INFORTE CORP
Form 10-Q
November 14, 2001

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

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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, 2001

OR

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

EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 000-29239

INFORTE CORP.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 36-3909334 |
| (State of incorporation) | (IRS Employer Identification No.) |

150 North Michigan Avenue, Suite 3400, Chicago, Illinois 60601 (Address of principal executive offices, including ZIP code)

(312) 540-0900
(Registrant's telephone number, including area code)

None
(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) Yes X No ___, and (2) has been subject to such filing requirements for the past 90 days. Yes X No _

The number of shares outstanding of the Registrant's Common Stock as of September 30, 2001 was 11,686,397.

INFORTE CORP.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

INFORTE CORP.
BALANCE SHEETS

| | SEPTEMBER 30, 2000 | DECEMBER 31, 2000 | MARCH 31 2001 |
|---|---|---|---|
| | (Unaudited) | | (Unaudited |
| ASSETS | | | |
| Current assets: | | | |
| Cash and cash equivalents | $38,226,516 | $42,391,880 | $44,122,97 |
| Short-term marketable securities | 27,167,323 | 26,220,945 | 34,684,37 |
| Accounts receivable | 13,606,517 | 10,385,795 | 7,684,12 |
| Allowance for doubtful accounts | (1,150,000) | (1,150,000) | (1,150,00 |
| Accounts receivable, net | 12,456,517 | 9,235,795 | 6,534,12 |
| Prepaid expenses and other current assets | 1,668,845 | 1,905,936 | 2,171,25 |
| Income taxes recoverable | - | 1,545,769 | |
| Deferred income taxes | 841,171 | 876,581 | 908,53 |
| Total current assets | 80,360,372 | 82,176,906 | 88,421,27 |
| Computers, purchased software and property | 3,844,265 | 4,535,670 | 4,599,49 |
| Less accumulated depreciation and amortization | 1,204,195 | 1,558,503 | 1,830,94 |
| Computers, purchased software and property, net | 2,640,070 | 2,977,167 | 2,768,54 |
| Long-term marketable securities | 14,442,823 | 14,383,998 | 5,292,94 |
| Deferred income taxes | 77,166 | 364,905 | 503,82 |
| Total assets | $97,520,431 | $99,902,976 | $96,986,58 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current liabilities: | | | |
| Accounts payable | $ 325,319 | $ 582,591 | $ 534,13 |
| Income taxes payable | 677,837 | - | 454,45 |
| Accrued expenses | 7,045,741 | 7,702,466 | 4,600,25 |
| Deferred revenue | 11,899,327 | 8,574,055 | 7,316,31 |
| Total current liabilities | 19,948,224 | 16,859,112 | 12,905,14 |
| Stockholders' equity: | | | |
| Common stock, $0.001 par value authorized- 50,000,000 shares; issued and outstanding (net of treasury stock) - 11,686,397 as of Sept. 30, 2001 | 12,570 | 12,703 | 12,73 |
| Additional paid-in capital | 70,732,687 | 74,192,205 | 74,717,49 |
| Treasury stock (1,355,702 shares as of Sept. 30 2001) | - | - | (472,40 |
| Retained earnings | 6,812,981 | 8,753,017 | 9,687,41 |
| Accumulated other comprehensive income | 13,969 | 85,939 | 136,19 |
| Total stockholders' equity | 77,572,207 | 83,043,864 | 84,081,44 |
| Total liabilities and stockholders' equity | $97,520,431 | $99,902,976 | $96,986,58 |

See notes to financial statements

INFORTE CORP.
STATEMENTS OF OPERATIONS

| | THREE MONTHS ENDED SEPTEMBER 30, | | NINE MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| Revenues | $17,790,784 | $10,600,439 | $46,473,946 | $37,189,424 |
| Operating expenses: | | | | |
| Project personnel and related expenses | 7,910,215 | 5,876,560 | 20,442,497 | 20,652,199 |
| Sales and marketing | 2,359,848 | 1,804,975 | 6,150,699 | 5,793,022 |
| Recruiting, retention and training | 1,731,123 | 596,767 | 5,237,746 | 2,230,805 |
| Management and administrative | 3,525,504 | 3,083,137 | 8,849,882 | 9,629,159 |
| Total operating expenses | 15,526,690 | 11,361,439 | 40,680,824 | 38,305,185 |
| Operating income | 2,264,094 | (761,000) | 5,793,122 | (1,115,761) |
| Interest income, net and other | 1,053,800 | 870,372 | 2,295,280 | 2,782,138 |
| Income before income tax | 3,317,894 | 109,372 | 8,088,402 | 1,666,377 |
| Income tax expense | 1,244,994 | - | 3,154,478 | 503,134 |
| Net income | $ 2,072,900 | $ 109,372 | $ 4,933,924 | $ 1,163,243 |
| Earnings per share: | | | | |
| -Basic | $ 0.17 | $ 0.01 | $ 0.42 | $ 0.09 |
| -Diluted | $ 0.15 | $ 0.01 | $ 0.37 | $ 0.09 |
| Weighted average common shares outstanding: | | | | |
| -Basic | 12,459,701 | 12,778,087 | 11,858,703 | 12,764,405 |
| -Diluted | 13,946,224 | 13,521,401 | 13,398,673 | 13,620,456 |

See notes to financial statements

INFORTE CORP.
STATEMENTS OF CASH FLOWS

| | THREE MONTHS ENDED SEPTEMBER 30, | | NINE MONTHS ENDED SEPTEMBER 30, | |
|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| Cash flows from operating activities | | | | |
| Net income | $2,072,900 | $ 109,372 | $ 4,933,924 | $ 1,163,2 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 350,651 | 409,770 | 818,049 | 1,244,4 |
| Non-cash compensation | - | 75,000 | - | 150,0 |
| Deferred income taxes | (15,895) | (140,094) | (246,278) | (388,5 |
| Changes in operating assets and liabilities | | | | |
| Accounts receivable | (1,316,386) | 230,804 | (6,132,267) | 2,194,5 |
| Prepaid expenses and other current assets | (253,322) | 552,939 | (987,282) | 168,9 |
| Accounts payable | (703,419) | 124,695 | (1,027,153) | 169,9 |
| Income taxes payable | 115,798 | 128,393 | 366,325 | 2,093,0 |
| Accrued expenses and other | 1,372,949 | (230,491) | 2,923,566 | (2,915,3 |
| Deferred revenue | 1,511,237 | 1,681,561 | 7,028,748 | 1,226,6 |
| Net cash provided by operating activities | 3,134,513 | 2,941,949 | 7,677,632 | 5,106,9 |
| Cash flows from investing activities | | | | |
| Increase in marketable securities | (18,156,894) | (26,103,051) | (41,612,578) | (8,780,6 |
| Purchases of property and equipment | (1,059,434) | (63,558) | (1,955,371) | (350,6 |
| Net cash used in investing activities | (19,216,328) | (26,166,609) | (43,567,949) | (9,131,3 |
| Cash flows from financing activities | | | | |
| Proceeds from issuance of common stock | - | - | 66,860,251 | |
| Proceeds from stock option and purchase plans | 1,410,846 | 348,739 | 3,463,399 | 1,081,7 |
| Purchase of treasury stock | - | (11,791,718) | - | (12,264,1 |
| Net cash provided (used in) by financing activities | 1,410,846 | (11,442,979) | 70,323,650 | (11,182,4 |
| Effect of changes in exchange rates on cash | 1,156 | 20,522 | 1,156 | 17,25 |
| Increase (decrease) in cash and cash equivalents | (14,669,813) | (34,647,117) | 34,434,489 | (15,189,5 |
| Cash and cash equivalents, beg. of period | 52,896,329 | 61,849,485 | 3,792,027 | 42,391,8 |
| Cash and cash equivalents, end of period | $38,226,516 | $27,202,368 | $38,226,516 | $27,202,3 |

See notes to financial statements



Inforte Corp.
Notes to financial statements
(Unaudited)
September 30, 2001

(1) BASIS OF PRESENTATION

The accompanying un-audited financial statements have been prepared by Inforte Corp. ("Inforte") pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2000 included in Inforte's annual report Form 10K (File No. 333-92325). The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The accompanying financial statements reflect all adjustments (consisting solely of normal, recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of results for the interim periods presented. The results of operations for the three month and nine month periods ended September 30, 2001 are not necessarily indicative of the results to be expected for the full fiscal year. Certain previously reported amounts have been reclassified to conform with current presentation format.

(2) TEASURY STOCK

During the September 2001 quarter, Inforte repurchased 1,297,202 shares of stock for $12.7 million at an average price of $9.79. Of the shares repurchased, 96,000 were settled in the month of October for $0.9 million. During the March 2001 quarter, Inforte repurchased 58,500 shares for $0.5 million at an average price of $8.08. The board approved a $25.0 million stock repurchase program on January 24, 2001 and as of September 30, 2001, $11.8 million remained authorized for repurchase.

(3) NET INCOME PER COMMON SHARE

Inforte computes basic earnings per share by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per common share is computed by dividing net income by the weighted average number of common shares and dilutive common share equivalents then outstanding.

| | Three Months Ended September 30, | | Nine Months Ended Septembe | |
|---|---|---|---|---|
| | 2000 | 2001 | 2000 | 2001 |
| | (unaudited) | | (unaudited) | |
| Basic weighted average shares | 12,459,701 | 12,778,087 | 11,858,703 | 12,764,405 |
| Effect of dilutive stock options | 1,486,523 | 743,314 | 1,539,970 | 856,051 |

| | | | | |
|---|---|---|---|---|
| Diluted common and common equivalent shares | 13,946,224 | 13,521,401 | 13,398,673 | 13,620,456 |

(4) COMPREHENSIVE INCOME
Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" (SFAS 130), establishes standards for reporting comprehensive income. Comprehensive income includes net income as currently reported under generally accepted accounting principles, and also considers the effect of additional economic events that are not required to be recorded in determining net income, but rather are reported as a separate component of stockholders' equity. The Company reports foreign currency translation gains and losses, and unrealized gains and losses on investments, as components of comprehensive income. Total comprehensive income was $179,572 and $1,393,988 for the three months and nine months ended September 30, 2001 and $2,079,237 and $4,947,893 for the three months and nine months ended September 30, 2000.

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(5) COST TO EXIT LEASED OFFICE SPACE
Since client research indicates that information technology spending is likely to remain at minimal levels for at least the remainder of 2001, Inforte took major steps to reduce its costs to better align its overall cost structure and organization with anticipated demand for its services. These steps included consolidating office space at the Chicago location where Inforte had multiple contractual rental commitments. Estimated costs for the consolidation of facilities comprise contractual rental commitments for office space being vacated and related costs in addition to future depreciation of the related leasehold improvements, offset by estimated sub-lease income. The total reduction of office space resulting from these office consolidations was approximately 17,770 square feet, all of which were vacated as of September 30, 2001. The total charge related to this reduction of office space in the third quarter of 2001 was $256,550. This charge is reported as management and administrative expense on the Income Statement, and as accrued expenses on the Balance Sheet. While we believe the current charge is sufficient to represent future net cash out flows, if future sub-lease income is less than estimated, additional charges in future periods will be necessary. Further, if we are unable to sub-lease our vacated office space, additional charges in future periods will be necessary.

(6) INCOME TAXES
Inforte's effective tax rate for the September 2001 quarter was 0.0% compared to 37.5% for the September 2000 quarter. The lower rate in 2001 is related to the results of operations being near break-even. Income tax expense in a quarter is the amount necessary to bring year-to-date income tax expense to the proper level. Year-to-date, Inforte's effective tax rate is 30.2%, compared to 39.0% for the nine-month period ending September 30, 2000. The decrease in the effective tax rate is a result of a higher percentage of pretax income in 2001 resulting from interest income versus operating income. Generally, a significant portion of Inforte's marketable securities are tax advantaged and reduce the effective tax rate for interest, resulting in interest income having a lower tax rate than operating income. The quarterly tax rate for the remainder of 2001 may remain volatile if interest income continues to provide the majority of taxable

income, and operating results continue to remain near break-even.



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

You should read the following discussion in conjunction with our financial statements, together with the notes to those statements, included elsewhere in this Form 10-Q. The following discussion contains forward-looking statements that involve risks, uncertainties, and assumptions such as statements of our plans, objectives, expectations and intentions. Our actual results may differ materially from those discussed in these forward-looking statements because of the risks and uncertainties inherent in future events that include, but are not limited to, those identified under the caption "Risk Factors" appearing in this 10Q as well as factors discussed elsewhere in this Form 10-Q. Actual results may differ from forward-looking results for a number of reasons, including but not limited to, Inforte's ability to: (i) effectively forecast demand and profitably match our resources with the demand during the current economic downturn; (ii) attract and retain clients and satisfy our clients' expectations; (iii) recruit and retain qualified professionals; (iv) reliably forecast revenue, particularly for clients in the insurance, financial services, or software and technology businesses, and those based in or near New York, since these firms may discover financial liabilities or experience business delays resulting from the September 11 terrorist attacks, or delays resulting from the negative impact the attacks may have on the overall economy (v) reliably forecast revenue when information technology services spending is less certain overall, and in particular when spending at current clients and with our alliance partners, our two main revenue lead sources, is less certain; (vi) accurately estimate the time and resources necessary for the delivery of our services; and (vii) build and maintain marketing relationships with leading software vendors. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, or projected. All forward-looking statements included in this document are made as of the date hereof, based on information available to Inforte on the date thereof, and Inforte assumes no obligation to update any forward-looking statements.

### Overview

Strategic technology consultancy Inforte Corp. helps create long-term return on investment and sustainable advantages for clients by capitalizing on the convergence of business strategy and technology across the value chain. Inforte delivers strategic technology consulting, comprehensive demand chain management solutions, plus solutions that optimize supply chain integration. Inforte's client advocacy approach and rigorous delivery methodologies have garnered the trust of Global 2000 clients, produced industry-leading project-efficiency metrics and helped Inforte earn references from 100 percent of its clients.

Since our inception in September 1993, we have followed an organic growth model with all growth generated internally rather than through mergers or acquisitions. As of September 30, 2001, we employed 298 people in our offices in Atlanta, Chicago, Dallas, London, Los Angeles, New York and San Francisco. Reflecting the importance we place on employee motivation and ownership, each of our employees is a stock or option holder.

The majority of our revenues are from professional services performed on a fixed-price basis; however, we also perform services on a time-and-materials basis. Typically, the first portion of an engagement involves a strategy project, a discovery phase or diagnostic lasting 30 to 60 days, which we perform on a fixed-price basis. This work enables us to determine with our clients the scope of successive phases for design and implementation, which in total generally last three to nine months, and to decide whether we will perform these additional phases for a fixed price or on a time-and-materials basis. Whether we use fixed pricing or time-and-material pricing depends upon our assessment of the project's risk, and how precisely our clients are able to define the scope of activities they wish us to perform. Fixed prices are based on estimates from senior personnel in our consulting organization who project the length of the engagement, the number of people required to complete the engagement, and the skill level and billing rates of those people. We then adjust the fixed price based on various qualitative risk factors such as the aggressiveness of the delivery deadline and the technical complexity of the solution.

We ask clients to pay 25%-50% of our fixed-price projects in advance to enable us to secure a project team in a timeframe that is responsive to the client's needs. We bill the remainder in advance of the work performed based upon a predetermined billing schedule over the course of the engagement. We do not perform work under milestone-based billing schedules. We recognize revenues from fixed-price contracts on the percentage-of-completion method, based on the ratio of costs incurred to total estimated costs. Amounts billed before we perform services are classified as deferred revenue. We bill time-and-materials projects twice per month on the 15th and last day of each month. We recognize time-and-materials revenues as we perform the services. We do not include in our revenues



the reimbursable expenses we charge to our clients, on either fixed-price or time-and-material projects.

Our revenues and earnings may fluctuate from quarter to quarter based on factors within and outside of our control. These include:

- the variability in market demand for information technology professional services;
- the growth rate of the U.S. economy and the impact that relative economic strength or weakness has on information technology services spending;
- the seasonal spending by our clients;
- the length of the sales cycle associated with our service offerings;
- the number, size, and scope of our projects;
- the efficiency with which we deliver projects and use our people;
- the compensation that we pay our people; and
- our ability to keep discretionary expenses within budget.

If revenues do not increase at a rate at least equal to increases in expenses, our results of operations could be materially and adversely affected.

RESULTS OF OPERATIONS

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The following table sets forth the percentage of revenues of certain items included in Inforte's statement of income:

| | % of Revenue Three months ended September 30, 2000 | 2001 | % of Revenue Nine months ended September 30 2000 | 2001 |
|---|---|---|---|---|
| Revenues | 100.0 | 100.0 | 100.0 | 100.0 |
| Operating expenses: | | | | |
| Project personnel and related expenses | 44.5 | 55.4 | 44.0 | 55.5 |
| Sales and marketing | 13.3 | 17.0 | 13.2 | 15.6 |
| Recruiting, retention and training | 9.7 | 5.6 | 11.3 | 6.0 |
| Management and administrative | 19.8 | 29.1 | 19.0 | 25.9 |
| Total operating expenses | 87.3 | 107.2 | 87.5 | 103.0 |
| Operating income | 12.7 | -7.2 | 12.5 | -3.0 |
| Interest income, net and other | 5.9 | 8.2 | 4.9 | 7.5 |
| Pretax income | 18.6 | 1.0 | 17.4 | 4.5 |
| Income tax expense | 7.0 | 0.0 | 6.8 | 1.4 |
| Net income | 11.7 | 1.0 | 10.6 | 3.1 |

Three months ended September 30, 2000 and 2001
----------------------------------------------

Revenues. Revenues decreased 40% to $10.6 million for the quarter ended September 30, 2001 from $17.8 million for quarter ended September 30, 2000. For the nine months ended September 30, 2001, revenues decreased 20% to $37.2 million from $46.5 million for the nine months ended September 30, 2000. Although we have historically experienced growth in our revenues, the market for strategic technology consulting services has decreased significantly this year due to the slower growth rate of the U.S. economy and the negative impact that heightened economic uncertainty has on information technology spending. For the quarter ended September 30, 2001, we had 41 significant clients with each of these clients contributing $1.0 million to revenue on average on an annualized basis. We had 50 significant clients during the quarter ended September 30, 2000, each contributing $1.4 million to revenue on average on an annualized basis. Sequentially, revenue declined 15% to



$10.6 million in the September 2001 quarter from $12.5 million in the June 2001 quarter. Although we typically experience lower sequential growth rates in the second half of the year, this decline is not typical for our business and can also be attributed to the slower growth rate of the U.S. economy and the negative impact heightened economic uncertainty has had on information technology spending. Given the current economic environment, we expect revenue for the December 2001 quarter to equal $10.0 million. Until we see a sustained turn in the economy and a sustained increase in information technology spending, we are forecasting revenue of $10.0 million per quarter in 2002.

Project personnel and related expenses. Project personnel and related expenses consist primarily of compensation and fringe benefits for our professional employees who deliver consulting services and non-reimbursable project costs. All labor costs for project personnel are included in project personnel and related expenses. These expenses decreased 26% to $5.9 million for the quarter ended September 30, 2001, from $7.9 million for quarter ended September 30, 2000. The decrease relates to recent reductions in consulting headcount. We employed 216 consultants on September 30, 2001, down from 348 one year earlier. These costs for the nine month period ending September 2001 increased by 1% over the prior year to $20.7 million from $20.4 million during the same period of the prior year. While ending number of billable consultants was down sharply at September 30, 2001 compared to September 30, 2000, the average headcount decrease was relatively flat. The average number of billable consultants decreased 8% to 282 in the nine month period ending September 30, 2001 from 306 one year earlier. The effect of lower headcount was offset by salary increases, which occurred in July 2000.

Project personnel and related expenses represented 55.4% of revenues for the quarter ended September 30, 2001, compared to 44.5% for the quarter ended September 30, 2000. Revenue per consultant was $189,000 in the September 2001 quarter, down from $210,000 during the September 2000 quarter. The decline in revenue per consultant versus the prior year results from a lower hourly rate due to more price sensitivity in the consulting market. Project personnel and related expenses represented 55.5% of revenues for the nine months ended September 30, 2001, compared to 44.0% for the same period in 2000. This increase is due to the lower revenue base.

Since client research indicates that information technology spending is likely to remain at minimal levels for at least the remainder of 2001, in June 2001 Inforte offered a six-to-nine-month voluntary leave of absence program and a voluntary resignation program to employees in underutilized areas. There were 90 people who participated in the programs. Individuals who selected the leave of absence program are receiving compensation at 20%-25% of regular pay if they remain available to return to full-time service. Individuals who chose the voluntary resignation package received pay through the end of August 2001. All costs related to resigning employees were included either in our June 2001 quarter results or our September 2001 quarter results. Salary costs for employees on leave of absence are expensed as incurred and included in the quarter ended September 2001. The costs of these programs will be less in future quarters, and will go to zero by the end of the June 2002 quarter.

Sales and marketing. Sales and marketing expenses consist primarily of compensation, benefits and travel costs for employees in the market development and practice development groups and costs to execute marketing programs. Sales and marketing expenses decreased 24% to $1.8 million for the quarter ended September 2001 from $2.4 million in the same period in 2000. Year to date, these expenses decreased 6% to $5.8 million from $6.2 million in the prior year. The spending decrease was due to lower discretionary marketing expenses and lower sales commission expense due to lower revenue. Sales and marketing expenses as a percentage of revenues increased to 17.0% for the quarter ended September 30, 2001 from 13.3% in the third quarter of 2000. For the nine months ended September 30, the expense as a percent of revenue increased from 13.2% in 2000 to 15.6% in 2001. This increase in these expenses is due to the lower revenue base. We expect our December 2001 quarterly spending on sales and marketing to remain similar to the September 2001 quarter dollar level.

Recruiting, retention, and training. Recruiting, retention and training expenses consist of compensation, benefits and travel costs for personnel engaged in human resources; costs to recruit new employees; costs of human resources programs; and training costs. These expenses decreased 66% to $0.6 million for the quarter ended September 30, 2001 from $1.7 million in the third quarter of 2000. Year to date, these expenses decreased 57% to $2.2 million from $5.2 million in the prior year. The decline was due to a slower hiring rate in 2001 versus 2000, reducing recruiting expenses and training expenses. During the September 2000 quarter, total employees grew by 7% to 438. In the quarter ended September 30, 2001, total employees declined 27% to 298. We expect our December 2001 quarterly spending on recruiting, retention and training to remain similar to the September 2001 quarter dollar level.

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Management and administrative. Management and administrative expenses consist primarily of compensation, benefits and travel costs for management, finance, information technology and facilities personnel, together with rent, telecommunications, audit, and legal costs, and depreciation and amortization of capitalized computers, purchased software and property. These expenses decreased 13% to $3.1 million for the quarter ended September 30, 2001 from $3.5 million for the same period in 2000. The decrease in expenses was due to lower spending on information technology, executive travel, and executive bonus compensation partially offset by higher facilities expense. As a percentage of revenue, management and administrative expenses were 29.1% in the quarter ended September 30, 2001, up from 19.8% for the quarter ended September 30, 2000, as spending decreased at a slower rate than revenue declined. Year to date, these expenses increased 9% to $9.6 million from $8.8 million in the prior year. As a percent of revenue, management and administrative expenses were 25.9% for the nine months ended September 2001, compared to 19.0% for the same period ending September 2000. In the December 2001 quarter we expect to incur a non-cash compensation charge if certain performance-based option criteria are met as of December 31, 2001. At the current stock price, the charge would be approximately $1.0 million or $0.08 per diluted share. Due to this expected non-cash charge, our December 2001 quarterly management and administrative expense is likely to increase from the September 2001 quarter dollar level.

Liquidity and capital resources. Cash and marketable securities decreased from $85.3 million as of June 30, 2001 to $76.7 million at September 30, 2001. This decrease results from the purchase of $11.8 million in treasury stock, partially offset by cash from operating activities of $2.9 million, and from stock option and purchase plans of $0.3 million.

During the September 2001 quarter, Inforte repurchased 1,297,202 shares of stock for $12.7 million at an average price of $9.79. Of the shares purchased, 96,000 were settled in the month of October for $0.9 million. The board approved a $25.0 million stock repurchase program on January 24, 2001 and as of September 30, 2001, $11.8 million remained authorized for repurchase. As of September 30, 2001, Inforte had 11,686,397 shares outstanding and $76.7 million in cash and marketable securities, resulting in $6.56 of cash and marketable securities per diluted share. At the end of the June 2001 quarter, cash and marketable securities per share were $6.62 per diluted share. As of September 30, 2001, the public float (shares not held by executive officers and directors) totaled 6.1 million shares or 52% of total outstanding shares.

Inforte believes that its current cash, cash equivalents and marketable securities will be sufficient to meet working capital and capital expenditure requirements for the foreseeable future.

Risk Factors

In addition to other information in this Form 10-Q, the following risk factors should be carefully considered in evaluating Inforte and its business because such factors currently may have a significant impact on Inforte's business, operating results and financial condition. As a result of the risk factors set forth below and elsewhere in this Form 10-Q, and the risk factors discussed in Inforte's other Securities and Exchange Commission filings, and in Inforte's earnings releases, actual results could differ materially from those projected in any forward-looking statements.

RISKS RELATED TO INFORTE

If we fail to identify and successfully transition to the latest and most advanced solutions or keep up with an evolving industry, we will not compete successfully for clients and our profits may decrease.

We focus on providing our clients solutions that employ the latest technologies. If we fail to identify the latest and most advanced solutions, or if we identify but fail to successfully transition our business to these advanced solutions, our reputation and our ability to compete for clients and the best employees could suffer. If we cannot compete successfully for clients, our revenues may decrease. Also, if our projects do not involve the latest and most advanced solutions, they would generate lower fees.

Because our market changes rapidly, some of the most important challenges facing us are the need to:



- effectively use advanced technologies;
- continue to develop our strategic and technical expertise;
- influence and respond to emerging industry standards and other technological changes;
- enhance our current services; and
- develop new services that meet changing customer needs.

All of these challenges must be met in a timely and cost-effective manner. We cannot assure you that we will succeed in effectively meeting these challenges.

If we fail to satisfy our clients' expectations, our existing and continuing business could be adversely affected.

If we fail to satisfy the expectations of our clients, we could damage our reputation and our ability to retain existing clients and attract new clients. In addition, if we fail to perform our engagements, we could be liable to our clients for breach of contract. Although most of our contracts limit the amount of any damages to the fees we received, we could still incur substantial cost, negative publicity, and diversion of management resources to defend a claim, and as a result, our business results could suffer.

If we are unable to accurately forecast our quarterly revenue our profitability may be reduced or eliminated.

Recently, the level of spending by clients and potential clients on information technology in the United States has become less certain. We believe the uncertainty stems from the rapid slowing of growth in Gross Domestic Product in the United States that began in the second half of calendar 2000. In some cases the uncertainty has reduced the overall number of projects available for bid. In other cases the uncertainty has resulted in project deferrals, project scope reductions or limited follow-on projects at existing clients. While our revenue forecast methods are sophisticated and have proven accurate historically, we believe the recent environment adds greater risk and uncertainty to our forecasts. If we fail to accurately forecast revenue, our actual results may differ materially from the amounts planned, and our profitability may be reduced.

We may be unable to hire and retain employees who are highly skilled, which would impair our ability to perform client services, generate revenue and achieve profitability.

If we are unable to hire and retain highly-skilled individuals, our ability to retain existing business and compete for new business will be harmed. Individuals who have the experience and expertise to perform the services we provide to our clients are limited and competition for these individuals is intense. To attract and retain these individuals, we invest a significant amount of time and money. In addition, we expect that both bonus payments and equity ownership will be an important component of overall employee compensation. In the current economic and market environment, overall bonus payments have been reduced significantly, increasing the risk that key employees will leave Inforte. Also, if our stock price does not increase over time, it may be more difficult to retain employees who have been compensated with stock options. Options granted to employees from the IPO date, February 17, 2000, through September 30, 2001 have exercise prices of $8.56 to $71.81 with an average exercise price of $22.99. Since the current market price for Inforte stock has recently been below this average strike price, it may be more difficult to retain employees. If employee retention rates grow to unacceptable levels because compensation is not at competitive rates, Inforte may increase the level of stock option grants or cash compensation. These actions would reduce earnings per share and may cause Inforte to become unprofitable.

If we fail to adequately manage rapid changes in demand, our profitability and cash flow may be reduced or eliminated.

If we cannot keep pace with the rapid changes in demand, we will be unable to effectively match resources with demand, and maintain high client satisfaction, which may eliminate our profitability and our ability to achieve positive cash flow from operations. Our business has grown dramatically over the past several years. For example, our revenue has increased from $13.4 million in 1998, to $30.1 million in 1999 and to $63.8 million in 2000. As a result of the current U.S. economic environment and overcapacity in our industry, however, we expect revenue in 2001 to decline compared to 2000. For 2001 and 2002, industry demand is highly dependent on the macroeconomic environment, which heavily influences our clients' level of IT services spending. The level of IT spending is subject to rapid positive and negative changes. If the level of IT services spending declines further, we may not be profitable or achieve positive cash flow from operations in 2002. If, on the other hand, our growth exceeds our expectations, our current resources and infrastructure may be inadequate to handle the growth. Also, our senior management team has limited collective experience managing a public company or a business the current size of Inforte. Additionally, our management team has limited collective experience managing a business during an economic slowdown or recession.

If our marketing relationships with software vendors deteriorate, we would lose their client referrals.

We currently have marketing relationships with software vendors, including Ariba, i2, Siebel, and Vignette. Although we have historically received a large number of business leads from these software vendors to implement their products, they are not required to refer business to us and they may terminate these relationships at any time. If our relationships with these software vendors deteriorate, we may lose their client leads and our ability to develop new clients could be negatively impacted. Any decrease in our ability to obtain clients may cause a reduction in our revenues.

If we are unable to rapidly integrate third-party software, we may not be able to deliver solutions to our clients on a timely basis, resulting in lost revenues and potential liability.



In providing client services, we recommend that our clients use software applications from a variety of third-party vendors. If we are unable to implement and integrate this software in a fully functional manner for our clients, we may experience difficulties that could delay or prevent the successful development, introduction, or marketing of services. Software often contains errors or defects, particularly when first introduced or when new versions or enhancements are released. Despite internal testing and testing by current and potential clients, our current and future solutions may contain serious defects due to third-party software or software we develop or customize for clients. Serious defects or errors could result in liability for damages, lost revenues, or a delay in implementation of our solutions.

Our revenues could be negatively affected by the loss of a large client or our failure to collect a large account receivable.

At times, we derive a significant portion of our revenue from large projects for a limited number of varying clients. In the September 2001 quarter, our five largest clients accounted for 37% of revenue and our ten largest clients accounted for 62% of revenue. In 1999, our five largest clients accounted for 36% of revenue and our ten largest clients accounted for 55% of revenue. In 2000, our five largest clients accounted for 31% of revenue and our ten largest clients accounted for 46% of revenue. Although these large clients vary from time to time and our long-term revenues do not rely on any one client, our revenues could be negatively affected if we were to lose one of these clients or if we were to fail to collect a large account receivable.

In addition, many of our contracts are short-term and provide that our clients can reduce or cancel our services without incurring any penalty. If our clients reduce or terminate our services, we would lose revenue and would have to reallocate our employees and our resources to other projects to attempt to minimize the effects of that reduction or termination. Accordingly, terminations, including any termination by a major client, could adversely impact our revenues. During 2001 and 2002 we believe the uncertain economic environment increases the probability that services may be reduced or canceled.

If we estimate incorrectly the time required to complete our projects, we will lose money on fixed-price contracts.

A majority of our contracts are fixed-price contracts, rather than contracts in which the client pays us on a time and materials basis. We must estimate the number of hours and the materials required before entering into a fixed-price contract. Our future success will depend on our ability to continue to set rates and fees accurately and to maintain targeted rates of employee utilization and project quality. If we fail to accurately estimate the time and the resources required for a project, any required increase in the time and resources to complete the project could cause our profits to decline.

Fluctuations in our quarterly revenues and operating results due to cyclical client demand may lead to reduced prices for our stock.

Our quarterly revenues and operating results have fluctuated significantly in the past and we expect them to continue to fluctuate significantly in the future. Historically, we have experienced our greatest sequential growth during the first and second quarters. We typically experience significantly lower sequential growth in the third and fourth quarters. We attribute this to the budgeting cycles of our customers, most of whom have calendar-based fiscal years and as a result are more likely to incur the expense of our services during the first half of the year. During 2001 and 2002, we do not expect this normal seasonal growth pattern, and have adjusted our recruiting and spending plans accordingly. Our cautious expectations for 2001 and 2002 are based upon slower U.S. economic growth that began in the second half of 2000 and business trends during 2001. If we are unable to predict the cyclical client demand in a slower growth or distressed economic environment, our expenses may be disproportionate to our revenue on a quarterly basis and our stock price may be adversely affected.

Others could claim that we infringe on their intellectual property rights, which may result in substantial costs, diversion of resources and management attention, and harm to our reputation.

A portion of our business involves the development of software applications for specific client engagements. Although we believe that our services do not infringe on the intellectual property rights of others, we may be the subject of claims for infringement,



which even if successfully defended could be costly and time-consuming. An infringement claim against us could materially and adversely affect us in that we may:

- experience a diversion of our financial resources and management attention;
- incur damages and litigation costs, including attorneys' fees;
- be enjoined from further use of the intellectual property;
- be required to obtain a license to use the intellectual property,

incurring licensing fees;

- o need to develop a non-infringing alternative, which could be costly and delay projects; and
- o have to indemnify clients with respect to losses incurred as a result of our infringement of the intellectual property.

Because we are newer and smaller than many of our competitors, we may not have the resources to effectively compete, causing our revenues to decline.

Many of our competitors have longer operating histories, larger client bases, longer relationships with clients, greater brand or name recognition, and significantly greater financial, technical, marketing, and public relations resources than we do. We may be unable to compete with the full-service consulting companies, including the consulting divisions of the largest global accounting firms, who are able to offer their clients a wider range of services. If our clients decide to take their information technology professional services projects to these companies, our revenues may decline. It is possible that in uncertain economic times our clients may prefer to work with larger firms to a greater extent than normal. In addition, new professional services companies may provide services similar to ours at a lower price, which could cause our revenues to decline.

Our expansion and growth internationally could negatively affect our business.

In both the June 2001 quarter and the September 2001 quarter, our international revenues were over 10% of our total revenues. As our international revenue grows, we face additional risks that we do not face domestically. Such risks include longer customer payment cycles, adverse taxes, compliance with local laws and regulations. Further, the effects of fluctuations in currency exchange rates may adversely affect the results of operations. Finally, there are indications that the U.S. economic slowdown is spreading to the rest of the world, which could limit our ability to obtain international revenue going forward. These risk factors, as well as others not cited here, may negatively impact our business.

RISKS RELATED TO OUR INDUSTRY

If the rate of adoption of advanced information technology slows substantially, our revenues may decrease.

We market our services primarily to firms that want to adopt information technology that provides an attractive return on investment or helps provides a sustainable competitive advantage. Our revenues could decrease if companies decide not to integrate the latest technologies into their businesses due to economic factors, governmental regulations, financial constraints, or other reasons.

Inforte's market research suggests that the level information technology spending in the United States is closely linked with the growth rate of the Gross Domestic Product (GDP). The recent slowdown in the GDP growth rate has caused a slower rate of adoption of advanced information technology by our target clients. We expect information technology spending and Inforte revenue to be highly dependent on the health of the US economy.

We expect that the terrorist attacks on September 11 of this year may have some impact on our business. Our clients, particularly those in the insurance, financial services, or software and technology businesses and those based in or near New York, may discover financial liabilities or experience business delays resulting from the attacks, or resulting from the impact the attacks may have on the overall economy or demand in a particular industry.



If the supply of information technology companies and personnel continues to exceed demand, this may adversely impact the pricing of our projects and our ability to win business.

Beginning in the second half of 2000 many firms in our industry announced significant employee layoffs and lower utilization rates of billable personnel. An oversupply of technology professionals may reduce the price clients are willing to pay for our services. An oversupply may also increase the talent pool for potential clients who may choose to complete projects in-house rather than use an outside consulting firm such as Inforte. Lower utilization rates increase the likelihood that a competitor will reduce their price to secure business in order to improve their utilization rate. The extent to which pricing and our ability to win business may be impacted is a function of both the magnitude and duration of the supply and demand imbalance in our industry.



RISKS RELATED TO THE OWNERSHIP OF OUR COMMON STOCK

Our stock price could be extremely volatile, like many technology stocks.

The market prices of securities of technology companies, particularly information technology services companies, have been highly volatile. We expect continued high volatility in our stock price, with prices at times bearing no relationship to Inforte's operating performance.

Inforte's average trading volume during 2001 has averaged approximately 95,000 shares per day. On any particular day, Inforte's trading volume can be less than 20,000 shares which increase the potential for volatile stock prices.

Volatility of our stock price could result in expensive class action litigation.

If our common stock suffers from volatility like the securities of other technology companies, we could be subject to securities class action litigation similar to that which has been brought against companies following periods of volatility in the market price of their common stock. Litigation could result in substantial costs and could divert our resources and senior management's attention. This could harm our productivity and profitability.

Officers and directors own a significant percentage of outstanding shares and, as a group, may control a vote of stockholders.

As of September 30, 2001 the executive officers and directors set forth below, own approximately 47.1% of the outstanding shares of our common stock and own individually the percentage set forth opposite their names:

| | | |
|---|---|---|
| o | Philip S. Bligh | 22.2% |
| o | Stephen C.P. Mack | 19.3% |
| o | Nick Padgett | 5.6% |

If the stockholders listed above act or vote together with other employees who own significant shares of our common stock they will have the ability to control the election of our directors and the approval of any other action requiring the approval of our stockholders, including any amendments to the certificate of incorporation and mergers or sales of all or substantially all assets, even if the other stockholders perceive that these actions are not in their best interests.

Over time, the influence or control executive officers have on a stockholder vote will decrease as officers supplement below-market salaries and diversify overall equity wealth with sales of Inforte stock. As permitted by SEC Rule 10b5-1, Inforte executive officers have or may set up a predefined, structured stock trading program. The trading program allows brokers acting on behalf of company insiders to trade company stock while the insiders may be aware of material, non-public information, if the transaction is performed according to a pre-existing contract, instruction or plan that was established with the broker when the insider was not aware of any material, non-public information.

The authorization of preferred stock, a staggered board of directors and supermajority voting requirements will make a takeover attempt more difficult, even if the takeover would be favorable for stockholders.

Inforte's certificate of incorporation and bylaws may have the effect of deterring, delaying or preventing a change in control of Inforte. For example, our charter documents provide for:

- the ability of the board of directors to issue preferred stock and to determine the price and other terms, including preferences and voting rights, of those shares without stockholder approval;
- the inability of our stockholders to act by written consent or to call a special meeting;
- advance notice provisions for stockholder proposals and nominations to the board of directors;



- a staggered board of directors, with three-year terms, which will lengthen the time needed to gain control of the board of directors; and
- supermajority voting requirements for stockholders to amend provisions of the charter documents described above.

We are also subject to Delaware law. Section 203 of the Delaware General Corporation Law prohibits us from engaging in a business combination with any significant stockholder for a period of three years from the date the person became a significant stockholder unless, for example, our board of directors approved the transaction that resulted in the stockholder becoming an interested stockholder. Any of the above could have the effect of delaying or preventing changes in control that a stockholder may consider favorable.

## Item 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

In all categories of cash, cash equivalents and short-term and long-term marketable securities, Inforte invests only in highly liquid securities of high credit quality. All investments bear a minimum Standard & Poor's rating of A1, Moody's investor service rating of P1, or equivalent. Inforte believes that it does not have any material market risk exposure with respect to financial instruments.

## PART II. OTHER INFORMATION

Item 1. Legal Proceedings
None

Item 2. Changes in Securities and Use of Proceeds
None

Item 3. Defaults upon Senior Securities
None

Item 4. Submission of Matter to a Vote of Security Holders
None

Item 5. Other Information
None

Item 6. Exhibits and Reports on Form 8-K
None



## SIGNATURES

Pursuant to the requirements 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.

Inforte Corp.

By: /s/ NICK PADGETT

November 14, 2001

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Nick Padgett,
Chief Financial Officer