

INVESTOOLS INC  
Form 10-Q  
November 14, 2002

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## Form 10-Q

UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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

FOR QUARTER ENDED September 30, 2002

Commission File Number: 0-31226

## INVESTOOLS INC.

(Exact name of Registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or  
organization)

**5959 Corporate Drive, Suite LL250  
Houston, Texas**

(Address of principal executive offices)

**76-0685039**

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

**77036**

(Zip Code)

Registrant's telephone number, including area code:

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(281) 588-9700

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 and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

\$.01 par value per share Common Stock: 42,892,726 as of November 11, 2002

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## PART I - FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements

## INVESTTOOLS INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

(in thousands, except per share amounts)

	September 30, 2002 (unaudited)	December 31, 2001
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,365	\$ 5,930
Accounts receivable, net (allowance: \$170; \$150)	1,374	1,560
Amounts due from related parties		15
Income tax receivable	591	746
Other current assets	642	407
<b>Total current assets</b>	<b>4,972</b>	<b>8,658</b>
Restricted cash	653	351
Goodwill and intangibles, net	12,402	40,945
Deferred tax assets	4,843	4,799
Furniture, fixtures and equipment, net	795	436
<b>Total assets</b>	<b>\$ 23,665</b>	<b>\$ 55,189</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Accounts payable	\$ 2,225	\$ 3,787
Deferred revenue	4,178	3,616
Accrued payroll	1,240	867
Accrued tax liabilities	592	705
Shares subject to rescission		366
Other current liabilities	693	1,502
<b>Total liabilities, current</b>	<b>8,928</b>	<b>10,843</b>
Minority interest liability		2
<b>Stockholders equity:</b>		
Convertible preferred stock (liquidation preference \$25 per share) (shares issued and outstanding 0, 120)		1

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Common stock (shares issued and outstanding: 42,893; 40,792)	429	408
Additional paid-in capital	126,604	125,855
Deferred compensation	(98)	
Accumulated deficit	(112,198)	(81,920)
<b>Total stockholders equity</b>	<b>14,737</b>	<b>44,344</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 23,665</b>	<b>\$ 55,189</b>

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

## INVESTTOOLS INC. AND SUBSIDIARIES

## Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
<b>Revenue</b>	\$ 12,228	\$ 10,103	\$ 40,114	\$ 39,877
<b>Costs and expenses</b>				
Cost of revenue	5,279	4,459	18,072	16,709
Selling, general and administrative expenses	5,861	3,861	19,626	15,379
Related party expense	1,234	1,821	3,964	5,214
Depreciation and amortization expense	241	1,155	477	3,477
Write down of assets and other charges		355		830
<b>Total costs and expenses</b>	<b>12,615</b>	<b>11,651</b>	<b>42,139</b>	<b>41,609</b>
<b>Net loss from operations</b>	<b>(387)</b>	<b>(1,548)</b>	<b>(2,025)</b>	<b>(1,732)</b>
<b>Other income (expense)</b>				
Gain on sale of assets			1	(41)
Interest income and other, net	29	40	1	(81)
<b>Total other income (expense)</b>	<b>29</b>	<b>40</b>	<b>2</b>	<b>(122)</b>
<b>Net loss before minority interest, income taxes, and discontinued operations</b>	<b>(358)</b>	<b>(1,508)</b>	<b>(2,023)</b>	<b>(1,854)</b>
Minority interest expense	9		36	
Income tax expense (benefit)		(90)		587
<b>Net loss from continuing operations</b>	<b>(367)</b>	<b>(1,418)</b>	<b>(2,059)</b>	<b>(2,441)</b>
Loss from discontinued operations				(133)
Loss on disposal of discontinued operations		(50)		(61)
<b>Net loss before cumulative effect of change in accounting principle</b>	<b>(367)</b>	<b>(1,468)</b>	<b>(2,059)</b>	<b>(2,635)</b>
Cumulative effect of change in accounting principle	10		(28,174)	
<b>Net loss</b>	<b>(357)</b>	<b>(1,468)</b>	<b>(30,233)</b>	<b>(2,635)</b>
Preferred stock dividend			(45)	

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<b>Net loss available to common stock holders</b>	\$	(357)	\$	(1,468)	\$	(30,278)	\$	(2,635)
<b>Net loss per common share basic and diluted</b>								
Continuing operations	\$	(0.01)	\$	(0.04)	\$	(0.05)	\$	(0.08)
Discontinued operations				(0.01)				
Cumulative effect of change in accounting principle						(0.68)		
Net loss per common share basic and diluted	\$	(0.01)	\$	(0.05)	\$	(0.73)	\$	(0.08)
Weighted average common shares outstanding basic and diluted		42,653		31,825		41,677		32,151

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

## INVESTTOOLS INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2002	2001
<b>Cash flows from operating activities:</b>		
Net loss	\$	(30,233) \$ (2,635)
Reconciling adjustments:		
Cumulative effect of change in accounting principle		28,174
Depreciation and amortization		477 3,477
Common stock/options/warrants for services		70 25
Minority interest expense		36
Write down and loss on equity investment		830
Discontinued operations		94
Changes in operating assets and liabilities, net of the effects of acquisitions		
Decrease in accounts receivable		258 175
Increase in amounts due from related parties		(5)
Increase in restricted cash		(302) (21)
(Increase)/decrease in other current assets		(80) 187
Decrease in accounts payable and other current liabilities		(2,028) (106)
Increase in deferred revenue		562 1,166
Increase in accrued payroll		858
Decrease in taxes payable		(113) (1,207)
Other		(54) 62
Net cash provided by (used in) operating activities		(2,375) 2,042
<b>Cash flows from investing activities:</b>		
Purchases of furniture, fixtures and equipment		(786) (41)
Proceeds from sale of assets		7
Capitalized acquisition costs		(1,103)
Investment in affiliate		(374)
Other		(14)
Net cash used in investing activities		(793) (1,518)
<b>Cash flows from financing activities:</b>		
Payments on share rescission liability		(366)
Additions to notes payable, current		47
Payments on notes payable, current		(78)

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Net cash used in financing activities	(397)	
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(3,565)</b>	<b>524</b>
<b>Cash and cash equivalents:</b>		
Beginning of period	5,930	3,524
End of period	\$ 2,365	\$ 4,048

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



**INVESTOOLS INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Basis of Presentation**

The consolidated financial statements include the accounts of INVESTools Inc. (the Company or INVESTools ) and its majority-owned subsidiaries for which the Company exercises control. All significant intercompany transactions have been eliminated.

The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2001 included in the Company s Annual Report on Form 10-K.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Rule 10-01 of Regulation S-X for interim financial statements required to be filed with the Securities and Exchange Commission and do not include all information and footnotes required by accounting principles generally accepted in the United States. However, in the opinion of management, the information furnished reflects all adjustments, consisting of normal recurring adjustments, which are necessary to make a fair presentation of financial position and operating results for the interim periods. The results of operations for the nine month period ended September 30, 2002 are not necessarily indicative of the results to be expected for the full year.

Certain amounts in the prior period consolidated financial statements have been reclassified to conform to the current period s presentation.

**2. 2001 Acquisition**

The Company was formed pursuant to a merger (the Merger ) between Telescan, Inc. ( Telescan ) and ZiaSun Technologies, Inc. ( ZiaSun ) on December 6, 2001. ZiaSun stockholders received one share of INVESTools common stock for each ZiaSun share they owned as of the record date, Telescan common stockholders received 0.55531 shares of INVESTools common stock for each Telescan common share they owned as of the record date and Telescan preferred stockholders received one share of INVESTools preferred stock for each Telescan preferred share they owned at the record date.

The Merger was accounted for under the purchase method of accounting. Although ZiaSun and Telescan are both wholly-owned subsidiaries of INVESTools, ZiaSun was deemed the acquirer of Telescan for accounting purposes.

The following unaudited pro forma results of operations for the nine month period ended September 30, 2001 assumes the acquisition of Telescan occurred on January 1, 2001 and assumes the purchase price has been allocated to the assets purchased and the liabilities assumed based on their values at the date of acquisition. Pro forma net loss includes amortization of the intangible assets acquired and the one time salary

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adjustment of \$446,000 related to the Merger.

			<b>Nine Months Ended September 30, 2001</b>	
			<b>(in thousands, except per share amount)</b>	
Revenue	\$			54,480
Net loss				(9,123)
Net loss attributable to common stockholders				(9,214)
Basic and diluted loss per common share				(0.22)

The foregoing unaudited pro forma results of operations are presented for illustrative purposes only and are not necessarily indicative of the operating results that would have occurred if the transaction had been consummated at the date indicated. Furthermore, such unaudited pro forma results of operations are not necessarily indicative of future operating results of the combined companies, due to changes in operating activities following the Merger.

and should not be construed as representative of the operating results of the combined companies for any future dates or periods.

### 3. Related Parties

D. Scott Elder and Ross Jardine, each an executive officer and a director of the Company, and Scott Harris, an executive officer of the Company, each own an approximate 17% interest in Generation Marketing, LLC. On an aggregate basis, these three individuals own a 51% interest in Generation Marketing, LLC. Generation Marketing, LLC supervises most of the worldwide marketing efforts of the Company, including buying advertising time in radio, television and print media and coordinating direct mail and some e-mail marketing campaigns. The Company paid \$4.0 million and \$5.2 million in marketing expenses to Generation Marketing, LLC for the nine month periods ended September 30, 2002 and 2001, respectively, and \$1.2 million and \$1.8 million for the third quarter of 2002 and 2001, respectively.

In May 2002, David M. McCoy, an executive officer of the Company, sold his 17% interest in Generation Marketing, LLC to an employee of Generation Marketing, LLC who had not previously held an ownership interest.

### 4. INVESTools Asia Pacific Pte. Ltd. ( INVESTools Asia )

During the third quarter, the Company renegotiated its agreement with Messrs. Chong and Tan regarding the operation and ownership of INVESTools Asia.

The amended agreement provides that INVESTools will acquire the minority interest ownership from Messrs. Chong and Tan causing INVESTools Asia to become a wholly owned subsidiary of INVESTools. Messrs. Chong and Tan will continue to manage the operations of INVESTools Asia under revised compensation arrangements. The effective date of the amended agreement is August 1, 2002.

### 5. Recently Accounting Pronouncements

On January 1, 2002, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Other Intangible Assets*. As a result, the Company stopped recording the amortization of goodwill as a charge to earnings effective January 1, 2002. Goodwill is now tested for impairment at least annually. For purposes of the impairment test, goodwill was allocated to each of the reporting units and was tested for impairment by comparing the fair value of each reporting unit to its carrying value.

As part of the transition provisions of SFAS 142, the Company completed the impairment testing of goodwill during the second quarter of 2002. The impairment testing is performed in two steps: (i) determine impairment, based upon the fair value of a reporting unit as compared to its carrying value, and (ii) if there is an impairment, measure the amount of impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. Using conservative but realistic assumptions, the Company determined that the carrying value of the Investor Education segment was greater than the derived fair value, indicating an impairment in the recorded goodwill. To determine fair value,

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the Company relied on a discounted cash flow analysis. Significant estimates used in the methodology included estimates of future earnings, future growth rates and a weighted average cost of capital. For goodwill valuation purposes only, the revised fair value of this segment was allocated to the assets and liabilities of the business unit to arrive at an implied fair value of goodwill, based upon known facts and circumstances, as if the acquisition occurred currently. This allocation resulted in a write-down of recorded goodwill in the amount of \$28.2 million, which has been reported as the cumulative effect of a change in accounting principle, as of January 1, 2002, in the accompanying consolidated statements of operations.

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The carrying value of goodwill attributable to each reporting unit was as follows:

	Investor Education	Publishing and Business Services	Total
Balance at December 31, 2001	\$ 40,445	\$ 40,445	\$ 40,445
Adjustment to purchase price allocation	(313)		(313)
Impairment charge	(28,174)		(28,174)
Balance at January 1, 2002	\$ 11,958	\$ 11,958	\$ 11,958

The following unaudited pro forma results of operations data for the three and nine months ended September 30, 2002 and 2001 are presented as if the provisions of SFAS No. 142 had been in effect for all periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
<b>Net income (loss) as reported</b>	\$ (357)	\$ (1,468)	\$ (30,278)	\$ (2,635)
Add: cumulative effect of change in accounting principle	(10)		28,174	
Add: goodwill amortization		1,134		3,403
Adjusted net income (loss)	\$ (367)	\$ (334)	\$ (2,104)	\$ 768
<b>Basic and diluted EPS:</b>				
Net income (loss)	\$ (0.01)	\$ (0.05)	\$ (0.73)	\$ (0.08)
Add: cumulative effect of change in accounting principle			0.68	
Add: goodwill amortization		0.04		0.11
Adjusted net income (loss)	\$ (0.01)	\$ (0.01)	\$ (0.05)	\$ 0.03

During the first quarter of 2002, the Company also adopted SFAS No. 144, *Accounting for the Impairment Or Disposal of Long-lived Assets*. Adoption of SFAS No. 144 did not have a material impact on the consolidated results of operations or financial position of the Company.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. SFAS No. 145 requires that gains and losses from extinguishment of debt be classified as extraordinary items only if they meet the criteria in Accounting Principles Board Opinion No. 30 ( *Opinion No. 30* ). Applying the provisions of Opinion No. 30 will distinguish transactions that are part of an entity's recurring operations from those that are unusual and infrequent and meet the criteria for classification as an extraordinary item. SFAS No. 145 is effective for the Company beginning January 1, 2003. Under SFAS No. 145, the Company would report gains and losses on the extinguishment of debt in pre-tax earnings rather than in extraordinary items. The Company does not believe the adoption of SFAS No. 145 will have a material effect on the Company's consolidated financial statements.

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In July 2002, the Financial Accounting Standards Board issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities, such as restructuring, involuntarily terminating employees, and consolidating facilities, initiated after December 31, 2002. The Company does not believe the adoption of SFAS No. 146 will have a material effect on the Company's consolidated financial statements.

## 6. Shares Subject to Rescission

In January 2001, the Company made an offer of rescission to the former shareholders of Seminar Marketing Group, Inc. ( SMG ) pursuant to which such shareholders would be compensated with a cash amount equal to the consideration paid for the shares originally granted plus the statutory rate of interest of 12%. The SMG shareholders had until February 6, 2002 to accept or reject the offer. During 2001, the Company paid approximately \$90,000 to SMG shareholders to purchase their shares and \$366,000 was paid during the first quarter of 2002. All but six SMG shareholders accepted the rescission offer. The liability at December 31, 2001 of \$366,000 did not include the amount reclassified from the share rescission liability into additional paid in capital related to these six shareholders as the deadline for these individuals had passed and the possibility of having any of these individuals later exerting their rights to the rescission offer is considered remote.

## 7. Segments

Following the Merger, the Company has two reportable business segments: Investor Education, which is primarily the operations of Online Investors Advantage, Inc. ( OIA ) and subsidiaries, and Publishing and Business Services, which is primarily the operations of Telescan and subsidiaries. The reportable segments are managed separately by the management teams in place before the Merger. Corporate and Eliminations consists primarily of the corporate operations of the holding company, INVESTools, and ZiaSun excluding OIA and intercompany eliminations. Prior to the Merger, ZiaSun operated in a single segment. Financial results of the Company for each segment were as follows (in thousands):

	Three Months Ended September 30, 2002		Nine Months Ended September 30, 2002	
<b>Revenue</b>				
Investor Education	\$	10,444	\$	33,922
Publishing and Business Services		1,871		6,783
Corporate and Eliminations		(87)		(591)
Total revenue	\$	12,228	\$	40,114
<b>Cumulative effect of change in accounting principles</b>				
Investor Education	\$	10	\$	(28,174)
Publishing and Business Services				
Corporate and Eliminations				
Total revenue	\$	10	\$	(28,174)
<b>Net income (loss)</b>				
Investor Education	\$	117	\$	(27,973)
Publishing and Business Services		(465)		(2,013)
Corporate and Eliminations		(9)		(247)
Total revenue	\$	(357)	\$	(30,233)

**8. Stockholders Equity**

In May 2002, the Board of Directors authorized payment of the first quarter bonuses to the officers and directors of the Company. Each officer elected to receive part of his bonus in Company common stock, in cash, or in a combination thereof. Each director elected to receive his entire bonus in stock. In August 2002, the Company issued a total of 469,855 shares to the officers and directors of the Company resulting in a non-cash increase to equity of approximately \$141,000 during the three months ended September 30, 2002.

In August 2002, the Board of Directors authorized payment of the second quarter bonuses to certain officers of the Company. Each officer elected to receive part of his bonus either in Company common stock, in cash, or in a



combination thereof. By November 14, 2002, approximately \$46,000 had been paid in cash for these bonuses, but the stock portion had not been distributed.

In September 2002, the Company amended two of its executive employment agreements. Under the previous employment agreements executed in December 2001, Messrs. Elder and Jardine each were entitled to receive cash payments of \$175,000 on December 31, 2002. Under the new agreements, each of Messrs. Elder and Jardine elected to accept options to purchase 300,000 shares of the Company's common stock at an exercise price of \$.18 per share. As a result of these contract amendments, the accrued payroll liability for the December 2002 cash payments was reversed and additional paid in capital was increased by \$350,000.

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

### **Business Overview**

INVESTools Inc. (the Company or INVESTools) is a provider of investor education worldwide. The Company offers classroom workshops domestically and abroad. The Company's investor education products are also available on videotape and on the Web. The Company was incorporated in Delaware on May 21, 2001, but did not begin business operations until December 6, 2001, when the merger transaction (the Merger) pursuant to the Second Amended and Restated Agreement and Plan of Merger (the Merger Agreement), dated September 25, 2001, between the Company, ZiaSun Technologies, Inc., a Nevada corporation (ZiaSun), and Telescan, Inc., a Delaware corporation (Telescan), was consummated. The stockholders of ZiaSun and Telescan approved the Merger Agreement on December 6, 2001.

As a result of the Merger, ZiaSun and Telescan each became wholly owned subsidiaries of the Company. The stock-for-stock Merger transaction resulted in (i) each share of ZiaSun common stock being converted into the right to receive one share of the Company's common stock, (ii) each share of Telescan common stock being converted into the right to receive 0.55531 of a share of the Company's common stock and (iii) each share of Telescan preferred stock being converted into one share of the Company's preferred stock. No fractional shares of the Company's common stock were issued and cash, without interest, was paid in lieu of fractional shares. Following the close of the Merger, former ZiaSun shareholders owned approximately 75% of the Company's common stock and former Telescan shareholders owned approximately 25%.

The Merger was accounted for under the purchase method of accounting as if ZiaSun had acquired Telescan. Therefore, results of operations for Telescan are included in the three and nine months ended September 30, 2002, but not included in the three and nine months ended September 30, 2001, as the Merger was not completed until December 2001.

Refer to Note 2 for pro forma information as if the companies had merged effective January 1, 2001.

### **Critical Accounting Policies**

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The discussion and analysis of financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. The Company evaluates its estimates on an on-going basis, based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances.

Actual results may differ from these estimates under different assumptions or conditions.

### **Revenue Recognition**

Revenue is not recognized until it is realized or realizable and earned. The criteria to meet this guideline are: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price to the buyer is fixed or determinable and collectibility is reasonably assured.

The Company primarily derives revenue from the following sources: (1) instructor-led and home study educational programs; (2) subscriptions to five different Web sites and other products; and (3) revenue from hosting financial Web sites. Hosting revenue are recognized ratably over the term of the hosting arrangements, which are generally less than one year. Revenue for all other services is recognized in the period in which the services are provided.

### **Deferred Revenue**

Deferred revenue is recorded for cash received for which services have not been provided. Deferred revenue is recognized into revenue over the period of the contractual obligation.

### **Goodwill and Intangible Assets**

Goodwill, which represents the excess costs over the fair value of net assets acquired, has historically been amortized on a straight-line basis over 10 years. Beginning January 1, 2002, goodwill will not be amortized but will be tested for impairment annually and any necessary adjustment charged to expense, in accordance with the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 142, Goodwill and Other Intangible Assets. Refer to the section Recent Accounting Pronouncements for further discussion on the adoption and implementation of SFAS No. 142.

In connection with the acquisition of Telescan, the Company reviewed the intangible assets acquired and valued them in accordance with SFAS No. 141 and No. 142. Using a valuation methodology allowable under SFAS No. 141, the Company determined that its software platforms containing ProSearch and its Orbit marketing/publishing engine should be capitalized at a value of \$250,000 each and assigned useful lives of 10 and 5 years, respectively. The useful lives were determined based on the proprietary nature of the software, absence of equivalent competitive products and the unlikelihood of any being developed, and the useful lives already realized.

### **Income Taxes**

Deferred tax assets are recognized for temporary differences between the financial reporting basis and the tax basis of assets and liabilities, at the enacted tax rates expected to be in effect when the temporary differences reverse. Deferred tax assets represent net operating loss carryforwards expected to be utilized to offset anticipated future earnings of the Company.

A valuation allowance for deferred tax assets is provided if it is more likely than not that some portion of the deferred tax asset will not be realized. An increase or decrease in a valuation allowance that results from a change in circumstances that causes a change in judgment about the reliability of the related deferred tax asset is included in income. The Company anticipates realizing the deferred tax asset and, accordingly, no valuation allowance is considered necessary as of September 30, 2002.

**Results of Operations**

**Quarter Ended September 30, 2002 Compared to Quarter Ended September 30, 2001**

As discussed above, only the results of ZiaSun are included in the 2001 amounts as the merger was not final until December 6, 2001. Revenue increased primarily due to the addition of revenue from the Publishing and Business Services segment of \$1.8 million from the merger in addition to an increase in revenue from the Investor Education segment of approximately \$300,000. Investor Education revenue was mostly flat primarily due to declines in workshop and home study revenue offset by increases in Web site revenue and revenue from new products. Workshop revenue declined approximately \$700,000 primarily due to the decline in average attendance to 28.6 attendants per workshop for the quarter ended September 30, 2002 from 33.4 attendants per workshop for the quarter ended September 30, 2001. This quarter average is largely due to the combination in the third quarter of the downturn in the stock market and the seasonal nature of the business cycle. Internet subscription revenue increased approximately \$800,000 or 83% over the prior year as Web site subscriptions and renewals are continuing to grow as the Company's base of customers increases each year. In August 2002, the Company launched the Personal Training System (PTS), an individualized

training program designed to enhance the workshop experience by providing individual telephone guidance using the lessons taught in the workshops. This new product combined with other backend sales efforts, such as option courses and tax courses, provided incremental revenue of approximately \$600,000 for the quarter ended September 30, 2002.

Cost of revenue as a percentage of revenue declined slightly primarily due to the addition of cost from the Publishing and Business Services segment which have a lower cost of revenue percentage. This effectively reduced the consolidated average. Cost of sales for Investor Education increased as a percentage of sales primarily due to commissions paid to co-branding partners BusinessWeek and CNBC in addition to increased commissions due to other sales channel partners.

Selling, general and administrative expenses, including the expenses paid to related parties, increased as a percentage of revenue to 58% from 56% in the prior year primarily due to the costs from the Publishing and Business Services segment of \$1.9 million. These costs are down 14% from the prior year and are expected to continue to decrease. Selling, general and administrative expenses from Investor Education have decreased over the prior year primarily due to reduced marketing costs as the Company shifts its marketing budget away from more expensive radio/television/newspaper advertising to more cost effective direct mail and email advertising. Professional fees declined as litigation continues to be settled.

#### **Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001**

As discussed above, only the results of ZiaSun are included in the 2001 amounts as the merger was not final until December 6, 2001. Revenue did not change significantly from the prior year primarily due to the addition of revenue from the Publishing and Business Services segment of \$6.2 million as a result of the merger, which was offset by the decrease in revenue from the Investor Education segment of approximately \$6.0 million. Investor Education revenue declined in workshops and home study sales which was offset by increases in Web site subscription renewals and new product offerings during the year. Declines in workshop revenue of \$6.9 million or 24% and home study revenue of \$1.1 million or 16% are primarily due to decline in average attendance to 34.4 attendants per workshop for the nine months ended September 30, 2002 from 41.4 attendants per workshop for the same period in 2001, and the continuing soft stock market and uncertainty in the economy. Web site renewals increased \$1.3 million over the prior year as Web site subscription renewals are continuing to increase each year as the Company's base of customers grows each year. New product offerings such as PTS, and other backend offerings such as tax courses and option courses contributed an additional \$600,000 in revenue in the current period.

Cost of revenue as a percentage of revenue increased to 45% compared to 42% for the prior period. The Publishing and Business Services segment added \$2.4 million of cost at a lower percentage of revenue, which reduced the consolidated average. Cost of sales for Investor Education as a percentage of sales increased even though sales were down, primarily due to a greater proportion of sales through co-branding partners BusinessWeek and CNBC, and other sales channel partners, which result in a paid commission.

Selling, general and administrative expenses, including the expenses paid to related parties, increased as a percentage of revenue to 59% from 52% in the prior year primarily due to the costs from the Publishing and Business Services segment of \$6.4 million. Selling, general and administrative expenses from Investor Education decreased \$3.5 million or 17% from the prior year primarily due to reduced marketing costs as the Company shifts its marketing budget away from more expensive radio/television/newspaper advertising to more cost effective direct mail and email advertising. In addition, a layer of overhead at ZiaSun was eliminated on September 29, 2001 in anticipation of the merger, reducing payroll and other administrative costs by approximately \$1.0 million. Professional fees declined as litigation continues to be settled or reach a conclusion.

**Other Activity**

In May 2002, the Board of Directors authorized payment of the first quarter bonuses to the officers and directors of the Company. Each officer elected to receive part of his bonus in Company common stock, in

cash, or in a combination thereof. Each director elected to receive his entire bonus in stock. In August 2002, the Company issued a total of 469,855 shares to the officers and directors of the Company resulting in a non-cash increase to equity of approximately \$141,000 during the three months ended September 30, 2002.

In August 2002, the Board of Directors authorized payment of the second quarter bonuses to certain officers of the Company. Each officer elected to receive part of his bonus either in Company common stock, in cash, or in a combination thereof. By November 14, 2002, approximately \$46,000 had been paid in cash for these bonuses, but the stock portion had not been distributed.

In September 2002, the Company amended two of its executive employment agreements. Under the previous employment agreements executed in December 2001, Messrs. Elder and Jardine each were entitled to receive cash payments of \$175,000 on December 31, 2002. Under the new agreements, each of Messrs. Elder and Jardine elected to accept options to purchase 300,000 shares of the Company's common stock at an exercise price of \$.18 per share. As a result of these contract amendments, the accrued payroll liability for the December 2002 cash payments was reversed and additional paid in capital was increased by \$350,000.

#### **Related Party Transactions**

D. Scott Elder and Ross Jardine, each an executive officer and a director of the Company, and Scott Harris, an executive officer of the Company, each own an approximate 17% interest in Generation Marketing, LLC. On an aggregate basis, these three individuals own a 51% interest in Generation Marketing, LLC. Generation Marketing, LLC supervises most of the worldwide marketing efforts of the Company, including buying advertising time in radio, television and print media and coordinating direct mail and some e-mail marketing campaigns. The Company paid \$4.0 million and \$5.2 million in marketing expenses to Generation Marketing, LLC for the nine months ended September 30, 2002 and 2001, respectively, and \$1.2 million and \$1.8 million for the third quarter of 2002 and 2001, respectively. The Company has no ongoing contractual or other commitments to Generation Marketing, LLC.

In May 2002, David M. McCoy, an executive officer of the Company, sold his 17% interest in Generation Marketing, LLC to an employee of Generation Marketing, LLC who had not previously held an ownership interest.

#### **Liquidity and Capital Resources**

During the first nine months of 2002, the Company used \$2.4 million of cash to finance operations. The cash decrease is due mostly to loss from operations of \$2.1 million as the large decrease in accounts payable and accrued liabilities that accumulated prior to the merger are offset by the increase in accrued payroll and the decrease in accounts receivable. Investing activities consisted primarily of \$786,000 of leasehold improvements and equipment purchases in connection with the Company's relocation of its Houston facilities. This relocation and resultant lease will save the Company more than \$3.0 million over the term of the original lease. Payments on the Seminar Marketing Group, Inc. ( SMG ) share rescission liability used \$366,000 of cash in a one-time transaction.

The Company's current assets at September 30, 2002 were \$5.0 million compared to \$8.7 million at December 31, 2001. At September 30, 2002 the Company's current liabilities were \$8.9 million and were \$10.8 million at December 31, 2001. Working capital was a deficit of \$4.0 million,

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an increase from a deficit of \$2.2 million as compared to December 31, 2001. Excluding deferred revenue, which represents a non-cash obligation, working capital decreased from \$1.4 million at December 31, 2001 to approximately \$200,000 at September 30, 2002.

The Company uses merchant account vendors to process credit card transactions. Under the terms of these agreements, the merchant account vendor has the right to withhold credit card funds to cover charge backs in the event the Company is unable to honor its commitments. Such funds can be held for up to a year after the Company has terminated its relationship with the merchant account vendor. At September 30, 2002, the Company has \$653,000 of restricted cash that is on deposit with merchant account vendors. In September 2002, a merchant account vendor withheld approximately \$300,000 of the Company's cash for deposit, in accordance with the contract with the vendor. This same vendor withheld an additional \$340,000 of the Company's cash for deposit in October 2002. Management intends to receive this cash upon termination of the relationship.



The Company believes that current cash resources and future cash flow from its continuing operations will be sufficient to meet its current obligations. The Company is successfully pursuing various cost containment measures, of which the relocation of the Company's Houston facilities is an example. Additionally, by the end of 2002 the Company will have paid off certain equipment lease commitments reducing cash requirements by more than \$170,000 per quarter from third quarter levels. In addition, the Company expects to develop and launch additional workshops, home study and other products over the course of the year.

### Recent Accounting Pronouncements

On January 1, 2002, the Company adopted SFAS, No. 142, *Goodwill and Other Intangible Assets*. As a result, the Company stopped recording the amortization of goodwill as a charge to earnings effective January 1, 2002. Goodwill is now tested for impairment at least annually. For purposes of the impairment test, goodwill was allocated to each reporting unit and was tested for impairment by comparing the fair value of each reporting unit to its carrying value.

As part of the transition provisions of SFAS 142, the Company completed the impairment testing of goodwill during the second quarter of 2002. The impairment testing is performed in two steps: (i) the determination of impairment, based upon the fair value of a reporting unit as compared to its carrying value, and (ii) if there is an impairment, measure the amount of impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. Using conservative, but realistic assumptions, the Company determined that the carrying value of the Investor Education segment was greater than the derived fair value, indicating an impairment in the recorded goodwill. To determine fair value, the Company relied on a discounted cash flow analysis. Significant estimates used in the methodology included estimates of future earnings, future growth rates and a weighted average cost of capital. For goodwill valuation purposes only, the revised fair value of this segment was allocated to the assets and liabilities of the business unit to arrive at an implied fair value of goodwill, based upon known facts and circumstances, as if the acquisition occurred currently. This allocation resulted in a write-down of recorded goodwill in the amount of \$28.2 million, which has been reported as the cumulative effect of a change in accounting principle, as of January 1, 2002, in the accompanying consolidated statements of operations.

The carrying value of goodwill attributable to each reporting unit was as follows:

	Investor Education	Publishing and Business Services	Total
Balance at December 31, 2001	\$ 40,445	\$	\$ 40,445
Adjustment to purchase price allocation	(313)		(313)
Impairment charge	(28,174)		(28,174)
Balance at January 1, 2002	\$ 11,958	\$	\$ 11,958

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The following unaudited pro forma results of operations data for the three and nine months ended September 30, 2002 and 2001 are presented as if the provisions of SFAS No. 142 had been in effect for all periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
<b>Net income (loss) as reported</b>	\$ (357)	\$ (1,468)	\$ (30,278)	\$ (2,635)
Add: cumulative effect of change in accounting principle	(10)		28,174	
Add: goodwill amortization		1,134		3,403
<b>Adjusted net income (loss)</b>	\$ (367)	\$ (334)	\$ (2,104)	\$ 768
<b>Basic and diluted EPS:</b>				
Net income (loss)	\$ (0.01)	\$ (0.05)	\$ (0.73)	\$ (0.08)
Add: cumulative effect of change in accounting principle			0.68	
Add: goodwill amortization		0.04		0.11
<b>Adjusted net income (loss)</b>	\$ (0.01)	\$ (0.01)	\$ (0.05)	\$ 0.03

During the first quarter of 2002, the Company also adopted SFAS No. 144, *Accounting for the Impairment Or Disposal of Long-lived Assets*. Adoption of SFAS No. 144 did not have a material impact on the consolidated results of operation or financial position of the Company.

In April 2002, the Financial Accounting Standards Board issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. SFAS No. 145 requires that gains and losses from extinguishment of debt be classified as extraordinary items only if they meet the criteria in Accounting Principles Board Opinion No. 30 ( *Opinion No. 30* ). Applying the provisions of *Opinion No. 30* will distinguish transactions that are part of an entity's recurring operations from those that are unusual and infrequent and meet the criteria for classification as an extraordinary item. SFAS No. 145 is effective for the Company beginning January 1, 2003. Under SFAS No. 145, the Company would report gains and losses on the extinguishment of debt in pre-tax earnings rather than in extraordinary items. The Company does not believe the adoption of SFAS No. 145 will have a material effect on the Company's consolidated financial statements.

In July 2002, the Financial Accounting Standards Board issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities, such as restructuring, involuntarily terminating employees, and consolidating facilities, initiated after December 31, 2002. The Company does not believe the adoption of SFAS No. 146 will have a material effect on the Company's consolidated financial statements.

**Item 4. Controls and Procedures**

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Within the 90 days prior to the date of this Form 10-Q, an evaluation was performed under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15d-14(c)). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer, concluded that the disclosure controls and procedures were effective. There were no significant changes in the internal controls and procedures or in other factors that could significantly affect internal controls subsequent to the date of the evaluation.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings.

From time to time, the Company is involved in certain legal actions arising from the ordinary course of business. It is the opinion of management that such litigation, described below, will be resolved without a material adverse effect on the Company's financial position or results of operations.

*Avner Hacoheh v. Telescan, Inc., No. 00CIV.5937* - In August 2000, a lawsuit was filed against Telescan in the United States District Court for the Southern District of New York by a former employee, Avner Hacoheh, alleging that Telescan failed to grant him certain stock options to which he was entitled. The plaintiff seeks monetary compensation for damages alleged to exceed \$1.0 million, plus interest and attorney fees. Telescan responded to the complaint and the case is proceeding before the court. Although no assurances can be given, the Company believes that the ultimate resolution of the litigation will not have a material adverse impact on the Company's financial position or results of operations. The Company believes that (i) Mr. Hacoheh's claim is without merit since he has no signed formal grant of stock options and (ii) nearly ten years have elapsed since the termination of his employment and the statute of limitations has expired on Mr. Hacoheh's claim.

*Scott Bowen v. ZiaSun Technologies, Inc.* Plaintiff alleged to have purchased shares of common stock of ZiaSun and various other companies (unaffiliated with ZiaSun) through Amber Securities Corporation, a registered broker dealer formerly known as World Trade Financial Corporation, and its sales associates, who were acting as agents of ZiaSun. The plaintiff alleged that Amber and its sales associates made misstatements regarding ZiaSun, upon which the plaintiff relied when purchasing ZiaSun shares. On September 26, 2002, the Superior Court of California, County of San Diego, granted summary judgment in favor of ZiaSun on all eight of plaintiff's alleged causes of action on the grounds that plaintiff's action had no merit. Although the plaintiff may appeal the decision, the Company does not expect the plaintiff to be successful.

*Leif Fredsted v. ZiaSun Technologies, Inc.* Plaintiff alleged to have purchased shares of common stock of ZiaSun and various other companies (unaffiliated with ZiaSun) through Amber Securities Corporation, a registered broker dealer formerly known as World Trade Financial Corporation, and its sales associates, who were acting as agents of ZiaSun. The plaintiff alleged that Amber and its sales associates made misstatements regarding ZiaSun, upon which the plaintiff relied when purchasing ZiaSun shares. On September 26, 2002, the Superior Court of California, County of San Diego, granted summary judgment in favor of ZiaSun on all eight of plaintiff's alleged causes of action on the grounds that plaintiff's action on the grounds that plaintiff's action had no merit. Although the plaintiff may appeal the decision, the Company does not expect the plaintiff to be successful.

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The Company is not aware of pending claims or assessments, other than as described above, which may have a material adverse impact on the Company's financial position or results of operation.

### **Item 2. Changes in Securities.**

In May 2002, the Board of Directors authorized payment of the first quarter bonuses to the officers and directors of the Company. These officers elected to receive part of their bonuses in Company common stock. The directors elected to receive their entire bonus in stock. In August 2002, the Company issued a total of 469,855 shares to the officers and directors of the Company. All shares of common stock were issued pursuant to Section 4(2) of the Securities Act of 1933.

### **Item 3. Defaults upon Senior Securities.**

None.

### **Item 4. Submission of Matters to a Vote of Security Holders.**

The Company held its Annual Meeting of Stockholders ( Annual Meeting ) on September 18, 2002. The purpose of the Annual Meeting was to elect a director for the ensuing year.

At the Annual Meeting, Stephen C. Wood was elected as director of the Company. There were 29,243,872 votes for and 102,611 votes withheld for Mr. Wood.

**Item 5. Other Information.**

None.

**Item 6. Exhibits and Reports on Form 8-K.**

- (a) Exhibits
- 99.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
- 99.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

(b) Reports on Form 8-K:

A current report on Form 8-K was filed by the Company on July 31, 2002 announcing the dismissal of Arthur Andersen LLP as the Company's independent accountants and the engagement of KPMG as the Company's new independent accountants.

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.

INVESTools Inc.

/s/ PAUL A. HELBLING

Paul A. Helbling  
Chief Financial Officer  
A duly authorized officer of the Registrant

Date: November 13, 2002

INVESTTOOLS INC.

a Delaware corporation

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

Section 302 Certification

I, Lee K. Barba, certify that:

1. I have reviewed this quarterly report on Form 10-Q of INVESTools Inc., a Delaware corporation (the registrant );

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other information included in this quarterly 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 quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) Designed such disclosure controls and procedures 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 quarterly report is being prepared;

b) Evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

/s/ LEE K. BARBA  
Chief Executive Officer



INVESTTOOLS INC.

a Delaware corporation

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

Section 302 Certification

I, Paul A. Helbling, certify that:

1. I have reviewed this quarterly report on Form 10-Q of INVESTools Inc., a Delaware corporation (the registrant );

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) Designed such disclosure controls and procedures 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 quarterly report is being prepared;

b) Evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date ); and

c) Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

/s/ PAUL A. HELBLING  
Chief Financial Officer