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CT HOLDINGS INC
Form 10QSB
May 17, 2004

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

FORM 10-QSB

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2004

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: 0-18718

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

DELAWARE
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

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

8750 CENTRAL EXPRESSWAY, SUITE 100, DALLAS, TX 75231
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(214) 520-9292
(ISSUER'S TELEPHONE NUMBER)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-25 of the Exchange Act). Yes No

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

Class	Outstanding at May 14, 2004
Common Stock, Par value \$.01 per share	58,545,928

Transitional Small Business Disclosure Format Yes No

CT HOLDINGS, INC.
FORM 10-QSB
QUARTERLY PERIOD ENDED MARCH 31, 2004
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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CT HOLDINGS, INC.
BALANCE SHEETS

	March 31, 2004 (unaudited)	DECEMBER 31, 2003
	-----	-----
ASSETS -----		
TOTAL ASSETS	\$ -	\$ -
	=====	=====
LIABILITIES AND STOCKHOLDERS' DEFICIT -----		

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CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 514,356	\$ 501,330
Payable to Citadel	695,000	635,000
Note payable to shareholder	9,000	9,000
Note payable to related party	30,000	-
Accrual for legal settlement	207,000	207,000
	-----	-----
Total current liabilities	1,455,356	1,352,330
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Preferred stock, \$.01 par value per share; 1,000,000 shares authorized; no shares issued at March 31, 2004 and December 31, 2003	-	-
Common stock, \$.01 par value per share; 60,000,000 shares authorized; 58,545,928 shares issued and outstanding at March 31, 2004 and December 31, 2003	585,460	585,460
Common stock pending issuance	600,000	600,000
Additional paid-in capital	57,190,601	57,190,601
Accumulated deficit	(59,831,417)	(59,728,391)
	-----	-----
Total stockholders' deficit	(1,455,356)	(1,352,330)
	-----	-----
	\$ -	\$ -
	=====	=====

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

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CT HOLDINGS, INC. STATEMENTS OF OPERATIONS (unaudited)

	Three Months Ended	
	March 31,	
	2004	2003
	-----	-----
Revenue	\$ -	\$ -
General and administrative expense	65,470	100,641
Interest expense	7,556	24,481
Write off of affiliate shares acquired through exercise of warrants	30,000	-
	-----	-----
Loss before income taxes	(103,026)	(125,122)
Provision for income taxes	-	-
	-----	-----
Net loss	\$ (103,026)	\$ (125,122)
	=====	=====
Net loss per share - basic and diluted	\$ -	\$ -
	=====	=====
Weighted average shares outstanding -		

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basic and diluted	63,487,686	57,545,928
	=====	=====

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

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CT HOLDINGS, INC.
STATEMENTS OF CASH FLOWS
(unaudited)

	Three Months Ended March 31,	
	2004	2003
	-----	-----
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$ (103,026)	\$ (125,122)
Adjustments to reconcile net loss to net cash used in operating activities		
Write off of affiliate shares acquired through exercise of warrants	30,000	-
Changes in operating assets and liabilities		
Accounts payable and accrued expenses	13,026	65,122
Payable to Citadel	60,000	60,000
	-----	-----
NET CASH USED IN OPERATING ACTIVITIES	-	-
NET CASH FROM INVESTING ACTIVITIES		
Exercise of warrants to acquire an affiliate's Series-A preferred stock	(30,000)	-
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from note payable to related party	30,000	-
	-----	-----
Net change in cash	-	-
Cash and cash equivalents at the beginning of the period	-	-
	-----	-----
Cash and cash equivalents at the end of the period	\$ -	\$ -
	=====	=====
Non cash financing and investment items		
Conversion of note payable to shareholder into pending issuance of common stock	\$ -	\$ 600,000
	=====	=====

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

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NOTES TO UNAUDITED INTERIM FINANCIAL STATEMENTS

NOTE A - NATURE OF BUSINESS AND CERTAIN SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited interim financial statements reflect, in the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary to present fairly the financial position, results of operations and

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cash flows of CT Holdings. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP") have been condensed or omitted pursuant to rules and regulations promulgated by the Securities and Exchange Commission (the "Commission"). These statements should be read together with the audited financial statements and notes thereto for the years ended December 31, 2003 and 2002, included in CT Holdings' Form 10-KSB for the fiscal year ended December 31, 2003 on file with the Commission. The results of operations for the interim periods shown herein are not necessarily indicative of the results to be expected for any future interim period or for the entire year.

NATURE OF BUSINESS

CT Holdings, Inc. (the "Company" or "CT Holdings") provides management expertise including consulting on operations, marketing and strategic planning and a single source of capital to early stage technology companies. The Company was incorporated in Delaware in 1992. The business model is designed to enable the companies with whom the Company acquires or invests to become market leaders in their industries. The strategy over the years has led to the development, acquisition and operation of technology based businesses with compelling valuations and strong business models. The goal is to realize the value of these investments for the Company's shareholders through a subsequent liquidity event such as a sale, merger or initial public offering of the investee companies.

At March 31, 2004 the Company held investments in two companies, Parago, Inc. ("Parago") and River Logic, Inc. ("River Logic"). The Company owns approximately 1% of Parago and approximately 8% of River Logic at March 31, 2004.

Parago was formed in 1999 as an application service provider ("ASP") and Internet based business process outsourcer that provides an online suite of offerings designed to increase sales, reduce costs, retain customers and increase client profitability. These services include online promotional management, online rebate processing, proactive email, online surveys, and customer data warehousing, analysis and reporting. Parago's comprehensive

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integrated suite of outsourced customer care solutions are marketed across multiple industry lines. The Company accounts for its investment in Parago using the cost method of accounting. As an early stage company, Parago, until recently has had a history of operating losses and due to uncertainty of future earnings capacity as well as lack of marketability of the common stock, the carrying value of the investment was written down in prior periods and the investment has no carrying value at March 31, 2004 and December 31, 2003.

In May 2000, CT Holdings acquired a minority interest in River Logic, Inc. ("River Logic"), which develops decision-support applications for industry. Using COR Technology, a rapid-application development system, developers at River Logic create applications that enable industry professionals to model complex enterprises and explore financial relationships on a desktop computer or laptop. Embedded analytics allow end-users to understand the financial implications of critical business decisions easily by manipulating graphical icons that model their enterprise. The Company accounts for its investment in River Logic using the cost method of accounting. As an early stage company, River Logic until recently has had a history of operating losses and due to uncertainty of future earnings capacity as well as lack of marketability of the common stock, the carrying value of the investment was written down in prior periods and has no carrying value at March 31, 2004 and December 31, 2003.

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LIQUIDITY

The Company received a report from its' independent auditors for the year ended December 31, 2003 containing an explanatory paragraph that describes the uncertainty regarding its ability to continue as a going concern due to recurring operating losses and a significant working capital deficiency. The Company has incurred recurring operating losses and has a significant working capital and stockholders' deficiency at March 31, 2004 of approximately \$1.5 million. The Company had no cash balance or current assets at March 31, 2004 and current liabilities total approximately \$1.5 million. The Company has been and continues to be dependent upon outside financing to perform its business development activities, make investments in new technology companies and to fund operations. Immediate funding needs of the business are expected to be provided by financings through short-term notes payable and additional investments from related parties although there can be no assurance that such funds will be available. In addition, the Company's current financial condition and limited investment opportunities have limited its' ability to raise funds. At March 31, 2004 the Company had no plans to raise capital nor had sources of capital been identified.

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During the three months ended March 31, 2004 there were no funds used in operating activities. Net cash used in investing activities included \$30,000 to exercise warrants to acquire 28.8749 shares of Parago's Series-A preferred stock. These shares were deemed to have no fair market value and were immediately written off.

Net cash provided from financing activities included \$30,000 from the CEO through issuance of a note payable secured by Parago's Series-A preferred stock. Future cash may come from the realization of the value of the investments in Parago and River Logic however there can be no assurance that any value will ever be realized from these investments.

The Company's strategy of continuing to support and expand its business development activities requires the Company to obtain additional capital. Achieving positive cash flow is currently highly dependent upon obtaining liquidity from the Company's investments in unconsolidated affiliates. The complete implementation of this element of the Company's strategy will not generate positive cash flow in the foreseeable future. The Company estimates it will need to raise \$1.5 million to settle liabilities and to begin to support its incubator and business development activities for the next twelve months. Historically, the Company has obtained short-term bridge funding from related parties. While this may occur in the future there can be no assurance that such financing will be available or if available with terms that the Company would be willing to accept.

The Company has made investments in entities that it believes may provide liquidity to the Company in the long term. The Company believes that the investment in Parago has been successful; and even though Parago has reported an unaudited net income for the year ended December 31, 2003, as expected in an early stage company, Parago has a history of operating losses and has experienced cash flow deficiencies as it implements its business plan. Parago has been successful in raising capital to support its operations but there is no assurance that it will be able to raise sufficient capital in the future to support operations or that its operations will attain profitability. The Company's percentage ownership in Parago is approximately 1%. The Company believes, however, that the investment of 20,000 common shares of Parago (following a 1-for-1000 reverse stock split), 28.8749 shares of Series-A preferred stock (convertible into 2,887 shares of common stock) and an additional 5,000 (5,000,000 pre 1:1000 reverse stock split) shares received from

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our CEO in February 2004 upon exercising his exchange right for 6,000,000 shares of the Company's common stock, may ultimately provide an appropriate return.

Since the Company's initial investment, River Logic has made progress in executing its strategy through its development and introduction of new products and establishment of new customer relationships. The Company's ownership percentage is approximately 8%. River Logic also has a history of operating

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losses as well as a limited access to capital. The Company recognized that its investment in River Logic would be illiquid in the early stages of its business and accordingly carries the investment at zero on its balance sheet.

There can be no assurance that management's plans will be successful or what other actions may become necessary. There can be no assurance that the Company will ever achieve liquidity for its investments. Until the Company is able to create liquidity from its investments through sale to a strategic investor, an initial public offering or some other liquidity transaction, the Company will continue to require external sources of working capital to fund its own operating expenses. Although the Company has been successful raising capital in the past, the inability of the Company to raise capital could have a material adverse effect on the Company's business and operations that could be material to the Company's business and results of operations.

BASIS OF PRESENTATION

The accompanying financial statements of CT Holdings have been prepared in accordance with accounting principles generally accepted in the United States. Where appropriate, prior year amounts have been reclassified to conform to the current period presentation.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates.

STOCK-BASED COMPENSATION

The Company accounts for stock-based employee compensation arrangements in accordance with provisions of Accounting Principles Board ("APB") Opinion No.25, "Accounting for Stock Issued to Employees," and complies with the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123". Under APB Opinion No. 25, compensation expense for employees is based on the excess, if any, on the date of grant, of the fair value of the Company's stock over the exercise price.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and SFAS No. 148 and Emerging Issues Task Force ("EITF") Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to

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Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services." All transactions in which goods or services are the consideration received for the issuance of equity instruments are accounted for based on the

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fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable. The measurement date of the fair value of the equity instrument issued is the earlier of the date on which the counterparty's performance is complete or the date on which it is probable that performance will occur.

If the Company had recognized compensation expense, in accordance with SFAS Nos. 123 and 148, based upon the fair value at the grant date for options granted to employees, officers and directors during the three months ended March 31, 2004 and 2003, the pro forma effect on net loss and net loss per share would have been as follows:

	THREE MONTHS ENDED MARCH 31,	
	2004	2003
Net loss attributable to common stockholders as reported	\$ (103,026)	\$ (125,122)
Add: Stock-based employee compensation expense included in reported net loss	-	-
Deduct: Stock-based employee compensation expense determined under fair value based method	-	-
Pro forma net loss	\$ (103,026)	\$ (125,122)
Net loss per common share - basic and diluted		
As reported	\$ (0.00)	\$ (0.00)
Pro forma	\$ (0.00)	\$ (0.00)

NET LOSS PER COMMON SHARE

Net loss per common share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Included in the weighted average number of common shares outstanding for the three months ended March 31, 2004 and 2003 are 2,700,000 shares that would have been issued when a shareholder exercised his right to convert a note payable to common stock if the Company had the available authorized

shares. These shares have been included in the computation from the date that they would have been issued.

In addition, the weighted average number of shares outstanding for the three months ended March 31, 2004 includes 6,000,000 shares that would have been issued when the CEO exercised his right to exchange 5,000,000 (5,000 after a 1:1000 reverse stock split) shares of Parago common stock if the Company had the available authorized shares. These shares have been included in the computation

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from the date that they would have been issued.

Basic loss per share excludes any dilutive effects of options and warrants. Stock options and warrant to purchase 4,917,500 shares of common stock and 6,307,451 shares of common stock at March 31, 2004 and 2003, respectively, have been excluded from the computation of diluted loss per share, as the effect would be anti-dilutive. At March 31, 2004, the Company does not have any outstanding stock options or warrants that have an exercise price below market value.

The inclusion of the shareholder's 2,700,000 common stock shares and the CEO's 6,000,000 common stock shares in the weighted average shares outstanding for the three months ended March 31, 2004, as discussed above, produces a weighted average shares outstanding for the loss per share computation exceeding the currently authorized shares of 60,000,000 common stock shares. Both the shareholder and the CEO have waived their rights to receive their respective shares until such time as the shares become authorized.

NOTE B - ADVANCES AND NOTES TO RELATED PARTIES

In February 2004, our CEO loaned the Company \$30,000 in order for the Company to exercise the Company's warrants to purchase shares of Series-A convertible preferred stock, pursuant to a promissory note payable to our CEO which is secured by a pledge of the Parago Series-A preferred stock that is payable May 17, 2004.

During 2003, CT Holdings received an advance of \$225,000 from Citadel Security Software Inc. ("Citadel") to pay a legal settlement in return for an unsecured Note Payable to Citadel due on demand and bearing interest at 12% per year. The accrued interest on the note payable at March 31, 2004, was approximately \$28,000 and approximately \$21,000 at December 31, 2003.

Pursuant to the terms of the transition services agreement with Citadel, the Company has agreed to pay Citadel a monthly fee of \$20,000 per month for the services of its CEO, CFO and accounting and information management staff, as well as office rent and indirect overhead expenses. The Company has a liability recorded for \$695,000 and \$635,000 for amounts payable to Citadel under

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this agreement at March 31, 2004 and December 31, 2003, respectively. The transition services agreement expires in May 2004 and may be renewed upon approval of the independent members of each company's board of directors.

NOTE C - NOTES PAYABLE TO SHAREHOLDERS

At March 31, 2004 and December 31, 2003, the principal balance of a \$9,000, 8% note payable to a shareholder remains outstanding, was in default and continues to bear interest at 8% per annum. Accrued interest payable of approximately \$3,200 and \$2,800 related to this note is included in accounts payable and accrued expenses at March 31, 2004 and December 31, 2003, respectively.

NOTE D - RELATED PARTY TRANSACTIONS

During February 2004, the CEO exercised his conversion right to exchange 5,000,000 (pre 1:1000 reverse stock split) shares of Parago common stock for 6,000,000 shares of common stock of the Company. This exchange right was granted during June 2001 as consideration for the CEO funding the Company's participation in a Parago bridge loan. Since the issuance of these shares would exceed the number of authorized shares, the CEO has waived his right to receive the shares until such time as the shares become authorized. When the Company is

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able to issue the shares, it will record a \$60,000 (par value) increase to common stock and an offsetting reduction to additional paid in capital.

In February 2004, our CEO loaned the Company \$30,000 in order for the Company to exercise the Company's warrants to purchase 28.8749 shares of Series-A convertible preferred stock, pursuant to a promissory note to our CEO which is secured by a pledge of the Parago Series-A preferred stock that is payable May 17, 2004.

NOTE E - COMMITMENTS AND CONTINGENCIES

In August 1998, Janssen-Meyers Associates L.P. (JMA) filed a lawsuit against the Company arising out of an alleged 1995 contract with the Company's predecessor (Old Citadel). The suit alleged that Old Citadel breached a letter of intent dated September 1995 and/or a Placement Agency Agreement dated November 1995 between JMA and Old Citadel. As its damages, JMA claimed that it was entitled to, among other things, the cash value of warrants to purchase 1.8 million shares of CT Holdings common stock at an exercise price of \$0.89 per share, valued during May 1996. According to JMA's valuation of those warrants, potential damages were alleged to exceed \$40 million. The Company vigorously disputes that it breached either the letter of intent or the Placement Agency Agreement or that it is liable to JMA. The lawsuit was styled Janssen-Meyers Associates, L.P. v. Citadel Technology, Inc., and was filed in the Supreme Court of the State of New York, County of New York. The Company removed the case to federal court in the Southern District of New York.

Following mediation in July 2000, the Company entered into a settlement term sheet, to attempt to resolve the disputes between

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it and JMA, pursuant to which the Company and JMA agreed in principle to settle the lawsuit for an aggregate of \$3 million, in a combination of \$1.5 million in cash and 300,000 shares of the Company's common stock with a guaranteed value of \$5 per share as of January, April and October 2001 (with respect to 100,000 of the shares for each period). The settlement was subject to execution of definitive settlement documents and approval of the boards of directors of both parties.

However, the Company and JMA were unable to negotiate the final definitive settlement agreement. The case was dismissed in August 2000 without any resolution of this issue. On March 27, 2001, JMA attempted to reopen this matter, but the Court hearing the JMA lawsuit issued a Summary Order denying JMA's motion to enforce the settlement term sheet and confirmed the prior dismissal of the lawsuit. The Court further ruled that JMA would either have to bring an action on the proposed settlement or move to re-open the dismissed case. The Court stated that it did not express any view with respect to the merits of the settlement that brought about the dismissal of the case. There was no activity on the case from March 2001 through August 2001. On August 27, 2001 JMA refiled its lawsuit with a federal court in New York, and the Company filed its motion to dismiss the case because the plaintiffs lacked the required diversity jurisdiction to pursue the claims in federal court. On October 31, 2001 the case was dismissed in federal court. In December 2001, the plaintiffs refiled the lawsuit in the state court seeking to enforce the proposed settlement term sheet. The case was filed in Supreme Court of New York, that state's trial court, in a case styled Roan Meyers v. CT Holdings. CT Holdings has filed counter claims for breach of the terms sheet as well as breach of the placement agency agreement. Cross motions for partial summary judgments have been argued but the court has not ruled on the motions. No trial date has been set at this time. The Company intends to vigorously defend this case.

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In August 2002, PriceWaterhouseCoopers, LLP ("PWC") filed a lawsuit against CT Holdings seeking payment of \$131,816 for services performed pursuant to a contract with CT Holdings related to the JMA lawsuit described above. The court ordered that mediation be held by July 2003. The case is styled PriceWaterhouseCoopers, LLP v. CT Holdings, and was filed in the 192nd District Court, Dallas County, Texas. In July 2003, PWC obtained a summary judgment against the Company for damages of \$131,816 plus pre-judgment interest of \$57,615, post-judgment interest at 10% and attorneys' fees in the amount of \$8,605. During the year ended December 31, 2003 the Company recorded an accrual for legal settlement of \$207,000 including accrued interest in association with this judgement. PWC has obtained a garnishment of the Company's bank accounts and is seeking to obtain post judgment discovery. The Company has reached a

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settlement in an amount less than the amount accrued at March 31, 2004. The settlement is payable on May 24, 2004.

In January 2003, R.R Donnelly asserted claims against the Company and Steve B. Solomon alleging non-payment for services provided to CT Holdings by the plaintiff. The plaintiff is seeking \$16,872 from the Company for past due invoices as well as attorney's fees in the amount of \$24,000, court costs and post judgment interest at the highest legal rate. The Company had a liability of approximately \$50,000 recorded at March 31, 2004 and December 31, 2003 for the services performed by the vendor. The Company intends to vigorously defend this case.

In April 2003 MWW Group re-filed an old suit styled "MWW Group v. CT Holdings et. al" in the Superior Court of Bergen County, New Jersey which had been dismissed for want of prosecution. On July 21, 2003, a default judgment was entered against CT Holdings and Steve Solomon. On December 9, 2003, the Court signed an order vacating the default judgment. The plaintiff alleges damages in the amount of \$91,290. The case is in the discovery stage and is not yet scheduled for trial. The Company intends to vigorously defend this case.

In April 2004 a lawsuit, styled Kevin Auger v. Citadel Security Software, aka Citadel Technology and CT Holdings, Inc., was filed in the Fourth District of Utah County, State of Utah for \$20,789 alleging breach of contract. The Company intends to vigorously defend this lawsuit but due to its recent filing cannot assess the outcome or liability if any at March 31, 2004.

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

NOTE F - CERTAIN TRANSACTIONS

At March 31, 2004, 50,000 shares of CT Holdings' common stock, and 12,500 pro rata dividend shares of Citadel were reserved and available to settle the liabilities of approximately \$32,000. The Company believes that the negotiations will ultimately be concluded with the issuance of the shares in full settlement of these liabilities however there can be no assurance that such settlement will be finalized or on terms favorable to the Company.

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ITEM 2 -MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

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AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The following discussion contains forward-looking statements that involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among other things, those risk factors set forth in this section and elsewhere in this report. We identify forward-looking statements by words such as may, should, could, expects, plans, anticipates, believes, estimates, predicts, potential, or continue or similar terms that refer to the future. We cannot guarantee future results, levels of activity, performance or achievements.

FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

Investing in our common stock involves a high degree of risk. Any of the following risks could materially adversely affect our business, operating results and financial condition and could result in a complete loss of your investment.

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

The following matters, among other things, may have a material adverse effect on the business, financial condition, liquidity, or results of operations the Company. Reference to these factors in the context of a forward-looking statement or statements shall be deemed to be a statement that any one or more of the following factors may cause actual results to differ materially from those in such forward-looking statement or statements. Before you invest in our common stock, you should be aware of various risks, including those described below. Investing in our common stock involves a high degree of risk. You should carefully consider these risk factors, together with all of the other information included in this Report, before you decide whether to purchase

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shares of our common stock. Our business and results of operations could be seriously harmed by any of the following risks. The trading price of our common stock could decline due to any of these risks, and you may lose part or all of your investment.

GENERAL RISKS

WE HAVE RECEIVED A GOING CONCERN REPORT FROM OUR AUDITORS, HAVE A HISTORY OF NET LOSSES AND WILL NEED ADDITIONAL FINANCING TO CONTINUE AS A GOING CONCERN.

We received a report from our independent auditors for our year ended December 31, 2003 containing an explanatory paragraph that describes the uncertainty regarding our ability to continue as a going concern due to our recurring operating losses and a significant working capital deficiency. Historically, we have incurred recurring operating losses and have a significant stockholders'

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deficit at March 31, 2004 of approximately \$1.5 million. We had no cash balance or current assets at March 31, 2004 and current liabilities total approximately \$1.5 million. We have no access to capital at March 31, 2004 and we have no plans to raise capital, nor have we identified sources of capital. In the past our funding needs of the business have been provided by financings through short-term notes payable and additional investments from related parties, including our Chief Executive Officer, however there can be no assurance that such funds will be available from these related parties. The Company has been and continues to be dependent upon outside financing to perform its business development activities, make investments in new technology companies and to fund operations.

Our plans to continue to support and expand our business development activities are limited due to a lack of identification of near term capital. As a result, it is unlikely that the implementation of the Company's business strategy will generate positive cash flow in the foreseeable future. Achieving positive cash flow is currently highly dependent upon obtaining liquidity from our investments in unconsolidated affiliates. We have no plans at March 31, 2004 to raise additional capital to invest in new business opportunities. We estimate that we will need to raise up to \$1.5 million to settle liabilities and to continue to support our incubator and business development activities. Historically, we have obtained short-term funding from our Chief Executive Officer or Directors of the Company. The amount of capital and the timing of any future financing have not been determined and there can be no assurance that we will be able to raise new capital or that sources of capital would be available at terms we would be willing to accept.

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We have made investments in entities that we believe may provide liquidity to the Company in the long term and we believe that our investments in Parago and River Logic have been successful. Parago has recently attained profitability. As is expected in early stage companies, River Logic has not been profitable and has had to scale back operations. Historically both companies have experienced cash flow deficiencies. The current private equity and venture capital market conditions have limited the availability of investment capital for investment in private companies. In addition, we have not participated in the additional capital infusions since our initial investments and as a result, our ownership percentage in both investee companies has been diluted. Our ownership percentage in Parago is approximately 1% and approximately 8% in River Logic and the carrying values of both investments have been written down to zero.

While the performance of the investee companies to date has been as expected, there can be no assurance that we will ever achieve liquidity from these investments. In addition, there can be no assurance that our plans will be successful or what other actions may become necessary in the future. Until we are able to create liquidity from our investments through sale to a strategic investor, an initial public offering or some other liquidity transaction, we will continue to require working capital to fund operating expenses. Although we have been successful raising capital in the past, an inability to raise capital may require us to sell assets. Such actions could have a material adverse effect on our business and operations and result in charges that could be material to the Company's business and results of operations. At December 31, 2003 we have not identified sources of capital nor do we have any plans to raise capital to settle liabilities or to fund business development activities.

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

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

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or initial public offering of the investee companies. However, the impact of any advice and expertise may be limited due to a lack of a significant ownership percentage in any of our investees and the lack of available capital.

In May 2002, we were successful in spinning off Citadel into a standalone company through the pro-rata dividend distribution of Citadel common stock to shareholders of CT Holdings. At March 31, 2004 and December 31, 2003 we held investments in two companies, Parago and River Logic. However the investments have no carrying value on the balance sheet of the Company at March 31, 2004 and December 31, 2003, due to information technology market conditions, as well as historical operating performance of the investee companies that have created uncertainty as to achievement of sustainable earnings and cash flow. During 2003 and through March 31, 2004 we have looked for businesses and technologies in which to invest but economic and stock market conditions along with a general decline in the availability of private and public capital available to us has prevented us from making any additional investments and there can be no assurance that these factors will improve so that the Company can continue to execute its business plan.

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

- We may be unable to identify or develop relationships with attractive emerging companies.
- Any companies that we are able to attract may not succeed and the value of our assets and the price of our common stock could consequently decline.
- Our business model is unproven and depends on the willingness of companies to participate in our business development model and collaborate with each other and us.
- Our expenses will increase as we build the infrastructure necessary to implement this model.
- We face competition from incubators, some of which are publicly traded companies, venture capital companies and large corporations; many of these competitors have greater

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financial resources and brand name recognition than we do, which may make it difficult for us to effectively compete.

- We will require additional capital resources in order to implement our business model and we may not be able to obtain these resources on attractive terms, if at all.

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

We have developed and invested in Parago and River Logic (our "investees" or "investee companies"). Inasmuch as our investee companies are early stage ventures, it is difficult to judge their future prospects. Economic, governmental, industry and internal company factors outside of our control affect each of our investee companies.

CT HOLDINGS DOES NOT HAVE ACCESS TO THE CASH FLOW OR ASSETS OF ITS INVESTEE COMPANIES AND HAS BEEN UNABLE TO OPERATE PROFITABLY.

Historically, businesses and technologies in which we have invested are not controlled by us and as such we have been unable to rely on the investee company businesses for a source of cash flow, earnings, assets or capital. There can be no assurance that CT Holdings will be able to successfully put in place the financial, administrative and managerial structure necessary to continue to operate as an independent public company, or that the development of such structure will not require a significant amount of management's time and other resources.

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

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

appointed receiver could take control of us and liquidate our business. Following the Distribution of Citadel, we may be deemed to be an investment company unless we qualify for a safe harbor within the time permitted under the 1940 Act.

Although we have yet to make any investments in the investment securities of companies other than Parago, and River Logic, such investments, if and when made, could fluctuate in value, which may cause the value of such securities to exceed 40% of our total assets. Unless an exclusion or safe harbor were available to us, we would have to attempt to reduce our investment securities as a percentage of our total assets. This reduction could be accomplished in a number of ways, including the disposition of investment securities and the

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acquisition of non-investment security assets. If we were required to sell investment securities, we may sell them sooner than we may otherwise have preferred. These sales may be at depressed prices and we might never realize anticipated benefits from, and may incur losses on, these investments. Some investments may not be sold due to contractual or legal restrictions or the inability to locate a suitable buyer. Moreover, we may incur tax liabilities when we sell assets. We may also be unable to purchase additional investment securities that may be important to our operating strategy. If we decide to acquire non-investment security assets, we may not be able to identify and acquire suitable assets and businesses.

OUR STOCK IS TRADED IN THE OVER THE COUNTER MARKET.

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

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

We are involved in legal proceedings as described in PART I Item 3. Legal Proceedings and from time to time, we may be subject to other legal proceedings, including but not limited to claims that we have infringed the intellectual property rights of others, product liability claims, or other claims incidental to our business. While we intend to defend such lawsuits, adverse decisions or settlements, and the costs of defending such suits, could have a material adverse effect on our business.

OUR EARNINGS AND STOCK PRICE ARE SUBJECT TO SIGNIFICANT FLUCTUATIONS.

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Due to the factors noted in this Report, our earnings and stock price have been and may continue to be subject to significant volatility, particularly on a quarterly basis. We have experienced no revenue or earnings which have had an immediate and significant adverse effect on the trading price of our common stock. This may occur again in the future.

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

In May 2002, CT Holdings effected a pro rata distribution of the commons stock of Citadel Security Software Inc. ("Citadel") to Stockholders of CT Holdings in a ratio of one(1) share of Citadel common stock for every four(4) shares of CT Holdings common stock(the "Distribution"). CT Holdings and Citadel intend for the Distribution to be tax-free for U.S. federal income tax purposes. Neither CT Holdings nor Citadel has requested an advance ruling from the Internal Revenue Service, or any opinion of their tax advisors, as to the tax consequences of the Distribution. No assurance can be given that the Internal Revenue Service or the courts will agree that the Distribution is tax-free.

If the Distribution does not qualify for tax-free treatment, a substantial corporate tax would be payable by the consolidated group of which CT Holdings is the common parent measured by the difference between (1) the aggregate fair market value of the Citadel Shares on the Distribution Date and (2) CT Holdings' adjusted tax basis in the Citadel Shares on the Distribution Date. The corporate level tax would be payable by CT Holdings. However, Citadel has agreed under certain circumstances to indemnify CT Holdings for all or a portion of this tax liability. In addition, under the applicable treasury regulations, each member

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of CT Holdings' consolidated group (including Citadel) is severally liable for such tax liability.

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

Even if the Distribution qualifies as tax-free, CT Holdings could nevertheless incur a substantial corporate tax liability under Section 355(e) of the Internal Revenue Code of 1986, as amended (the Internal Revenue Code or the Code), if CT Holdings or Citadel were to undergo a change in control (whether by acquisition, additional share issuance or otherwise) pursuant to a plan or series of related transactions which include the Distribution. Any transaction which occurs within the four-year period beginning two years prior to the Distribution is presumed to be part of a plan or series of related transactions which

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includes the Distribution unless CT Holdings establishes otherwise. Under certain circumstances, Citadel would be obligated to indemnify CT Holdings for all or a portion of this substantial corporate tax liability under the tax disaffiliation agreement.

RISKS RELATED TO OUR INVESTEES

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

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

There can be no assurance that any of our investees will complete an initial public offering, merger, sale or other liquidity event. The failure to complete an offering or other liquidity event such as an acquisition by a third party could have a material adverse effect on our stock price. You cannot be assured that an initial public offering or other liquidity event will occur in the near future or ever at all. Even if a liquidity event is achieved, we may not receive material proceeds from a liquidity event because of the existence of other securities with preferences to the securities we hold or if the price received by the investee company is not sufficient to generate a favorable return to us. In addition, we have agreed to convert the shares of Parago common stock issued in connection with the acquisition of 2-Lane Media by Parago into up to 500,000 of our shares at the option of the 2-Lane Media shareholders, and in May 2002 we exchanged 1,200 Parago shares held by some of the 2-Lane Media shareholders into 139,806 shares of our common stock. Pursuant to the terms of the subscription agreements between Parago and some of its stockholders, we may be required to issue up to 414,000 shares of our common stock based on a conversion price of \$3.75 per share (above the fair market value on the dates of issuance) at the option of such stockholders. In May 2002, the Company exchanged 16,000 shares of the Company's common stock for 40 shares of Parago common stock with one of these shareholders. In February 2004, our CEO elected to exercise an exchange right whereby he exchanged 5,000,000 (pre 1:1000 reverse split shares) shares of Parago common stock for 6,000,000 shares of CT Holdings common stock. These provisions could have the effect of diluting our stockholders if the market price for our stock is above that price at the time of conversion.

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

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

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

Our investees are early stage companies, and therefore each investee has only a limited operating history on which one can base an investment decision. You should consider their prospects in light of the uncertainties and difficulties frequently encountered by companies in their early stages of development. In addition, each investee's business model is new, unproven and evolving. We cannot assure that our investees' business models will be commercially successful, or that their solutions will be accepted by businesses or consumers. If our investees are unable to establish pricing and service models acceptable to manufacturers, retailers and service providers and attractive to their customers, their solutions may not be commercially successful.

EACH INVESTEE HAS A HISTORY OF NET LOSSES AND COULD INCUR SUBSTANTIAL NET LOSSES IN THE FUTURE.

Parago has only recently reported its first unaudited full year profit and River Logic has never reported a profit. Both investees could incur substantial losses in the future, if our investees' revenues do not grow as they anticipate, our investees may never be profitable.

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

Parago has only recently reported its first unaudited full year profit and River Logic has never reported a profit. Both investees could incur substantial losses in the future, if our investees do not raise additional funds, or achieve profitability, their businesses and results of operations will be seriously harmed, and our assets and share price would be materially and adversely impacted. This additional financing may not be available to our investees on a timely basis if at all, or, if available, on terms acceptable to our investees. Moreover,

additional financing may cause material and immediate dilution to existing stockholders of our investees, including us.

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

Currently, the securities of our investees cannot be bought or sold publicly. There can be no assurance that any of our investees will be able to complete an initial public offering. Although it is anticipated that the initial public offering price (if an initial public offering is completed) would be determined

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based on several factors, the market price after the offering may vary significantly from the initial offering price. The market price of our investees' common stock is likely to be highly volatile and could be subject to wide fluctuations in response to factors that are beyond its control. A decline in their stock price will adversely affect our stock price.

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

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

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion in conjunction with our audited financial statements for the years ended December 31, 2003 and 2002 and the related notes in the Company's Form 10-KSB. Our year ends on December 31, and each of our quarters end on the final day of a calendar quarter (each March 31, June 30 and September 30). The following discussion contains forward-looking statements. Please see Forward-Looking Statements for a discussion of uncertainties, risks and assumptions associated with these statements.

OVERVIEW

CT Holdings, Inc. provides management expertise and sources of capital to early stage companies. At March 31, 2004 and December 31, 2003 we held investments in Parago and River Logic. We were incorporated in Delaware in 1992. Our business model is designed to enable the companies in whom we invest or acquire to become market leaders in their industries. Our strategy has led to the development, acquisition and operation of technology based businesses with compelling valuations and strong business models. We believe that the anticipated growth in technology creates strong opportunities for us to increase shareholder value by investing in well-positioned early stage ventures. Our goal is to realize the value of our investments for our shareholders through a subsequent liquidity event such as a spin-off, sale, merger or initial public offering of the investee companies.

Recent geopolitical, economic and stock market conditions along with lack of available capital have limited our ability to raise sufficient capital to invest in additional companies and technologies that could offer us and our shareholders a reasonable rate of return on their investment in the foreseeable future. Historically, these factors have also affected the businesses of our investee companies and as a result, in years prior to the year ended December 31, 2003 the carrying values of our investments in Parago and River Logic have been written down to zero. We expect that if and when capital becomes available to us, we may continue our business development and investment activities, however there can be no assurance that any capital will be available to us. Until such time as capital becomes available the Company's business activities will be limited to reviewing investment opportunities, filing of compliance documents and defending the lawsuits disclosed in Part I, Item 3 - Legal Proceedings.

OUR INVESTEE COMPANIES

Parago

In January 1999, we formed Parago, an application service provider and Internet based business process outsourcer that provides a suite of technology offerings (including PromoCenter, ClickChoice and KnowledgeCenter) designed to increase sales, reduce costs, and retain customers for retailers, manufacturers and service organizations. Parago's continuous customer interaction services include online promotional management (including online rebate processing), proactive email, online surveys, and customer data analysis and reporting. We account for our investment in Parago using the cost method, due to the Company's ownership percentage of approximately 1% of the fully diluted shares outstanding. Due to Parago's history of operating losses and inherent risks associated with an early stage companies, the carrying amount of our investment is zero.

River Logic

In May 2000, we made an investment in River Logic by acquiring shares of common stock of River Logic from several of its existing shareholders in exchange for 333,333 shares of our common stock. We also acquired shares of Series A Convertible Preferred Stock ("Series A") from River Logic in exchange for the contribution of assets acquired from a third party by the Company through exchange of 666,667 shares of our common stock. In connection with the investment in River Logic, we also made two bridge loans totaling \$600,000 to River Logic that were convertible into shares of capital stock of River Logic. We account for our investment in River Logic using the cost method, due to the Company's ownership percentage of approximately 8% of the fully diluted shares outstanding. Due to River Logic's history of operating losses and inherent risks associated with an early stage companies, the carrying amount of our investment is zero.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to our investments in our investee companies and commitments and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable

under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies are most important to the presentation of our financial statements and require the most difficult, subjective and complex judgments.

IMPAIRMENT CHARGES

We periodically evaluate the carrying value of our ownership interests in our investee companies for possible impairment based on achievement of business plan

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objectives and milestones, the value of each ownership interest in the investee company relative to carrying value, the financial condition and prospects of the investee company, and other relevant factors. The business plan objectives and milestones we consider include, among others, those related to financial performance such as achievement of planned financial results or completion of capital raising activities, and those that are not primarily financial in nature such as obtaining key business relationships or the hiring of key employees. If an indication of impairment exists with respect to the carrying value of an investee company, we perform an evaluation by comparing the estimated fair value of the asset with its carrying value. Fair value is determined by estimating the cash flows related to the asset, including estimated proceeds on disposition, if any. If the fair value is less than the carrying value a loss is recorded.

COMMITMENTS AND CONTINGENCIES

From time to time, we are a defendant or plaintiff in various legal actions, which arise in the normal course of business. We are also a guarantor of various third-party obligations and commitments. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of reserves required for these contingencies, if any, which would be charged to earnings, is made after careful analysis of each individual issue. The required reserves may change in the future due to new developments in each matter or changes in circumstances, such as a change in settlement strategy.

Changes in required reserves could increase or decrease our earnings in the period the changes are made.

EFFECT OF VARIOUS ACCOUNTING METHODS FOR EQUITY INVESTMENTS

The various interests that we acquire in our investee companies are accounted for under three broad methods: consolidation,

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equity method and cost method. The applicable accounting method is generally determined based on our percentage ownership in an investee company.

CONSOLIDATION METHOD: Investee companies in which we directly or indirectly own more than 50% of the outstanding securities or those where we have effective control are generally accounted for under the consolidation method of accounting. Under this method, an investee company's accounts are consolidated within our financial statements. Participation of other unrelated stockholders in the earnings or losses of a consolidated investee company would be reflected as a minority interest in consolidated financial statements. Minority interest adjusts our consolidated net results of operations to reflect only our share of the earnings or losses of the consolidated investee company. At March 31, 2004 and December 31, 2003 we had no investee company qualified for this accounting method.

EQUITY METHOD: Investee companies whose results we do not consolidate, but over whom we exercise significant influence, are generally accounted for under the equity method of accounting. Whether or not we exercise significant influence with respect to an investee company depends on an evaluation of several factors including, among others, representation on the investee company's board of directors and percentage ownership level, which is generally a 20% to 50% interest in the securities of the investee company, including our holdings in common, preferred and other convertible instruments in the investee company where we may have voting rights. Under the equity method of accounting, an investee company's accounts are not reflected within our financial statements; however, our share of the earnings or losses of the investee company is

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reflected in our statements of operations. At March 31, 2004 and December 31, 2003 we had no investee company qualified for this accounting method.

COST METHOD: Investee companies not accounted for under either the consolidation or the equity method of accounting are accounted for under the cost method of accounting. Under this method, our share of the earnings or losses of these companies is not included in our statements of operations. Our investments in Parago and River Logic were accounted for using this method of accounting at March 31, 2004 and December 31, 2003.

RESULTS OF OPERATIONS

THE QUARTER ENDED MARCH 31, 2004 COMPARED WITH THE QUARTER ENDED MARCH 31, 2003

Our continuing operations consist of costs and expenses for providing services to our investee companies and the activities to identify additional technologies and companies in which we might invest. We do not generate any direct revenue and because

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our investee companies are not consolidated, we do not report revenue from investee businesses.

GENERAL AND ADMINISTRATIVE EXPENSES

During the quarter ended March 31, 2004 general and administrative expenses were approximately \$65,000 representing a decrease of approximately \$36,000 or 35.6% from the approximately \$101,000 of general and administrative expenses recorded for the quarter ended March 31, 2003. The decrease is primarily due to lower legal, accounting, consulting and other professional fees and expenses resulting from the lower business development activities during the quarter ended March 31, 2004 versus the similar period of 2003.

INTEREST (INCOME) EXPENSE

Interest expense for the quarter ended March 31, 2004 was approximately \$7,600 representing interest expense on advances and notes payable to shareholders and the demand note payable to Citadel. Interest expense for the quarter ended March 31, 2003 was approximately \$24,000. The decrease in interest expense is due to lower average balances of interest bearing debt outstanding during the quarter ended March 31, 2004 versus the same quarter of 2003.

WRITE-OFF OF AFFILIATES SHARES ACQUIRED THROUGH EXERCISE OF WARRANT

The \$30,000 write off of investment in affiliates is related to the warrant exercised by the Company to obtain Series-A Parago preferred Stock, which was determined by the Company to have no fair market value and was immediately written off.

NET INCOME (LOSS)

For the quarter ended March 31, 2004 we reported a net loss of approximately \$103,000 versus a net loss of approximately \$125,000 for the quarter ended March 31, 2003.

LIQUIDITY AND CAPITAL RESOURCES

We received a report from our independent auditors for our year ended December 31, 2003 containing an explanatory paragraph that describes the uncertainty regarding our ability to continue as a going concern due to our recurring

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operating losses and our significant working capital deficiency. Historically, we have incurred recurring operating losses and have a significant stockholders' deficit at March 31, 2004 of approximately \$1.5 million. We had no cash balance or current assets at March 31,

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2004 and current liabilities total approximately \$1.5 million. We have no access to capital at March 31, 2004 and we have no plans to raise capital nor have we identified sources of capital. Our past funding needs of the business have been provided by financings through short-term notes payable and additional investments from related parties, including our Chief Executive Officer, however there can be no assurance that such funds will be available from this related party. The Company has been and continues to be dependent upon outside financing to perform its business development activities, make investments in new technology companies and to fund operations.

PLAN OF OPERATIONS

Our plans to continue to support and expand our business development activities are limited due to a lack of identification and availability of near term capital. As a result, it is unlikely that the implementation of the Company's business strategy will generate positive cash flow in the foreseeable future. Achieving positive cash flow is currently highly dependent upon obtaining liquidity from our investments in unconsolidated affiliates. We have no plans at March 31, 2004 to raise additional capital to invest in new business opportunities. To do so we estimate that we will need to raise up to \$1.5 million to settle liabilities after which we may then begin to support our incubator and business development activities. However there can be no assurance that we will raise additional funds needed to settle our liabilities.

There can be no assurance that management's plans will be successful or what other actions may become necessary. There can be no assurance that the Company will ever achieve liquidity for its investments. Until we are able to create liquidity from an additional inflow of new capital or from our investments through sale to a strategic investor, an initial public offering or some other liquidity transaction, we will continue to require external sources of working capital to fund our operating expenses. Our inability to raise capital could have a material adverse effect on our business and operations that could be material to our results of operations.

There was no net cash used in operating activities for the quarter ended March 31, 2004. This is the result of net loss of approximately \$103,000 for the quarter ended March 31, 2004 and an offset by cash from changes in operating assets and liabilities of approximately \$73,000 and \$30,000 write-off of investment in affiliate.

CASH FLOW ACTIVITIES

There was no net cash used in operations for the quarter ended March 31, 2003 which is principally a result of the net loss of approximately \$125,000 offset by the changes in operating assets and liabilities of approximately \$125,000.

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Net cash provided from financing activities during the quarter ended March 31, 2004 included \$30,000 from the CEO through a note payable secured by Parago's Series-A preferred stock.

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Net cash used in investing activities during the quarter ended March 31, 2004, included \$30,000 to exercise warrants to acquire Parago's Series-A preferred stock.

There was no cash from investing activities for the quarter ended March 31, 2003. There were no cash flows provided from financing activities for the quarter ended March 31, 2003.

At March 31, 2004 the Company was in default on the following indebtedness:

- \$9,000, an 8% note payable to a shareholder. The note continues to bear interest at 8% with accrued interest at March 31, 2004 of \$3,200.

As a result of the aforementioned factors, there were no net cash flows in the quarters ended March 31, 2004 and 2003.

CONTRACTUAL OBLIGATIONS

At March 31, 2004 we have a note payable to a related party of \$30,000 secured by Parago Series-A Preferred Stock due May 17, 2004. There are no other long term debt obligations, capital lease obligations, operating lease obligations or long term capital purchase commitments. However at March 31, 2004 we have accrued obligations for estimated payments of legal judgments against us and for payments to Citadel under the transition services agreement and demand note payable, none of which may be paid until such time as the Company has sufficient cash to pay these obligations.

ITEM 3. CONTROLS AND PROCEDURES

The Company's management, including the Company's principal executive officer and principal financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-QSB. Based upon that evaluation, the Company's principal executive officer and principal financial officer have concluded that the disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-QSB.

There were no changes in the Company's internal control over financial reporting that occurred during the Company's last

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fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In August 1998, Janssen-Meyers Associates L.P. (JMA) filed a lawsuit against the Company arising out of an alleged 1995 contract with the Company's predecessor (Old Citadel). The suit alleged that Old Citadel breached a letter of intent dated September 1995 and/or a Placement Agency Agreement dated November 1995 between JMA and Old Citadel. As its damages, JMA claimed that it was entitled to, among other things, the cash value of warrants to purchase 1.8 million shares of CT Holdings common stock at an exercise price of \$0.89 per share, valued during May 1996. According to JMA's valuation of those warrants,

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potential damages were alleged to exceed \$40 million. The Company vigorously disputes that it breached either the letter of intent or the Placement Agency Agreement or that it is liable to JMA. The lawsuit was styled Janssen-Meyers Associates, L.P. v. Citadel Technology, Inc., and was filed in the Supreme Court of the State of New York, County of New York. The Company removed the case to federal court in the Southern District of New York.

Following mediation in July 2000, the Company entered into a settlement term sheet, to attempt to resolve the disputes between it and JMA, pursuant to which the Company and JMA agreed in principle to settle the lawsuit for an aggregate of \$3 million, in a combination of \$1.5 million in cash and 300,000 shares of the Company's common stock with a guaranteed value of \$5 per share as of January, April and October 2001 (with respect to 100,000 of the shares for each period). The settlement was subject to execution of definitive settlement documents and approval of the boards of directors of both parties.

However, the Company and JMA were unable to negotiate the final definitive settlement agreement. The case was dismissed in August 2000 without any resolution of this issue. On March 27, 2001, JMA attempted to reopen this matter, but the Court hearing the JMA lawsuit issued a Summary Order denying JMA's motion to enforce the settlement term sheet and confirmed the prior dismissal of the lawsuit. The Court further ruled that JMA would either have to bring an action on the proposed settlement or move to re-open the dismissed case. The Court stated that it did not express any view with respect to the merits of the settlement that brought about the dismissal of the case. There was no activity on the case from March 2001 through August 2001. On August 27, 2001 JMA refiled its lawsuit with a federal court in New York, and the Company filed its motion to dismiss the case because the plaintiffs lacked the required diversity jurisdiction to pursue the claims in federal court. On October 31, 2001 the case was dismissed in federal court. In December 2001, the plaintiffs refiled the lawsuit in the state court seeking to enforce the proposed settlement term sheet. The case was filed in Supreme

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Court of New York, that state's trial court, in a case styled Roan Meyers v. CT Holdings. CT Holdings has filed counter claims for breach of the terms sheet as well as breach of the placement agency agreement. Cross motions for partial summary judgments have been argued but the court has not ruled on the motions. No trial date has been set at this time. The Company intends to vigorously defend this case.

In June 2000, CT Holdings was served with a lawsuit filed in the 157th State District Court in Houston, Texas by Michael and Patricia Ferguson for breach of contract, breach of fiduciary duty, tortuous interference, violation of the Texas Deceptive Trade Practices Act and negligence. The case was styled Michael and Patricia Ferguson v. CT Holdings, Inc. Specifically, the Ferguson's claim that they were damaged when they attempted to exercise warrants during a time when CT Holdings' related registration statement could not be used. In July, 2002, the plaintiffs were awarded damages of \$575,510, pre-judgment interest of \$86,748, attorneys' fees of \$103,818, post-judgment interest at 10% per year, and costs. The Company had a liability of \$785,000 recorded at December 31, 2002 for this judgment.

In August 2002, PriceWaterhouseCoopers, LLP ("PWC") filed a lawsuit against CT Holdings seeking payment of \$131,816 for services performed pursuant to a contract with CT Holdings related to the JMA lawsuit described above. The court ordered that mediation be held by July 2003. The case is styled PriceWaterhouseCoopers, LLP v. CT Holdings, and was filed in the 192nd District Court, Dallas County, Texas. In July 2003, PWC obtained a summary judgment against the Company for damages of \$131,816 plus pre-judgment interest of

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\$57,615, post-judgment interest at 10% and attorneys' fees in the amount of \$8,605. During the year ended December 31, 2003 the Company recorded an accrual for legal settlement of \$207,000 including accrued interest in association with this judgment. PWC has obtained a garnishment of the Company's bank accounts and is seeking to obtain post judgment discovery. The Company has reached a settlement in an amount less than the amount accrued at March 31, 2004. The settlement is payable on May 24, 2004.

In January 2003, R.R Donnelly asserted claims against the Company and Steve B. Solomon alleging non-payment for services provided to CT Holdings by the plaintiff during the nine months ended September 30, 2002. The plaintiff is seeking \$16,872 from the Company for past due invoices as well as attorney's fees in the amount of \$24,000, court costs and post judgment interest at the highest legal rate. The Company had a liability of approximately \$50,000 recorded at March 31, 2004 and December 31, 2003 and 2002

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for the services preformed by the vendor. The Company intends to vigorously defend this case.

In April 2003 MWW Group re-filed an old suit styled "MWW Group v. CT Holdings et. al" in the Superior Court of Bergen County, New Jersey which had been dismissed for want of prosecution. On July 21, 2003, a default judgment was entered against CT Holdings ad Steve Solomon. On December 9, 2003, the Court signed an order vacating the default judgment. The plaintiff alleges damages in the amount of \$91,290. The case is in the discovery stage and is not yet scheduled for trial. The Company intends to vigorously defend this case.

In April 2003, Harte Hanks, Inc. filed a lawsuit styled "Harte Hanks, Inc. v. CT Holdings Inc. dba Citadel Computer" seeking payment of \$12,513 for services performed. In July 2003, the plaintiffs filed a motion for receivership and alternatively to compel discovery in the lawsuit. At a hearing on the matter held on September 5, 2003 in the County Court of Law Number Three of Dallas County, Texas, the court ordered the Company to provide additional discovery by October 20, 2003 which the Company failed to produce. As part of the Distribution, Citadel assumed responsibility for this liability, and has settled this liability for a total payment of \$8,000.

In April 2004 a lawsuit, styled Kevin Auger v. Citadel Security Software, aka Citadel Technology and CT Holdings, Inc., was filed in the Fourth District of Utah County, State of Utah for \$20,789 alleging breach of contract. The Company intends to vigorously defend this lawsuit but due to its recent filing cannot assess the outcome or liability if any at March 31, 2004.

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

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ITEM 2 - RECENT SALES OF UNREGISTERED SECURITIES

During February 2004, the CEO exercised his conversion right to exchange 5,000,000 (pre 1:1000 reverse split) shares of Parago common stock for 6,000,000 shares of common stock of the Company. Since the issuance of these shares would exceed the number of authorized shares, the CEO has waived his right to receive

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the shares until such time as the shares become authorized.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

At March 31, 2004, and December 31, 2003 the Company was in default on the following indebtedness:

- \$9,000, an 8% note payable to a shareholder. The note continues to bear interest at 8% with accrued interest at March 31, 2004 of approximately \$3,200.

ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

31.1 Certification of Chief Executive Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 302 Of The Sarbanes-Oxley Act of 2002

32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002

(b) Current Reports on Form 8-K

None

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

CT Holdings, Inc.
(REGISTRANT)

Date: May 17, 2004

By: /s/ STEVEN B. SOLOMON

Steven B. Solomon,
President and Chief
Executive Officer
(Duly Authorized Signatory and
Principal Executive Officer)

/s/ RICHARD CONNELLY

Richard Connelly,
Chief Financial Officer
(Duly Authorized Signatory and
Principal Accounting and Financial
Officer)

