NETZEE INC
Form 10-Q
November 14, 2002

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

[X] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2002**

Or

[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _______________ to _______________, 20___.**

Commission file number: 0-27925

Netzee, Inc.

(Exact name of registrant as specified in its charter)

Georgia	**58-2488883**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

6190 Powers Ferry Road, Suite 400, Atlanta, Georgia 30339
(Address of principal executive offices)

(770) 850-4000
(Registrant s telephone number including area code)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of November 12, 2002, there were 3,327,442 shares of the Registrant s Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

NETZEE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2001	September 30, 2002
		(Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 464,889	$ 1,251,551
Restricted cash	325,000	310,000
Accounts receivable, net of allowance for doubtful accounts of $375,202 and $142,316, at December 31, 2001 and September 30, 2002, respectively	2,708,227	1,345,278
Leases receivable, current portion	630,083	553,310
Prepaid and other current assets	1,091,442	640,380
Total current assets	5,219,641	4,100,519
Property and equipment, net of accumulated depreciation of $3,007,404 and $4,247,419, at December 31, 2001 and September 30, 2002, respectively	4,315,900	3,844,064
Intangible assets, net of accumulated amortization of $50,028,727 and $63,619,331, at December 31, 2001 and September 30, 2002, respectively	22,261,157	6,890,553
Leases receivable, net of current portion	638,267	492,822
Other non-current assets	65,607	
Total assets	$ 32,500,572	$ 15,327,958
LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 1,303,835	$ 577,878
Accrued liabilities	1,354,045	584,352
Deferred revenue	2,697,894	1,846,099
Accrued dividends	1,039,996	1,430,000
Related-party borrowings, current portion		13,532,869
Total current liabilities	6,395,770	17,971,198
Related-party borrowings	13,191,715	
Deferred revenue, net of current portion	1,180,780	915,176
Total liabilities	20,768,265	18,886,374
Commitments and contingencies		
Redeemable preferred stock, no par value; 5,000,000 shares authorized:		
8% convertible preferred stock, $13 stated value; 500,000 shares authorized, issued and outstanding at December 31, 2001 and September 30, 2002	6,500,000	6,500,000
Shareholders equity (deficit):		
Common stock, no par value; 70,000,000 shares authorized at December 31, 2001 and September 30, 2002, 3,377,911 and 3,327,442 shares issued and outstanding at December 31, 2001 and September 30, 2002, respectively	190,555,255	190,134,547
Notes receivable from shareholders	(579,486)	(486,876)
Deferred stock-based compensation	(629,234)	
Accumulated deficit	(184,114,228)	(199,706,087)

Total shareholders equity (deficit)	5,232,307	(10,058,416)
Total liabilities and shareholders equity (deficit)	$ 32,500,572	$ 15,327,958

The accompanying notes are an integral part of these balance sheets.

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NETZEE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Nine Months Ended	
	September 30, 2001	September 30, 2002	September 30, 2001	September 30, 2002
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Revenues:				
Monthly maintenance and service	$ 5,736,534	$ 3,840,098	$ 18,532,106	$ 12,302,596
License, hardware, implementation and other	499,553	670,157	1,521,987	1,407,614
Total revenues	6,236,087	4,510,255	20,054,093	13,710,210
Operating expenses:				
Cost of services, license, hardware, implementation and maintenance	3,314,774	1,550,885	11,445,978	4,963,186
Selling and marketing	772,393	233,207	3,142,097	609,032
General and administrative, excluding amortization of stock-based compensation and restructuring costs	2,354,084	1,404,979	9,191,449	5,393,692
Amortization of stock-based compensation	299,667	79,294	1,027,854	234,016
Depreciation	524,827	448,223	1,504,518	1,414,435
Amortization	8,600,423	3,062,717	26,853,284	14,643,977
Restructuring costs			1,535,193	
Long-lived asset impairment charges	12,142,146		12,142,146	
Net loss on sales of assets	8,987		4,557,737	
Total operating expenses	28,017,301	6,779,305	71,400,256	27,258,338
Operating loss	(21,781,214)	(2,269,050)	(51,346,163)	(13,548,128)
Interest expense, net	(218,088)	(245,139)	(697,655)	(663,241)
Net loss before cumulative effect of change in accounting principle	(21,999,302)	(2,514,189)	(52,043,818)	(14,211,369)
Cumulative effect of change in accounting principle				(743,065)
Net loss	(21,999,302)	(2,514,189)	(52,043,818)	(14,954,434)
Preferred stock dividends	(130,000)	(252,383)	(390,000)	(637,425)
Net loss attributable to common shareholders	$(22,129,302)	$(2,766,572)	$(52,433,818)	$(15,591,859)
Basic and diluted net loss attributable to common shareholders per share before cumulative effect of change in accounting principle	$ (6.60)	$ (0.83)	$ (15.65)	$ (4.41)
Loss per share from cumulative effect of change in accounting principle				(0.22)
Net loss attributable to common shareholders per share	$ (6.60)	$ (0.83)	$ (15.65)	$ (4.63)
Weighted average common shares outstanding	3,354,680	3,352,660	3,351,242	3,369,523

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

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NETZEE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	September 30, 2001	September 30, 2002
	(Unaudited)	(Unaudited)
Cash flows from operating activities:		
Net loss	$(52,043,818)	$(14,954,434)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Cumulative effect of change in accounting principle		743,065
Depreciation and amortization	28,357,802	16,058,412
Stock-based compensation expense	1,027,854	234,016
Net loss on sales of assets	4,557,737	
Long-lived asset impairment charges	12,142,146	
Provision for bad debt	(41,851)	(118,863)
Interest income on shareholder notes	(40,375)	(19,605)
Changes in assets and liabilities, net of effect of acquisitions and dispositions:		
Accounts receivable	1,234,000	1,481,812
Leases receivable	444,482	222,218
Prepaid and other assets	306,067	889,244
Accounts payable and accrued liabilities	(2,533,574)	(1,495,650)
Deferred revenue	(1,277,725)	(1,117,399)
Other	(284,397)	(36,742)
Net cash (used in) provided by operating activities	(8,151,652)	1,886,074
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(420,954)	
Purchase of property, equipment and capitalized software	(1,609,030)	(1,052,378)
Proceeds from sales of assets	15,513,801	121,250
Purchase of short-term investments related to restricted cash	(475,000)	(110,000)
Proceeds from sales of short-term investments related to restricted cash	350,000	125,000
Net cash provided by (used in) investing activities	13,358,817	(916,128)
Cash flows from financing activities:		
Related party borrowings	9,425,335	1,650,000
Payments on related party borrowings	(16,196,706)	(1,300,000)
Debt extension costs		(620,000)
Repayment of shareholder notes	995,179	112,215
Redemption of common stock		(25,499)
Payments of notes payable	(22,372)	
Proceeds from exercise of options for common stock	71	
Net cash used in financing activities	(5,798,493)	(183,284)
Net (decrease) increase in cash and cash equivalents	(591,328)	786,662
Cash and cash equivalents, beginning of period	960,231	464,889
Cash and cash equivalents, end of period	$ 368,903	$ 1,251,551

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid for interest	$ 1,115,515	$ 693,202

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

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NETZEE, INC. AND SUBSIDIARIES

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND NATURE OF BUSINESS

Overview

We are a provider of a suite of integrated Internet banking products and services and Internet commerce solutions to community financial institutions and their customers. This suite provides cost-effective, secure and scalable Internet banking and Internet commerce products that enable financial institutions to offer to their customers a wide array of financial products and services over the Internet in either an in-house or fully outsourced environment. Customers can select from the components of our suite to develop an e-commerce strategy that best suits their business requirements. Included in the suite are full service Internet banking, bill payment, cash management, and Internet commerce services, as well as custom web site design and hosting services, branded portal services, targeted marketing services, and implementation and marketing services.

Formation and Acquisitions

Direct Access Interactive, Inc. (Direct Access) was incorporated on October 10, 1996. On March 9, 1999, Direct Access was purchased by InterCept, Inc. (InterCept). Direct Access was operated as a separate subsidiary of InterCept. On August 6, 1999, Direct Access purchased the remote banking operations of SBS Corporation (SBS). SBS provided automated technology products and services to community financial institutions nationwide. Direct Access was later merged with and into Netzee, Inc. (Netzee). On September 3, 1999, we purchased the Internet banking divisions of TIB The Independent BankersBank (TIB) and The Bankers Bank (collectively, the Divisions), and we acquired Dyad Corporation and subsidiaries (Dyad) and Call Me Bill, LLC (Call Me Bill). Call Me Bill provided 24-hour electronic bill payment services to financial institutions customers. In November 1999, we completed an initial public offering of our common stock. On December 15, 1999, we purchased DPSC Software, Inc. (DPSC), which provided regulatory reporting and related software to community financial institutions.

On March 7, 2000, we purchased Digital Visions, Inc. (DVI), which provided Internet-based information and analytic tools to financial institutions. In July 2000, we acquired Card Plus, Inc., (Card Plus), which provided outsourced technology consulting and programming services. In November 2000, we acquired the Internet banking and bill payment businesses of John H. Harland Company (Harland). In March 2001, we acquired the Internet banking assets of HomeCom Communications, Inc. (HomeCom).

We collectively refer to SBS, the Divisions, Dyad, Call Me Bill, DPSC, DVI, Card Plus, the Internet banking and bill payment businesses acquired from Harland and the Internet banking assets acquired from HomeCom as the Acquired Operations.

Dispositions

On February 2, 2001, we sold to InterCept the regulatory reporting business acquired from DPSC in 1999, and InterCept assumed certain of the related operating liabilities. Effective May 1, 2001, we sold to iPay, LLC (iPay) certain assets not considered to be part of our core business related to our bill payment operations formerly located in Elizabethtown, Kentucky, and iPay assumed certain of the related operating liabilities. On November 15, 2001, we sold substantially all the assets acquired from DVI to SS&C Technologies, Inc. (SS&C), and SS&C assumed substantially all the related operating liabilities.

Significant Accounting Policies

The accompanying statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of

management, the accompanying unaudited consolidated financial statements reflect all adjustments, which are of a normal recurring nature, to present fairly our financial position, results of operations and cash flows at the dates and for the periods presented. Interim results of operations are not necessarily indicative of results to be expected for a 12-month period. The interim financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2001 as filed with the Securities and Exchange Commission on April 1, 2002.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires us to make certain estimates regarding the reported amounts of revenue, expenses, assets and liabilities, as well as certain contingencies. We evaluate these estimates and the underlying assumptions for reasonableness on an on-going basis. Actual results may vary from these estimates.

The unaudited consolidated financial statements include the accounts of our company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Certain amounts in prior periods have been reclassified to conform to the current year presentation. These reclassifications had no impact on previously reported results of operations.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) approved Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 established new standards for accounting and additional disclosure requirements for business combinations initiated after June 30, 2001. Additionally, SFAS No. 141 prohibits the use of the pooling-of-interest method for business combinations initiated after June 30, 2001. SFAS No. 142 changed the accounting for goodwill from an amortization method to an impairment-only approach. Under SFAS No. 142, goodwill is to be tested at the reporting unit level annually and whenever events or circumstances occur indicating that goodwill might be impaired. Amortization of goodwill ceased effective January 1, 2002. We adopted SFAS No. 141 and SFAS No. 142 effective January 1, 2002. As discussed further in Note 2, we recorded an impairment charge of approximately $740,000 from the adoption of SFAS No. 142.

In August 2001, the FASB issued SFAS No. 143, Accounting for Obligations Associated with the Retirement of Long-Lived Assets, which establishes accounting standards for the recognition and measurement of tangible long-lived asset retirement obligations and associated asset retirement costs. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. SFAS No. 143 will not apply to us until January 1, 2003, and we do not expect that the adoption of SFAS No. 143 will have a significant impact on our results of operations or financial condition.

In October 2001, the FASB issued SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. SFAS No. 144 supersedes SFAS No. 121 and addresses financial accounting and reporting for the impairment or disposal of long-lived assets. In contrast to SFAS No. 121, this statement requires the exclusion of goodwill from its scope and, therefore, eliminates the requirement of SFAS No. 121 to allocate goodwill to long-lived assets to be tested for impairment. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. We have adopted SFAS No. 144 effective January 1, 2002. The adoption of SFAS No. 144 did not have a material impact on our results of operations or financial condition.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002. We do not believe that the adoption of SFAS No. 146 will have a material impact on our results of operations or financial condition.

2. GOODWILL, INTANGIBLE ASSETS, AND CHANGE IN ACCOUNTING PRINCIPLE

Upon our adoption of SFAS No. 141 as of January 1, 2002, we reclassified certain intangible assets previously allocated to Workforce into goodwill, and ceased the amortization related to these intangibles.

During the second quarter, we completed the impairment test required by SFAS No. 142. As a result of this impairment test, we determined that the carrying amount of goodwill was in excess of its fair value as determined by a discounted cash flow approach. As a result, we have recorded an impairment charge of $743,065 relating to goodwill which is presented as a cumulative effect of change in accounting principle.

A summary of the changes to goodwill for the nine months ended September 30, 2002 is presented below:

	Goodwill	Accumulated Amortization	Carrying Value
Balance at December 31, 2001	$	$	$
ADD: Reclassification of Workforce	1,780,000	(1,036,935)	743,065
LESS: Goodwill Impairment	(1,780,000)	1,036,935	(743,065)
Balance at September 30, 2002	$	$	$

Our other intangible assets are subject to amortization with useful lives ranging from three to four years. We reviewed the carrying value of these assets under the guidance of SFAS No. 144 and determined there was no impairment related to these balances. The balances of these intangible assets are summarized below:

Balances at December 31, 2001	Total	Accumulated Amortization	Carrying Value
Workforce	$ 1,780,000	$ (1,036,935)	$ 743,065
Contracts in Progress	1,880,000	(1,294,583)	585,417
Acquired Technology	68,629,884	(47,697,209)	20,932,675
	$72,289,884	$(50,028,727)	$22,261,157

Balances at September 30, 2002	Total	Accumulated Amortization	Carrying Value
Contracts in Progress	$ 1,880,000	$ (1,600,833)	$ 279,167
Acquired Technology	68,629,884	(62,018,498)	6,611,386
	$70,509,884	$(63,619,331)	$6,890,553

For the nine months ended September 30, 2002, amortization expense related to these intangible assets was approximately $14.7 million. Estimated amortization for the remainder of 2002 and the next four fiscal years is as follows:

2002	$1,600,000
2003	5,270,000
2004	25,000
2005	
2006	

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The following tables reconcile the impact of adopting SFAS No. 142 for the three and nine months ended September 30, 2001 and 2002:

	Three Months Ended	
	September 30, 2001	September 30, 2002
Net loss as reported	$(21,999,302)	$(2,514,189)
Add back goodwill amortization	148,334	
Adjusted net loss	$(21,850,968)	$(2,514,189)
Basic and diluted net loss per share	$ (6.56)	$ (0.75)
Add back goodwill amortization per share	0.05	
Adjusted basic and diluted net loss per share	$ (6.51)	$ (0.75)

	Nine Months Ended	
	September 30, 2001	September 30, 2002
Net loss as reported	$(52,043,818)	$(14,954,434)
Add back cumulative effect of change in accounting principle		743,065
Net loss before cumulative impact of change in accounting principle as reported	(52,043,818)	(14,211,369)
Add back goodwill amortization	445,000	
Adjusted net loss	$(51,598,818)	$(14,211,369)
Basic and diluted net loss per share	$ (15.53)	$ (4.44)
Add back cumulative effect of change in accounting principle		$ 0.22
Adjusted net loss per share	$ (15.53)	$ (4.22)
Add back goodwill amortization per share	0.13	
Adjusted net loss per share	$ (15.40)	$ (4.22)

3. RELATED-PARTY BORROWINGS

We have a joint credit facility with InterCept and Harland with a maturity date of April 10, 2003. Of the total $18 million that may be borrowed, the first $17 million, to the extent borrowed, will be funded approximately 77% by InterCept and 23% by Harland. The remaining $1 million, if borrowed, will be funded solely by InterCept.

As of September 30, 2002, the balance on this joint facility was $13,532,869 with InterCept s and Harland s portion totaling $10,381,064 and $3,151,805 respectively, including accrued interest of $229,575. At September 30, 2002, we were in compliance with all the covenants of the credit agreement. We have classified our related-party borrowings as current liabilities at September 30, 2002 due to their maturity date of April 10, 2003.

4. PREFERRED STOCK

On March 29, 2002, the Registration Rights Agreement with the former shareholders of DPSC was amended to defer, until April 10, 2003, the right of the holders of our Series B 8% Convertible Preferred Stock (the Series B Preferred Stock) to require Netzee to repurchase the preferred stock at a price of $13.00 per share, plus all accrued and unpaid dividends

thereupon. In connection with this amendment, we paid an extension fee of approximately $500,000, which will be amortized over the term of the extension as preferred dividend expense. As of September 30, 2002, we have accrued $1,430,000 in dividends on our Series B Preferred Stock.

5. BASIC AND DILUTED NET LOSS PER SHARE

Basic and diluted net loss per share has been computed in accordance with SFAS No. 128, Earnings per Share, using net loss divided by the weighted average number of shares of common stock outstanding for the periods presented. Potentially dilutive options to purchase 149,642 shares of common stock with a weighted average exercise price of $19.06 per share and 319,609 shares of common stock with a weighted average exercise price of $53.04 per share were outstanding at September 30, 2002 and September 30, 2001, respectively. Additionally, 51,384 shares of common stock issuable upon conversion of the Series B Preferred Stock were outstanding for the nine months ended September 30, 2002 and September 30, 2001, and 102,343 shares of common stock issuable upon the achievement of certain performance targets associated with the DVI acquisition were outstanding for the nine months ended September 30, 2001. These amounts have been excluded from the presentation of diluted net loss per share, as they are antidilutive.

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

The following discussion contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include all statements that are not statements of historical fact regarding the intent, belief or expectations of Netzee, Inc. and our management with respect to, among other things: (1) whether we can improve or continue to improve our financial condition; (2) our ability to control our operating costs; (3) trends affecting our operations, financial condition and business; (4) our growth and operating strategies; (5) our ability to achieve our sales, cash flow, and cost-saving objectives; (6) the continued and future acceptance of and demand for our products and services by our customers; (7) our ability to retain existing customers and execute agreements with new customers; and (8) our ability to comply with all of the terms, conditions and covenants under our credit facility and the terms related to our Series B Preferred Stock. The words may, will, anticipate, believe, intend, expect, estimate, plan, strategy and similar expressions are intended to identify forward-looking statements. These statements are based upon a number of assumptions and estimates that are subject to significant uncertainties, many of which are beyond our control. These forward-looking statements are not guarantees of future performance, and actual results may differ materially from those projected in the forward-looking statements as a result of risks related to our brief operating history and our ability to achieve or maintain profitability; our ability to achieve, manage or maintain growth and execute our business strategy successfully; our ability to achieve our cash flow and cost-saving objectives; our dependence on developing, testing and implementing, and our ability to successfully market and sell, our products and services; risks associated with possible system failures and rapid changes in technology; risks associated with previous and potential future security breaches; our ability to retain existing customers and execute agreements with new customers; our ability to sell our products and services to financial institution customers and their customers; our ability to respond to competition; the volatility associated with Internet-related companies; our ability to obtain adequate funding; our ability to comply with all of the terms, conditions and covenants under our credit facility and the terms related to our Series B Preferred Stock; and various other factors discussed in detail in the section entitled Factors That May Affect Our Future Results of Operations and Financial Condition, in our Form 10-K for the fiscal year ended December 31, 2001, as filed with the Securities and Exchange Commission on April 1, 2002, and in our subsequent quarterly and current reports that we have filed with the SEC. We do not undertake any obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results.

Overview

For our outsourced suite of products and services, we charge a fixed monthly fee based on the number and type of products and services purchased by the financial institution. We also charge variable fees that are based on the number of end users and the number of transactions for certain products and services. We generally provide products and services under contracts with terms ranging from three to five years. Revenues from these types of arrangements are recognized over the term over which the related services are provided.

We charge fees for our in-house Internet banking products under either a perpetual license agreement which includes a software license fee, implementation fees and recurring monthly fees based on the number of active users and user-generated transactions, or under a three- to five-year subscription that includes annual subscription and maintenance fees. Revenues from the software and implementation component of those types of arrangements are recognized in accordance with Statement of Position (SOP) No. 97-2, Software Revenue Recognition and Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition. Recurring fees represent post-contract customer support and are recognized over the period in which the support services are provided.

Our costs of services, license, hardware, implementation and maintenance are comprised of the initial equipment and personnel costs required to implement Internet and telephone banking products and services for our financial institution customers, on-going personnel and system maintenance costs associated with our data and call centers, royalties paid to information providers, and personnel, production and shipping costs associated with our former fulfillment business, but exclude non-cash stock-based compensation and restructuring costs.

Selling and marketing expenses include marketing expenses, sales commissions and related costs as well as sales employee compensation and benefits. Commissions are paid to sales personnel based on products and services sold. Selling and marketing expenses exclude non-cash stock-based compensation and restructuring costs.

General and administrative expenses include employee compensation and benefits and general office expenses incurred in the ordinary course of business, but exclude non-cash stock-based compensation and restructuring costs.

Amortization of stock-based compensation consists of amortization of deferred compensation for certain stock options with an exercise price below our initial public offering price and compensation expense for stock sold or awarded to employees at prices below our initial public offering price.

Depreciation consists of depreciation of property, equipment and capitalized software development costs.

Amortization relates to acquired technology and other intangible assets resulting from our acquisitions. Intangible assets are being amortized over lives ranging from three to four years.

Restructuring costs include charges related to severance and other payroll-related items, as well as certain office lease and other contract termination costs resulting from the consolidation of our Internet and bill payment operations during 2001.

Net loss on sales of assets includes non-cash charges recorded to reduce the carrying costs of certain assets to their fair market value upon their sale.

Net interest expense includes our borrowing costs related to our credit facility less amounts received related to our lease receivables, interest on shareholders notes and other interest income.

Preferred stock dividends are related to our Series B Preferred Stock.

We use pro forma EBITDA as a metric to measure our on-going operating performance. We define pro forma EBITDA as earnings before interest, taxes, depreciation, amortization, amortization of stock-based compensation, restructuring costs, net loss on sales of assets and long-lived asset impairment charges. Even though we use pro forma EBITDA to measure our on-going operating performance, it is not an accepted measure of profitability under accounting principles generally accepted in the United States. Additionally, our calculation of pro forma EBITDA may differ from other companies calculations of EBITDA.

We also use pro forma cash earnings (loss) as a metric to measure our on-going operating performance. Pro forma cash earnings (loss) is defined as net loss attributable to common shareholders, excluding the effects of amortization of intangible assets, amortization of stock-based compensation, restructuring costs, net loss on sales of assets and long-lived asset impairment charges. Even though we use pro forma cash earnings (loss) to measure our on-going operating performance, it is not an accepted measure of profitability under accounting principles generally accepted in the United States. Additionally, our calculation of pro forma cash earnings (loss) may differ from other companies calculations of cash earnings (loss) and will differ from actual cash flow from operations.

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We have incurred operating losses through September 30, 2002. Due to the uncertainty of our ability to realize the net operating losses, we have not reflected an income tax benefit in our statements of operations, and we have recorded a valuation for the full amount of our net operating loss carry-forwards.

We have incurred substantial operating losses, and although cash flow from operations was positive for the first nine months of fiscal 2002, we have negative cash flows from operations since inception. We incurred net losses of approximately $22.1 million and $2.8 million for the three months ended September 30, 2001 and September 30, 2002, respectively, and approximately $52.4 million and $15.6 million for the nine months ended September 30, 2001 and September 30, 2002, respectively. Non-cash expenses, including depreciation, amortization, amortization of stock-based compensation, net loss on sales of assets, long-lived asset impairment charges, and cumulative effect of change in accounting principle, accounted for approximately 98%, 130%, 88% and 109% of the net loss attributable to common shareholders for the three months ended September 30, 2001 and September 30, 2002, and for the nine months ended September 30, 2001 and September 30, 2002, respectively.

Results of Operations

The following tables set forth the results of our operations for the three months and the nine months ended September 30, 2001 and 2002, selected cash flow information for the nine months ended September 30, 2001 and 2002, and selected balance sheet data as of December 31, 2001 and September 30, 2002. These operating results are not necessarily indicative of our future results.

	Three Months Ended			
	September 30, 2001	% of Revenue	September 30, 2002	% of Revenue
	(Unaudited)		(Unaudited)	
Revenues	$ 6,236,087	100%	$ 4,510,255	100%
Cost of services, license, hardware, implementation and maintenance	3,314,774	53%	1,550,885	34%
GROSS PROFIT	2,921,313	47%	2,959,370	66%
Operating expenses:				
Selling and marketing	772,393	12%	233,207	5%
General and administrative, excluding amortization of stock-based compensation and restructuring costs	2,354,084	38%	1,404,979	31%
Amortization of stock-based compensation	299,667	5%	79,294	2%
Depreciation	524,827	8%	448,223	10%
Amortization	8,600,423	138%	3,062,717	68%
Long-lived asset impairment charges	12,142,146	195%		
Loss on sales of assets	8,987			
Total operating expenses	24,702,527	396%	5,228,420	116%
Operating loss	(21,781,214)	- 349%	(2,269,050)	-50%
Interest expense, net	(218,088)	-3%	(245,139)	-5%
Net loss	(21,999,302)	- 352%	(2,514,189)	-55%
Preferred stock dividends	(130,000)	-2%	(252,383)	-6%
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ (22,129,302)	- 354%	$ (2,766,572)	-61%
Weighted average basic and diluted shares outstanding	3,354,680		3,352,660	
Basic and diluted net loss attributable to common shareholders per share	$ (6.60)		$ (0.83)	
Reconciliation of operating loss to pro forma measures:				
Pro forma EBITDA:				
Operating loss	$ (21,781,214)		$ (2,269,050)	
Add back amortization	8,600,423		3,062,717	
Add back amortization of stock-based compensation	299,667		79,294	
Add back depreciation	524,827		448,223	
Add back long-lived asset impairment charges	12,142,146			
Add back loss on sales of assets	8,987			
Pro forma EBITDA	$ (205,164)	-3%	$ 1,321,184	29%
Pro forma cash loss:				
Operating loss	$ (21,781,214)		$ (2,269,050)	
Add back amortization	8,600,423		3,062,717	
Add back amortization of stock-based compensation	299,667		79,294	
Add back long-lived asset impairment charges	12,142,146			

Add back gain on sales of assets	8,987			
Less interest expense, net	(218,088)		(245,139)	
Less preferred stock dividends	(130,000)		(252,383)	
Pro forma cash (loss) earnings	$ (1,078,079)	-17%	$ 375,439	8%

	Nine Months Ended			
	September 30, 2001	% of Revenue	September 30, 2002	% of Revenue
	(Unaudited)		(Unaudited)	
Revenues	$ 20,054,093	100%	$ 13,710,210	100%
Cost of services, license, hardware, implementation and maintenance	11,445,978	57%	4,963,186	36%
GROSS PROFIT	8,608,115	43%	8,747,024	64%
Operating expenses:				
Selling and marketing	3,142,097	16%	609,032	5%
General and administrative, excluding amortization of stock-based compensation and restructuring costs	9,191,449	46%	5,393,692	39%
Amortization of stock-based compensation	1,027,854	5%	234,016	2%
Depreciation	1,504,518	7%	1,414,435	10%
Amortization	26,853,284	134%	14,643,977	107%
Restructuring costs	1,535,193	8%		
Long-lived asset impairment charges	12,142,146	60%		
Net loss on sales of assets	4,557,737	23%		
Total operating expenses	59,954,278	299%	22,295,152	163%
Operating Loss	(51,346,163)	-256%	(13,548,128)	-99%
Interest expense, net	(697,655)	-3%	(663,241)	-4%
Net loss before cumulative effect of change in accounting principle	(52,043,818)	-259%	(14,211,369)	-103%
Cumulative effect of change in accounting principle			(743,065)	-6%
Net loss	(52,043,818)	-259%	(14,954,434)	-109%
Preferred stock dividends	(390,000)	-2%	(637,425)	-5%
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS	$ (52,433,818)	-261%	$ (15,591,859)	-114%
Weighted average basic and diluted shares outstanding	3,351,242		3,369,523	
Basic and diluted net loss attributable to common shareholders per share before cumulative effect of change in accounting principle	$ (15.65)		$ (4.41)	
Basic and diluted loss per share from cumulative effect of change in accounting principle				