convertible into shares of common stock that represented approximately 13.1% of the currently outstanding shares of capital stock of River Logic on a post conversion basis as of May 5, 2000.

In connection with the investment in River Logic, the Company also made two $300,000 convertible bridge loans to River Logic. In April 2001, River Logic received a venture capital investment from the Intel 64 Fund, Cardinal Investment, Inc, eMed Ventures and Mercury Ventures, and the Company converted $450,000 of the principal amount of the notes into shares of the Series C Preferred Stock, and the remainder was paid in cash in April, 2001. As a result of the transactions, the Company owns as of September 30, 2001 approximately 10% of the capital stock of River Logic.

Altogether, the carrying value of the River Logic investment includes the fair value of 1,000,000 shares of the Company's common stock exchanged to acquire the interest in River Logic. The carrying value also includes legal fees paid in connection with the investment and 50,000 shares of the Company's common stock granted to a consultant for identifying the investment. The total value of the 1,050,000 shares granted equated to $2,486,917. Soon after the closing of the transaction the consultant that identified the investment became President and Chief Operating Officer of River Logic, and was granted 100,000 fully vested stock options to purchase the Company's stock at $5 per share.

NOTE 3. CONTINGENCIES

The plaintiffs in the previously disclosed lawsuit by Janssen Meyers Associates L.P. (JMA) refiled their lawsuit with the federal court, and we filed a motion to dismiss the case because the plaintiffs lacked the required diversity jurisdiction to pursue the claims in federal court and the court granted our motion. In November 2001, the plaintiffs refiled the lawsuit in the state court and added a claim seeking to enforce the settlement term sheet described below in the Supreme Court of New York, that state's trial court, in a case styled Roan Meyers v. CT Holdings. We intend to vigorously defend against this lawsuit and file a counterclaim. In July 2000, we entered into a settlement term sheet to resolve the disputes between us and Janssen-Meyers Associates L.P. (JMA), pursuant to which we and JMA tentatively agreed 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. As a result, we recorded approximately $1,912,500 as a nonrecurring charge related to the settlement of the litigation during 2000. However, the Company and JMA were unable to negotiate the final definitive settlement agreement. On March 27, 2001, the Court hearing the JMA lawsuit issued a Summary Order that denied 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. Given these recent 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 has determined to reverse the nonrecurring charge that the Company had recorded related to the settlement of the lawsuit.

We are party to certain litigation matters. We believe that we have meritorious defenses and will vigorously defend ourselves. However, an unfavorable resolution of or 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.

At this time, the Company is unable to predict the ultimate outcome of some of these suits, the costs associated with defending the claims and pursuing counterclaims, and monetary compensation awarded, if any. The Company has, when appropriate, recorded its current estimate of the amounts necessary to settle the litigation.

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

OVERVIEW

We develop and market our Citadel Technology Security Software line of desktop and network security software, and we also have developed early stage companies, including Parago and River Logic. Our Citadel Technology software division develops and markets computer security and privacy software for one of the fastest growing segments today - security inside the firewall. Our products, Winshield SecurePC and NetOff, enable companies to enforce security policies from a single point of control across multiple operating systems and platforms. Citadel's software products, provide the flexibility and scalability that security administrators are demanding for managing security policies within their computing environments. These security policies operate inside the firewall and are designed to secure computers against unauthorized configuration changes and

software installations, which cause the majority of system vulnerabilities. Additionally, SecurePC provides hardening of system files that deliver the first line of defense against viruses, malicious code and unauthorized access or theft of confidential information. The products specifically enforce policies recently mandated by the Health Insurance Portability and Accountability Act (HIPAA) and the Gramm-Leach-Bliley legislation, which impose strict new security and privacy requirements on the health care and financial industries, respectively. Our Citadel Technology clients include IBM Global Services, Washington Mutual Bank, Merrill Lynch, the U.S. Navy, and numerous health care, education and corporate clients.

In addition to its current product offerings, we are also developing additional security products, including our new "Hercules" vulnerability remediation software, that we anticipate launching in the fourth quarter of 2001 with commercial sales expected to commence in the first quarter of 2002.

Our Hercules software includes both real time network security vulnerability assessments and remediation capabilities for corporate and government environments, and we believe it is the only solution that will automatically identify and deploy the appropriate patches and fixes, repair the problem, and secure the environment.

This solution aggregates vulnerability information from key resources throughout the Internet and provides customers with real-time remediation updates, allowing

system administrators and security officers to quickly select and deploy resolutions for the vulnerabilities that are found. We believe that the software will save significant IT labor and management resources that were previously needed to examine each computer and apply the necessary fix manually.

Along with those vulnerabilities introduced through external sources, major security exposures are also being introduced "inside the firewall" by users tampering with desktop configurations, downloading applications and accessing unauthorized applications and information.

Capabilities of the Hercules software include:

. Allows the systems administrators and security officers to select and deploy resolutions for vulnerabilities automatically.

. Automated system allows remediation to be scheduled during non-peak hours.

. Provides full reporting on status of the deployment process.

. Integrates with leading vulnerability scanning solutions.

. Designed to run on Microsoft Windows 9x, ME, NT, 2000 and XP, with future support for Unix/Linux and wireless devices.

. Supported by the Hercules Server, which coordinates the real-time receipt of updated vulnerability information from Citadel and provides a centralized repository for deploying selected vulnerability resolutions to the targeted host computers.

We announced in November 2001 our intention to spin off the shares of our Citadel Technology Security Software to our shareholders upon effectiveness of required Securities and Exchange Commission filings. We anticipate that we will file a Registration Statement on Form 10-SB with respect to the spin off transaction in the fourth quarter of 2001.

We also assist in the development of technology-based companies and we provide early stage ventures with management capital, as well as consulting on operations, marketing and strategic planning. In addition, we may pursue acquisitions of complementary companies that fit our business strategy. Our business model is designed to enable the companies with whom we partner to become market leaders in their industries. We believe that by focusing on technology companies, we are positioned to identify the latest trends and opportunities and attract promising companies and talent in this industry. We may also pursue business opportunities in markets other than technology for companies with compelling valuations and strong business models. Our strategy is to leverage the expertise of our management and affiliates and to capitalize upon opportunities to cross- pollinate the strongest qualities among the companies we assist. We believe that the anticipated growth in technology and e-commerce creates strong opportunities for us to increase shareholder value by investing in well-positioned early stage ventures.

OVERVIEW OF PARAGO SUBSIDIARY

We began our business development activities in January 1999 with the formation of Parago, Inc., an application service provider (ASP) and Internet based business process outsourcer (BPO) that provides a suite of technology offerings (including PromoCenter, ValueRewards 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. Parago's comprehensive integrated suite of outsourced customer care solutions are

marketed across multiple industry lines. Parago's preliminary unaudited results for the three months ended September 30, 2001 included revenues of approximately $7.6 million. Through June 2001, Parago had received approximately $81.3 million in private equity financing from venture capital investors including THLee.Putnam Internet Partners, Dain Rauscher Wessels Investors, Watershed Capital and Seaboard Ventures, as well as angel investors. CT Holdings continues to hold 20 million shares of Parago common stock, and warrants to purchase 28,874.90 shares of Series A-3 Preferred Stock, convertible into 2,887,490 shares of Parago common stock. These warrants only become exercisable in the event the Company fulfills all of its obligations under the Participation Agreement or Parago repays the bridge loan.

Parago provides Internet-based solutions that automate customer relationship management. Parago's solutions enable both brick-and-mortar and e-commerce businesses to more efficiently develop, retain and extend customer relationships and improve sales, marketing and customer retention. Parago's Internet-enabled enterprise solutions include PromoCenter, ValueRewards and KnowledgeCenter. By automating customer care activities such as online and traditional rebate processing and promotions, Parago allows its clients to enhance customer retention, increase revenue opportunities and improve operating efficiencies. Parago's Internet-based solutions seek to transform promotional management and product information from customer service liabilities to retention and extension opportunities.

Parago's online solutions provide a new vehicle for its clients to conduct targeted marketing to customers with whom they have traditionally lost contact subsequent to the point of purchase.

Parago is developing proprietary software that will provide an online mechanism for customers, many of whom have immediate purchasing power in the form of promotional proceeds, to apply those proceeds towards the purchase of additional products or services. Parago's solutions also capture valuable customer information that can help its clients better understand customer behavior. Parago plans to provide fee-based customer specific or aggregated data analyses to assist clients in designing future promotions.

Parago's solutions also enable businesses to improve operating efficiencies by allowing them to analyze the results of their

promotions and manage these promotions on a real time basis. Parago markets its solutions to retailers, manufacturers and service providers across multiple industries. Parago provided its online solutions to approximately 180 clients as of December 31, 2000, an increase of more than 38.5% over last year.

At September 30, 2001, we owned 20,000,000 shares of the common stock of Parago, representing less than 50% of the outstanding common stock of Parago, as well as warrants to purchase 28,874.90 shares of Series A-3 Preferred Stock, convertible into 2,887,490 shares of Parago common stock. These warrants only become exercisable in the event the Company fulfills all of its obligations under the Participation Agreement or Parago repays the bridge loan. As a result, we account for our ownership interest in Parago using the equity method of accounting. Since its inception, Parago has incurred net losses and now has a substantial accumulated deficit, which have had an impact upon and are reflected in our financial statements. For example, for the three and nine months ended September 30, 2001, we recorded an equity in loss of unconsolidated affiliate of $0 and $2,099,211, respectively, and for the nine months ended September 30, 2000, we recorded an equity in loss of unconsolidated affiliate of $4,553,047.

In the quarter ended June 30, 2001, the Company participated in the Parago bridge loan guaranty described below and as a result was required under the equity method to recognize equity in losses equal to its participation of $692,739 and an additional $1,406,472 as a result of the participation in the bridge loan guaranty. The total equity in losses of unconsolidated affiliate of $2,099,211 recorded for the three months ended June 30, 2001 reduces the amount of net losses not recognized during the periods the equity method was suspended. In addition, in the event Parago is unsuccessful in repaying the bridge loan by December 2001, CT Holdings would be required to advance up to an additional $1,406,472 to pay for its participation in the bridge loan guarantee. We understand that Parago expects to incur net losses for the foreseeable future.

In May 2001, Parago obtained a Term Loan from Comerica Bank--Texas (Comerica) in the principal amount of $8,000,000. The funds derived from the Term Loan were necessary to enable Parago to continue operations, as Parago's cash resources were depleted. Parago intends to repay the Term Loan with proceeds from a contemplated sale of shares of a new series of preferred stock, the terms of which have not yet been established (the Series E Stock). As a condition to the extension of the Term Loan, Comerica required a guarantee of Parago's obligations under the Term Loan from certain affiliates of TH Lee.Putnam Internet Partners, L.P. (collectively, TH Lee), which own shares of Parago's Series C Convertible Preferred Stock (Series C Stock) and Series D Convertible Preferred Stock (Series D Stock), common stock and warrants to purchase shares of common and Series A-3 Preferred Stock.

TH Lee executed the Guaranty in consideration of its receipt of 110,000 warrants to purchase shares of Parago's Series A-3 Stock, convertible into 11,000,000 shares of Parago common stock, a new series of preferred stock that was created in connection with the bridge loan and guaranty transaction, and, in the event that TH Lee is called upon to make payment under the Guaranty, its receipt of shares of Series A-1 Stock and Series A-2 Stock, two new series of preferred stock the issuance of which would have the effect of substantially diluting Parago's existing stockholders, including CT Holdings.

Parago and TH Lee also entered into a Participation Agreement, pursuant to which Parago securityholders (including CT Holdings) who met the required suitability criteria were offered the opportunity to participate in the Guaranty through a Pro Rata Participation Interest, by paying one third of their guaranty amount into escrow and agreeing to pay the remaining two thirds in December 2001 in the event Parago is unable to repay the bridge loan. In the event that TH Lee is required to pay all or a portion of the Term Loan under the Guaranty, those offerees who participate in the offering will maintain their percentage equity ownership in Parago upon the payment of their remaining two thirds guaranty payment, while those offerees who do not participate in the offering will be substantially diluted. If offerees holding a significant portion of Parago's current equity ownership fail to make their payments when due in December 2001 in the event Parago is unable to repay the bridge loan, then TH Lee may gain a controlling interest in Parago as a result of the transactions. See Risk Factors--The issuance of the securities will result in dilution of existing Parago stockholders and possibly a change in control of Parago. The terms of the participation offering are more fully described under Part II--Item 5-- Parago Bridge Financing. CT Holdings participated in this offering and may be required to advance additional funds in the event Parago is unable to repay the bridge loan. The warrants to purchase shares of Series A-3 Stock are immediately exercisable with respect to the warrants received by TH Lee and are exercisable upon the earlier to occur of the repayment of the bridge loan or the payment of all remaining guaranty amounts by the other participating stakeholders at $1.00 per share and the Series A-3 Stock to be acquired upon exercise is convertible into 11 million shares of Parago common stock.

OVERVIEW OF RIVER LOGIC

In May 2000, CT Holdings acquired a minority interest in River Logic, Inc. (River Logic). River Logic develops decision-support applications for industry. Using its open and rapid-application development (ORAD) 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. Headquartered in Beverly, Massachusetts, with

offices in Austin, Dallas, and Portland, River Logic is a privately held corporation receiving venture capital support from Cardinal Investment, Inc., CT Holdings, EBSCO CASIAS, eMed Ventures, the Intel 64 Fund, and Mercury Ventures. River Logic's solutions incorporate several patented technologies and leverages research originally conducted at University of Massachusetts and the Russian Academy of Sciences.

In May 2000, the Company acquired approximately 1.19 million shares, or 5.9%, of common stock of River Logic from several of its existing shareholders in exchange for 333,333 shares of the Company's common stock. The Company also acquired shares of Series A Convertible Preferred Stock 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 the Company's common stock. The acquired shares of River Logic's preferred stock are convertible into shares of common stock that represented approximately 13.1% of the currently outstanding shares of capital stock of River Logic on a post conversion basis as of May 5, 2000.

In connection with the investment in River Logic, the Company also made two $300,000 convertible bridge loans to River Logic. In April 2001, River Logic received a strategic investment from the Intel 64 Fund, Cardinal Investment, Inc, eMed Ventures and Mercury Ventures, and the Company converted $450,000 of the principal amount of the notes into shares of the Series C Preferred Stock, and River Logic repaid the $216,000 balance of these notes as of April 2001. As a result of the transactions, the Company owns as of September 30, 2001 approximately 10% of the capital stock of River Logic.

Altogether, the carrying value of the River Logic investment includes the fair value of 1,000,000 shares of the Company's common stock exchanged to acquire the interest in River Logic. The carrying value also includes legal fees paid in connection with the investment and 50,000 shares of the Company's common stock granted to a consultant for identifying the investment. Soon after the closing of the transaction this consultant became President and Chief Operating Officer of River Logic, and was granted 100,000 fully vested stock options to purchase the Company's stock at $5 per share.

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 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 others 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, results of operations or prospects, financial or otherwise, of 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.

We cannot guarantee future results, levels of activity, performance or achievements. Please refer to our annual report on Form 10-KSB for the ten months ended December 31, 2000 for further discussion of these and other risk factors related to the CT Holdings and its subsidiaries. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment.

GENERAL RISKS

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

We have incurred recurring operating losses and have a working capital deficiency. We have used cash in operations of approximately $609,727 during the nine months ended September 30, 2001. We have a cash balance of approximately $12,352 at September 30, 2001 and current liabilities exceed current assets by approximately $3.6 million. As outlined below, these assets do not reflect the value that may be realized from our investments in Parago and River Logic. We have been and continue to be dependent upon outside financing to develop our software products, perform our business development activities, invest in unconsolidated affiliates and provide for ongoing working capital requirements. During the nine months ended September 30, 2001, substantially all of this

financing has been provided by related parties.

We expect to generate cash from the sale of our software and will incur costs relating to such operations that may result in a cash deficiency. Following the spinoff of the Company's software business, revenues and expenses related to the software business will be recognized by the new entity. We will also continue to incur expenses relating to corporate overhead and activities related to managing our investments and considering additional opportunities.

Our strategy of continuing to support and expand our business development activities requires us to obtain additional capital. The complete implementation of this element of our strategy will not generate positive cashflow in the foreseeable future. Achieving positive cashflow is currently highly dependent upon obtaining liquidity from our investments in unconsolidated affiliates. We estimate we will need to raise additional capital to fund the plan through the remainder of 2001 and substantially greater funds if we expect to continue to acquire investments, if amounts become due to settle contingent liabilities, or we are required to fund the remaining $1.4 million of our Parago guaranty. Historically, we have obtained any short-term bridge funding from our Chief Executive Officer or Directors. In order to participate in the bridge loan guaranty participation offering by Parago, we received $365,017 from our CEO as repayment of indebtedness and an advance from our CEO of $489,983. One of the Company's directors loaned $250,000 to the Company in the third quarter. The loan bears interest at 8% and is payable on demand. While this may occur in the future there can be no assurance that such financing will be available, or if available on terms that we would be willing to accept.

As expected in an early stage company, Parago has not been profitable and has experienced cash flow deficiencies as it implements its business plan. Until we are able to create liquidity from our investments through sale to a strategic investor, an initial public offering or some other activity, we will continue to require working capital to fund our own operating expenses. While we are pleased with the performance of Parago and River Logic to date, there can be no assurance that we will ever achieve liquidity for our investments.

There can be no assurance that management's plans will be successful or what other actions may become necessary. Although we have been successful raising capital in the past, any inability to raise capital may require us to sell assets or reduce the level of our operations. Such actions could have a material adverse effect on our business and operations and result in charges that could be material to our business and results of operations.

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

We are involved in legal proceedings from time to time, and 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 previously experienced shortfalls in revenue and earnings from levels expected by investors, which have had an immediate and significant adverse effect on the trading price of our common stock. This may occur again in the future.

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IF WE LOSE THE SERVICES OF ANY OF OUR KEY PERSONNEL, INCLUDING OUR CHIEF EXECUTIVE OFFICER OR OUR DIRECTORS, OUR BUSINESS MAY SUFFER.

We are dependent on our key officers and directors, including Steven B. Solomon, our Chairman and Chief Executive Officer, our directors, and our key employees in our finance, technology, sales and marketing operations. Our business could be negatively impacted if we were to lose the services of one or more of these persons.

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, Inc. and River Logic, Inc. Inasmuch as Parago and River Logic are early stage ventures, it is difficult to judge their future prospects.

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 voidable, and a court-appointed receiver could take control of us and liquidate our business.

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.

RISKS RELATED TO OUR CITADEL TECHNOLOGY BUSINESS

WE MAY NOT BE ABLE TO EFFECT THE DISTRIBUTION OF CITADEL TECHNOLOGY SECURITY SOFTWARE SHARES.

We previously announced that we intend to distribute shares of Citadel

Technology Security Software common stock to our shareholders upon compliance with the Securities and Exchange Commission (SEC) requirements applicable in connection with the proposed distribution. If there are problems associated with compliance with SEC requirements or state law, then the distribution of Citadel Technology Security Software 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. We anticipate that we will file a Registration Statement on Form 10-SB with resect to the proposed spin-off in the fourth quarter of 2001.

FOLLOWING THE SPINOFF OF OUR CITADEL TECHNOLOGY SOFTWARE BUSINESS, WE WILL NOT HAVE ACCESS TO REVENUES FROM THE SOFTWARE BUSINESS AND WILL BE DEPENDENT ON OUTSIDE SOURCES OF FUNDS, AND THERE CAN BE NO ASSURANCE THAT WE WILL BE ABLE TO ACQUIRE AN OPERATING ENTITY.

If we are successful in completing our previously announced distribution of all of the shares of Citadel Technology Security Software common stock to our shareholders, we will no longer have access to the revenues of the Citadel Technology business to fund our operations. Our investments in Parago and River Logic do not currently provide us with operating funds. While we intend to acquire an operating business in connection with or following the spin off, there can be no assurances that we will be successful, and we may be dependent on outside sources of funds. Any failure to obtain such funds would have a material adverse effect on our business and results of operations, and shareholders may suffer material dilution in connection with any such financings, if available.

OUR INDUSTRY IS CHARACTERIZED BY RAPID TECHNOLOGICAL CHANGE AND WE WILL NEED TO ADAPT OUR DEVELOPMENT TO THESE CHANGES.

We participate in a highly dynamic industry characterized by rapid change and uncertainty relating to new and emerging technologies and markets. The recent trend toward server-based applications in networks and applications distributed over the Internet could have a material adverse affect on sales of our products. Future technology or market changes may cause some of our products to become obsolete more quickly than expected.

THE MARKET FOR OUR PRODUCTS IS INTENSELY COMPETITIVE AND WE EXPECT THAT COMPETITION WILL CONTINUE AND MAY INCREASE.

The market in which we compete is influenced by the strategic direction of major microcomputer hardware manufacturers and operating system providers. Our competitiveness depends on our ability to enhance existing products and to offer successful new products on a timely basis. We have limited resources and must restrict product development efforts to a relatively small number of projects.

INTRODUCTION OF NEW OPERATING SYSTEMS MAY CAUSE SIGNIFICANT FLUCTUATIONS IN OUR FINANCIAL RESULTS AND STOCK PRICE.

If we are unable to successfully and timely develop products that operate under existing or new operating systems, or if pending or actual releases of the new operating systems delay the purchase of our products, our future net revenues and operating results could be materially adversely affected. Additionally, as hardware vendors incorporate additional server-based network management and security tools into network operating systems, the demand may decrease for some of our products, including those currently under development.

THE TREND TOWARD CONSOLIDATION IN OUR INDUSTRY MAY IMPEDE OUR ABILITY TO COMPETE

EFFECTIVELY.

As consolidation in the software industry continues, fewer companies dominate particular markets, changing the nature of the market and potentially providing consumers with fewer choices. Also, many of these companies offer a broader range of products than us, ranging from desktop to enterprise solutions. We may not be able to compete effectively against these competitors. Furthermore, we may use strategic acquisitions, as necessary, to acquire technology, people and products for our overall product strategy. We have completed a number of acquisitions and dispositions of technologies, companies and products and may acquire and dispose of other technologies, companies and products in the future. The trend toward consolidation in our industry may result in increased competition in acquiring these technologies, people or products, resulting in increased acquisition costs or the inability to acquire the desired technologies, people or products. Any of these changes may have a significant adverse effect on our future revenues and operating results.

WE MUST EFFECTIVELY ADAPT TO CHANGES IN THE DYNAMIC TECHNOLOGICAL ENVIRONMENT OF THE INTERNET IN A TIMELY MANNER.

Critical issues concerning the commercial use of the Internet, including security, reliability, cost, ease of use, accessibility, quality of service or potential tax or other government regulation, remain unresolved and may affect the use of the Internet as a medium to distribute or support our software products and the functionality of some of our products. If we are unsuccessful in timely assimilating changes in the Internet environment into our business operations and product development efforts, our future net revenues and operating results could be adversely affected.

WE FACE INTENSE PRICE-BASED COMPETITION FOR SALES OF OUR PRODUCTS.

Price competition is often intense in the software market, especially for utility and security products. Many of our competitors have significantly reduced the price of their products. Price competition may continue to increase and become even more significant in the future, resulting in reduced profit margins.

OUR QUARTERLY FINANCIAL RESULTS ARE SUBJECT TO SIGNIFICANT FLUCTUATIONS.

We have been subject to substantial fluctuations in quarterly net revenues, and these fluctuations may occur in the future. Fluctuations may be caused by a number of factors, including:

- the introduction of competitive products by existing or new competitors;
- reduced demand for any given product;
- seasonality in the end-of-period buying patterns of foreign and domestic software markets; and
- the market's transition between operating systems.

Due to these factors, forecasts may not be achieved, either because expected sales do not occur or because they occur at lower prices or on terms that are less favorable to us. In addition, these factors increase the chances that our results could diverge from the expectations of investors and analysts.

WE MAY BE UNSUCCESSFUL IN UTILIZING NEW DISTRIBUTION CHANNELS.

We currently offer products over the Internet. We may not be able to effectively adapt our existing, or adopt new, methods of distributing our software products utilizing the rapidly evolving Internet and related technologies. The adoption of new channels may adversely impact existing channels and/or product pricing, which may reduce our future revenues and profitability.

PRODUCT RETURNS MAY AFFECT OUR NET REVENUES.

Product returns can occur when we introduce upgrades and new versions of products or when distributors or retailers have excess inventories. Our return policy allows distributors, subject to various limitations, to return purchased products in exchange for new products or for credit towards future purchases. End users may return our products through dealers and distributors within a reasonable period from the date of purchase for a full refund. In addition, retailers may return older versions of our products. We estimate and maintain reserves for product returns. However, future returns could exceed the reserves we have established, which could have a material adverse affect on our operating results.

OUR INCREASED SALES OF SITE LICENSES MAY INCREASE FLUCTUATIONS IN OUR FINANCIAL RESULTS AND COULD AFFECT OUR BUSINESS.

We sell corporate site licenses through the distribution channel and through corporate resellers. We are increasingly emphasizing sales to corporations and small businesses through volume licensing agreements. These licensing arrangements tend to involve a longer sales cycle than sales through other distribution channels, require greater investment of resources in establishing the enterprise relationship and can sometimes result in lower operating margins. The timing of the execution of volume licenses, or their non-renewal or renegotiation by large customers, could cause our results of operations to vary significantly from quarter to quarter and could have a material adverse impact on our results of operations. In addition, if the corporate marketplace grows and becomes a larger component of the overall marketplace, we may not be successful in expanding our corporate segment to take advantage of this growth.

WE DEPEND ON DISTRIBUTION BY VALUE ADDED RESELLERS AND DISTRIBUTORS FOR A SIGNIFICANT PORTION OF OUR REVENUES.

We distribute some of our products through value added resellers and distributors under arrangements through which our products are included with these resellers' and distributors hardware and software products prior to sale by them through retail channels. If we are unsuccessful in maintaining our current relationships and securing license agreements with additional value added resellers and distributors, or if these resellers and distributors are unsuccessful in selling their products, our future net revenues and operating results may be adversely affected.

THE RESULTS OF OUR RESEARCH AND DEVELOPMENT EFFORTS ARE UNCERTAIN.

We believe that we will need to make significant research and development expenditures to remain competitive. While we perform extensive usability and beta testing of new products, the products we are currently developing or may develop in the future may not be technologically successful. If they are not technologically successful, our resulting products may not achieve market acceptance and our products may not compete effectively with products of our competitors currently in the market or introduced in the future.

THE LENGTH OF THE PRODUCT DEVELOPMENT CYCLE IS DIFFICULT TO PREDICT.

The length of our product development cycle has generally been greater than we originally expected. We are likely to experience delays in future product

development. These delays could have a material adverse affect on the amount and timing of future revenues.

WE MUST MANAGE AND RESTRUCTURE OUR OPERATIONS EFFECTIVELY.

We continually evaluate our product and corporate strategy. We have in the past undertaken and will in the future undertake organizational changes and/or product and marketing strategy modifications. These organizational changes increase the risk that objectives will not be met due to the allocation of valuable limited resources to implement changes. Further, due to the uncertain nature of any of these undertakings, these efforts may not be successful and we may not realize any benefit from these efforts.

WE MUST ATTRACT AND RETAIN PERSONNEL WHILE COMPETITION FOR PERSONNEL IN OUR INDUSTRY IS INTENSE.

We believe that our future success will depend in part on our ability to recruit and retain highly skilled management, marketing and technical personnel. Competition in recruiting personnel in the software industry is intense. To accomplish this, we believe that we must provide personnel with a competitive compensation package, including stock options, which requires ongoing stockholder approval.

WE RELY ON INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS.

We regard our software as proprietary and underlying technology as proprietary. We seek to protect our proprietary rights through a combination of confidentiality agreements and copyright, patent, trademark and trade secret laws. However, we do not employ technology to prevent copying of our products. Third parties may copy aspects of our products or otherwise obtain and use our proprietary information without authorization or develop similar technology independently. We do not have any patents or statutory copyrights on any of our proprietary technology that we believe to be material to our future success, although Parago has filed a provisional patent application with respect to some of its business applications and intellectual property rights. In selling our products, we rely primarily on shrink wrap licenses that are not signed by licensees, and, therefore, such licenses may be unenforceable under the laws of some jurisdictions. In addition, existing copyright laws afford limited practical protection. Furthermore, the laws of some foreign countries do not offer the same level of protection of our proprietary rights as the laws of the United States. There can be no assurance that our means of protecting our proprietary rights will be adequate or that our competitors will not independently develop similar technology substantially equivalent or superseding proprietary technology. Furthermore, there can be no assurance that any confidentiality agreements between us and our employees will provide meaningful protection of our proprietary information, in the event of any unauthorized use or disclosure thereof. Any legal action that we may bring to protect proprietary information could be expensive and may distract management from day-to-day operations.

WE ARE INVOLVED IN LITIGATION THAT COULD, AND FUTURE CLAIMS AGAINST US MAY, AFFECT OUR FINANCIAL RESULTS.

From time to time, we may be subject to claims that we have infringed the intellectual property rights of others, product liability claims, or other claims incidental to our business. We are involved in a number of judicial and administrative proceedings incidental to our business. We intend to defend all claims against us. We may suffer an unfavorable outcome as a result of one or

more claims. We do not expect the final resolution of these claims to have a material adverse effect on our financial position, individually or in the aggregate. However, depending on the amount and timing of unfavorable resolutions of claims against us, or the costs of settlement or litigation, our future results of operations or cash flows could be materially adversely affected in a particular period.

SOFTWARE DEFECTS AND PRODUCT LIABILITY.

Software products frequently contain errors or defects, especially when first introduced or when new versions or enhancements are released. We have not experienced any material adverse effects resulting from any of these defects or errors to date and we test our products prior to release. Nonetheless, defects and errors could be found in current versions of our products, future upgrades to current products or newly developed and released products. Software defects could result in delays in market acceptance or unexpected reprogramming costs, which could materially adversely affect our operating results. Most of our license agreements with customers contain provisions designed to limit our exposure to potential product liability claims. It is possible, however, that these provisions limiting our liability may not be valid as a result of federal, state, local or foreign laws or ordinances or unfavorable judicial decisions. A successful product liability claim could have a material adverse affect on our business, operating results and financial condition.

OUR SOFTWARE PRODUCTS AND WEB SITE MAY BE SUBJECT TO INTENTIONAL DISRUPTION.

While we have not been the target of software viruses specifically designed to impede the performance of our products, such viruses could be created and deployed against our products in the future. Similarly, experienced computer programmers, or hackers, may attempt to penetrate our network security or the security of our Web site from time to time. A hacker who penetrates our network or Web site could misappropriate proprietary information or cause interruptions of our services. We might be required to expend significant capital and resources to protect against, or to alleviate, problems caused by virus creators and hackers.

WE RELY ON MICROSOFT AND NOVELL TECHNOLOGY.

Our software products are designed for Microsoft Windows and Novell NetWare operating systems. Although we believe that Microsoft and Novell technologies are and will be widely utilized by businesses in the corporate market, no assurances can be given that these businesses will actually adopt such technologies as anticipated or will not in the future migrate to other computing technologies that the Company does not support. Moreover, if our products and technology are not compatible with new developments in Microsoft and Novell technologies, as to which there can be no assurances, our business, results of operations and financial condition could be materially and adversely affected.

RISKS RELATED TO OUR INTERNET SUBSIDIARY, PARAGO, INC.

The following are some risks related to the business of Parago, Inc., our Internet subsidiary, and should be considered in addition to the other risk factors described in this Report. Any of these factors could have a material adverse effect on us, as we owned 20,000,000 of the outstanding shares of common stock, and warrants to purchase 28,874.90 shares of Series A-3 Preferred Stock, convertible into 2,887,490 shares of common stock, of Parago at September 30, 2001. These warrants only become exercisable in the event the Company fulfills all of its obligations under the Participation Agreement or Parago repays the

bridge loan.

THE ISSUANCE OF THE GUARANTY SECURITIES CONTEMPLATED BY PARAGO WILL RESULT IN DILUTION OF EXISTING PARAGO STOCKHOLDERS INCLUDING CT HOLDINGS AND POSSIBLY A CHANGE IN CONTROL OF PARAGO.

Offerees who do not participate in the Guaranty described in Part II, Item 5 -- Other Information--Parago Bridge Financing will experience dilution of their ownership interest in Parago as a result of the grant of 110,000 warrants to purchase Series A-3 Stock, convertible into 11,000,000 shares of Parago common stock, to TH Lee and the participating offerees. Non-participating offerees, and participants who fail to pay the remaining two thirds of their guaranty payment if it is required in the event that Parago is unable to repay the bridge loan, will experience further substantial dilution upon the issuance of Series A-1 Stock and Series A-2 Stock, which will occur if repayment of the Term Loan under the Guaranty is required. Additionally, TH Lee will receive that portion of the Warrants, Series A-1 Stock and Series A-2 Stock to which current Parago securityholders who do not satisfy the criteria to, or choose not to, participate in the offering or do not perform all of their obligations under the Participation Agreement are entitled. Hence, TH Lee's percentage ownership of Parago will increase as a result of the transactions, and if a substantial portion of offerees do not participate or participating offerees do not perform their obligations, then TH Lee may gain a controlling interest in Parago as a result of the transactions. CT Holdings may suffer dilution with respect to its holdings in Parago. CT Holdings has participated in the proposed transactions by making its one-third escrow payment but may be required to advance additional funds of up to $1,406,472 in order to maintain its equity interest.

In addition, in the event Parago is successful in its proposed private placement of Series E Stock, its current shareholders, including CT Holdings, will suffer material dilution. Any material change in the conversion price of the Series D Stock issued to TH Lee and Watershed , or the issuance of the Series E Stock at a low valuation, would result in material dilution to the holders of Parago's securities, including CT Holdings, and could possibly result in change in control of Parago.

PARAGO MAY NOT BE ABLE TO REPAY THE BRIDGE LOAN, WHICH WILL RESULT IN PAYMENTS UNDER THE GUARANTY BEING REQUIRED FROM TH LEE AND THE PARTICIPATING OFFEREES, AND SUBSTANTIAL DILUTION TO PARAGO SHAREHOLDERS WHO FAIL TO PARTICIPATE.

Parago intends to repay the Term Loan with proceeds from the sale of shares of its Series E Stock. There is no guarantee that the Series E round of financing will occur, or that it will raise adequate capital to repay the Term Loan in full. If Parago is unable to repay the Term Loan in full, TH Lee and the participating offerees will be required to pay Comerica under the Guaranty. Parago is fully reliant on external sources of financing for repayment of the principal under the Term Loan, as any cash generated from operations will not be adequate to fund such repayment. If Parago is unable to raise funds to repay the bridge loan, we would be required to pay an additional $1,406,472 to Comerica to repay our Pro Rata portion of the bridge loan. If we are unable to raise these funds, we will suffer substantial dilution.

IF A PARTICIPATING OFFEREE DOES NOT PAY THE REMAINDER OF ITS PRO RATA PERCENTAGE OF LIABILITY UNDER THE GUARANTY, IT WILL FORFEIT THE BENEFITS OF PARTICIPATION AND MAY BE SUBJECT TO A COLLECTION ACTION.

A participating offeree who does not pay the remainder of its Pro Rata Percentage under the Guaranty will forfeit the escrowed funds deposited under the Escrow Agreement and the Warrants it received will be cancelled and reissued to TH Lee. Further, Parago may pursue collection of the remainder of such a participating offeree's Pro Rata Percentage portion that is due, and even if such amount is delinquently collected, Parago will not be obligated to issue any

shares of Series A-1 Stock or Series A-2 Stock in exchange therefore.

AS ALMOST ALL PARTICIPATING OFFEREES WILL ONLY BE ENTITLED TO RECEIVE SERIES A-2 STOCK, AND WARRANTS TO PURCHASE SERIES A-3 STOCK, AND BECAUSE THE SERIES A-2 STOCK AND SERIES A-3 STOCK WILL HAVE A LIQUIDATION PREFERENCE JUNIOR TO THAT OF THE SERIES A-1 STOCK AND ALL CURRENTLY EXISTING SERIES OF PREFERRED STOCK, IF A LIQUIDATION EVENT WERE TO OCCUR, THE HOLDERS OF COMMON STOCK, SERIES A-2 STOCK AND SERIES A-3 STOCK MAY RECEIVE LITTLE OR NOTHING FOR THEIR SHARES.

CT Holdings currently owns only shares of Parago common stock and warrants to purchase shares of Series A-3 Preferred Stock, so in the event that a payment is made under the Guaranty, CT Holdings will receive shares of Series A-2 Stock rather then Series A-1 Stock. The Series A-1 Stock and Series A-2 Stock are similar, except that the Series A-2 Stock will have a liquidation preference junior to that of the Series A-1 Stock and all currently existing series of preferred stock, but pari passu with that of the Series A-3 Stock. This means that in the event of a liquidation, dissolution or winding up of Parago (which is also defined to include a merger, acquisition, sale, consolidation or other form of corporate reorganization of Parago in which Parago's stockholders prior to such event do not own 50% of the voting interest in Parago following such event), then the holders of Parago's Series A-1 Stock and the other existing series of preferred stock of Parago shall be entitled to receive all payments and distributions up to the respective liquidation preferences (defined as their issue prices) of their shares of preferred stock prior to and in preference to any payment or distribution being made to holders of the Series A-2 Stock or Series A-3 Stock, including CT Holdings. As of September 30, 2001, this senior priority liquidation preference amounted to approximately $51.5 million. In addition, the Series E Stock, if any is issued, would have a senior liquidation preference to the Series A-2 Stock and Series A- 3 Stock. As a consequence, where limited assets remain following a liquidation event (including reorganization events), holders of Parago's Common Stock, Series A-2 Stock and Series A-3 Stock, including CT Holdings, may receive little or no payment or distribution for their shares.

TO CONTINUE ITS OPERATIONS AND BUSINESS, PARAGO MUST RAISE ADDITIONAL FINANCING.

Even if Parago successfully completes a round of financing of its Series E Stock, Parago may need to raise additional funds in the future. Further, if Parago fails to complete the Series E round and TH Lee and the participating offerees are called upon to repay the Term Loan, it is highly likely that Parago will require further additional funds in order to continue operations. In addition, Parago has a $1.5 million term loan from Comerica (the Previous Loan) that requires Parago to meet certain financial covenants. Among other things, these financial covenants require Parago to raise at least $6.5 million in its proposed private placement of Series E Stock, prior to August 31, 2001, or to maintain cash in the amount of the outstanding balance under the Previous Loan as cash collateral. Accordingly, if Parago is unable to complete its Series E Stock private placement prior to December 15, 2001, Parago may be required to use a portion of the Term Loan as cash collateral for the Previous Loan and the proceeds of the Term Loan would not be sufficient to fund Parago's operations until it generates positive cashflow, and Parago would be required to raise additional funds to continue its operations. There can be no assurance that Parago will be able to obtain additional financing on favorable terms, if at all. If Parago cannot raise funds on acceptable terms, if and when needed, its business will suffer and could be discontinued.

Parago's ability to maintain and grow its business is dependent on its access to sufficient funds to support its working capital and capital expenditure needs.

If Parago does not raise additional funds, its business and results of operations will be seriously harmed, and its assets and share price would be materially and adversely impacted. This additional financing may not be available to Parago on a timely basis if at all, or, if available, on terms acceptable to Parago. Moreover, additional financing may cause material and immediate dilution to existing stockholders including CT Holdings.

THERE CAN BE NO ASSURANCE THAT PARAGO WILL COMPLETE AN INITIAL PUBLIC OFFERING.

There can be no assurance that Parago will complete an initial public offering. The delay or complete abandonment of the contemplated initial public offering could have a material adverse effect on our stock price due to our substantial equity interest in Parago. You cannot be assured that the initial public offering 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. 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. 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. In consideration of certain of its directors' funding of the Company's participation in the Parago bridge loan, the Company has agreed to permit the directors to exchange up to 5,000,000 Parago shares into up to 6,000,000 shares of the Company's common stock.

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 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.

PARAGO'S BUSINESS AND FUTURE PROSPECTS ARE EXTREMELY DIFFICULT TO EVALUATE BECAUSE ITS OPERATING HISTORY IS VERY LIMITED AND ITS BUSINESS MODEL IS NEW, UNPROVEN AND EVOLVING.

Parago was formed in January 1999. Since its formation, Parago has:

- acquired its rebates operation in May 1999;
- launched its Web site in September 1999; and
- completed the initial development of its online rebate application in December 1999.

As a result, Parago has only a limited operating history on which one can base an investment decision. You should consider its prospects in light of the uncertainties and difficulties frequently encountered by companies in their early stages of development.

In addition, its business model is new, unproven and evolving. In December 1999,

Parago focused its business to concentrate on its online customer care solutions. Parago cannot assure that its new, focused business model will be commercially successful. Parago cannot assure you that that its online solutions will be accepted by businesses or consumers. If Parago is unable to establish pricing and service models acceptable to manufacturers, retailers and service providers and attractive to their customers, its Internet-based solution may not be commercially successful.

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

Parago had a net loss of approximately $4.6 million (unaudited) for the three months ended September 30, 2001 and an accumulated deficit of approximately $85 million (unaudited) at September 30, 2001. Parago anticipates that its operating expenses will continue at least their current levels for the foreseeable future. In addition, because its expense levels are based, in part, on expectations of its future revenues, any decline in its revenues below its expectations would have a material adverse impact on its operating results and cash flow. Accordingly, Parago expects to incur additional losses for the foreseeable future. If its revenues do not grow as Parago anticipates, Parago may never be profitable.

PARAGO AND OUR COMPANY, CT HOLDINGS, COULD FACE POTENTIAL CONFLICTS OF INTERESTS RELATING TO EACH OTHER.

Because of Parago's relationship with us, and because we owned 20,000,000 of its outstanding shares of common stock at September 30, 2001, and because of our interlocking directors and officers, who collectively owned 16.7% of Parago's outstanding shares of common stock as of September 30, 2001, Parago and we are likely to face potential conflicts of interest relating to each other.

Executives, employees and consultants associated with us assisted in the development of Parago's business model. Steven B. Solomon, our CEO and President, was the founder, Chairman and CEO of Parago during its formative stages. In addition, Lawrence Lacerte and Steven B. Solomon serve as directors of both Parago and CT Holdings.

Some of Parago's executive officers, key employees and directors also beneficially own, or hold options or warrants to purchase, approximately 30.4% of our outstanding common stock as of September 30, 2001. Steven B. Solomon owned approximately 10.0% of our common stock as of September 30, 2001.

Accordingly, conflicts of interest may arise from time to time between Parago and us, particularly with respect to the pursuit of overlapping business or financing opportunities. Neither Parago nor CT Holdings has adopted any formal plan or arrangement to address these potential conflicts of interest and each company intends to review related-party transactions on a case-by-case basis. Because Parago has interlocking directors and officers with CT Holdings, there may be inherent conflicts of interest for

these directors and officers related to transactions between Parago and us. Directors may be required to abstain from voting with respect to matters involving both us and Parago. Parago may lose valuable management input from the directors and officers who have conflicts.

RESULTS OF OPERATIONS

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED WITH THE THREE AND NINE

MONTHS ENDED SEPTEMBER 30, 2000

NET SALES

During the quarter ended September 30, 2001, the Company had net sales of $141,028, a decrease of $59,586 or 29.7%, from net sales of $200,614 during the quarter ended September 30, 2000. For the nine months ended September 30, 2001, the Company had net sales of $322,447, a decrease of $125,703 or 28.0%, over net sales of $448,150 during the nine months ended September 30, 2000. We attribute the decrease in our software product revenues for the quarter and nine months ended September 30, 2001 to our redesign and relaunch of our software products for new markets created by the current marketplace, including the Health Insurance Portability and Accountability Act (HIPAA) and the Gramm-Leach-Bliley regulations relating to security and privacy requirements in the health care and finance industries.

COST OF SALES, EXCLUDING DEPRECIATION AND AMORTIZATION

The costs and expenses incurred in connection with producing the Company's products were $20,043 during the quarter ended September 30, 2001, a increase of $17,727 or 88.4%, from cost of sales of $2,316 for the same period last year. For the nine months ended September 30, 2001, cost of sales were $22,500, a increase of $10,234 or 45.5%, over cost of sales of $12,266 for the nine months ended September 30, 2000. The decrease in our cost of sales can be attributed to the overall decrease in revenues due to our shift in focus to new product lines.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the quarter ended September 30, 2001 were $491,102 as compared to $458,378 for the quarter ended September 30, 2000, or an increase of $32,724 or 6.6%. For the nine months ended September 30, 2001, selling, general and administrative expenses decreased $968,489 or 37.2% to $1,631,867 for the nine month period ended September 30, 2001 as compared to $2,600,356 for the same period in the prior year. The increase in our selling, general and administrative expenses for the quarter ended September 30, 2001 resulted primarily from an increase in headcount as a result of our expanded efforts with respect to sales of Citadel software. We expect that these expenses will increase in future periods as we commence sales through distribution channels and strategic alliances, and we add additional headcount.

RESEARCH AND DEVELOPMENT EXPENSE

For the nine month period ended September 30, 2001, research and development costs charged to expense were $0 as compared to $238,760 for the same period last year, or a decrease of $238,760, or 100%. The decrease in costs for the three months ended September 30, 2001 related primarily to the reduction of development work on products due to decreases in headcount. We anticipate that these costs will increase as we increase our headcount in future periods as we continue our software development.

REVERSAL OF ACCRUAL FOR LEGAL SETTLEMENT

Operating income and expense for the quarter and nine month period ended September 30, 2001 included income of $0 and $1,912,000, respectively, related to the reversal of an accrual for a proposed litigation settlement described below. Operating income and expense for the quarter and nine month period ended September 30, 2000 included expense of $0 and $1,912,000, respectively, related to the accrual for a proposed legal settlement.

DEPRECIATION AND AMORTIZATION EXPENSE

Depreciation and amortization expense decreased $114,595, or 42.6%, to $154,740

for the quarter ended September 30, 2001 from $269,335 for the quarter ended September 30, 2000. For the nine months ended September 30, 2001, depreciation and amortization expense was $574,105 compared to $883,420 for the same period in prior year, or a decrease of $309,315, or 35.01%. The decrease in depreciation and amortization is primarily due to the decrease in the Company's depreciable asset base. This decrease in assets is due to the company not acquiring any new property and equipment over the last 22 months, not developing any new software products over the last 15 months, and writing off approximately $856,000 of unrecoverable capitalized software costs over the last 18 months.

OTHER INCOME (EXPENSE)

Interest expense for the three and nine month periods ended September 30, 2001 were $23,694 and $15,815, respectively as compared to $352 and $39,358 for the same periods in the prior year. This decrease in expense resulted primarily from having less interest bearing debt during these periods than we did in the same periods last year. Equity in loss of unconsolidated affiliate was $2,099,211 for the three and nine months ended September 30, 2001 as compared to $105,734 and $4,658,781 for the same periods in the prior year. The significant increase in the equity in loss of unconsolidated affiliate is due the Company applying the equity method to the amount invested in the participation of the guarantee due to our share of Parago's accumulated losses being less than the carrying value of our investment in Parago. For further discussion of our application of the equity method see Note 1 in the financial statements. We expect that these losses would continue to be significant for at least the foreseeable future as Parago continues to develop its business services.

Interest income of $3,250 during the quarter ended September 30, 2001 primarily represents interest income earned on notes receivable from River Logic and PerClick during the quarter.

LIQUIDITY AND CAPITAL RESOURCES

Our cash and cash equivalents at September 30, 2001 were $12,352.

The net cash used in operations of $609,727 for the nine months ended September 30, 2001 is principally a result of the net loss of $2,002,258, and the reversal of the accrual for legal settlement of $1,912,500, partially offset by non-cash charges including $574,105 of depreciation and amortization and the equity in loss of unconsolidated affiliate of $2,099,211 and the increase in account payable and accrued expenses. The net cash used in operations of $401,368 for the nine months ended September 30, 2000 is principally a result of the net loss of $10,500,238, partially offset by non-cash charges including $4,658,781 associated with equity in losses of unconsolidated affiliate, $883,420 of depreciation and amortization and other non-cash charges totaling $625,336.

Cash flows used by investing activities was $40,919 for the nine months ended September 30, 2001, as compared to cash used in investing activities of $600,000 for the nine months ended September 30, 2000. The change in investing activities is primarily due to the Company not investing as much cash in unconsolidated subsidiaries in the nine months ended September 30, 2001. Cash flows provided by financing activities were $641,351 for the nine months ended September 30, 2001, primarily resulting from funds borrowed from the Company's CEO and other related parties as compared to cash provided by financing activities of $5,760,928 for the nine months ended September 30, 2000 primarily resulting from sales of the Company's common stock.

As a result of the aforementioned factors, cash and cash equivalents decreased by $9,295 for the nine months ended September 30, 2001, versus an increase of $1,296,943 for the same period last year.

The Company has incurred recurring operating losses and has a working capital deficiency. The Company has used cash in operations of approximately $609,727 during the quarter nine months ended September 30, 2001. The Company had a cash balance of approximately $12,352 at September 30, 2001 and current liabilities exceed current assets by approximately $3.6 million. As outlined below, these assets do not reflect the value that we believe may be realized from our investments in Parago and River Logic. The Company has been and continues to be dependent upon outside financing to develop its software products, perform its business development activities, invest in unconsolidated affiliates and provide for ongoing working capital requirements. During the three months ended September 30, 2001, substantially all of this financing has been provided by related parties.

The Company expects to generate cash from the sale of the Company's software and will incur costs relating to such operations that may result in a cash deficiency. Following the spinoff of the Company's software business, revenues and expenses related to the software business will be recognized by the new entity. The Company will also continue to incur expenses relating to corporate overhead and activities related to managing the Company's investments and considering additional opportunities. The Company may require cash from financing activities to fund the deficits expected over the next year, as well as the remaining payments under the Parago guaranty participation, if Parago is unable to repay the bridge loan when due.

The Company's strategy of continuing to support and expand its business development activities, in addition to its core focus on its software activities, requires the Company to obtain additional capital. The complete implementation of this element of our strategy will not generate positive cashflow in the foreseeable future. Achieving positive cashflow is currently highly dependent upon obtaining liquidity from the Company's investments in unconsolidated affiliates. The Company estimates it will need to raise additional capital to fund the plan through the remainder of 2001 and substantially greater funds if the Company expects to continue to acquire investments, as well as the remaining payments under the Parago guaranty

participation, if Parago is unable to repay the bridge loan when due, or if amounts become due to settle contingent liabilities. Historically, the Company has obtained any 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 based on terms that the Company would be willing to accept.

Since the development of our new focus on businesses development activities we have made investments in two companies that we believe may provide liquidity to the Company in the long term. Our first investment in Parago we believe has been successful in that it has grown from the original $50,000 of equity provided by the Company and no revenue, to net revenue of approximately $7.6 million for the three months ended September 30, 2001 (unaudited). As expected in an early stage company, Parago has not been profitable and has experienced cash flow deficiencies as it implements its business plan. We believe, however, that our investment of 20,000,000 common shares and warrants to purchase 28,874.90 shares of Series A-3 Preferred Stock of Parago, convertible into 2,887,490 shares of Parago common stock, may ultimately provide an appropriate return. These warrants only become exercisable in the event the Company fulfills all of its obligations under the Participation Agreement or Parago repays the bridge loan. Until we are able to create liquidity from the company's investments through sale to a strategic investor, an initial public offering or some other activity,

the Company will continue to require working capital to fund its own operating expenses.

Similarly, the Company's investment in River Logic we believe has also been successful. Since our initial investment, River Logic has made substantial progress in executing its strategy through its development and introduction of new products and establishment of new customer relationships. In addition, during April, 2001 River Logic obtained a significant strategic investment from a subsidiary of Intel, Cardinal Investments, eMed Ventures, and Mercury Ventures. As part of that round, the Company converted $450,000 of demand notes receivable into River Logic Series C Preferred stock, the same equity instruments purchased by the other investees. The remainder of our note receivable totaling approximately $200,000 was paid in April 2001. Similar to the investments into Parago, the Company recognized that these investments would be initially illiquid. While we are pleased with the performance of Parago and River Logic to date, there can be no assurance that the Company will ever achieve liquidity for its investments.

There can be no assurance that management's plans will be successful or what other actions may become necessary. Although the Company has been successful raising capital in the past, the inability of the Company to raise capital may require the Company to sell assets or reduce the level of its operations. Such actions could have a material adverse effect on the Company's business and operations and result in charges that could be material to the Company's business and results of operations.

CONTINGENT LIABILITY

The plaintiffs in the previously disclosed lawsuit by Janssen Meyers Associates L.P. (JMA) refiled their lawsuit with the federal court, and we filed a motion to dismiss the case because the plaintiffs lacked the required diversity jurisdiction to pursue the claims in federal court and the court granted our motion. In November 2001, the plaintiffs refiled the lawsuit in the state court and added a claim seeking to enforce the settlement term sheet described below in the Supreme Court of New York, that state's trial court, in a case styled Roan Meyers v. CT Holdings. We intend to vigorously defend against this lawsuit and file a counterclaim. In July 2000, we entered into a settlement term sheet to resolve the disputes between us and Janssen-Meyers Associates L.P. (JMA), pursuant to which we and JMA tentatively agreed 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. As a result, we recorded approximately $1,912,500 as a nonrecurring charge related to the settlement of the litigation during 2000. However, the Company and JMA were unable to negotiate the final definitive settlement agreement. On March 27, 2001, the Court hearing the JMA lawsuit issued a Summary Order that denied 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. Given these recent 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 has determined to reverse the nonrecurring charge that the Company had recorded related to the settlement of the lawsuit.

PART II. OTHER INFORMATION

Except as listed below, all information required by Part II is omitted because the items are inapplicable or the answer is negative.

ITEM 1. LEGAL PROCEEDINGS

We are party to certain litigation matters. We believe that we have meritorious defenses and will vigorously defend ourselves. However, an unfavorable resolution of or 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.

The plaintiffs in the previously disclosed lawsuit by Janssen Meyers Associates L.P. (JMA) refiled their lawsuit with the federal court, and we filed a motion to dismiss the case because the plaintiffs lacked the required diversity jurisdiction to pursue the claims in federal court and the court granted our motion. In November 2001, the plaintiffs refiled the lawsuit in the state court and added a claim seeking to enforce the settlement term sheet described below in the Supreme Court of New York, that state's trial court, in a case styled Roan Meyers v. CT Holdings. We intend to vigorously defend against this lawsuit and file a counterclaim. In July 2000, we entered into a settlement term sheet to resolve the disputes between us and Janssen-Meyers Associates L.P. (JMA), pursuant to which we and JMA tentatively agreed 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. As a result, we recorded approximately $1,912,500 as a nonrecurring charge related to the settlement of the litigation during 2000. However, the Company and JMA were unable to negotiate the final definitive settlement agreement. On March 27, 2001, the Court hearing the JMA lawsuit issued a Summary Order that denied 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. Given these recent 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 has determined to reverse the nonrecurring charge that the Company had recorded related to the settlement of the lawsuit.

At this time, the Company is unable to predict the ultimate outcome of some of these suits, the costs associated with defending the claims and pursuing counterclaims, and monetary compensation awarded, if any. The Company has, when appropriate, recorded its current estimate of the amounts necessary to settle the litigation.

ITEM 5. OTHER INFORMATION

Changes in Certifying Accountant

On October 30, 2001, the Audit Committee of the Company's Board of Directors determined to dismiss the Company's current independent public accountants, Ernst & Young LLP ("Ernst & Young LLP"), and engage a new accounting firm for fiscal year 2001. This decision was made as a result of the Company's changes in its business model and the Company's focus on operating efficiencies and reductions in cost. The Audit Committee has determined that the engagement of a different firm as the Company's independent public accountants would be in the best interests of the Company at this time.

The reports of Ernst & Young LLP on the Company's financial statements for the past two fiscal years did not contain an adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope, or accounting principles except for the addition of an explanatory paragraph regarding the Company's ability to continue as a going concern. In connection with the audits of the Company's financial statements for each of the two fiscal periods ended December 31, 2000 and February 28, 2000 and in the subsequent interim period, there were no disagreements with Ernst & Young LLP on any matters of accounting principles or practices, financial statement disclosure, or auditing scope and procedures which, if not resolved to the satisfaction of Ernst & Young LLP would have caused Ernst & Young LLP to make reference to the matter in their report. The Company filed a Current Report on Form 8-K on November 6, 2001 including a letter from Ernst & Young LLP to the effect that it agreed with the above statements.

On November 14, 2001, the Audit Committee of our Board of Directors determined to engage King Griffin & Adamson P.C. (KGA) as our independent public accountants for fiscal year 2001.

We have been advised by KGA that neither the firm nor any of its associates has any material relationship with us or any affiliate of ours. During our two most recent fiscal years and the subsequent interim periods prior to engaging KGA, we have has not consulted KGA regarding either: (i) the application of accounting principles to a specific transaction, either completed or proposed, or the type of audit opinion that might be rendered on our financial statements, for which advice was provided that KGA concluded was an important factor considered by us in reaching a decision as to an accounting, auditing or financial reporting issue; or (ii) any matter that was either the subject of a disagreement (as defined in paragraph (a)(1)(iv) of Regulation S-K Item 304) or a reportable event (as described in paragraph (a)(1)(v) of Regulation S-K, Item 304).

We filed a Current Report on Form 8-K on November 19, 2001 related to the engagement of KGA as its independent public accountants for fiscal year 2001.

Parago Bridge Financing

In May 2001, Parago obtained a Term Loan from Comerica Bank--Texas (Comerica) in the principal amount of $8,000,000. The funds derived from the Term Loan were necessary to enable Parago to continue operations, as Parago's cash resources were depleted. Parago intends to repay the Term Loan with proceeds from a contemplated sale of shares of a new series of preferred stock, the terms of which have not yet been established (the Series E Stock). As a condition to the extension of the Term Loan, Comerica required a guarantee of Parago's obligations under the Term Loan from certain affiliates of TH Lee.Putnam Internet Partners, L.P. (collectively, TH Lee), which own shares of Parago's Series C Convertible Preferred Stock (Series C Stock) and Series D Convertible Preferred Stock (Series D Stock), common stock and certain warrants.

TH Lee executed the Guaranty in consideration of its receipt of 110,000 Warrants to purchase shares of Parago's Series A-3 Stock, convertible into 11,000,000 shares of Parago common stock, a new series of preferred stock that was created in connection with the bridge loan and guaranty transaction, and, in the event that TH Lee is called upon to make payment under the Guaranty, its receipt of shares of Series A-1 Stock and Series A-2 Stock, two new series of preferred stock the issuance of which could have the effect of substantially diluting by up to approximately 90% Parago's existing stockholders, including CT Holdings.

Parago reached a further understanding with TH Lee pursuant to which Parago

securityholders (including CT Holdings) who met the required suitability criteria were offered the opportunity to participate in the Guaranty through a Pro Rata Participation Interest. In the event that TH Lee is required to pay all or a portion of the Term Loan under the Guaranty, those offerees who participate in the offering and perform all of their obligations under the Participation Agreement will maintain their percentage equity ownership in Parago, while those offerees who do not participate in the offering or do not perform all of their obligations under the Participation Agreement will be substantially diluted by approximately 90%. If offerees holding a significant portion of Parago's current equity ownership elect not to participate in the offering or fail to fully perform their obligations under the Participation Agreement, then TH Lee may gain a controlling interest in Parago as a result of the transactions. See Risk Factors--The issuance of the securities will result in dilution of existing Parago stockholders and possibly a change in control of Parago. CT Holdings participated in this participation offering and was required to pay $692,740, although there can be no assurance that CT Holdings will be able to fully perform its remaining payment obligations, including the payment of up to approximately $1,406,472 in the event Parago is unable to repay the bridge loan.

The terms of an investment in a Participation Interest, including the terms of issuance of the related Warrants and Shares of Series A-1 Stock and Series A-2 Stock, and the assumption of a Pro Rata Percentage of the indebtedness under the Term Loan, are further described below.

Terms

The opportunity to participate in the Guaranty, as set forth in the Participation Agreement, was extended to Parago shareholders on the following terms:

1. Participation in the Guaranty. Parago and TH Lee entered into a Participation Agreement to which offerees who on or before June 15, 2001 elected to participate were added, including CT Holdings. TH Lee will be liable for all obligations owed to Comerica under the Guaranty, while each participating offeree, including CT Holdings, will only be liable to Parago to the extent of its Pro Rata Percentage of all amounts paid by TH Lee under the Guaranty.

2. Pro Rata Calculations. A participating offeree's Pro Rata Percentage is determined based on a fraction, the numerator of which is the sum of the participating offeree's shares of Parago common stock and shares of Parago common stock into which any other shares of Parago preferred stock, Parago warrants or Parago options held by such offeree that would vest on or before December 31, 2001 are convertible or exercisable (Common Stock Equivalents), and the denominator of which is all outstanding shares of Parago common stock and all Common Stock Equivalents, in each case as of June 15, 2001. Because it was not expected that Parago's outstanding securities would change in any material respect before June 15, 2001, and as the Warrants to purchase shares of Series A-3 Stock were not issued until after June 15, 2001, they were not be included in making pro rata ownership calculations. In determining pro rata amounts for TH Lee for all calculations made under the Participation Agreement, TH Lee assumed not only its pro rata share based upon its current percentage ownership of Parago, but also the pro rata share of those of Parago securityholders who do not meet the criteria to participate in the Guaranty (because they do not meet the suitability criteria), as well as the pro rata share of those offerees who elected not to participate and those offerees who do not perform all of their obligations under the Participation Agreement.

3. Subscription and Deposit of Escrow Amounts. Simultaneous with its entry into

the Participation Agreement, each participating offeree also became a party to an Escrow Agreement. Comerica has agreed to act as escrow agent under the Escrow Agreement. On or before June 15, 2001, each participating offeree was required to deliver its fully completed and executed subscription booklet, along with the participating offeree's Escrow Amount in immediately available funds, which was equal to 33% of such participating offeree's Pro Rata Percentage of $8,000,000, and CT Holdings was required to pay approximately $693,000. At such time, TH Lee also delivered cash to the escrow agent in an amount equal to 33% of its Pro Rata Percentage of $8,000,000. As further described below, the escrowed funds contributed by participating offerees are being held, and may be applied against, amounts paid by TH Lee pursuant to the Guaranty.

4. Relationship of Escrow Funds to Guaranty Payment Obligations. The escrow agent will hold the funds deposited in escrow until such time as either payment of the loan is made in full by Parago or payment under the Guaranty is required. In the event that the Term Loan is fully repaid by Parago, then the escrow funds (including any accrued interest) will be released back to each respective participating offeree and TH Lee. In the event that repayment of the Term Loan is made under the Guaranty but the amount of such repayment is less than the amount of the escrow funds, then a pro rata portion of such excess amount will be returned to each respective participating offeree and to TH Lee. In the event that TH Lee repays the Term Loan to Comerica under the Guaranty, and the amount repaid exceeds the escrow funds, then each participating offeree will be required under the terms of the Participation Agreement to pay to Parago by December 31, 2001 its Pro Rata Percentage of such excess amount, which amounts Parago will deliver to TH Lee. This amount is not limited to the $8,000,000 in principal amount of the Term Loan, but would also include any additional unpaid interest, fees and expenses that may be imposed by Comerica, which each participant would have to bear based on its Pro Rata Percentage of these additional amounts.

5. The Warrants to Purchase Shares of Series A-3 Stock. As consideration to TH Lee for executing the Guaranty and to the participating offerees for executing the Participation Agreement, Parago issued Warrants to purchase shares of its Series A-3 Stock, with a Common Stock Equivalent exercise price of $0.01 per share. Parago granted a total of 110,000 Warrants (or 11,000,000 common shares on a Common Stock Equivalent basis) to the participating offerees and TH Lee, with the participating offerees each receiving their Pro Rata Percentage of the total number of Warrants granted and TH Lee receiving the balance. The Series A-3 Stock is a series of preferred stock that has a conversion ratio of 1 to 100. The shares of Series A-3 Stock will be convertible into 11,000,000 shares of Parago common stock and will have terms substantially similar to Parago's Series D Stock, except that (A) the conversion ratio will not be subject to price protection, (B) a majority vote will be required for certain amendments and approvals rather than the two-thirds vote required by the Series D Stock, and (C) the holders of Series A-3 Stock will not have the preemptive, information, voting or co-sale rights that holders of the Series D Stock have by virtue of their current stockholder agreements. In addition, the Series A-3 Stock will have a liquidation preference that is on a par with the Series A-2 Stock, but junior to that of the Series D Stock, the Series A-1 Stock and all of Parago's other currently existing series of preferred stock. The liquidation preference of the Series A-3 Stock will be equal to $1.77 per common equivalent share, or, in the event that Parago is successful in issuing the Series E Stock to repay the Term Loan, the per common equivalent share price of the Series E Stock. The Warrants will be immediately exercisable by TH Lee, but will not be exercisable by the participating offerees until the earlier of (a) January 1, 2002 or (b) the date on which the Term Loan has been fully repaid by Parago, and will be exercisable only by either (i) participating offerees who fully perform their obligations under the Participation Agreement or (ii) all participating offerees in the event Parago repays the Term Loan in full. If Parago does not fully repay the Term Loan, and any participating offeree fails to fully perform its obligations under the Participation Agreement, those Warrants issued to such

participating offeree will automatically be cancelled, and Parago will reissue those Warrants to TH Lee. The Warrants may be exercised through the earlier to occur of Parago's initial public offering or January 9, 2004.

6. Events Relating to Required Performance Under the Guaranty. In the event that TH Lee is required to repay any portion of the Term Loan pursuant to the Guaranty, Parago will issue to TH Lee a convertible promissory note (the Convertible Note) in a principal amount equal to such amount paid by TH Lee less the escrow funds contributed by participating offerees that are received by TH Lee pursuant to the terms of the Escrow Agreement. The Convertible Note will be convertible into shares of Series A-1 Stock and Series A-2 Stock on the basis indicated below. Immediately after TH Lee's payment under the Guaranty, and assuming the amount of that payment exceeds the escrow funds, Parago will send a notice to all participating offerees requiring that the participating offerees send their remaining Pro Rata Percentage portion of the amount in excess of the escrow balance to Parago by December 31, 2001, which amounts Parago will forward to TH Lee. These payments will be credited against the principal amount of the Convertible Note in order to accurately reflect the net amount TH Lee has expended in repaying the Term Loan pursuant to the Guaranty. In the event that a participating offeree fails to timely pay the balance of its Pro Rata Percentage due for amounts paid under the Guaranty, then the amounts it deposited into the escrow fund will be forfeited, the Warrants the offeree received will be cancelled, the offeree will not be entitled to receive any shares of Series A-1 Stock or Series A-2 Stock and may be subject to a collection action by Parago for the balance of its Pro Rata Percentage. In this case, all current equity holdings in Parago (including the shares held by CT Holdings) would be diluted to approximately one-tenth of the fully-diluted current percentage ownership that they currently represent. CT Holdings would be required to pay up to approximately $1.4 million in the event Parago is unable to repay the bridge loan.

7. Full Repayment of the Term Loan Under the Guaranty. In the event that the entire principal amount of the Term Loan is repaid pursuant to the Guaranty, TH Lee and each participating offeree who performs under the Participation Agreement will receive as consideration for the payment of such amount shares of either Series A-1 Stock or Series A-2 Stock. TH Lee and participating offerees who currently own shares of Parago's preferred stock will be entitled to receive shares of Series A-1 Stock, the number of which will be determined based on TH Lee's and each participating offeree's relative ownership of preferred stock as a percentage of their total Common Stock Equivalent ownership. TH Lee and participating offerees who currently own shares of Parago common stock or the right to purchase common stock (including CT Holdings) will be entitled to receive shares of Series A-2 Stock, the number of which will be determined based on TH Lee's and each participating offeree's relative ownership of common stock or the right to purchase common stock as a percentage of their total Common Stock Equivalent ownership. In addition to the Shares of Series A-1 Stock and Series A-2 Stock that TH Lee will receive based upon its current percentage ownership of Parago, TH Lee will also receive shares of Series A-1 Stock related to the pro rata share of those of those securityholders of Parago who are not eligible to participate in the offering, those offerees who do not participate in the offering and those participating offerees who do not perform all of their obligations under the Participation Agreement. The combined amount of Series A-1 Stock and Series A-2 Stock issued by Parago to TH Lee and the participating offerees in the event that the amount paid under the Guaranty equals or exceeds the principal amount of the Term Loan will be an amount such that the Common Stock Equivalents of Parago as of June 15, 2001 (excluding the Warrants to purchase shares of Series A-3 Stock) will equal approximately 10% of Parago's total capitalization (excluding the warrants) after the issuance of such shares

of Series A-1 Stock and Series A-2 Stock.

8. Partial Repayment of the Term Loan. If less than the entire principal amount of the Term Loan is repaid pursuant to the Guaranty, TH Lee and each participating offeree who performs under the Participation Agreement will receive as consideration for the payment of such amount their pro rata share of either Series A-1 Stock and/or Series A-2 Stock. The manner of allocating the Series A-1 Stock and the Series A-2 Stock would be similar to that described in the preceding paragraph. The combined amount of Series A-1 Stock and Series A-2 Stock issued by Parago to TH Lee and the participating offerees in the case of a partial payment of the Term Loan pursuant to the Guaranty will be an amount computed using the following formula:

$$X = \frac{(A)}{(1-(.9B))} - A$$

X = the total amount of Series A-1 Stock and Series A-2 Stock, expressed on an as-converted basis as Common Stock Equivalents

A = the total number of shares of Parago common stock and Common Stock Equivalents as of June 15, 2001 (excluding the Warrants to purchase shares of Series A-3 Stock)

B = a percentage equal to the quotient of (i) the portion of the Term Loan repaid pursuant to the Guaranty and (ii) the total amount, including fees and expenses, required to be paid to Comerica at the maturity of the Term Loan.

9. Terms of Series A-1 and Series A-2 Stock. The Series A-1 Stock and Series A-2 Stock will each have terms, similar to Parago's existing Series D Stock, provided that the Series A-1 Stock will have a liquidation preference senior to the Series A-2 Stock and the Series A-3 Stock, and pari passu with all of Parago's other currently existing series of preferred stock, while the Series A-2 Stock will have a liquidation preference junior to that of the Series A-1 Stock and all currently existing series of preferred stock and pari passu with that of the Series A-3 Stock.

10. Cross-Default of the Term Loan Due to TH Lee Actions. The foregoing description of the terms and procedures relating to participation in the Guaranty is subject in all respects to the following description of other terms and procedures that would be followed in the event that certain actions or inactions by TH Lee resulted in a default under the Term Loan.

In some circumstances, an action or inaction by TH Lee could cause a default of the Term Loan. If this were to occur, then TH Lee is required to immediately pay the entire outstanding balance of the Term Loan, at which time Parago will effectively become indebted to TH Lee rather than to Comerica on similar but not identical terms (the TH Lee Debt). Parago would be entitled to prepay the TH Lee Debt at any time on or prior to December 15, 2001, the original maturity date of the Term Loan (the Original Maturity Date), in which event the escrowed funds (including accrued interest) would be released in full back to TH Lee and each participating offeree, the Warrants previously granted would become fully exercisable and no shares of Series A-1 Stock or Series A-2 Stock would be issued. If, however, the TH Lee Debt is not fully repaid by the Original Maturity Date, then the rights and obligations of all parties would operate in a fashion similar to the case where TH Lee had made a payment under the Guaranty at the time of maturity of the Term Loan, as more fully described in Paragraphs 6-8 above. In such

circumstances, the TH Lee Debt, as evidenced by the Convertible Note, would be reduced by the amount of escrowed funds contributed by participating offerees and by the payment by participating offerees of the balance of their respective Pro Rata Percentages of the outstanding amount due under the Convertible Note. Following payment of the balance of their respective Pro Rata Percentage of the amounts due under the Convertible Note, participating offerees would receive shares of Series A-1 Stock or Series A-2 Stock, allocated in a manner similar to that set forth in Paragraph 7 above. In the event that a participating offeree fails to timely pay the balance of its Pro Rata Percentage of the outstanding amount due under the Convertible Note, then the amounts that the participating offeree deposited into the escrow fund will be forfeited, the Warrants that the participating offeree received will be cancelled, the offeree will not be entitled to receive any shares of Series A-1 Stock or Series A-2 Stock and the offeree may be subject to a collection action by Parago for the balance of its Pro Rata Percentage obligation. In this case, all current equity holdings (including those of the participating offerees who fail to perform timely their obligations to provide the additional funds) in Parago would be diluted to approximately ten percent (10%) of the fully-diluted current percentage ownership that they represent.

11. Investors' Rights Agreements. Parago has executed an Investors' Rights Agreement for the benefit of TH Lee and each participating offeree with respect to the Series A-3 Stock and related shares of common stock that may be acquired upon conversion of the Series A-3 Stock. In addition, a similar Investors' Rights Agreement will also be executed in the event of the issuance of the Series A-1 Stock and Series A-2 Stock at the time of issuance of such stock. The Investors' Rights Agreements will provide TH Lee and each participating offeree, beginning 180 days following an initial public offering by Parago, the right to (a) piggyback registrations on registration statements filed by Parago and (b) subject to certain restrictions, one demand registration on Form S-3 in any twelve (12)-month period. All expenses of any such registrations, other than underwriting discounts and commissions incurred, shall be borne by Parago. TH Lee and each participating offeree are bound by the terms of the Investors' Rights Agreements to hold their common stock for a period to be determined by Parago and its underwriter in an initial public offering for a period of no more than 180 days following such initial public offering. TH Lee's and the participating offeree's registration rights described above expire four (4) years following an initial public offering.

12. Waivers Obtained. Parago has obtained waivers from its preferred stockholders and warrantholders and from Comerica of certain anti-dilution and preemptive rights with respect to the issuance of the Warrants, the Series A-1 Stock, the Series A-2 Stock and the Series A-3 Stock to TH Lee and the participating offerees. Parago has also obtained waivers of anti-dilution, preemptive and voting rights in connection with our proposed issuance of a new series of preferred stock (the Series E Stock) in its next round of financing assuming such round is on the same terms as Parago's Series D Stock and at a valuation of at least $60,000,000. In the event Parago is unable to obtain a valuation of at least $60,000,000, the consent of the holders of the existing preferred stock would be required to issue securities on a par with or senior to the existing preferred stock.

13. Increase of Authorized Capital Stock. Parago has obtained the approval of a majority of the shares owned by its stockholders to amend its Certificate of Incorporation to authorize the additional shares of common stock and preferred stock.

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 19, 2001   By: /s/ STEVEN B. SOLOMON

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