
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)



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

For the quarterly period ended June 30, 2005

OR

☐

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

For the transition period from ____ to ____

Commission file number: 001-15169

PERFICIENT, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of
Incorporation or Organization)

No. 74-2853258

(I.R.S. Employer Identification No.)

**1120 South Capital of Texas Highway, Building 3, Suite 220
Austin, Texas 78746**

(Address of Principal Executive Offices, including Zip Code)

(512) 531-6000

(Registrant's Telephone Number, Including Area Code)

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

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

As of August 9, 2005, there were 22,225,766 shares of Common Stock outstanding.

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PART I. CONDENSED CONSOLIDATED FINANCIAL INFORMATION

Item 1. Financial Statements

Perficient, Inc.
Condensed Consolidated Balance Sheets
(unaudited)

	December 31, 2004	June 30, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,905,460	\$ 2,029,511
Accounts receivable, net	20,049,500	22,348,345
Other current assets	336,309	438,732
Total current assets	24,291,269	24,816,588
Property and equipment, net	805,831	894,740
Goodwill	32,818,431	39,262,536
Intangible assets, net	4,521,460	4,970,415
Other non-current assets	145,374	1,475,324
Total assets	<u>\$ 62,582,365</u>	<u>\$ 71,419,603</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 6,927,523	\$ 1,614,770
Note payable and current portion of long-term debt	1,135,354	1,291,431
Other current liabilities	6,750,968	6,212,760
Current portion of note payable to related parties	243,847	234,899
Total current liabilities	15,057,692	9,353,860
Long-term borrowings, net of current portion	2,676,027	8,019,032
Note payable to related party, net of current portion	226,279	—
Total liabilities	17,959,998	17,372,892
Stockholders' equity:		
Common stock	20,914	22,083
Additional paid-in capital	102,637,699	108,856,983
Deferred stock compensation	(1,656,375)	(1,538,063)
Accumulated other comprehensive loss	(57,837)	(87,372)
Accumulated deficit	(56,322,034)	(53,206,920)
Total stockholders' equity	44,622,367	54,046,711
Total liabilities and stockholders' equity	<u>\$ 62,582,365</u>	<u>\$ 71,419,603</u>

See accompanying notes to interim unaudited condensed consolidated financial statements.

Perficient, Inc.
Condensed Consolidated Statements of Operations
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2005	2004	2005
Revenue				
Services	\$ 9,653,450	\$19,233,997	\$16,317,236	\$36,891,098
Software	1,071,766	1,393,302	2,402,242	2,800,158
Reimbursable expenses	602,928	1,033,485	981,093	1,693,678
Total revenue	11,328,144	21,660,784	19,700,571	41,384,934
Cost of revenue (exclusive of depreciation shown separately below)				
Project personnel costs	5,868,854	11,626,782	9,563,997	22,547,278
Software costs	831,082	1,198,393	1,984,435	2,377,933
Reimbursable expenses	602,928	1,033,485	981,093	1,693,678
Other project related expenses	52,025	519,010	162,298	762,683
Total cost of revenue	7,354,889	14,377,670	12,691,823	27,381,572
Gross margin	3,973,255	7,283,114	7,008,748	14,003,362
Selling, general and administrative	2,341,285	4,090,638	4,193,956	7,824,821
Depreciation	123,753	132,885	224,875	310,221
Amortization of intangibles	162,778	303,763	212,779	580,639
Total operating expense	2,627,816	4,527,286	4,631,610	8,715,681
Income from operations	1,345,439	2,755,828	2,377,138	5,287,681
Interest income	539	6,256	637	7,919
Interest expense	(14,762)	(121,264)	(29,133)	(233,768)
Other	(193)	9,292	1,899	8,129
Income before income taxes	1,331,023	2,650,112	2,350,541	5,069,961
Provision for income taxes	521,000	1,023,301	920,000	1,954,847
Net income	\$ 810,023	\$ 1,626,811	\$ 1,430,541	\$ 3,115,114
Basic net income per share	\$ 0.05	\$ 0.08	\$ 0.09	\$ 0.15
Diluted net income per share	\$ 0.04	\$ 0.07	\$ 0.08	\$ 0.13
Shares used in computing basic net income per share	17,312,707	21,529,502	15,906,432	21,345,581
Shares used in computing diluted net income per share	20,234,707	24,794,723	18,928,871	24,799,587

See accompanying notes to interim unaudited consolidated financial statements.

Perficient, Inc.
Condensed Consolidated Statement of Stockholders' Equity
Six Months Ended June 30, 2005
(unaudited)

	Common Stock Shares	Common Stock Amount	Common Stock Warrants	Additional Paid-in Capital	Deferred Compen- sation	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2004	20,913,532	\$20,914	\$450,166	\$102,187,533	\$(1,656,375)	\$(57,837)	\$(56,322,034)	\$44,622,367
Warrants exercised	24,557	25	(54,560)	161,678	—	—	—	107,143
Stock options exercised	364,640	364	—	567,484	—	—	—	567,848
Tax benefit of non-qualified stock option exercises	—	—	—	596,931	—	—	—	596,931
Amortization of deferred compensation	—	—	—	—	59,156	—	—	59,156
Foreign currency translation adjustment	—	—	—	—	—	(20,800)	—	(20,800)
Net income	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,488,303</u>	<u>1,488,303</u>
Balance at March 31, 2005	<u>21,302,729</u>	<u>\$21,303</u>	<u>\$395,607</u>	<u>\$103,513,625</u>	<u>\$(1,597,219)</u>	<u>\$(78,637)</u>	<u>\$(54,833,731)</u>	<u>\$47,420,948</u>
iPath acquisition	623,803	624		4,515,710	—	—	—	4,516,334
Forfeiture of contingent shares for Genisys acquisition	(41,190)	(41)		(155,245)	—	—	—	(155,286)
Stock options exercised	197,378	197	—	334,121	—	—	—	334,318
Tax benefit of non-qualified stock option exercises	—	—	—	253,165	—	—	—	253,165
Amortization of deferred compensation	—	—	—	—	59,156	—	—	59,156
Foreign currency translation adjustment	—	—	—	—	—	(8,735)	—	(8,735)
Net income	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,626,811</u>	<u>1,626,811</u>
Balance at June 30, 2005	<u>22,082,720</u>	<u>\$22,083</u>	<u>\$395,607</u>	<u>\$108,461,376</u>	<u>\$(1,538,063)</u>	<u>\$(87,372)</u>	<u>\$(53,206,920)</u>	<u>\$54,046,711</u>

See accompanying notes to interim unaudited condensed consolidated financial statements.

Perficient, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30,	
	2004	2005
OPERATING ACTIVITIES		
Net income	\$ 1,430,541	\$ 3,115,114
Adjustments to reconcile net income to net cash provided by (used in) operations:		
Depreciation	224,875	310,221
Amortization of Intangibles	212,779	580,639
Non-cash stock compensation	24,770	118,312
Non-cash interest expense	24,698	14,773
Changes in operating assets and liabilities (net of acquisitions):		
Accounts receivable	(132,446)	(729,463)
Other assets	(11,529)	(356,783)
Accounts payable	27,406	(5,312,236)
Other liabilities	(855,463)	57,255
Net cash provided by (used in) operating activities	945,631	(2,202,168)
INVESTING ACTIVITIES		
Purchase of property and equipment	(115,248)	(335,000)
Purchase of businesses, net of cash acquired	(7,338,875)	(4,779,641)
Payments on Javelin Notes	(375,000)	(250,000)
Net cash used in investing activities	(7,829,123)	(5,364,641)
FINANCING ACTIVITIES		
Proceeds from short-term borrowings	2,500,000	8,000,000
Payments on short-term borrowings	—	(2,000,000)
Payments on long-term debt	—	(500,918)
Deferred offering costs	—	(792,170)
Proceeds from exercise of stock options	215,196	902,166
Proceeds from exercise of warrants	2,430,000	107,143
Proceeds from stock issuances, net	2,373,162	—
Net cash provided by financing activities	7,518,358	5,716,221
Effect of exchange rate on cash	(17,152)	(25,361)
Change in cash	617,714	(1,875,949)
Cash and cash equivalents at beginning of period	1,989,395	3,905,460
Cash and cash equivalents at end of period	<u>\$ 2,607,109</u>	<u>\$ 2,029,511</u>
Supplemental disclosures:		
Interest paid	<u>\$ —</u>	<u>\$ 191,548</u>
Cash paid for income taxes	<u>\$ 1,025,327</u>	<u>\$ 869,575</u>
Non cash activities:		
Stock issued for Purchase of Business	<u>\$10,982,551</u>	<u>\$ 4,516,334</u>
Change in goodwill	<u>\$13,747,381</u>	<u>\$ 661,131</u>
Tax benefit of non-qualified stock option exercises	<u>\$ —</u>	<u>\$ 850,096</u>

See accompanying notes to interim unaudited condensed consolidated financial statements.

PERFICIENT, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements of Perficient, Inc. (the “Company”), have been prepared in accordance with accounting principles generally accepted in the United States and are presented in accordance with the rules and regulations of the Securities and Exchange Commission applicable to interim financial information. Accordingly, certain footnote disclosures have been condensed or omitted. In the opinion of management, the unaudited interim condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the Company’s financial position, results of operations and cash flows for the periods presented. These financial statements should be read in conjunction with the Company’s consolidated financial statements and notes thereto filed with the Securities and Exchange Commission in the Company’s annual report on Form 10-KSB for the year ended December 31, 2004, as amended. Operating results for the three months and six months ended June 30, 2005 may not be indicative of the results for the full fiscal year ending December 31, 2005.

2. Summary of Significant Accounting Policies

Stock-Based Compensation

Statement of Financial Accounting Standards (“SFAS”) No. 123, *Accounting for Stock-Based Compensation*, prescribes accounting and reporting standards for all stock-based compensation plans, including employee stock options. As allowed by SFAS No. 123, the Company has elected to account for its employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, *Accounting For Stock Issued To Employees*, and (“APB 25”), which allows the use of the intrinsic value method. The Company’s basis for electing accounting treatment under APB 25 is principally due to the incorporation of the dilutive effect of these shares in the reported earnings per share calculation and the presence of pro forma supplemental disclosure of the estimated fair value methodology prescribed by SFAS No. 123 and SFAS No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure*. The fair value of options was calculated at the date of grant using the Black-Scholes pricing model with the following weighted-average assumptions for the three months and six months ended June 30, 2004 and 2005, respectively: risk free interest rate of 2.98% and 3.61%; dividend yield of 0%; weighted-average expected life of options of 5 years; and a volatility factor of 1.515 and 1.384.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and which are fully transferable. In addition, option valuation models in general require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company’s employee stock options have characteristics significantly different than traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management’s opinion, the existing models do not necessarily provide a single reliable measure of the fair value of its stock options.

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The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS 123:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2005	2004	2005
Net Income – as reported	\$ 810,023	\$1,626,811	\$1,430,541	\$ 3,115,114
Total stock-based compensation costs included in the determination of net income, as reported	12,300	36,322	24,768	72,704
The stock-based employee compensation costs that would have been included in the determination of net income if the fair value based method had been applied to all awards	(249,324)	(576,780)	(585,331)	(1,055,067)
Pro forma net income available to common stockholders	<u>\$ 572,999</u>	<u>\$1,086,353</u>	<u>\$ 869,978</u>	<u>\$ 2,132,751</u>
Earnings per share:				
Basic – as reported	<u>\$ 0.05</u>	<u>\$ 0.08</u>	<u>\$ 0.09</u>	<u>\$ 0.15</u>
Basic – pro forma	<u>\$ 0.03</u>	<u>\$ 0.05</u>	<u>\$ 0.06</u>	<u>\$ 0.10</u>
Diluted – as reported	<u>\$ 0.04</u>	<u>\$ 0.07</u>	<u>\$ 0.08</u>	<u>\$ 0.13</u>
Diluted – pro forma	<u>\$ 0.03</u>	<u>\$ 0.05</u>	<u>\$ 0.05</u>	<u>\$ 0.09</u>

Revenue Recognition

Revenues are primarily derived from professional services provided on a time and materials basis. For time and material contracts, revenue is recognized and billed by multiplying the number of hours expended in the performance of the contract by the established billing rates. For fixed fee projects, revenue is generally recognized using the proportionate performance method based on the ratio of hours expended to total estimated hours. Provisions for estimated losses on uncompleted contracts are made on a contract-by-contract basis and are recognized in the period in which such losses are determined. Billings in excess of costs plus earnings are classified as deferred revenues. On many projects the Company is also reimbursed for out-of-pocket expenses such as airfare, lodging and meals. These reimbursements are included as a component of revenue in accordance with the Financial Accounting Standards Board's Emerging Issues Task Force ("EITF") 01-14, *Income Statement Characterization of Reimbursements Received for "Out-of-Pocket" Expenses Incurred*. In accordance with EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, revenue from software sales is recorded on a gross basis based on the Company's role as principal in the transaction. In accordance with EITF 99-19, the Company will be considered "principal" if the Company is the primary obligor and bears the associated credit risk in the transaction. In the event the Company does not meet the requirements to be considered a principal in the software sale transaction and acts as an agent, the revenue would be recorded on a net basis.

We also recognize revenue in accordance with Statement of Position ("SOP") 97-2, *Software Revenue Recognition*, as amended by SOP 98-4 and SOP 98-9, and Securities and Exchange Commission Staff Accounting Bulletin ("SAB") 101, *Revenue Recognition in Financial Statements*, as revised by SAB 104. Revenue is recognized when the following criteria are met: (i) persuasive evidence of the customer arrangement exists, (ii) fees are fixed and determinable, (iii) acceptance has occurred, and (iv) collection is deemed probable. We determine the fair value of each element in the arrangement based on vendor-specific objective evidence (VSOE) of fair value. VSOE of fair value is based upon the normal pricing and discounting practices for those products and services when sold separately. We follow very specific and detailed guidelines, discussed above, in determining revenues; however, certain judgments and estimates are made and used to determine revenue recognized in any accounting period. Material differences may result in the amount and timing of revenue recognized for any period if different

conditions were to prevail. For example, in determining whether collection is probable, we assess our customers' ability and intent to pay. Our actual experience with respect to collections could differ from our initial assessment if, for instance, unforeseen declines in the overall economy occur and negatively impact our customers' financial condition.

Intangible Assets

Intangible assets, primarily resulting from purchased business combinations, are being amortized using the straight-line method with a life of three to five years for non-compete agreements, a life of three to eight years for customer relationship intangibles and a life of six months to one year for customer backlog. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* ("Statement 142"), we assess our goodwill on October 1 of each year or more frequently if events or changes in circumstances indicate that goodwill might be impaired.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates, and such differences could be material to the financial statements.

3. Segment Information

The Company operates as a single segment. The Company's chief operating decision maker is considered to be the Chief Executive Officer and Chairman of the Board. The chief operating decision maker allocates resources and assesses performance of the business and other activities at the consolidated level.

4. Net Income Per Share

The following table presents the calculation of basic and diluted net income per share:

	Three months ending June 30,		Six months ending June 30,	
	2004	2005	2004	2005
Net income	\$ 810,023	\$ 1,626,811	\$ 1,430,541	\$ 3,115,114
Basic:				
Weighted-average shares of common stock outstanding	16,488,669	20,279,460	15,494,414	20,223,632
Weighted-average shares of common stock outstanding subject to contingency (i.e. restricted stock)	824,038	1,250,042	412,018	1,121,949
Shares used in computing basic net income per share	17,312,707	21,529,502	15,906,432	21,345,581
Effect of dilutive securities:				
Stock options	2,782,075	3,125,957	2,725,700	3,305,617
Warrants	139,925	139,264	296,739	148,389
Shares used in computing diluted net income per share	20,234,707	24,794,723	18,928,871	24,799,587
Basic net income per share	\$ 0.05	\$ 0.08	\$ 0.09	\$ 0.15
Diluted net income per share	\$ 0.04	\$ 0.07	\$ 0.08	\$ 0.13

5. Commitments and Contingencies

The Company leases its office facilities and certain equipment under various operating lease agreements. The Company has the option to extend the term of certain of its office facilities leases. Future minimum commitments under these lease agreements are as follows:

	Operating Leases
2005 remaining	\$ 756,377
2006	1,152,917
2007	638,669
2008	318,598
2009	229,636
Thereafter	—
Total minimum lease payments	\$3,096,197

[Table of Contents](#)**6. Balance Sheet Components (unaudited)**

The components of accounts receivable are as follows:

	December 31, 2004	June 30, 2005
Accounts receivable	\$12,426,107	\$15,599,071
Unbilled revenue	8,277,573	7,251,468
Allowance for doubtful accounts	(654,180)	(502,194)
Total	\$20,049,500	\$22,348,345

The components of other current liabilities are as follows:

	December 31, 2004	June 30, 2005
Accrued bonuses	\$2,094,987	\$2,065,417
Accrued vacation	395,127	297,468
Other payroll liabilities	714,049	414,727
Sales and use taxes	221,249	82,705
Accrued income taxes	170,354	223,785
Other accrued expenses	1,702,853	1,543,552
Accrued acquisition costs	317,982	17,188
Accrued subcontractor fees	510,018	1,138,588
Deferred revenue	624,349	429,330
Total	\$6,750,968	\$6,212,760

Property and equipment consist of the following:

	December 31, 2004	June 30, 2005
Computer Hardware & Software	\$ 2,506,699	\$ 3,264,114
Furniture & Fixtures	726,570	341,980
Leasehold Improvements	125,797	128,002
	3,359,066	3,734,096
less: Accumulated Depreciation	(2,553,235)	(2,839,356)
Total	\$ 805,831	\$ 894,740

[Table of Contents](#)**7. Comprehensive Income (unaudited)**

The components of comprehensive income are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2005	2004	2005
Net income	\$810,023	\$1,626,811	\$1,430,541	\$3,115,114
Foreign currency translation adjustments	(4,876)	(8,735)	(17,152)	(29,535)
Total comprehensive net income	<u>\$805,147</u>	<u>\$1,618,076</u>	<u>\$1,413,389</u>	<u>\$3,085,579</u>

8. Business CombinationsAcquisition of Genisys Consulting, Inc.

On April 2, 2004, the Company consummated the acquisition of Genisys Consulting, Inc. ("Genisys"), a privately held information technology consulting company, for total purchase consideration of approximately \$8.8 million representing a net purchase price of approximately \$9.1 net of tangible net liabilities acquired. This total purchase consideration consists of approximately \$1.5 million in cash, transaction costs of approximately \$0.5 million, approximately 1.7 million shares of Perficient's common stock valued at \$3.77 per share (approximately \$6.4 million worth of Company's common stock) and stock options valued at approximately \$0.4 million. The total purchase consideration of \$8.8 million has been allocated to the assets acquired and liabilities assumed, including identifiable intangible assets, based on their respective fair values at the date of acquisition. Such allocation resulted in goodwill of approximately \$7.4 million. Goodwill is assigned at the enterprise level and is not expected to be deductible for tax purposes. The purchase price was allocated to intangibles based on an independent appraisal and management's estimate. The results of the Genisys operations have been included in the Company's consolidated financial statements since April 2, 2004.

The purchase price allocation is as follows (in millions):

Intangibles:	
Customer relationships	\$ 1.1
Non-compete agreements	0.4
Customer backlog	0.2
Goodwill	7.4
Tangible Assets and Liabilities	
Accounts receivable	1.2
Other current assets	0.1
Property and equipment	0.1
Accounts payable and accrued expenses	(0.4)
Deferred income tax liability	(1.0)
Income tax payable	(0.3)
Net assets acquired	<u>\$ 8.8</u>

The Company believes that the intangible assets acquired have useful lives of nine months to eight years.

In the second quarter of 2005, a former Genisys stockholder forfeited 41,190 shares of restricted stock that were issued in connection with the acquisition resulting in a reduction of Goodwill and Stockholders' Equity of approximately \$0.2 million.

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Acquisition of Meritage Technologies, Inc.

On June 18, 2004, the Company consummated the acquisition of Meritage Technologies, Inc. (“Meritage”), a privately held information technology consulting company for total purchase consideration of approximately \$10.4 million, representing a net purchase price of approximately \$9.2 million net of tangible net assets acquired. This total purchase consideration consists of approximately \$2.9 million in cash, \$2.4 of liabilities repaid on behalf of Meritage Technologies, Inc., transaction costs of approximately \$0.9 million, and approximately 1.2 million shares of the Company’s common stock valued at approximately \$3.595 per share (approximately \$4.2 million worth of Company’s common stock). The total purchase price consideration of \$10.4 million, including transaction costs of \$0.9 million, has been allocated to the assets acquired and liabilities assumed, including identifiable intangible assets, based on their respective fair values at the date of acquisition. Such allocation resulted in goodwill of approximately \$6.9 million. Goodwill is assigned at the enterprise level and is not expected to be deductible for tax purposes. The purchase price was allocated to intangibles based on management’s estimate with assistance from an independent appraisal firm. The results of the Meritage operations have been included in the Company’s consolidated financial statements since June 18, 2004.

The purchase price allocation is as follows (in millions):

Intangibles:	
Customer relationships	\$ 0.3
Non-compete agreements	1.5
Deferred tax asset, net of valuation allowance	0.4
Goodwill	6.9
Tangible Assets and Liabilities Acquired:	
Accounts receivable	2.2
Property and equipment	0.1
Accounts payable and accrued expenses	(1.0)
Net assets acquired	<u>\$10.4</u>

The Company believes that the intangible assets acquired have useful lives of five years. The Company has accrued exit costs of approximately \$0.2 million, which relate to lease obligations for excess office space that the Company has vacated or intends to vacate under the approved facilities exit plan. The estimated costs of vacating these leased facilities, including estimated costs to sub-lease, and sub-lease income were based on market information and trend analysis as estimated by the Company. It is reasonably possible that actual results could differ from these estimates in the near term. The Company has accrued severance of \$0.2 million, which relate to severance and related payroll taxes for certain employees of Meritage impacted by the approved plan of termination. The Company acquired deferred tax assets of approximately \$1.9 million. These assets primarily relate to net losses incurred by Meritage prior to the acquisition. The Company has placed a full valuation allowance on these assets given the level of cumulative historical losses for both Meritage and the Company.

Acquisition of ZettaWorks LLC

On December 20, 2004, the Company consummated the acquisition of ZettaWorks LLC (“ZettaWorks”), a privately held technology consulting company for total purchase consideration of approximately, \$11.4 million, representing a net purchase price of approximately \$9.6 million net of tangible net assets acquired. This total purchase consideration consists of approximately \$2.9 million in cash, transaction costs of approximately \$0.7 million, and approximately 1.2 million shares of the Company’s common stock valued at approximately \$6.537 per share (approximately \$7.8 million worth of Company’s common stock). The total purchase price consideration of \$11.4 million, including transaction costs of \$0.7 million, have been allocated to the assets acquired and liabilities assumed, including identifiable intangible assets, based on their respective fair values at the date of acquisition. Such allocation resulted in goodwill of approximately \$8.2 million. Goodwill is assigned at the enterprise level and is expected to be deductible for tax purposes. The purchase price was allocated to intangibles based on management’s estimate with assistance from an independent appraisal firm. Management expects to finalize the purchase price

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allocation within twelve months of the acquisition date as certain initial accounting estimates are resolved such as the collectibility of acquired accounts receivable. The results of the ZettaWorks operations have been included in the Company's consolidated financial statements since December 20, 2004.

The purchase price allocation is as follows (in millions):

Intangibles:	
Customer relationships	\$ 1.1
Customer backlog	0.2
Non-compete agreements	0.1
Goodwill	8.2
Tangible Assets and Liabilities Acquired:	
Accounts receivable	2.9
Property and equipment	0.1
Accounts payable and accrued expenses	<u>(1.2)</u>
Net assets acquired	<u>\$11.4</u>

The Company believes that the intangible assets acquired have useful lives of one to five years.

Acquisition of iPath Solutions, Ltd.

On June 10, 2005, the Company consummated the acquisition of iPath Solutions, Ltd. ("iPath"), a privately held technology consulting company for total purchase consideration of approximately \$9.8 million, representing a net purchase price of approximately \$8.1 million net of tangible net assets acquired. This total purchase consideration consists of \$3.9 million in cash, \$0.9 million of liabilities repaid on behalf of iPath, transaction costs of approximately \$0.5 million, and 623,803 shares of the Company's common stock valued at approximately \$7.24 per share (approximately \$4.5 million worth of Company's common stock). The total purchase price consideration of \$9.8 million, including transaction costs of \$0.5 million, have been allocated to the assets acquired and liabilities assumed, including identifiable intangible assets, based on their respective fair values at the date of acquisition. Such allocation resulted in goodwill of approximately \$7.1 million. Goodwill is assigned at the enterprise level and is expected to be deductible for tax purposes. The purchase price was allocated to intangibles based on management's estimate and an independent appraisal. Management expects to finalize the purchase price allocation within twelve months of the acquisition date as certain initial accounting estimates are resolved such as the collectibility of acquired accounts receivable. The results of the iPath operations have been included in the Company's consolidated financial statements since June 10, 2005.

The preliminary purchase price allocation is as follows (in millions):

Intangibles:	
Customer relationships	\$0.7
Customer backlog	0.2
Non-Compete Agreements	0.1
Goodwill	7.1
Tangible Assets Acquired:	
Accounts receivable	1.6
Property and equipment	<u>0.1</u>
Net assets acquired	<u>\$9.8</u>

The Company believes that the intangible assets acquired have useful lives of six months to five years.

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Pro-forma Results of Operations

The following presents the unaudited pro-forma combined results of operations of the Company with Genisys, Meritage, ZettaWorks and iPath, for the three months ended June 30, 2004 and 2005 and six months ended June 30, 2004 and 2005, as if the acquisitions had each been completed on January 1, 2004 and January 1, 2005, after giving effect to certain pro forma adjustments related to the amortization of acquired intangible assets, interest expense on debt incurred and shares issued in connection with the acquisitions. These unaudited pro-forma results are not necessarily indicative of the actual consolidated results of operations had the acquisitions actually occurred on January 1, 2004 and January 1, 2005 or of future results of operations of the consolidated entities:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2005	2004	2005
Revenues	\$20,957,954	\$23,416,378	\$42,754,654	\$45,208,988
Net Income	398,032	1,733,620	1,025,165	3,310,680
Basic Income per Share	0.02	0.08	0.05	0.15
Diluted Income per Share	0.02	0.07	0.05	0.13

9. Intangible Assets

Intangible Assets with Indefinite Lives

The changes in the carrying amount of Goodwill for the six months ended June 30, 2005 are as follows:

Balance at December 31, 2004	\$32.8 million
iPath Acquisition	7.1 million
Adjustments to Goodwill related to forfeiture of stock in purchase consideration, uncollected accounts receivable purchased, change in estimated acquisition transaction costs and tax adjustments	(0.6 million)
Balance at June 30, 2005	<u>\$39.3 million</u>

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Intangible Assets with Definite Lives

Following is a summary of Company's intangible assets (in millions) that are subject to amortization:

	December 31, 2004			June 30, 2005		
	Gross Carrying Amounts	Accumulated Amortization	Net Carrying Amounts	Gross Carrying Amounts	Accumulated Amortization	Net Carrying Amounts
Customer Relationships	\$3,000	\$(410)	\$2,590	\$3,790	\$ (675)	\$3,115
Non-Compete	1,950	(213)	1,737	2,003	(409)	1,594
Customer Backlog	400	(206)	194	390	(129)	261
Total	<u>\$5,350</u>	<u>\$(829)</u>	<u>\$4,521</u>	<u>\$6,183</u>	<u>\$ (1,213)</u>	<u>\$4,970</u>

10. Line of Credit and Long-Term Debt

On June 9, 2005, the Company entered into an Amended and Restated Loan and Security Agreement with Silicon Valley Bank and KeyBank National Association to be effective as of June 3, 2005. The amended agreement increases the total size of the Company's senior bank credit facilities from \$13 million to \$28.5 million by increasing the accounts receivable line of credit from \$9 million to \$15 million and increasing the acquisition term line of credit from \$4 million to \$13.5 million.

The accounts receivable line of credit, which expires in December 2008, provides for a borrowing capacity equal to all eligible accounts receivable, including 80% of unbilled revenue, subject to certain borrowing base calculations as defined in the agreement, but in no event more than \$15 million. Borrowings under this line of credit bear interest at the bank's prime rate plus 1.25% (7.25% at June 30, 2005). As of June 30, 2005, there was \$6 million outstanding under the accounts receivable line of credit and the amount available was approximately \$8.5 million, as determined by the end of period borrowing base calculation.

The Company's \$13.5 million term acquisition line of credit provides an additional source of financing for certain qualified acquisitions. As of June 30, 2005 the balance outstanding under this acquisition line of credit was approximately \$3.3 million. Borrowings under this acquisition line of credit bear interest equal to the average four year U.S. Treasury note yield plus 3.50% — the initial \$2.5 million draw, of which \$1.9 million remains outstanding, bears interest of 7.11% at June 30, 2005 and the subsequent \$1.5 million draw, of which \$1.4 million remains outstanding, bears interest of 6.90% at June 30, 2005. Each are repayable in thirty-six equal monthly installments beginning October 21, 2004, and April 20, 2005, respectively. The Company is entitled to make payments of accrued interest only for the first three monthly installments.

The Company is required to comply with various financial covenants under the \$28.5 million credit facility. Specifically, the Company is required to maintain:

- a ratio of after tax earnings before interest, depreciation and amortization, based on trailing three months annualized results, to current maturities of long-term debt and capital leases plus interest, of at least 1.50 to 1.00,
- a ratio of cash plus eligible accounts receivable including 80% of unbilled revenue less principal amount of all outstanding advances on the accounts receivable line of credit to advances under the term acquisition line of credit, of at least 0.75 to 1.00; and
- a maximum ratio of all outstanding advances under the entire credit facility to earnings before taxes, interest, depreciation, amortization and other non-cash charges, including but not limited to,

stock and stock option compensation including pro forma adjustments for acquisitions on a trailing twelve month basis of no more than 2.50 to 1.00.

As of June 30, 2005, the Company was in compliance with all covenants under this credit facility.

Notes payable to related party at December 31, 2004 and June 30, 2005, consisted of non interest-bearing notes issued to the shareholders of Javelin Solutions, Inc. ("Javelin") in April 2002 in connection with the Company's acquisition of Javelin. The notes provide for payments totaling \$1,500,000, of which \$234,899 remained outstanding on June 30, 2005. The Company made payments totaling \$62,500 in January 2004, \$312,500 in April 2004 and \$250,000 in April 2005. The Company expects to make the final payments totaling \$250,000 in April 2006. For financial reporting purposes, an imputed interest rate of 7.5% was used to compute the net present value of the note payments. These notes are subordinate to the Company's line of credit.

11. Shelf Stock Offering

On March 7, 2005, the Company filed a registration statement with the Securities and Exchange Commission to register the offer and sale by the Company and certain selling stockholders of shares of the Company's common stock. Due to overall market conditions during the second quarter of 2005, the Company converted its registration statement into a shelf registration statement to allow for offers and sales of common stock from time to time as market conditions permit. To date, the Company has recorded approximately \$792,000 of deferred offering costs (approximately \$487,000 after tax, if ever expensed) in connection with the offering and has classified these costs as prepaid expenses in other non-current assets on its balance sheet. If the Company sells shares of common stock off of its shelf registration statement, the Company will net these accumulated deferred offering costs against the proceeds of the offering. If the Company does not raise funds through an equity offering off of the shelf registration statement or fails to maintain the effectiveness of the shelf registration statement, the currently capitalized deferred offering costs will be expensed. Such expense would be a non-cash accounting charge as substantially all of these expenses have already been paid.

Item 2. Management's Discussion and Analysis or Plan or Operations

Statements made in this Report on Form 10-Q, including without limitation this Management's Discussion and Analysis of Financial Condition and Operations, other than statements of historical information, 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. These forward-looking statements may sometimes be identified by such words as "may," "will," "expect," "anticipate," "believe," "estimate" and "continue" or similar words. We believe that it is important to communicate our future expectations to investors. However, these forward-looking statements involve many risks and uncertainties. Our actual results could differ materially from those indicated in such forward-looking statements as a result of certain factors, including but not limited to, those set forth under Risk Factors and elsewhere in this Report on Form 10-Q. We are under no duty to update any of the forward-looking statements after the date of this Report on Form 10-Q to conform these statements to actual results.

Overview

We are a rapidly growing information technology consulting firm serving Global 2000 and midsize companies in the central United States. We help clients gain competitive advantage by using Internet-based technologies to make their businesses more responsive to market opportunities and threats, strengthen relationships with customers, suppliers and partners, improve productivity and reduce information technology costs. Our solutions enable these benefits by integrating, automating and extending business processes, technology infrastructure and software applications end-to-end within an organization and with key partners, suppliers and customers. This provides real-time access to critical business applications and information and a scalable, reliable, secure and cost-effective technology infrastructure.

Services Revenue

Our services revenue is derived from professional services performed developing, implementing, integrating, automating and extending business processes, technology infrastructure and software applications. Most of our projects are performed on a time and materials basis, and a smaller amount of revenue is derived from projects performed on a fixed fee basis. Fixed fee engagements represented approximately 15.1% and 11.9% of our services revenue for the three and six months ended June 30, 2005. For time and material projects, revenue is recognized and billed by multiplying the number of hours our professionals expend in the performance of the project by the established billing rates. For fixed fee projects, revenue is generally recognized using the proportionate performance method. Provisions for estimated profits or losses on uncompleted projects are made on a contract-by-contract basis and are recognized in the period in which such profits or losses are determined. Billings in excess of costs plus earnings are classified as deferred revenues. On many projects, we are also reimbursed for out-of-pocket expenses such as airfare, lodging and meals. These reimbursements are included as a component of revenue in accordance with the Financial Accounting Standards Board's Emerging Issues Task Force ("EITF") 01-14, *Income Statement Characterization of Reimbursements Received for "Out-of-Pocket" Expenses Incurred*. The aggregate amount of reimbursed expenses will fluctuate depending on the location of our customers, the total number of our projects that require travel, and whether our arrangements with our clients provide for the reimbursement of travel and other project related expenses.

Software Revenue

A smaller but growing portion of our revenue is derived from sales of third-party software, particularly IBM WebSphere® products. In accordance with EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, revenue from sales of third-party software is recorded on a gross basis provided we act as a principal in the transaction. In accordance with EITF 99-19 we will be considered "principal" if the we are the primary obligor and bears the associated credit risk in the transaction. In the event we do not meet the requirements to be considered a principal in the software sale transaction and act as an agent, the revenue is recorded on a net basis. Software revenue is expected to fluctuate from quarter to quarter and from year to year depending on our customers' demand for our partners' software products. Generally, spending on software sales is a strong indicator of future spending on software services. We also recognize software revenue in accordance with Statement of Position ("SOP") 97-2, *Software Revenue Recognition*, as amended by SOP 98-4 and SOP 98-9, and Securities and Exchange Commission Staff Accounting Bulletin ("SAB") 101, *Revenue Recognition in Financial Statements*, as revised by SAB 104. Revenue is recognized when the following criteria are met: (i) persuasive evidence of the customer arrangement

exists, (ii) fees are fixed and determinable, (iii) acceptance has occurred, and (iv) collection is deemed probable. We determine the fair value of each element in the arrangement based on vendor-specific objective evidence (VSOE) of fair value. VSOE of fair value is based upon the normal pricing and discounting practices for those products and services when sold separately. We follow very specific and detailed guidelines, discussed above, in determining revenues; however, certain judgments and estimates are made and used to determine revenue recognized in any accounting period. Material differences may result in the amount and timing of revenue recognized for any period if different conditions were to prevail. For example, in determining whether collection is probable, we assess our customers' ability and intent to pay. Our actual experience with respect to collections could differ from our initial assessment if, for instance, unforeseen declines in the overall economy occur and negatively impact our customers' financial condition.

Cost of Revenue

Cost of revenue consists primarily of salaries and benefits associated with our technology professionals and subcontractors. Cost of revenue also includes third-party software costs, reimbursable expenses and other unreimbursed project related expenses. Project related expenses will fluctuate generally depending on outside factors including the cost and frequency of travel and the location of our customers. Cost of revenue does not include depreciation of assets used in the production of revenues, which is considered immaterial.

Gross Margins

Our gross margins for services are affected by the utilization rates of our professionals, defined as the percentage of our professionals' time billed to customers divided by the total available hours in the respective period, the salaries we pay our consulting professionals and the average billing rate we receive from our customers. If a project ends earlier than scheduled or we retain professionals in advance of receiving project assignments, or if demand for our services declines, our utilization rate will decline and adversely affect our gross margins. For more than the past two years, as the information technology software and services industry has recovered from the protracted downturn experienced in 2001 and 2002, we have seen an improvement in our utilization rates while our billing, retention and base salary rates have remained relatively stable. Subject to fluctuations resulting from our acquisitions, we expect these key metrics of our services business to remain relatively constant for the foreseeable future assuming there are no further declines in the demand for information technology software and services. Gross margin percentages of third party software sales are typically much lower than gross margin percentages for services and the mix of services and software for a particular period can significantly impact total combined gross margin percentage for such period. In addition, gross margin for software sales can fluctuate due to pricing and other competitive pressures.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of cash and non-cash compensation for sales, executive and administrative employees, training, sales and marketing activities, investor relations, recruiting, travel costs and expenses, and miscellaneous expenses. Non-cash compensation includes stock compensation expenses arising from various option grants to employees with exercise prices below fair market value at the date of grant. Such stock compensation is generally expensed across the vesting periods of the related equity grants. We work to minimize selling costs by focusing on repeat business with existing customers and by accessing sales leads generated by our software company partners, most notably IBM, whose products we use to design and implement solutions for our clients. These partnerships enable us to reduce our selling costs and sales cycle times and increase win rates through leveraging our partners' marketing efforts and endorsements.

Quarterly Fluctuations

Our quarterly operating results are subject to seasonal fluctuations. Our fourth and first quarters include the months of December and January, when billable services activity by professional staff, as well as engagement decisions by clients, may be reduced due to client budget planning cycles. Demand for our services generally has been lower in the fourth quarter due to reduced activity during the holiday season. Our results will also fluctuate, in part, based on whether we succeed in counterbalancing periodic declines in services revenues when a project or engagement is completed or cancelled by entering into arrangements to provide additional services to the same clients or others. Software sales tend to show some seasonality as well, in that we tend to see higher software demand during the third and fourth quarter of the calendar year due to client budget planning and usage cycles,

though this is not always the case. These and other seasonal factors may contribute to fluctuations in our operating results from quarter to quarter.

Plans for Growth & Acquisitions

Our goal is to be the leading independent information technology consulting firm in the central United States through, among other things, expanding our relationships with existing and new clients, expanding our operations in the central United States and continuing to make disciplined acquisitions. We believe the central United States represents an attractive market for growth, both organically and through acquisitions. As demand for our services grows in the central United States, we believe we will attempt to increase the number of professionals in our nine central United States offices to meet such demand and, as a result, increase our services revenue. In addition, we believe our track record for identifying attractive acquisitions and our ability to integrate acquired businesses helps us successfully complete acquisitions efficiently and productively, while continuing to offer quality services to our clients, including new clients resulting from the acquisitions.

Consistent with our strategy of growth through disciplined acquisitions, since January 1, 2004 we have consummated four acquisitions: Genisys on April 2, 2004; Meritage on June 18, 2004; ZettaWorks on December 20, 2004 and iPath on June 10, 2005. The operating results of these businesses have been included in our consolidated operating results from the respective dates of acquisition. They significantly affected the comparability of our 2005 operating results to those of prior years, and they will continue to affect the comparability of our results in 2005, when they are included in our operating results for the full year.

Results of Operations

Three months ended June 30, 2005 compared to three months ended June 30, 2004

Revenue. Total revenue increased 91% to \$21.7 million for the three months ended June 30, 2005 from \$11.3 million for the three months ended June 30, 2004. Services revenue, including reimbursed expenses, increased 98% to \$20.3 million for the three months ended June 30, 2005 from approximately \$10.3 million for three months ended June 30, 2004. The increase in services revenue resulted from increases in average project size and number of projects. These increases were largely attributable to the acquisitions of Meritage, ZettaWorks and iPath. The utilization rate of our professionals, excluding subcontractors also increased to 86% for the three months ended June 30, 2005 from 82% for the three months ended June 30, 2004. For the three months ended June 30, 2005 and 2004, 10% and 26%, respectively, of our revenue was derived from IBM. Software revenue increased 30% to \$1.4 million for the three months ended June 30, 2005 from \$1.1 million for the three months ended June 30, 2004 due to increased customer demand. Included in services revenue discussed above, reimbursable expenses increased 71% to \$1.0 million for the three months ended June 30, 2005 from \$0.6 million for the three months ended June 30, 2004. We do not realize any profit on reimbursable expenses.

Cost of Revenue. Cost of revenue increased 95% to \$14.4 million for the three months ended June 30, 2005 from \$7.4 million for the three months ended June 30, 2004. The increase in cost of revenue is attributable to an increase in the number of professionals due to hiring and the acquisitions of Meritage, ZettaWorks and iPath. The average number of professionals performing services, including subcontractors, increased to 409 for the three months ended June 30, 2005 from 124 for the three months ended June 30, 2004. Also, costs associated with software sales increased 44% to \$1.2 million for the three months ended June 30, 2005 in connection with the increased software revenue.

Gross Margin. Gross margin increased 83% to \$7.3 million for the three months ended June 30, 2005 from \$4.0 million for the three months ended June 30, 2004. Gross margin as a percentage of revenue, excluding reimbursed expenses, decreased to 35.3% for the three months ended June 30, 2005 from 37.1% for the three months ended June 30, 2004. The decrease in gross margin as a percentage of revenue is primarily due to the increase in software sales revenue in proportion to total revenue, which typically yields a lower margin than our services revenue. Services gross margin decreased to 36.9% for the three months ended June 30, 2005 from 38.7% for the three months ended June 30, 2004 primarily due to lower gross margins on consulting services contracts acquired in the acquisitions of Meritage and ZettaWorks. Software gross margin decreased to 14.0% for the three months ended June 30, 2005 from 22.5% for the three months ended June 30, 2004 primarily as a result of

fluctuations in selling prices to customers based on competitive pressures and fluctuations in vendor pricing based on market conditions at the time of the sales and an increase in unreimbursed direct expenses as a result of the acquisition of ZettaWorks.

Selling, General and Administrative. Selling, general and administrative expenses increased 75% to \$4.1 million for the three months ended June 30, 2005 from \$2.3 million for the three months ended June 30, 2004 due primarily to the increases in sales personnel, management personnel, support personnel and facilities related to the acquisitions of Meritage, ZettaWorks and iPath. However, selling, general and administrative expenses as a percentage of revenue decreased to 18.8% for the three months ended June 30, 2005 from 20.6% for the three months ended June 30, 2004. The decrease in selling, general and administrative expenses as a percentage of revenue is the result of leveraging operating efficiencies and scalability of the back office.

Depreciation. Depreciation expense increased 7% to \$132,885 for the three months ended June 30, 2005 from \$123,753 for the three months ended June 30, 2004. The increase is due to general purchases of fixed assets along with an increasing number of fully depreciated assets.

Intangibles Amortization. Intangibles amortization expenses, arising from acquisitions, increased 87% to \$303,763 for the three months ended June 30, 2005 from \$162,778 for the three months ended June 30, 2004. The increase in amortization expense reflects the acquisition of intangibles acquired from Genisys, Meritage, ZettaWorks and iPath.

Interest Expense. Interest expense increased 721% to \$121,264 for the three months ended June 30, 2005 compared to \$14,762 for the three months ended June 30, 2004. This increase in interest expense is due to interest expense now being incurred on the newly funded acquisition term debt that was drawn down in connection with the acquisitions of Meritage in June 2004, ZettaWorks in December 2004 and draws on the accounts receivable line of credit in connection with the acquisitions of ZettaWorks in December 2004 and iPath in June 2005.

Provision for Income Taxes. We accrue a provision for federal, state and foreign income tax at the applicable statutory rates adjusted for non-deductible expenses. Our tax provision rate remained relatively constant at 38.6% for the three months ended June 30, 2005 as compared to 39.1% for the three months ended June 30, 2004. We have total deferred tax assets of \$3.3 million mostly resulting from net operating losses of acquired companies amounting to approximately \$2.8 million for which we have a valuation allowance of \$2.4 million. The remaining deferred tax asset of \$0.5 million is partially off-set by deferred tax liabilities of \$0.7 million related to identifiable intangibles and cash to accrual adjustments from prior acquisitions. Any reversal of the valuation allowance on the deferred tax assets will be adjusted against goodwill and will not have an impact on our statement of operations. All of the net operating losses relate to acquired entities, and as such are subject to annual limitations on usage under the “change in control” provisions of the Internal Revenue Code.

Six months ended June 30, 2005 compared to six months ended June 30, 2004

Revenue. Total revenue increased 110% to \$41.4 million for the six months ended June 30, 2005 from \$19.7 million for the six months ended June 30, 2004. Services revenue, including reimbursed expenses, increased 123% to \$38.6 million for the six months ended June 30, 2005 from approximately \$17.3 million for six months ended June 30, 2004. The increase in services revenue resulted from increases in average project size and number of projects. These increases were largely attributable to the acquisitions of Genisys, Meritage, ZettaWorks and iPath. The utilization rate of our professionals, excluding subcontractors also increased to 85% for the six months ended June 30, 2005 from 81% for the six months ended June 30, 2004. For the six months ended June 30, 2005 and 2004, 11% and 29%, respectively, of our revenue was derived from IBM. Software revenue increased 17% to \$2.8 million for the six months ended June 30, 2005 from \$2.4 million for the six months ended June 30, 2004 due to increased customer demand. Included in services revenue discussed above, reimbursable expenses increased 73% to \$1.7 million for the six months ended June 30, 2005 from \$1.0 million for the six months ended June 30, 2004. We do not realize any profit on reimbursable expenses.

Cost of Revenue. Cost of revenue increased 116% to \$27.4 million for the six months ended June 30, 2005 from \$12.7 million for the six months ended June 30, 2004. The increase in cost of revenue is attributable to an increase in the number of professionals due to hiring and the acquisitions of Genisys, Meritage, ZettaWorks and iPath. The average number of professionals performing services, including subcontractors, increased to 391 for the six months ended June 30, 2005 from 123 for the six months ended June 30, 2004. Also, costs associated with software sales increased 17% to \$2.8 million for the six months ended June 30, 2005 in connection with the increased software revenue.

Gross Margin. Gross margin increased 100% to \$14.0 million for the six months ended June 30, 2005 from \$7.0 million for the six months ended June 30, 2004. Gross margin as a percentage of revenue, excluding reimbursed expenses, decreased to 35.3% for the six months ended June 30, 2005 from 37.4% for the six months ended June 30, 2004. The decrease in gross margin as a percentage of revenue is primarily due to the acquisitions of Genisys, Meritage, Zettaworks and iPath. Services gross margin decreased to 36.8% for the six months ended June 30, 2005 from 40.4% for the six months ended June 30, 2004 primarily due to lower gross margins on consulting services contracts acquired in the acquisitions of Genisys, Meritage and ZettaWorks. Software gross margin decreased to 15.1% for the six months ended June 30, 2005 from 21.2% for the six months ended June 30, 2004 primarily as a result of fluctuations in selling prices to customers based on competitive pressures and fluctuations in vendor pricing based on market conditions at the time of the sales and an increase in unreimbursed direct expenses as a result of the acquisition of ZettaWorks.

Selling, General and Administrative. Selling, general and administrative expenses increased 86% to \$7.8 million for the six months ended June 30, 2005 from \$4.2 million for the six months ended June 30, 2004 due primarily to the increases in sales personnel, management personnel, support personnel and facilities related to the acquisitions of Genisys, Meritage, ZettaWorks and iPath. However, selling, general and administrative expenses as a percentage of revenue decreased to 18.7% for the three months ended June 30, 2005 from 21.2% for the six months ended June 30, 2004. The decrease in selling, general and administrative expenses as a percentage of revenue is the result of leveraging operating efficiencies and scalability of the back office.

Depreciation. Depreciation expense increased 38% to \$310,221 for the six months ended June 30, 2005 from \$224,875 for the six months ended June 30, 2004. The increase is due to general purchases of fixed assets along with an increasing number of fully depreciated assets.

Intangibles Amortization. Intangibles amortization expenses, arising from acquisitions, increased 173% to approximately \$580,639 for the six months ended June 30, 2005 from approximately \$212,779 for the six months ended June 30, 2004. The increase in amortization expense reflects the acquisition of intangibles acquired from Genisys, Meritage, ZettaWorks and iPath.

Interest Expense. Interest expense increased 702% to \$233,769 for the six months ended June 30, 2005 compared to \$29,133 for the six months ended June 30, 2004. This increase in interest expense is due to interest expense now being incurred on the newly funded acquisition line of credit that was drawn down in connection with the acquisitions of Meritage in June 2004, ZettaWorks in December 2004 and iPath in June 2005.

Provision for Income Taxes. We accrue a provision for federal, state and foreign income tax at the applicable statutory rates adjusted for non-deductible expenses. Our tax provision rate remained relatively constant at 38.6% for the six months ended June 30, 2005 as compared to 39.1% for the six months ended June 30, 2004. We have total deferred tax assets of \$3.3 million mostly resulting from net operating losses of acquired companies amounting to approximately \$2.8 million for which we have a valuation allowance of \$2.4 million. The remaining deferred tax asset of \$0.5 million is partially off-set by deferred tax liabilities of \$0.7 million related to identifiable intangibles and cash to accrual adjustments from prior acquisitions. Any reversal of the valuation allowance on the deferred tax assets will be adjusted against goodwill and will not have an impact on our statement of operations. All of the net operating losses relate to acquired entities, and as such are subject to annual limitations on usage under the “change in control” provisions of the Internal Revenue Code.

Liquidity And Capital Resources

Selected measures of liquidity and capital resources are as follows:

	As of December 31, 2004	As of June 30, 2005
	(in millions)	
Cash and cash equivalents	\$3.9	\$ 2.0
Working capital	\$9.2	\$15.4

Net Cash Provided By Operating Activities

We expect to fund our operations from cash generated from operations and short-term borrowings as necessary from our credit facility. We believe that these capital resources will be sufficient to meet our needs for at least the next twelve months. Net cash used by operations for the six months ended June 30, 2005 was \$2.2 million as compared to net cash provided by operations of \$0.9 million for the six months ended June 30, 2004.

Accounts receivable, net of allowance for doubtful accounts, totaled \$22.3 million at June 30, 2005, compared to \$20.0 million at December 31, 2004. There were approximately 88 days of sales outstanding (“DSOs”) for the quarter ended June 30, 2005 calculated using accounts receivable as of June 30, 2005, and adjusting revenues and accounts receivable to exclude non-recurring increases in software sales at the end of the quarter. This compares to 77 DSOs at March 31, 2005 and 65 DSOs at December 31, 2004. DSOs for the quarter ended June 30, 2005 decrease to 83 days after taking into account \$1 million of collections on aged accounts receivable received from one major customer during the first week of July 2005. Approximately two-thirds of our customers are billed on a monthly basis representing a 30 day billing cycle. In addition, we generally take about 14 days to generate, approve and release invoices to our customers. Lastly, our collection terms range from 45 days with IBM to 30 days for the remainder of our customers. Therefore, with a monthly billing cycle of 30 days, a 14 day cycle for generating, approving and releasing invoices, and 30 to 45 day collection cycles, our expected DSOs should range between 74 and 89 days.

Accounts payable decreased from \$6.9 million as of December 31, 2004, to \$1.6 million as of June 30, 2005, as a result of paying off the cost of sales of the \$7.4 million of third party software sold during the quarter ended December 31, 2004.

A significant amount of our revenue is derived from IBM. Accordingly, our accounts receivable generally includes significant amounts due from IBM. As of June 30, 2005, approximately 6% of our accounts receivable was due from IBM.

Net Cash Used in Investing Activities

For the six months ended June 30, 2005 we used approximately \$4.7 million in cash to consummate the acquisition of iPath Solutions, Ltd., a privately held technology consulting company on June 10, 2005, including \$3.9 million in cash paid to iPath and another \$0.9 million in cash used to pay off existing liabilities on behalf of iPath. We also used \$0.3 million in cash to purchase equipment fixed assets.

Net Cash From Financing Activities

Our financing activities consisted primarily of a net draw of \$6 million from our line of credit, stock option and warrant exercises of approximately \$1.0 million and payments on long term debt of approximately \$0.5 million during the six months ended June 30, 2005. We also made the annual payments on the notes related to the Javelin acquisition of approximately \$250 thousand during the six months ended June 30, 2005. The Company expects to make the final payments on the Javelin notes totaling \$250,000 in April 2006.

At June 30, 2005, we had \$2.0 million in cash and cash equivalents.

We initially filed a registration statement with the Securities and Exchange Commission on March 7, 2005 to register the offer and sale by the Company and certain selling stockholders of shares of our common stock. Due to overall market conditions during the second quarter, we converted our registration statement into a shelf

registration statement to allow for offers and sales of common stock from time to time as market conditions permit. To date, we have recorded approximately \$792,000 of deferred offering costs (approximately \$487,000 after tax, if ever expensed) in connection with the offering and have classified these costs as prepaid expenses in other non-current assets on our balance sheet. If we sell shares of common stock off of our shelf registration statement, we will be allowed to net these accumulated deferred offering costs against the proceeds of the offering. If we do not raise funds through an equity offering off of the shelf registration statement or fail to maintain the effectiveness of the shelf registration statement, the currently capitalized deferred offering costs will be expensed. Such expense would be a non-cash accounting charge as substantially all of these expenses have already been paid.

Availability of Funds from Bank Line of Credit Facilities

We have a \$28.5 million credit facility with Silicon Valley Bank and Key Bank comprising a \$15.0 million accounts receivable line of credit and a \$13.5 million acquisition term line of credit. Borrowings under the accounts receivable line of credit bear interest at the bank's prime rate plus 1.00%, or 7.25%, as of June 30, 2005. As of June 30, 2005, there was \$6.0 million outstanding under the accounts receivable line of credit and the amount available was approximately \$8.5 million, as determined by the end of period borrowing base calculation.

Our \$13.5 million term acquisition line of credit with Silicon Valley Bank and Key Bank provides an additional source of financing for certain qualified acquisitions. As of June 30, 2005 the balance outstanding under this acquisition line of credit was approximately \$3.2 million. Borrowings under this acquisition line of credit bear interest equal to the average four year U.S. Treasury note yield plus 3.50%—the initial \$2.5 million draw, of which \$1.9 million remains outstanding, bears interest of 7.11% at June 30, 2005 and the subsequent \$1.5 million draw, of which \$1.4 million remains outstanding, bears interest of 6.90% at June 30, 2005. Each are repayable in thirty-six equal monthly installments beginning October 21, 2004, and April 20, 2005, respectively. We are entitled to make payments of accrued interest only for the first three monthly installments.

As of June 30, 2005, we were in compliance with all covenants under this credit facility and we expect to be in compliance during the next twelve months.

We believe that the current available funds, access to capital from our new debt facility, possible capital from registered placements of equity through the shelf registration statement, and cash flows generated from operations will be sufficient to meet our working capital requirements and meet our capital needs to finance acquisitions for the next twelve months.

Critical Accounting Policies

Revenue Recognition and Allowance for Doubtful Accounts

Consulting revenues are comprised of revenue from professional services fees recognized primarily on a time and materials basis as performed. For fixed fee engagements, revenue is recognized using the proportionate performance method based on the ratio of hours expended to total estimated hours. Provisions for estimated losses on uncompleted contracts are made on a contract-by-contract basis and are recognized in the period in which such losses are determined. Billings in excess of costs plus earnings are classified as deferred revenues. Our normal payment terms are net 30 days. Our agreement with IBM provides for net 45 days payment terms. Reimbursements for out-of-pocket expenses are included in gross revenue. Revenue from the sale of third-party software is recorded on a gross basis provided that we act as the principal in the transaction. In the event we do not meet the requirements to be considered the principal in the software sale transaction, we record the revenue on a net basis. There is no effect on net income between recording the software sales on a gross basis versus a net basis. We assess our allowance for doubtful accounts at each financial reporting date based on expected losses on uncollectible accounts receivable with known facts and circumstances for the respective period.

Goodwill and Other Intangible Assets

We adopted Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets* on January 1, 2002. In accordance with SFAS 142, we replaced the ratable amortization of goodwill with a periodic review and analysis of such intangibles for possible impairment. In accordance with SFAS

142, we assess our goodwill on October 1 of each year or more frequently if events or changes in circumstances indicate that goodwill might be impaired.

Business acquisitions typically result in goodwill and other intangible assets, and the recorded values of those assets may become impaired in the future. The determination of the value of such intangible assets requires us to make estimates and assumptions that affect our consolidated financial statements. We assess potential impairments to intangible assets on an annual basis or when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset may not be recovered. Our judgments regarding the existence of impairment indicators and future cash flows related to intangible assets are based on operational performance of the acquired businesses, market conditions and other factors. Future events could cause us to conclude that impairment indicators exist and that goodwill associated with the acquired businesses is impaired. Any resulting impairment loss could have an adverse impact on our results of operations by decreasing net income.

Accounting for Stock-Based Compensation

We account for our employee stock-based compensation using the intrinsic value method in accordance with Accounting Principles Board Opinion, or APB, No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. We also make disclosures regarding employee stock-based compensation using the fair value method in accordance with SFAS, No. 123, *Accounting for Stock Based Compensation*. Accordingly, compensation cost is recognized only when options are granted below market price on the date of grant. Had compensation cost for our stock compensation plans been determined based on fair value at the grant dates for awards under these plans consistent with SFAS 123, our net income and earnings per share would have been reduced to pro forma amounts indicated in the notes to our financial statements included in this prospectus. Option valuation models incorporate highly subjective assumptions. Because changes in the subjective assumptions can materially affect the fair value estimate, the existing models do not necessarily provide a single reliable measure of the fair value of our employee stock options.

Income Taxes

Management believes that our deferred tax assets resulting from net operating losses of acquired companies amounting to approximately \$2.8 million should be reduced by a valuation allowance of \$2.4 million based on an assessment of our ability to recapture these net operating losses in the future. Future operating results and projections could alter this conclusion, potentially resulting in an increase or decrease in the valuation allowance. Since the valuation allowance relates solely to net operating losses from acquired companies which are subject to usage limitations, any decrease in the valuation allowance will be applied first to reduce goodwill and then to reduce other acquisition related non-current intangible assets to zero. Any remaining decrease in the valuation allowance would be recognized as a reduction of income tax expense.

Recent Accounting Pronouncements

On December 16, 2004, the Financial Accounting Standards Board issued Statement No. 123 (revised 2004), *Share-Based Payment* ("Statement 123(R)"). Statement 123(R) replaces SFAS No. 123, *Accounting for Stock-Based Compensation*, supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in Statement 123(R) is similar to the approach described in SFAS 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, pro forma disclosure will no longer be an alternative to financial statement recognition. Statement 123(R) is effective for public companies at the beginning of the Company's fiscal year beginning after June 15, 2005. We are currently assessing the impact, the amount of compensation based upon the Black-Scholes model versus a binomial model, of Statement 123(R) on our financial statements and related disclosures. Both models will increase compensation expense related to past grants which are not fully vested as of December 31, 2005 and all future grants.

RISK FACTORS

You should carefully consider the following risk factors together with the other information contained in or incorporated by reference into this annual report before you decide to buy our common stock. If any of these risks actually occur, our business, financial condition, operating results or cash flows could be materially adversely affected. This could cause the trading price of our common stock to decline and you may lose part or all of your investment.

Risks Related to Our Business

Prolonged economic weakness in the Internet software and services market could adversely affect our business, financial condition and results of operations.

The market for Internet software and services has changed rapidly over the last six years. The market for Internet software and services expanded dramatically during 1999 and most of 2000, but declined significantly in 2001 and 2002. Market demand for Internet software and services began to stabilize and improve throughout 2003 and 2004, but this trend may not continue. Our future growth is dependent upon the demand for Internet software and services, and, in particular, the information technology consulting services we provide. Demand and market acceptance for Internet services are subject to a high level of uncertainty. Prolonged weakness in the Internet software and services industry has caused in the past, and may cause in the future, business enterprises to delay or cancel information technology projects, reduce their overall budgets and/or reduce or cancel orders for our services. This, in turn, may lead to longer sales cycles, delays in purchase decisions, payment and collection, and may also result in price pressures, causing us to realize lower revenues and operating margins. If companies cancel or delay their business and technology initiatives or choose to move these initiatives in-house, our business, financial condition and results of operations could be materially and adversely affected.

We may not be able to attract and retain information technology consulting professionals, which could affect our ability to compete effectively.

Our business is labor intensive. Accordingly, our success depends in large part upon our ability to attract, train, retain, motivate, manage and effectively utilize highly skilled information technology consulting professionals. Additionally, our technology professionals are primarily at-will employees. Failure to retain highly skilled technology professionals would impair our ability to adequately manage staff and implement our existing projects and to bid for or obtain new projects, which in turn would adversely affect our operating results.

Our success will depend on retaining our senior management team and key personnel.

Our industry is highly specialized and the competition for qualified management and key personnel is intense. We expect this to remain so for the foreseeable future. We believe that our success will depend on retaining our senior management team and key technical and business consulting personnel. Retention is particularly important in our business as personal relationships are a critical element of obtaining and maintaining strong relationships with our clients. If a significant number of these individuals stop working for us, our level of management, technical, marketing and sales expertise could diminish. We may be unable to achieve our revenue and operating performance objectives unless we can attract and retain technically qualified and highly skilled sales, technical, business consulting, marketing and management personnel. These individuals would be difficult to replace, and losing them could seriously harm our business.

We may have difficulty in identifying and competing for strategic acquisition and partnership opportunities.

Our business strategy includes the pursuit of strategic acquisitions. We may acquire or make strategic investments in complementary businesses, technologies, services or products, or enter into strategic partnerships or alliances with third parties in the future in order to expand our business. We may be unable to identify suitable acquisition, strategic investment or strategic partnership candidates, or if we do identify suitable candidates, we may not complete those transactions on terms commercially favorable to us, or at all. If we fail to identify and successfully complete these transactions, our competitive position and our growth prospects could be adversely

affected. In addition, we may face competition from other companies with significantly greater resources for acquisition candidates, making it more difficult for us to acquire suitable companies on favorable terms.

Pursuing and completing potential acquisitions could divert management’s attention and financial resources and may not produce the desired business results.

We do not have specific personnel dedicated to pursuing and making strategic acquisitions. As a result, if we pursue any acquisition, our management could spend a significant amount of time and financial resources to pursue and integrate the acquired business with our existing business. To pay for an acquisition, we might use capital stock, cash or a combination of both. Alternatively, we may borrow money from a bank or other lender. If we use capital stock, our stockholders will experience dilution. If we use cash or debt financing, our financial liquidity may be reduced and the interest on any debt financing could adversely affect our results of operations. From an accounting perspective, an acquisition may involve amortization or the write-off of significant amounts of intangible assets that could adversely affect our results of operations.

Despite the investment of these management and financial resources, and completion of due diligence with respect to these efforts, an acquisition may not produce the anticipated revenues, earnings or business synergies for a variety of reasons, including:

- difficulties in the integration of the technologies, services and personnel of the acquired business;
- the failure of management and acquired services personnel to perform as expected;
- the risks of entering markets in which we have no, or limited, prior experience;
- the failure to identify or adequately assess any undisclosed or potential legal liabilities of the acquired business;
- the failure of the acquired business to achieve the forecasts we used to determine the purchase price; or
- the potential loss of key personnel of the acquired business.

These difficulties could disrupt our ongoing business, distract our management and colleagues, increase our expenses and materially and adversely affect our results of operations.

The market for the information technology consulting services we provide is competitive, has low barriers to entry and is becoming increasingly consolidated, which may adversely affect our market position.

The market for the information technology consulting services we provide is competitive, rapidly evolving and subject to rapid technological change. In addition, there are relatively low barriers to entry into this market and therefore new entrants may compete with us in the future. For example, due to the rapid changes and volatility in our market, many well-capitalized companies, including some of our partners, that have focused on sectors of the Internet software and services industry that are not competitive with our business may refocus their activities and deploy their resources to be competitive with us.

Our future financial performance will depend, in large part, on our ability to establish and maintain an advantageous market position. We currently compete with regional and national information technology consulting firms, and, to a limited extent, offshore service providers and in-house information technology departments. Many of the larger regional and national information technology consulting firms have substantially longer operating histories, more established reputations and potential partner relationships, greater financial resources, sales and marketing organizations, market penetration and research and development capabilities, as well as broader product offerings and greater market presence and name recognition. We may face increasing competitive pressures from these competitors as the market for Internet software and services continues to grow. This may place us at a disadvantage to our competitors, which may harm our ability to grow, maintain revenue or generate net income.

In recent years, there has been substantial consolidation in our industry, and we expect that there will be significant additional consolidation in the near future. As a result of this increasing consolidation, we expect that we will increasingly compete with larger firms that have broader product offerings and greater financial resources than

we have. We believe that this competition could have a significant negative effect on our marketing, distribution and reselling relationships, pricing of services and products and our product development budget and capabilities. Any of these negative effects could significantly impair our results of operations and financial condition. We may not be able to compete successfully against new or existing competitors.

Our business will suffer if we do not keep up with rapid technological change, evolving industry standards or changing customer requirements.

Rapidly changing technology, evolving industry standards and changing customer needs are common in the Internet software and services market. We expect technological developments to continue at a rapid pace in our industry. Technological developments, evolving industry standards and changing customer needs could cause our business to be rendered obsolete or non-competitive, especially if the market for the core set of eBusiness solutions and software platforms in which we have expertise does not grow or if such growth is delayed due to market acceptance, economic uncertainty or other conditions. Accordingly, our success will depend, in part, on our ability to:

- continue to develop our technology expertise;
- enhance our current services;
- develop new services that meet changing customer needs;
- advertise and market our services; and
- influence and respond to emerging industry standards and other technological changes.

We must accomplish all of these tasks in a timely and cost-effective manner. We might not succeed in effectively doing any of these tasks, and our failure to succeed could have a material and adverse effect on our business, financial condition or results of operations, including materially reducing our revenue and operating results.

We may also incur substantial costs to keep up with changes surrounding the Internet. Unresolved critical issues concerning the commercial use and government regulation of the Internet include the following:

- security;
- intellectual property ownership;
- privacy;
- taxation; and
- liability issues.

Any costs we incur because of these factors could materially and adversely affect our business, financial condition and results of operations, including reduced net income.

A significant portion of our revenue is dependent upon building long-term relationships with our clients and our operating results could suffer if we fail to maintain these relationships.

Our professional services agreements with clients are in most cases terminable on 10 to 30 days' notice. A client may choose at any time to use another consulting firm or choose to perform services we provide through their own internal resources. Accordingly, we rely on our clients' interests in maintaining the continuity of our services rather than on contractual requirements. Termination of a relationship with a significant client or with a group of clients that account for a significant portion of our revenues could adversely affect our revenues and results of operations.

If we fail to meet our clients' performance expectations, our reputation may be harmed.

As a services provider, our ability to attract and retain clients depends to a large extent on our relationships with our clients and our reputation for high quality services and integrity. We also believe that the importance of reputation and name recognition is increasing and will continue to increase due to the number of providers of information technology services. As a result, if a client is not satisfied with our services or does not perceive our solutions to be effective or of high quality, our reputation may be damaged and we may be unable to attract new, or retain existing, clients and colleagues.

We may face potential liability to customers if our customers' systems fail.

Our eBusiness integration solutions are often critical to the operation of our customers' businesses and provide benefits that may be difficult to quantify. If one of our customers' systems fails, the customer could make a claim for substantial damages against us, regardless of our responsibility for that failure. The limitations of liability set forth in our contracts may not be enforceable in all instances and may not otherwise protect us from liability for damages. Our insurance coverage may not continue to be available on reasonable terms or in sufficient amounts to cover one or more large claims. In addition, a given insurer might disclaim coverage as to any future claims. If we experience one or more large claims against us that exceed available insurance coverage or result in changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, our business and financial results could suffer.

The loss of one or more of our significant software partners would have a material adverse effect on our business and results of operations.

Our partnerships with software vendors enable us to reduce our cost of sales and increase win rates through leveraging our partners' marketing efforts and strong vendor endorsements. The loss of one or more of these relationships and endorsements could increase our sales and marketing costs, lead to longer sales cycles, harm our reputation and brand recognition, reduce our revenues and adversely affect our results of operations.

In particular, a substantial portion of our solutions are built on IBM WebSphere platforms and a significant number of our clients are identified through joint selling opportunities conducted with IBM, through sales leads obtained from our relationship with IBM and through a services agreement we have with IBM. Revenue from IBM was approximately 11% and 29% of total revenue for the six-months ended June 30, 2005 and 2004, respectively. The loss of our relationship with, or a significant reduction in the services we perform for IBM would have a material adverse effect on our business and results of operations.

Our quarterly operating results may be volatile and may cause our stock price to fluctuate.

Our quarterly revenue, expenses and operating results have varied in the past and may vary significantly in the future. In addition, many factors affecting our operating results are outside of our control, such as:

- demand for Internet software and services;
- customer budget cycles;
- changes in our customers' desire for our partners' products and our services;
- pricing changes in our industry;
- government regulation and legal developments regarding the use of the Internet; and
- general economic conditions.

As a result, if we experience unanticipated changes in the number or nature of our projects or in our employee utilization rates, we could experience large variations in quarterly operating results and losses in any particular quarter.

Our services revenues may fluctuate quarterly due to seasonality or timing of completion of projects.

We may experience seasonal fluctuations in our services revenues. We expect that services revenues in the fourth quarter of a given year may typically be lower than in other quarters in that year as there are fewer billable days in this quarter as a result of vacations and holidays. In addition, we generally perform services on a project basis. While we seek wherever possible to counterbalance periodic declines in revenues on completion of large projects with new arrangements to provide services to the same client or others, we may not be able to avoid declines in revenues when large projects are completed. Our inability to obtain sufficient new projects to counterbalance any decreases in work upon completion of large projects could adversely affect our revenues and results of operations.

Our software revenue may fluctuate quarterly, leading to volatility in the price of our stock.

Our quarterly revenues from sales of third-party software have varied in the past and may vary significantly from quarter to quarter, making them difficult to predict. This may lead to volatility in our share price. The factors that are likely to cause these variations are:

- the business decisions of our clients regarding the investment in new technology;
- customer demand in any given quarter; and
- the stage of completion of existing projects and/or their termination.

Our software revenue may fluctuate quarterly and be higher in the fourth quarter of a given year as procurement policies of our clients may result in higher technology spending towards the end of budget cycles. This seasonal trend may materially affect our quarter-to-quarter revenues, margins and operating results.

Our overall gross margin fluctuates quarterly based on our services and software revenue mix, which may cause our stock price to fluctuate.

The gross margin on our services revenue is, in most instances, greater than the gross margin on our software revenue. As a result, our gross margin will be higher in quarters where our services revenue, as a percentage of total revenue, has increased, and will be lower in quarters where our software revenue, as a percentage of total revenue, has increased. In addition, gross margin on software revenue may fluctuate as a result of variances in gross margin on individual software products. Our stock price may be negatively affected in quarters in which our gross margin decreases.

Our services gross margins are subject to fluctuations as a result of variances in utilization rates and billing rates.

Our services gross margins are affected by trends in the utilization rate of our professionals, defined as the percentage of our professionals' time billed to customers divided by the total available hours in a period, and in the billing rates we charge our clients. Our operating expenses, including employee salaries, rent and administrative expenses are relatively fixed and cannot be reduced on short notice to compensate for unanticipated variations in the number or size of projects in process. If a project ends earlier than scheduled, we may need to redeploy our project personnel. Any resulting non-billable time may adversely affect our gross margins.

The average billing rates for our services may decline due to rate pressures from significant customers and other market factors, including innovations and average billing rates charged by our competitors. Also, our average billing rates will decline if we acquire companies with lower average billing rates than ours. To sell our products and services at higher prices, we must continue to develop and introduce new services and products that incorporate new technologies or high-performance features. If we experience pricing pressures or fail to develop new services, our revenues and gross margins could decline, which could harm our business, financial condition and results of operations.

If we fail to complete fixed-fee contracts within budget and on time, our results of operations could be adversely affected.

We perform a limited number of projects on a fixed-fee, turnkey basis, rather than on a time-and-materials basis. Under these contractual arrangements, we bear the risk of cost overruns, completion delays, wage inflation and other cost increases. If we fail to estimate accurately the resources and time required to complete a project or fail to complete our contractual obligations within the scheduled timeframe, our results of operations could be adversely affected. We cannot assure you that in the future we will not price these contracts inappropriately, which may result in losses.

We may not be able to maintain our level of profitability.

Although we have been profitable for the past nine quarters, we may not be able to sustain or increase profitability on a quarterly or annual basis in the future. We cannot assure you of any operating results. In future quarters, our operating results may not meet public market analysts' and investors' expectations. If this occurs, the price of our common stock will likely fall.

If we do not effectively manage our growth, our results of operations could be adversely affected.

Our ability to operate profitably depends largely on how effectively we manage our growth. In order to create the additional capacity necessary to accommodate the demand for our services, we may need to implement a variety of new and upgraded operational and financial systems, procedures and controls, open new offices or hire additional colleagues. Implementation of these new systems, procedures and controls may require substantial management efforts and our efforts to do so may not be successful. The opening of new offices or the hiring of additional colleagues may result in idle or underutilized capacity. We periodically assess the expected long-term capacity utilization of our offices and professionals. We may not be able to achieve or maintain optimal utilization of our offices and professionals. If demand for our services does not meet our expectations, our revenues will not be sufficient to offset these expenses and our results of operations could be adversely affected.

We have recorded deferred offering costs in connection with the conversion of our registration statement into a shelf registration statement, and our inability to net these costs against the proceeds of future offerings off of our shelf registration statement could result in a non-cash expense in our Statement of Operations in a future period.

We initially filed a registration statement with the Securities and Exchange Commission on March 7, 2005 to register the offer and sale by the Company and certain selling stockholders of shares of our common stock. Due to overall market conditions during the second quarter, we converted our registration statement into a shelf registration statement to allow for offers and sales of common stock from time to time as market conditions permit. To date, we have recorded approximately \$792,000 of deferred offering costs (approximately \$487,000 after tax, if ever expensed) in connection with the offering and have classified these costs as prepaid expenses in other non-current assets on our balance sheet. If we sell shares of common stock off of our shelf registration statement, we will be allowed to net these accumulated deferred offering costs against the proceeds of the offering. If we do not raise funds through an equity offering off of the shelf registration statement or fail to maintain the effectiveness of the shelf registration statement, the currently capitalized deferred offering costs will be expensed. Such expense would be a non-cash accounting charge as substantially all of these expenses have already been paid.

We may be exposed to potential risks resulting from new requirements under Section 404 of the Sarbanes-Oxley Act of 2002.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we will be required, beginning with our fiscal year ending December 31, 2005, to include in our annual report our assessment of the effectiveness of our internal control over financial reporting as of the end of fiscal 2005. Furthermore, our independent registered public accounting firm, BDO Seidman, LLP, will be required to attest to whether our assessment of the effectiveness of our internal control over financial reporting is fairly stated in all material respects and separately report on whether it believes we have maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005. We have not yet completed our assessment of the effectiveness of our internal control over financial reporting. We expect to incur additional expenses and diversion of management's time as a result of performing the system and process evaluation, testing and remediation required in order to comply with the

management certification and auditor attestation requirements. If we fail to timely complete this assessment, or if our independent registered public accounting firm cannot timely attest to our assessment, we could be subject to regulatory sanctions and a loss of public confidence in our internal control. In addition, any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to timely meet our regulatory reporting obligations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity

We have a \$28.5 million credit facility with Silicon Valley Bank and Key Bank comprising a \$15.0 million accounts receivable line of credit and a \$13.5 million acquisition term line of credit. Borrowings under the accounts receivable line of credit bear interest at the bank's prime rate plus 1.25%, or 7.25%, as of June 30, 2005. As of June 30, 2005, there was \$6.0 million outstanding under the accounts receivable line of credit and the amount available was approximately \$8.5 million, as determined by the end of period borrowing base calculation. As the interest rate floats based on the bank's prime rate for this accounts receivable line of credit, our interest expense will fluctuate.

We had unrestricted cash and cash equivalents totaling \$2.0 million and \$3.9 million at June 30, 2005 and December 31, 2004, respectively. These amounts were invested primarily in money market funds. The unrestricted cash and cash equivalents are held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, will reduce future investment income.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our management, including our Chief Financial Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of June 30, 2005.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting during the quarter ended June 30, 2005 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

PART II. OTHER INFORMATION**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In connection with our acquisition of substantially all of the asset of iPath Solutions, Ltd. on June 10, 2005 we issued 623,803 shares of our common stock in partial consideration for the acquisition. The shares of common stock issued in connection with the acquisition were ascribed a value of \$7.24 per share, which was the average closing price of our common stock for the 30 consecutive trading days ending on June 9, 2005. The issuance was exempt from registration under Section 4(2) of the Securities Act of 1933.

Item 6. Exhibits and Reports in Form 8-K**(a) Exhibits**

Exhibit Number	Description
2.1	Asset Purchase Agreement, dated as of June 10, 2005, by and among Perficient, Inc., Perficient iPath, Inc. and iPath Solutions, Ltd., previously filed with the Securities and Exchange Commission as an Exhibit to our Current Report on Form 8-K filed on June 15, 2005 and incorporated herein by reference
3.1	Certificate of Incorporation of Perficient, Inc., previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form SB-2 (File No. 333-78337) declared effective on July 28, 1999 by the Securities and Exchange Commission and incorporated herein by reference
3.2	Certificate of Amendment to Certificate of Incorporation of Perficient, Inc., previously filed with the Securities and Exchange Commission as an Exhibit to our Form 8-A filed with the Securities and Exchange Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 on February 15, 2005 and incorporated herein by reference
3.3	Bylaws of Perficient, Inc., previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form SB-2 (File No. 333-78337) declared effective on July 28, 1999 by the Securities and Exchange Commission and incorporated herein by reference
4.1	Specimen Certificate for shares of common stock, previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form SB-2 (File No. 333-78337) declared effective on July 28, 1999 by the Securities and Exchange Commission and incorporated herein by reference
4.2	Warrant granted to Gilford Securities Incorporated, previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form SB-2 (File No. 333-78337) declared effective on July 28, 1999 by the Securities and Exchange Commission and incorporated herein by reference
4.3	Form of Common Stock Purchase Warrant, previously filed with the Securities and Exchange Commission as an Exhibit to our Current Report on Form 8-K filed on January 17, 2002 and incorporated herein by reference
4.4	Form of Common Stock Purchase Warrant, previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form S-3 (File No. 333-117216) filed on July 8, 2004 and incorporated herein by reference
10.1	Amended and Restated Loan and Security Agreement by and among Silicon Valley Bank, KeyBank National Association, Perficient, Inc., Perficient Canada Corp., Perficient Genisys, Inc., Perficient Meritage, Inc. and Perficient Zettaworks, Inc. dated effective as of June 3, 2005, previously filed with the Securities and Exchange Commission as an Exhibit to our Current Report on Form 8-K filed on June 15, 2005 and incorporated herein by reference

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Exhibit Number	Description
31.1*	Certification by the Chief Executive Officer of Perficient, Inc. as required by Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification by the Chief Financial Officer of Perficient, Inc. as required by Section 302 of the Sarbanes-Oxley Act of 2002
32.1 †	Certification by the Chief Executive Officer and Chief Financial Officer of Perficient, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith.

† Included but not to be considered “filed” for the purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section.

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.

PERFICIENT, INC.

Dated: August 11, 2005

/s/ JOHN T. McDONALD

John T. McDonald, Chief Executive Officer
(Principal Executive Officer)

Dated: August 11, 2005

/s/ MICHAEL D. HILL

Michael D. Hill, Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description
2.1	Asset Purchase Agreement, dated as of June 10, 2005, by and among Perficient, Inc., Perficient iPath, Inc. and iPath Solutions, Ltd., previously filed with the Securities and Exchange Commission as an Exhibit to our Current Report on Form 8-K filed on June 15, 2005 and incorporated herein by reference
3.1	Certificate of Incorporation of Perficient, Inc., previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form SB-2 (File No. 333-78337) declared effective on July 28, 1999 by the Securities and Exchange Commission and incorporated herein by reference
3.2	Certificate of Amendment to Certificate of Incorporation of Perficient, Inc., previously filed with the Securities and Exchange Commission as an Exhibit to our Form 8-A filed with the Securities and Exchange Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 on February 15, 2005 and incorporated herein by reference
3.3	Bylaws of Perficient, Inc., previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form SB-2 (File No. 333-78337) declared effective on July 28, 1999 by the Securities and Exchange Commission and incorporated herein by reference
4.1	Specimen Certificate for shares of common stock, previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form SB-2 (File No. 333-78337) declared effective on July 28, 1999 by the Securities and Exchange Commission and incorporated herein by reference
4.2	Warrant granted to Gilford Securities Incorporated, previously filed with the Securities and Exchange Commission as an Exhibit to our Registration Statement on Form SB-2 (File No. 333-78337) declared effective on July 28, 1999 by the Securities and Exchange Commission and incorporated herein by reference
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32.1†	Certification by the Chief Executive Officer and Chief Financial Officer of Perficient, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, John T. McDonald, Chief Executive Officer of Perficient, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Perficient, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) [omitted per SEC Release No. 33-8238] for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) [Omitted per SEC Release No. 33-8238]
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 11, 2005

/s/ JOHN T. McDONALD

John T. McDonald,
Chief Executive Officer

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Michael D. Hill, Chief Financial Officer of Perficient, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Perficient, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) [omitted per SEC Release No. 33-8238] for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) [Omitted per SEC Release No. 33-8238]
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 11, 2005

/s/ MICHAEL D. HILL

Michael D. Hill,
Chief Financial Officer

**CERTIFICATION OF
CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
OF PERFICIENT, INC.
PURSUANT TO 18 U.S.C. §1350**

In connection with the accompanying report on Form 10-Q for the period ended June 30, 2005 and filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John T. McDonald, Chief Executive Officer of Perficient, Inc. (the "Company"), hereby certify that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JOHN T. McDONALD

John T. McDonald,
Chief Executive Officer
August 11, 2005

In connection with the accompanying report on Form 10-Q for the period ended June 30, 2005 and filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael D. Hill, Chief Financial Officer of Perficient, Inc. (the "Company"), hereby certify that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ MICHAEL D. HILL

Michael D. Hill,
Chief Financial Officer
August 11, 2005