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CT HOLDINGS INC  
Form 10KSB  
April 15, 2003

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

FORM 10-KSB

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

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

COMMISSION FILE NUMBER: 0-08718

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

DELAWARE  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

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

8750 N. CENTRAL EXPRESSWAY, SUITE 100, DALLAS, TEXAS 75231  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(214) 520-9292  
(ISSUER'S TELEPHONE NUMBER, INCLUDING AREA CODE)

SECURITIES REGISTERED UNDER SECTION 12(B) OF THE EXCHANGE ACT: NONE

SECURITIES REGISTERED UNDER SECTION 12(G) OF THE EXCHANGE ACT:

COMMON STOCK, PAR VALUE \$.01 PER SHARE  
(TITLE OF CLASS)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference to such filing requirements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenue from continuing operations for its most recent fiscal year \$ 0

As of April 9, 2003, the last reported sale price of the Company's common stock was \$ 0.012 per share. The aggregate market value of the voting and non-voting common stock held by non-affiliates of the Company was \$463,825 as of April 9, 2003.

As of April 9, 2003, there were 57,770,928 shares of common stock, \$.01 par value per share, outstanding.

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

CT HOLDINGS, INC.  
FORM 10-KSB  
ANNUAL REPORT  
FOR THE FISCAL YEAR ENDED  
DECEMBER 31, 2002  
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This Annual Report on Form 10-KSB contains forward-looking statements that involve known and unknown risks and uncertainties. The statements contained in this Report that are not purely historical are 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, including statements regarding the Company's expectations, beliefs, intentions or strategies regarding the future. In this Report, the words anticipates, believes, expects, estimates, intends, future and similar expressions identify forward-looking statements. All forward-looking statements included in this document are based on information available to the Company on the date hereof,

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and the Company assumes no obligation to update any such forward-looking statements. The Company's actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed elsewhere in this Report under the heading Factors That May Affect Future Operating Results as well as those discussed elsewhere in this Report, and the risks discussed in our Securities and Exchange Commission filings.

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### PART I

#### ITEM 1. DESCRIPTION OF BUSINESS

##### OVERVIEW OF CT HOLDINGS

CT Holdings, Inc. was incorporated in Delaware in 1992 and previously operated under the name Citadel Technology Inc. Our business model is designed to enable the companies in whom we invest or acquire to become market leaders in their industries. Our strategy over the years has led to the development, acquisition and operation of technology based businesses with strong business models and compelling valuations. We believe that the anticipated growth in technology creates strong opportunities for us to increase shareholder value by investing in early stage ventures well positioned for growth in their respective marketplaces. We will attempt to increase the value of each investee by providing management, marketing and financial expertise along with financial capital and then realize this new value through a subsequent liquidity event such as a spin-off, sale, merger or initial public offering of the investee companies.

At December 31, 2002 the Company held investments in Parago, Inc. ("Parago") and River Logic, Inc. ("River Logic"). An overview of each business is provided below. On May 17, 2002 the Company completed the spin-off of its Citadel Security Software Inc. subsidiary as a special dividend to shareholders of CT Holdings as of May 6, 2002. In October 2002 the Company's investment in Encore Telecommunications, Inc. was liquidated.

##### THE CITADEL SECURITY SOFTWARE DISTRIBUTION

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

After the Distribution, two of five directors of CT Holdings were also directors of Citadel and the Chief Executive Officer and the Chief Financial Officer of CT Holdings hold the same positions with Citadel. It is expected that 20% to 33% of the officers' time will be allocated to CT Holdings. All other employees of CT Holdings became employees of Citadel following the Distribution. Under the

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transition services agreement Citadel will provide accounting, administrative, information management and other services, including the services of the two officers, to CT Holdings in return for a payment of a monthly administrative fee initially estimated at \$20,000 per month. The fee may be adjusted quarterly subject to a reallocation of the estimated time devoted to each company.

### OVERVIEW OF PARAGO

We formed Parago in 1999 through the contribution of some technology assets acquired in the late 1990's during the growth period of Internet electronic commerce businesses. Parago provides a proprietary, promotional marketing technology platform that helps clients reduce promotional program costs, increase sales, and enhance customer relationships.

#### Services include:

- Technology applications that automate and optimize both traditional and non-traditional promotional marketing initiatives
- On-line and off-line rebate management
- Patent-pending upsell/cross-sell application
- Transaction data client reporting

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Many companies today use promotional marketing programs such as rebates, buy-one-get-one-free and instant discounts to entice customers and hopefully drive some measure of customer satisfaction and loyalty. But while these programs may be effective for acquisition, they most often fail when it comes to retention as there is little focus on customer satisfaction.

Parago's solutions seek to change the way companies think about rebates and other promotional tools. Currently rebates are viewed as a necessary evil required to remain competitive. However, all parties are dissatisfied with the status quo. By implementing Parago's solutions, clients can turn these flawed tactical, one-way customer acquisition initiatives into strategic, two-way customer retention imperatives. By leveraging the power of the Internet, innovative technology Parago takes the pain of traditional, short-term promotional marketing programs like rebates and converts it into long-term gain and competitive advantage in the form of lower costs, increased sales and better customer relationships.

Parago's products, PromoCenter, ClickChoice and KnowledgeCenter, have all been developed collectively with the objective of leveraging Internet-based technology, processes and resources to make promotional marketing programs more efficient and effective resulting in an improved bottom line and happier customers for our clients. Parago offers a Continuous Customer Interaction business model powered by three fully integrated business centers dedicated to automating and optimizing promotions like rebates thereby creating significant competitive advantage for our clients:

- **PromoCenter:** A client-branded site where customers can search for current promotional information, initiate the redemption process, obtain continuously updated claim status and take advantage of upsell/cross-sell opportunities.
- **ClickChoice:** A patent-pending, fully integrated application that provides customers the ability to upgrade their promotion to higher valued products or services while reducing client's promotional expense.
- **KnowledgeCenter:** A powerful transactional data collection and reporting environment that provides fresh, accurate and usable

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information reporting.

At December 31, 2002 the Company holds 20,000 shares of Parago common stock and warrants to purchase 28.8749 shares of Series A preferred stock (convertible into 2,887 shares of common stock), after giving effect to 1 for 1000 reverse stock split in connection with Parago's Series E preferred stock offering in December 2001 to February 2002, in which the Company elected not to participate. In December 2001 and January 2002 Parago raised equity financing of approximately \$15.0 million. We elected not to participate in the equity financing and as a result, our ownership percentage in Parago was reduced to approximately 1%. Our investment in Parago has no carrying value on our balance sheet as a result of applying the equity method of accounting prior to our investment falling below the 20% ownership requirement for applying the equity method of accounting. While Parago continues to incur operational losses we believe that our initial \$50,000 investment in Parago represented by 20,000 shares of common stock and 28.8749 warrants (convertible into 2,887 shares of Parago common stock) may ultimately provide an appropriate return.

### OVERVIEW OF RIVER LOGIC

In May 2000 CT Holdings acquired a minority interest in River Logic. River Logic develops decision-support applications for industry. River Logic develops and markets enterprise optimization technologies and decision support applications. Recognizing a need in the market place, River Logic created strategic-level, process modeling tools and approaches for helping senior managers suggest, evaluate, and understand the impact of business decisions as they relate to the overall profitability of their organizations. River Logic's optimization tools integrate several technologies such as mixed integer optimization, visual process modeling, accounting, and constraint theory to bring together the best active financial planning and profitability tool on the market.

The Enterprise Optimizer tool suite provides a structured process for modeling an enterprise, identifying material relationships, uncovering hidden value, and measuring the impact of decisions and relationships as they relate to the bottom-line profit of the entire organization. With Enterprise Optimizer, quickly developing a powerful and robust model that combines operational processes, profit implications, and financial analysis can be achieved without programming or understanding of the theoretical or mathematical principles used.

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A new user of Enterprise Optimizer may quickly become a productive modeler and financial analyst. River Logic's tools allow flexibility in abstracting organizational data so that the time-to-value for building valid and valuable models is very short without any loss in functionality. The power of the embedded expert knowledge base is that it automatically translates visual diagrams into mathematical representations that are validated, verified, optimized, and processed by several hundred algorithms and analytical procedures. Financial reports such as income statements, balance sheets, and cash flow statements are automatically prepared and analyzed.

River Logic's Xerator Server enables users to quickly re-purpose content products and other intellectual property using standard applications and delivery mediums to reduce the product development cycle and quickly generate new revenue streams. Xerator provides the power to securely and transparently organize, share and publish internal and external information and data across an extended organization or to customers.

The Company holds an ownership interest in River Logic of approximately 8% at December 31, 2002. River Logic is an early stage software company, has a history of operating losses and requires additional funding to continue operations and

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to attain profitability. Since the initial investment in May 2000, River Logic has raised additional capital through the issuance of preferred stock and other equity securities. The Company periodically evaluates the carrying value of its ownership interests in its investee companies taking into consideration, among other factors, the investee company's valuation following recent infusions of capital. The Company views the pricing of recent capital transactions with unrelated third parties as a measure of the fair value of the investment in River Logic.

A preferred stock financing in April 2001 reflected a valuation below the carrying value River Logic. As a result, the Company determined that the carrying value of its investment had a fair value of approximately \$2,700,000 and accordingly reduced the carrying value by \$360,000 at December 31, 2001. In June 2002 River Logic entered into an equity credit line financing arrangement at a valuation substantially below the carrying value of the investment in River Logic. As a result of the lower valuation, general information technology industry conditions and lower operational performance by River Logic, the Company believes that the net realizable value of the investment has been permanently impaired, is now zero and accordingly, the Company wrote down its investment in River Logic to zero at December 31, 2002.

### EMPLOYEES

As of December 31, 2002, CT Holdings had no employees. Pursuant to the transition services agreement between Citadel and CT Holdings all employees employed by CT Holdings prior to the Distribution were transferred to Citadel after the Distribution. Approximately five employees of Citadel including the CEO and CFO will spend 20% to 33% of their time managing the business development activities of CT Holdings. Citadel will receive a transition services fee from CT Holdings for administrative serves including the costs of the shared employees. Our CEO also serves as a director of Citadel, Parago and River Logic.

### GOVERNMENT REGULATION

Government regulation has not had a material effect on the conduct of our business to date.

### ACCOUNTANT'S REPORT

We have received a report from our independent auditors for our year ended December 31, 2002 containing an explanatory paragraph that describes the uncertainty regarding our ability to continue as a going concern due to our recurring operating losses and our significant working capital deficiency. Please see Management's Discussion and Analysis - Liquidity and Capital Resources and Note A to our financial statements that discuss some of the conditions that could impact our ability to continue operations under the current business conditions.

### 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,

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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.

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

The following matters, among other things, may have a material adverse effect on the business, financial condition, liquidity, or results of operations the Company. Reference to these factors in the context of a forward-looking statement or statements shall be deemed to be a statement that any one or more of the following factors may cause actual results to differ materially from those in such forward-looking statement or statements.

Before you invest in our common stock, you should be aware of various risks, including those described below. Investing in our common stock involves a high degree of risk. You should carefully consider these risk factors, together with all of the other information included in this Report, before you decide whether to purchase shares of our common stock. Our business and results of operations could be seriously harmed by any of the following risks. The trading price of our common stock could decline due to any of these risks, and you may lose part or all of your investment.

### GENERAL RISKS

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

Our business model is designed to enable the companies in whom we invest or acquire to become market leaders in their industries. Our strategy over the years has led to the development, acquisition and operation of technology based businesses with strong business models and compelling valuations. We believe that the anticipated growth in technology creates strong opportunities for us to increase shareholder value by investing in early stage ventures well positioned for growth in their respective marketplace. We will attempt to increase the value of each investee by providing management, marketing and financial expertise along with financial capital and then realize this new value through a subsequent liquidity event such as a sale, merger or initial public offering of the investee companies.

At December 31, 2002 the Company held investments in two companies, Parago and River Logic. In May 2002, we were successful in spinning out Citadel into a

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standalone company. During 2002 we looked at businesses and technologies in which to invest but economic and market conditions along with a general decline in the availability of capital prevented us from making investments.

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

- We may be unable to identify or develop relationships with attractive emerging companies.
- Any companies that we are able to attract may not succeed and the value of our assets and the price of our common stock could consequently decline.
- Our business model is unproven and depends on the willingness of companies to participate in our business development model and collaborate with each other and us.
- Our expenses will increase as we build the infrastructure necessary to implement this model.

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- We face competition from incubators, some of which are publicly traded companies, venture capital companies and large corporations; many of these competitors have greater financial resources and brand name recognition than we do, which may make it difficult for us to effectively compete.
- We will require additional capital resources in order to implement our business model and we may not be able to obtain these resources on attractive terms, if at all.

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

We have developed and invested in Citadel, Parago and River Logic (our "investees" or "investee companies"). Inasmuch as our investee companies are early stage ventures, it is difficult to judge their future prospects. Economic, governmental, industry and internal company factors outside of our control affect each of our investee companies. A significant portion of our assets is comprised of ownership interests in our investee companies. If our investee companies do not succeed, the value of our assets will and decline.

CT HOLDINGS WILL NOT HAVE ACCESS TO THE CASH FLOW OR ASSETS OF CITADEL, AND MAY BE UNABLE TO OPERATE PROFITABLY FOLLOWING THE DISTRIBUTION

Historically, since the businesses that comprise each of Citadel and CT Holdings have been under one ultimate parent, they have been able to rely, to some degree, on the earnings, assets and cash flow of each other for capital requirements. After the Distribution, CT Holdings has not been able to rely on the security software business for such requirements. Following the Distribution, CT Holdings continues to maintain its own credit and banking relationships and perform its own financial and investor relations functions. Because a significant number of key employees of CT Holdings have been employed by Citadel following the Distribution, there can be no assurance that CT Holdings will be able to successfully put in place the financial, administrative and managerial structure necessary to continue to operate as an independent public company, or that the development of such structure will not require a



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significant amount of management's time and other resources.

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

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

Although we have yet to make any investments in the investment securities of companies other than Citadel, Parago, River Logic and Encore, 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.

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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 significant working capital deficiency at December 31, 2002 of approximately \$3.4 million and a stockholders' deficit of approximately \$3.4 million. Cash used in operations was approximately \$418,000 during the year ended December 31, 2002. There was no cash balance at December 31, 2002. Immediate funding needs of the business are expected to be provided by financings through advances, short-term notes payable and additional investments from related parties although there can be no assurance that such financing will be available or on terms favorable to the Company.

We have been and continue to be dependent upon outside financing to perform our business development activities, make investments in new technology companies and to fund operations. During the year ended December 31, 2002, related parties provided substantially all of this financing. The financings during the

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year ended December 31, 2002 included proceeds of \$600,000 from the issuance of a convertible note to a shareholder and advances and proceeds of notes payable from the Company's CEO, directors and other related parties. Future cash may come from the realization of the value of our investments in Parago and River Logic, although there can be no assurance that any value will ever be realized from these investments.

Our strategy to support and expand business development activities will not generate positive cash flow in the foreseeable future. The complete implementation of this element of our strategy requires us to obtain additional capital. Achieving positive cash flow is highly dependent upon obtaining liquidity from the Company's investments in unconsolidated affiliates. We estimate that we will need to raise \$1.5 million to \$3.8 million to settle liabilities and support our incubator and business development activities through the next twelve months. Historically, we have obtained short-term bridge funding from our Chief Executive Officer and Directors of the Company. While this may occur in the future there can be no assurance that such financing will be available or if available with terms that we would be willing to accept.

We have made investments in entities that we believe may provide liquidity to the Company in the long term. We believe that our investments in Parago and River Logic have been successful however as expected in early stage companies, neither Parago nor River Logic have been profitable and have experienced cash flow deficiencies as they implement their respective business plans. The current economic and geopolitical conditions are inhibiting the availability of investment capital in early stage companies. We have not participated in the additional capital infusions made in 2001 and 2002 and as a result our ownership percentage has been diluted. Our ownership percentage in Parago is less than 1% and approximately 8% in River Logic and the carrying values of both investments have been written down to zero.

While we are pleased with the performance of the investee companies to date, there can be no assurance that we will ever achieve liquidity for these investments. In addition there can be no assurance that our plans will be successful or what other actions may become necessary in the future. Until we are able to create liquidity from our investments through sale to a strategic investor, an initial public offering or some other liquidity transaction, we will continue to require working capital to fund operating expenses. Although we have been successful raising capital in the past, an inability to raise capital may require us to sell assets or to further reduce the level of operations. Such actions could have a material adverse effect on our business and operations and result in charges that could be material to the Company's business and results of operations.

OUR STOCK IS TRADED IN THE OVER THE COUNTER MARKET.

Our common stock was de-listed from the NASDAQ SmallCap Market on May 17, 2001, because we did not meet the NASDAQ's requirements for continued listing. Our common stock now trades on the OTC Bulletin Board maintained by the National Quotation Bureau, Inc. The OTC Bulletin Board is generally considered to be a less efficient market, and our stock price, as well as the liquidity of our common stock, may be adversely impacted as a result.

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

We are involved in legal proceedings as described in Item 3. Legal Proceedings and from time to time, we may be subject to other legal proceedings, including

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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.

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

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

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

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

Even if the Distribution qualifies as tax-free, CT Holdings could nevertheless incur a substantial corporate tax liability under Section 355(e) of the Internal Revenue Code of 1986, as amended (the Internal Revenue Code or the Code), if CT Holdings or Citadel were to undergo a change in control (whether by acquisition, additional share issuance or otherwise) pursuant to a plan or series of related transactions which include the Distribution. Any transaction which occurs within the four-year period beginning two years prior to the Distribution is presumed to be part of a plan or series of related transactions which includes the Distribution unless CT Holdings establishes otherwise. Under certain circumstances, Citadel would be obligated to indemnify CT Holdings for all or a portion of this substantial corporate tax liability under the tax disaffiliation agreement. This indemnification obligation would have a material adverse effect on the results of operations and financial position of Citadel.

RISKS RELATED TO OUR INVESTEES

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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### ITEM 2. DESCRIPTION OF PROPERTY

CT Holdings shares office space with Citadel Security Software and as part of the transition services agreement will be charged a monthly administrative fee of approximately \$20,000 per month which includes the cost of the space. We believe that these facilities will be sufficient to meet our needs for the foreseeable future.

The telephone number of our principal office is (214) 520-9292. The Company maintains a site at <http://www.ct-holdings.com>.

### ITEM 3. LEGAL PROCEEDINGS

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

In October 2001, Roan-Meyers Associates (formerly Janssen Meyers Associates L.P.) filed suit in the Supreme Court of the State of New York, County of New York against CT Holdings, Inc. to enforce a settlement term sheet arising out of a prior lawsuit alleging breach of a Placement Agency Agreement. This case is styled Roan Meyers Associates v. CT Holdings, Inc. In August 1998, Janssen-Meyers Associates L.P. ("JMA") filed a lawsuit against CT Holdings arising out of an alleged 1995 contract with CT Holdings' predecessor. The suit alleged that this predecessor breached a letter of intent dated September 1995 and/or a Placement Agency Agreement dated November 1995 between JMA and the predecessor. As its damages, JMA claimed that it was entitled to, among other things, the cash value of warrants to purchase 1.8 million shares of CT Holdings common stock at an exercise price of \$0.89 per share, valued during May 1996. According to JMA's valuation of those warrants, potential damages were alleged to exceed \$40 million. CT Holdings vigorously disputes that it breached either the letter of intent or the Placement Agency Agreement or that it is liable to JMA. The lawsuit was styled Janssen-Meyers Associates, L.P. v. Citadel Technology, Inc., and was filed in the Supreme Court of the State of New York, County of New York. CT Holdings removed the case to federal court in the Southern District of New York. Following mediation in July 2000, CT Holdings and JMA entered into a settlement term sheet to attempt to resolve the disputes between it and JMA, pursuant to which CT Holdings and JMA agreed in principle to settle the lawsuit for an aggregate of \$3 million, in a combination of \$1.5 million in cash and 300,000 shares of common stock with a guaranteed value of \$5 per share as of January, April and October 2001 (with respect to 100,000 of the shares for each period). The settlement was subject to execution of definitive settlement documents and approval of the boards of directors of the companies. CT Holdings and JMA were unable to negotiate the final definitive settlement agreement and, as a result, the matter was not settled. The case was dismissed in August 2000 without any resolution of this issue. On March 27, 2001, JMA attempted to reopen this matter, but the Court hearing the JMA lawsuit issued a Summary Order denying JMA's motion to enforce the settlement term sheet and confirmed the prior dismissal of the lawsuit. The Court further ruled that JMA would either have to bring an action on the proposed settlement or move to re-open the dismissed case. The Court stated that it did not express any view with respect to the merits of the proposed settlement that brought about the dismissal of the case. There was no activity on the case from March 2001 through August 2001. On August 27, 2001 JMA refiled its lawsuit with a federal court in New York, and CT Holdings filed a motion to dismiss the case because the plaintiffs lacked the required diversity jurisdiction to pursue the claims in federal court. On October 31, 2001 the case was dismissed in federal court. In December 2001, the plaintiffs refiled the lawsuit in the state court seeking to enforce the settlement term sheet. The case was filed in Supreme Court of New York, that state's trial court, in a case styled Roan Meyers v. CT Holdings. CT Holdings intends to vigorously defend against this lawsuit and has filed a counterclaim to, among other things, recover excess amounts charged by JMA in connection with related bridge loans. Trial has not been set on this matter and the parties are conducting discovery through September 2003.

In June 2000, CT Holdings was served with a lawsuit filed in the 157th State District Court in Houston, Texas by Michael and Patricia Ferguson for breach of contract, breach of fiduciary duty, tortious interference, violation of the Texas Deceptive Trade Practices Act and negligence. The case was styled Michael and Patricia Ferguson v. CT Holdings, Inc. Specifically, the Fergusons claim that they were damaged when they attempted to exercise warrants during a time when CT Holdings' related registration statement could not be used. In July, 2002, the plaintiffs were awarded damages of \$575,510, pre-judgment interest of

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\$86,748.20, attorneys' fees of \$103,818.31, post-judgment interest at 10% per year, and costs. CT Holdings appealed the judgment in a case styled CT Holdings Inc. v. Michael and Patricia Ferguson in the Fourteenth Court of Appeals in Houston, Texas. In January 2003, the plaintiffs filed a motion to have the District Court appoint a receiver to sell assets to satisfy the judgment. In April 2003 the parties

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settled the lawsuit for \$225,000 in cash, which was obtained from Citadel as a demand note payable bearing interest at 12% per year.

In June 2000, Tech Data Corporation filed suit against CT Holdings, alleging a breach of a Software Distribution Agreement ("the Agreement") with CT Holdings. The lawsuit is styled Tech Data Corporation v. Citadel Technology, Inc. (now known as CT Holdings), and was filed in Dallas County Court at Law No. 2. Because CT Holdings was not properly served, Tech Data obtained a default judgment for \$101,048.53. When CT Holdings discovered the default judgment, it filed and won a motion to set aside this judgment. In June 2001, Tech Data properly served CT Holdings. CT Holdings answered and demanded binding arbitration pursuant to the agreement. The parties filed a Joint Motion to Arbitrate in December 2001. The judge granted this motion and abated the lawsuit pending arbitration. The arbitration was held in 2002, and in January 2003, the arbitrator entered a judgment of \$71,655 against CT Holdings in favor of Tech Data, together with pre-judgment interest at the applicable rate under Florida law for the period from January 2, 2000 to January 10, 2003, attorneys' fees of \$3,500, and interest on these amounts in the amount of 10% per year from February 10, 2003 until the amounts are paid. In March 2003, Tech Data filed a motion to revive the abated lawsuit for purposes of entering the arbitration award as a judgment in the case and judgment was entered. As part of the Distribution, we anticipate that Citadel Security Software will assume responsibility for this lawsuit, although there can be no assurance that we will be released from the lawsuit.

In October 2002, S&S Public Relations Inc. filed a lawsuit against CT Holdings and Steven B. Solomon, its CEO, alleging breach of contract and fraud, and seeking damages in the amount of at least \$25,214.97, along with exemplary damages, attorneys' fees, court costs, and pre- and post-judgment interest. CT Holdings intends to vigorously defend the case. The parties are currently conducting discovery. The case is styled S&S Public Relations Inc. v. CT Holdings and Steven B. Solomon, and was filed in the County Court at Law No. 4, Dallas County, Texas.

In August 2002, Pricewaterhousecoopers, LLP filed a lawsuit against CT Holdings seeking payment of \$131,816 for services performed pursuant to a contract with CT Holdings related to the JMA lawsuit described above. The court ordered that mediation be held by July 2003, and CT Holdings is preparing for the mediation and conducting discovery. CT Holdings intends to vigorously defend the case. The case is styled Pricewaterhousecoopers, LLP v. CT Holdings, and was filed in the 192nd District Court, Dallas County, Texas.

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

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

MARKET INFORMATION

Our common stock trades on the OTC Bulletin Board under the symbol CITN. Between February 2000 and May 2001 our stock was traded on the NASDAQ SmallCap Market. In May 2001 our stock was delisted from the NASDAQ SmallCap Market because we did not meet the requirements for continued listing. The following table sets forth, for the periods indicated, the high and low closing sale prices for the Common Stock as reported by the NASDAQ and displayed on its website. The quotations reflect inter-dealer prices, without retail markup, markdown or commission, and may not represent actual transactions.

	HIGH	LOW
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YEAR ENDED DECEMBER 31, 2001		
1st Quarter. . . . .	\$ 0.81	\$ 0.28
2nd Quarter. . . . .	0.60	0.16
3rd Quarter. . . . .	0.42	0.17
4th Quarter. . . . .	0.58	0.26
YEAR ENDED DECEMBER 31, 2002		
1st Quarter. . . . .	\$0.449	\$0.208
2nd Quarter. . . . .	0.343	0.060
3rd Quarter. . . . .	0.070	0.026
4th Quarter. . . . .	0.030	0.006

At December 31, 2002 there were approximately 789 holders of common stock of the Company. Holders of common stock are entitled to dividends when and if declared by the Board of Directors out of funds legally available therefore. The Company has never paid cash dividends on its Common Stock, and management intends, for the immediate future, to retain any earnings for the operation and expansion of the Company's business. Any future determination regarding the payment of dividends will depend upon results of operations, capital requirements, the financial condition of the Company and such other factors that the Board of Directors of the Company may consider. The Company has issued preferred stock, which entitles the holders thereof to preferences as to payment of dividends and liquidation proceeds.

The stock option information shown below is not subject to a stock option plan approved by shareholders.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights
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	(a)	(b)
Equity compensation plans approved by security holders.	-	-
Equity compensation plans not approved by security holders.	6,307,451 (1)	\$2.06