

Edgar Filing: INFORTE CORP - Form 10-Q

INFORTE CORP
Form 10-Q
November 15, 2004

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

Form 10-Q

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

For the quarterly period ended September 30, 2004

OR

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

For the transition period from _____ to _____

Commission File Number 000-29239

INFORTE CORP.

(Exact name of registrant as specified in its charter)

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

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

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

None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), 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-2 of the Exchange Act). Yes No

The number of shares outstanding of the Registrant's Common Stock as of September 30, 2004 was 11,065,218.

INFORTE CORP.

Edgar Filing: INFORTE CORP - Form 10-Q

INDEX

	Page No.	

PART I.	Financial Information	
Item 1.	Consolidated Financial Statements (Unaudited)	
	Consolidated Balance Sheets - September 30, 2003, December 31, 2003, March 31, 2004, June 30, 2004, September 20, 2004	1
	Consolidated Statements of Operations - Three months and nine months ended September 30, 2003 and 2004	2
	Consolidated Statements of Cash Flows - Three months and nine months ended September 30, 2003 and 2004	3
	Notes to Consolidated Financial Statements	4-7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	7-18
Item 3.	Qualitative and Quantitative Disclosure about Market Risk	19
Item 4.	Controls and Procedures	19
PART II.	Other Information	
Item 1	Legal Proceedings	19-20
Item 2.	Changes in Securities and Use of Proceeds	20
Item 3	Defaults of Senior Securities	20
Item 4.	Submission of Matters to a Vote of Security Holders	20
Item 5	Other Information	20
Item 6.	Exhibits and Reports on Form 8-K	21
Signature		22
Exhibit 31.1	Section 302 certification of the Chief Executive Officer	23
Exhibit 31.2	Section 302 certification of the Chief Financial Officer	24
Exhibit 32	Section 906 certification of the Chief Executive Officer and Chief Financial Officer	25

PART I. FINANCIAL INFORMATION

Edgar Filing: INFORTE CORP - Form 10-Q

Item 1. Consolidated Financial Statements

INFORTE CORP.
CONSOLIDATED BALANCE SHEETS
(000's)

	SEPT 30, 2003 ----- (Unaudited)	DEC 31, 2003 -----	MAR 31, 2004 ----- (Unaudited)
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 22,114	\$ 24,071	\$ 18,630
Short-term marketable securities	27,866	25,471	15,860
Accounts receivable	5,094	4,811	8,633
Allowance for doubtful accounts	(525)	(500)	(500)
	-----	-----	-----
Accounts receivable, net	4,569	4,311	8,133
Prepaid expenses and other current assets	1,009	692	1,273
Interest receivable on investment securities	469	372	403
Income taxes recoverable	-	-	401
Deferred income taxes	953	664	643
	-----	-----	-----
Total current assets	56,980	55,581	45,343
Computers, purchased software and property	2,091	2,084	2,525
Less accumulated depreciation and amortization	1,334	1,370	1,572
	-----	-----	-----
Computers, purchased software and property, net	757	714	953
Long-term marketable securities	17,237	18,187	24,457
Goodwill and intangible assets	-	-	5,505
Deferred income taxes	350	326	317
	-----	-----	-----
Total assets	\$ 75,324 =====	\$ 74,808 =====	\$ 76,575 =====
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	887	573	1,554
Income taxes payable	357	299	-
Accrued expenses	3,312	3,558	3,146
Accrued loss on disposal of leased property	681	558	489
Deferred acquisition payment	-	-	500
Deferred revenue	3,539	2,617	2,657
	-----	-----	-----
Total current liabilities	8,776	7,605	8,346
Non-current liabilities:			
Deferred acquisition payment	-	-	-
Stockholders' equity:			
Common stock, \$0.001 par value authorized- 50,000,000 shares; issued and outstanding (net of treasury stock)- 11,065,218 as of Sept. 30, 2004	11	11	11
Additional paid-in capital	79,658	79,791	80,113

Edgar Filing: INFORTE CORP - Form 10-Q

Cost of common stock in treasury (2,720,823 shares as of Sept. 30, 2004)	(24,997)	(24,997)	(24,997)
Stock-based compensation	-	-	60
Retained earnings	11,629	12,026	12,541
Accumulated other comprehensive income	247	372	501
	-----	-----	-----
Total stockholders' equity	66,548	67,203	68,229
	-----	-----	-----
Total liabilities and stockholders' equity	75,324	74,808	76,575
	=====	=====	=====

See notes to consolidated financial statements

1

CONSOLIDATED STATEMENTS OF OPERATIONS
(000's, except per share data)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS END SEPTEMBER 30,
	2003	2004	2003
	-----	-----	-----
	(Unaudited)	(Unaudited)	(Unaudited)
Revenues:			
Revenue before reimbursements (net revenue)	\$ 7,720	\$ 11,516	\$ 24,094
Reimbursements	1,359	1,675	3,404
	-----	-----	-----
Total Revenues	9,079	13,191	27,498
Operating expenses:			
Project personnel and related expenses	4,107	7,085	12,424
Reimbursed expenses	1,359	1,675	3,404
Sales and marketing	1,040	1,178	3,702
Recruiting, retention and training	183	370	476
Management and administrative	2,135	3,142	7,057
	-----	-----	-----
Total operating expenses	8,824	13,450	27,063
Operating income (loss)	255	(259)	435
Interest income, net and other	257	267	1,084
	-----	-----	-----
Income before income tax	512	8	1,519
Income tax expense	65	3	167
	-----	-----	-----
Net income	\$ 447	\$ 5	\$ 1,352
	=====	=====	=====
Earnings per share:			
-Basic	\$ 0.04	\$ 0.00	\$ 0.12
-Diluted	\$ 0.04	\$ 0.00	\$ 0.12
Weighted average common shares outstanding:			

Edgar Filing: INFORTE CORP - Form 10-Q

-Basic	10,915	11,056	10,881
-Diluted	11,055	11,183	10,993

See notes to consolidated financial statements

2

INFORTE CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(000's)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS E SEPTEMBER 3
	2003 ----- (Unaudited)	2004 ----- (Unaudited)	2003 ----- (Unaudited)
Cash flows from operating activities			
Net income	\$ 447	\$ 5	\$ 1,352
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	364	435	1,024
Non-cash compensation	-	-	(75)
Stock based compensation	-	19	-
Deferred income taxes	252	48	249
Changes in operating assets and liabilities			
Accounts receivable	(620)	1,424	(69)
Prepaid expenses and other current assets	148	84	168
Accounts payable	416	(346)	647
Income taxes	(228)	(41)	66
Accrued expenses and other	(124)	(650)	(2,328)
Deferred revenue	310	(569)	(948)
	-----	-----	-----
Net cash provided by (used in) operating activities	965	409	86
Cash flows from investing activities			
Acquisition of Compendit, net of cash (Increase)/Decrease in marketable securities	-	(1)	-
Purchases of property and equipment	(9,189)	981	2,484
	(94)	(431)	(301)
	-----	-----	-----
Net cash provided by (used in) investing activities	(9,283)	549	2,183
Cash flows from financing activities			
Proceeds from stock option and purchase plans	231	178	541
	-----	-----	-----
Net cash provided by financing activities	231	178	541
	-----	-----	-----
Effect of changes in exchange rates on cash	34	(14)	118
Increase (decrease) in cash and cash equivalents	(8,053)	1,122	2,928
Cash and cash equivalents, beg. of period	30,167	17,767	19,186
	-----	-----	-----
Cash and cash equivalents, end of period	\$ 22,114	\$ 18,889	\$ 22,114

Edgar Filing: INFORTE CORP - Form 10-Q

=====

See notes to consolidated financial statements

3

Notes to consolidated financial statements
(Unaudited)
September 30, 2004

(1) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared by Inforte Corp. ("Inforte") pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete consolidated financial statements and should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2003 included in Inforte's annual report on Form 10-K (File No. 000-29239). The balance sheet at December 31, 2003 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The accompanying consolidated financial statements reflect all adjustments (consisting solely of normal, recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of results for the interim periods presented. The results of operations for the three-month and nine-month periods ended September 30, 2004 are not necessarily indicative of the results to be expected for the full fiscal year. Certain previously reported amounts have been reclassified to conform with current presentation format.

(2) DILUTED EARNINGS PER COMMON SHARE

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

	Three Months Ended September 30,		Nine Months End September 30,	
	2003	2004	2003	
	(Unaudited)		(Unaudited)	
Basic weighted average shares	10,915,317	11,056,289	10,880,583	11,
Effect of dilutive stock options	139,929	127,050	111,974	
Diluted common and common equivalent shares	11,055,246	11,183,340	10,992,557	11,

(3) COMPREHENSIVE INCOME

Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive

Edgar Filing: INFORTE CORP - Form 10-Q

Income" (SFAS 130), establishes standards for reporting comprehensive income. Comprehensive income includes net income as currently reported under generally accepted accounting principles, and also considers the effect of additional economic events that are not required to be recorded in determining net income, but rather are reported as a separate component of stockholders' equity. Inforte reports foreign currency translation gains and losses, and unrealized gains and losses on investments, as components of comprehensive income. Total comprehensive income was \$460,477 and \$1,348,789 for the three and nine months ended September 30, 2003 and \$31,266 and \$659,568 for the three and nine months ended September 30, 2004.

(4) CONTINGENCIES

Inforte, Philip S. Bligh, an officer of Inforte, and Stephen C.P. Mack and Nick Padgett, both former officers of Inforte, have been named as defendants in *Mary C. Best v. Inforte Corp.; Goldman, Sachs & Co.; Salomon Smith Barney, Inc.; Philip S. Bligh; Stephen C.P. Mack and Nick Padgett*, Case No. 01 CV 10836, filed on November 30, 2001 in Federal Court in the Southern District of New York (the "Case"). The Case is among more than 300 putative class actions against certain issuers, their officers and directors, and underwriters with respect to such issuers' initial public offerings, coordinated as *In re Initial Public Offering Securities Litigation*, 21 MC 92 (SAS) (collectively, the "Multiple IPO Litigation"). An amended class action complaint was filed in the Case on April 19, 2002. The amended complaint in the Case alleges violations of federal

4

securities laws in connection with Inforte's initial public offering occurring in February 2000 and seeks certification of a class of purchasers of Inforte stock, unspecified damages, interest, attorneys' and expert witness fees and other costs. The amended complaint does not allege any claims relating to any alleged misrepresentations or omissions with respect to our business. The individual defendants (Messrs. Bligh, Mack and Padgett) have been dismissed from the case without prejudice pursuant to a stipulated dismissal and a tolling agreement. We have moved to dismiss the plaintiff's case. On February 19, 2002, the Court granted this motion in part, denied it in part and ordered that discovery in the case may commence. The Court dismissed with prejudice the plaintiff's purported claim against Inforte under Section 10(b) of the Securities Exchange Act of 1934, but left in place the plaintiff's claim under Section 11 of the Securities Act of 1933.

Inforte has entered into a Memorandum of Understanding (the "MOU"), along with most of the other defendant issuers in the Multiple IPO Litigation, whereby such issuers and their officers and directors (including Inforte and Messrs. Bligh, Mack and Padgett) will be dismissed with prejudice from the Multiple IPO Litigation, subject to the satisfaction of certain conditions. Under the terms of the MOU, neither Inforte nor any of its formerly named individual defendants admit any basis for liability with respect to the claims in the Case. The MOU provides that insurers for Inforte and the other defendant issuers participating in the settlement will pay approximately \$1 billion to settle the Multiple IPO Litigation, except that no such payment will occur until claims against the underwriters are resolved and such payment will be paid only if the recovery against the underwriters for such claims is less than \$1 billion and then only to the extent of any shortfall. Under the terms of the MOU, neither Inforte nor any of its named directors will pay any amount of the settlement. The MOU further provided that participating defendant issuers will assign certain claims they may have against the defendant underwriters in connection with the Multiple IPO Litigation. The MOU is subject to the satisfaction of certain conditions, including, among others, approval of the Court. Pursuant to the MOU, the parties have filed motions with the Court seeking certification of the class and approval of the settlement contemplated by the MOU. The Court has not yet ruled

Edgar Filing: INFORTE CORP - Form 10-Q

on the motions.

(5) SEGMENT REPORTING

Inforte engages in business activities in one operating segment, which provides consulting services either on a fixed-price, fixed-timeframe basis or on a time-and-materials basis. Inforte's services are delivered to clients in North America and Europe, and Inforte's long-lived assets are located in North America, Europe and India. Domestic and foreign operating revenues are based on the location of customers. Inforte's European operations had \$4,820,553 and \$6,531,831 of revenues for the nine months ending September 30, 2003 and 2004, respectively, and \$1,467,405 and \$2,120,237 of revenues for the three months ending September 30, 2003 and 2004, respectively. Asset information by operating segment is not reported to or reviewed by the chief operating decision maker, therefore, Inforte has not disclosed asset information for each operating segment or geographical location.

(6) STOCK BASED COMPENSATION

Inforte accounts for stock-based employee compensation in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123") related to options. For options issued to employees during the three and nine months ending September 30, 2003 no stock-based employee compensation is reflected in net income in the accompanying consolidated statements of operations, as all such options had an exercise price equal to the market value of the underlying common stock on the date of grant. Stock-based compensation expense of \$19,000 was recognized in the quarter ending September 30, 2004, \$7,000 of which was related to option grants related to the acquisition of COMPENDIT, Inc. ("COMPENDIT") and \$12,000 was related to grants of restricted stock. During the first nine months of 2004 we recognized a stock-based compensation expense of \$180,000, \$104,000 which was related to the COMPENDIT acquisition and \$76,000 was related to grants of restricted stock. Had we applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation during the three and nine months ended September 30, 2003 and 2004, net income and net income per share would have been as follows:

5

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,
	2003	2004	2003
	(Unaudited)	(Unaudited)	(Unaudited)
Net income, as reported	\$ 446,395	\$ 5,020	\$ 1,350,783
Add: Stock-based compensation expense recorded, net of related tax effects	-	19,135	-
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(1,481,971)	(1,026,914)	(4,082,644)
Pro forma net loss	\$ (1,035,576)	\$ (1,002,759)	\$ (2,731,861)

Edgar Filing: INFORTE CORP - Form 10-Q

Net income, per share:			
Basic -- as reported	0.04	0.00	0.12
	=====	=====	=====
Basic -- pro forma	(0.09)	(0.09)	(0.25)
	=====	=====	=====
Diluted -- as reported	0.04	0.00	0.12
	=====	=====	=====
Diluted -- pro forma	(0.09)	(0.09)	(0.25)
	=====	=====	=====

(7) ACQUISITIONS

On March 12, 2004, by way of a merger of a wholly owned subsidiary of Inforte with COMPENDIT, Inforte acquired all of the outstanding shares of COMPENDIT, a leading provider of SAP Business Intelligence implementation consulting services, for initial cash consideration of \$5.5 million on closing. An additional cash payment of \$0.5 million was paid in cash in May based on a closing statement calculation of cash less transaction costs. A supplementary cash amount of \$6.3 million will be paid in two equal amounts of \$3.15 million on January 2005 and on January 2006. This acquisition enhanced Inforte's ability to offer analytics and business intelligence solutions through COMPENDIT's services partnership with SAP.

The unaudited consolidated financial statements reflect a total purchase price of \$12.5 million, consisting of the following: (i) the payment of the initial cash consideration of \$5.5 million, (ii) transaction costs of \$0.2 million, (iii) additional cash consideration paid after closing of the acquisition of \$0.5 million, and (iv) earnout of \$6.3 million payable in January 2005 and January 2006. Under the purchase method of accounting, the purchase price is allocated to COMPENDIT's net tangible and intangible assets based upon their estimated fair value as of the date of the acquisition. The purchase price allocation is as follows (in thousands):

Tangible assets:	
Cash and cash equivalents.....	\$ 547
Accounts receivable and other current assets....	2,269
Property and equipment.....	156

Total tangible assets.....	2,972
Intangible assets:	
Goodwill and other intangible assets.....	11,864

Total assets.....	14,836

Liabilities assumed:	(2,310)

Net assets acquired.....	\$ 12,526
	=====

6

The following is a summary of intangible assets and goodwill as of September 30, 2004 (in thousands except for amortization life):

Gross carrying amount	Accumulated amortization	Net book value	Weighted average amortization life (months)
-----	-----	-----	-----

Edgar Filing: INFORTE CORP - Form 10-Q

Customer contracts	\$ 127	\$99	\$ 38	12
Goodwill	11,737	-	11,737	N/A
	-----	-----	-----	-----
Total	\$ 11,864	\$99	\$ 11,775	
	=====	=====	=====	

Goodwill represents the excess of the purchase price over the fair value of the tangible and intangible assets acquired. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill will not be amortized but will be tested for impairment at least annually.

There were no historical transactions between Inforte and COMPENDIT.

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

You should read the following discussion in conjunction with our consolidated financial statements, together with the notes to those statements, included elsewhere in this Form 10-Q. The following discussion contains forward-looking statements that involve risks, uncertainties, and assumptions such as statements of our plans, objectives, expectations and intentions. Our actual results may differ materially from those discussed in these forward-looking statements because of the risks and uncertainties inherent in future events that include, but are not limited to, those identified under the caption "Risk Factors" appearing in this 10-Q as well as factors discussed elsewhere in this Form 10-Q. Actual results may differ from forward-looking results for a number of reasons, including but not limited to, Inforte's ability to: (i) effectively forecast demand and profitably match resources with the demand during a period where information technology spending is not strong and when worldwide economic and geopolitical uncertainty is high; (ii) attract and retain clients and satisfy our clients' expectations; (iii) recruit and retain qualified professionals; (iv) accurately estimate the time and resources necessary for the delivery of our services; (v) build and maintain marketing relationships with leading software vendors while occasionally competing with their professional services organizations; (vi) compete with emerging alternative economic models for delivery, such as offshore development; (vii) effectively integrate newly acquired businesses, such as COMPENDIT; and (viii) identify and successfully offer the solutions that clients demand, as well as other factors discussed from time to time in our other Securities and Exchange Commission filings. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or projected. All forward-looking statements included in this document are made as of the date hereof, based on information available to Inforte on the date thereof, and Inforte assumes no obligation to update any forward-looking statements.

Overview

Inforte Corp. is a customer strategy and solutions consultancy that helps clients improve performance by tying together customer and corporate strategy. Inforte combines strong business and operational planning with innovative software solutions to ensure its Global 2000 client base serves the right customers in the right ways to generate the greatest return. Inforte executives are the authors of several leading books on customer strategy, marketing and business intelligence, including CRM Unplugged: Releasing CRM's Strategic Value, Enterprise Marketing Management: The New Science of Marketing, and Mastering the SAP Business Information Warehouse. Founded in 1993, Inforte is headquartered in Chicago and has offices in Atlanta; Dallas; Delhi, India; Hamburg, Germany; London; Los Angeles; New York; San Francisco; Walldorf, Germany; and Washington, D.C.

Edgar Filing: INFORTE CORP - Form 10-Q

Our revenue is derived almost entirely through the performance of professional services. The majority of our services are performed on a time and materials basis; however, we also perform services on a fixed-price basis if this structure best fits out clients' preferences or the requirements of the project. Typically, the first portion of an engagement involves a strategy project or a discovery phase lasting 30 to 60 days. This work enables us to determine with our clients the scope of successive phases of work. These successive phases of work can be additional strategy phases, or phases for technology design and implementation, and generally last three to nine months. If a project is to be performed on a fixed price basis, the fixed price is based upon estimates from

7

senior personnel in our consulting organization who project the length of the engagement, the number of people required to complete the engagement and the skill level and billing rates of those people. We then adjust the fixed price based on various qualitative risk factors such as the aggressiveness of the delivery deadline, the technical complexity of the solution and the value of the solution delivered to the client. We typically ask clients to pay 25%-50% of our fixed price projects in advance to enable us to secure a project team in a timeframe that is responsive to the client's needs.

The acquisition and integration of COMPENDIT, in the first quarter of 2004, was a factor in the increases in Inforte's consultant base, revenues and costs compared with prior year amounts. The effective date of the transaction was March 04, 2004 and, as such, the income statement for the nine months ended September 30, 2004 includes approximately seven months of results from operations for COMPENDIT.

RESULTS OF OPERATIONS

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

	% of Net Revenue Three Months Ended		% of Net Revenue Nine Months Ended	
	September 30, 2003	2004	September 30, 2003	2004
	-----	-----	-----	-----
Revenues				
Revenue before reimbursements (net revenue)	100.0%	100.0%	100.0%	100.0%
Reimbursements	17.6	14.5	12.5	14.2
	-----	-----	-----	-----
Total Revenue	117.6	114.5	112.5	114.2
	-----	-----	-----	-----
Operating expenses:				
Project personnel and related expenses	53.2	61.5	50.8	56.3
Reimbursements	17.6	14.5	12.5	14.2
Sales and marketing	13.5	10.2	16.3	11.4
Recruiting, retention and training	2.4	3.2	1.8	3.2
Management and administrative	27.7	27.3	30.1	26.0
	-----	-----	-----	-----
Total operating expenses *	114.3	116.8	111.4	111.2
	-----	-----	-----	-----

Edgar Filing: INFORTE CORP - Form 10-Q

Operating income	3.3	(2.2)	1.1	3.0
Interest income, net and other	3.3	2.3	5.1	2.2
	----	----	----	----
Pretax income	6.6	0.1	6.1	5.2
Income tax expense	0.8	0.1	0.6	2.1
	---	---	---	---
Net income	5.8%	0.0%	5.5%	3.1%
	====	====	====	====
*Total operating expenses, excluding reimbursements	96.7%	102.2%	98.9%	97.0%

Nine and three months ended September 30, 2003 and 2004

Net revenue. Net revenue excludes reimbursable expenses that are billed to our clients. Net revenue increased 49% to \$11.5 million for the quarter ended September 30, 2004 from \$7.7 million for the quarter ended September 30, 2003. Net revenue increased 42% to \$34.2 million for the nine months ended September 30, 2004 from \$24.1 million for the nine months ended September 30, 2003. We attribute this increase in revenues in part to the acquisition of our new SAP Practice which had revenue of approximately \$2.7 million in the quarter as well as to an increased demand for our other services. For the quarter ended September 30, 2004, we had 43 significant clients with each of these clients contributing, on average, \$1.0 million to revenue on an annualized basis. For the quarter ended September 30, 2003, we had 28 significant clients with each of these clients contributing, on average, \$1.1 million to revenue on an annualized basis.

8

Sequentially, net revenue dropped 4% to \$11.5 million in the September 2004 quarter from \$12.0 million in the June 2004 quarter. This sequential drop resulted primarily from normal seasonal effects and the commoditization of one of our service offerings.

Project personnel and related expenses. Project personnel and related expenses consist of compensation and benefits for our professional employees who deliver consulting services, non-reimbursable costs and any estimated revisions for our allowance for doubtful accounts. All labor costs for project personnel are included in project personnel and related expenses. These expenses increased 72% to \$7.1 million for the quarter ended September 30, 2004 from \$4.8 million for the quarter ended September 30, 2003. Year to date, project personnel and related expenses were \$19.8 million, a 53% increase from \$12.4 million for the first nine months of 2003. These increases resulted from growth in consulting headcount, increased compensation and an increased use of outside contractors. We employed 260 consultants on September 30, 2004, up from 148 one year earlier. This is an increase of 112 consultants which includes the addition of 48 consultants through the COMPENDIT acquisition completed in the first quarter of 2004. The remaining consultant headcount increase was a function of the ongoing recruiting efforts. Project personnel and related expenses represented 61.5% of net revenue for the quarter ended September 30, 2004, up from 53.2% for the quarter ended September 30, 2003, as revenue grew at a slower rate than project personnel and related expenses did. Similarly, for the nine months ended September 30, 2004, project personnel and related expenses represented 58.1% of

Edgar Filing: INFORTE CORP - Form 10-Q

net revenue up from 51.6% in the prior year period. Project personnel and related expenses may decrease in subsequent quarters due to our continuous efforts to align consulting headcount with current revenue forecast.

Sales and marketing. Sales and marketing expenses consist primarily of compensation, benefits, bonus and travel costs for employees in the marketing and sales groups and costs to execute marketing programs. Sales and marketing expenses increased 13% to \$1.2 million, or 10.2% of net revenue, for the quarter ended September 30, 2004 from \$1.0 million, or 13.5% of net revenue, in quarter ended September 30, 2003. This increase is due to a combination of intensified marketing activities and higher performance based compensation payable to sales personnel. Sales and marketing expenses increased by 1% to \$3.8 million for the nine months ended September 30, 2004 from \$3.7 million for the nine months ended September 30, 2003. Year to date, sales and marketing expenses were 11.0% of net revenue compared to 15.4% in the prior year period.

Recruiting, retention and training. Recruiting, retention and training expenses consist of compensation, benefits and travel costs for personnel engaged in human resources activities; costs to recruit new employees; costs of human resource programs; and training costs. These expenses increased 102% to \$370,000 for the quarter ended September 30, 2004 from \$183,000 for the quarter ended September 30, 2003. As a percent of net revenue, these costs increased to 3.2% in the quarter ended September 30, 2004 from 2.4% in the quarter ended September 30, 2003. Year to date, recruiting, retention and training costs increased by 132% from \$435,000 for the nine months ended September 30, 2003 to \$1.1 million for the nine months ended September 30, 2004. As a percent of net revenue, these costs increased to 3.2% in the nine months ended September 30, 2004 from 2.0% for the nine months ended September 30, 2003. The increase in spending results primarily from more recruiting costs due to the increase in the number of personnel recruited, more human resources spending due to higher company-wide headcount and the reinstatement of formal training programs. As our staffing needs increase, recruiting efforts require spending on recruiting finder fees, signing bonuses, relocation allowances and employee referral bonuses to identify and attract qualified candidates. Total headcount was 310 as of September 30, 2004 and 187 as of September 30, 2003. At the time of the acquisition of our SAP practice total headcount increased by 54 people.

Management and administrative. Management and administrative expenses consist primarily of compensation, benefits and travel costs for management, finance, information technology and facilities personnel, together with rent, telecommunications, audit, legal, business insurance and depreciation and amortization of capitalized computers, purchased software and property. These expenses increased 47% to \$3.1 million for the quarter ended September 30, 2004, from \$2.1 million for the quarter ended September 30, 2003. As a percent of net revenue, management and administrative expenses were 27.3% for the quarter ended September 30, 2004, down from 27.7% for the quarter ended September 30, 2003, as management and administrative expenses grew at a lower rate than revenue did. Year to date, management and administrative expenses increased 28% to \$9.0 million for the nine months ended September 30, 2004 from \$7.1 million for the nine months ended September 30, 2003. As a percent of revenue, management and administrative expenses fell to 26.5% for the nine months ended September 30, 2004 from 29.3% for the nine months ended September 30, 2003. Higher management and administrative expenses, in particular executive and operation-management related costs, for the three months ending September 30, 2004 were due to

9

increased efforts to build the infrastructure supporting faster revenue growth. Our plan to set up and make fully functional our India location was successfully completed as of the end of the first quarter of 2004. There were also additional

Edgar Filing: INFORTE CORP - Form 10-Q

legal and finance costs for Sarbanes-Oxley, SEC and NASDAQ compliance and rent for offices in Chicago and Hamburg, Germany associated with the acquisition of COMPENDIT. Management and administrative employees were 28 and 19 as of September 30, 2004 and September 30, 2003, respectively.

On October 1, 2004, Inforte's executive team authorized a plan to reduce its office space to better align with its space needs. The total reduction of office space resulting from this consolidation of our office space was approximately 41,345 square feet, all of which was vacated as of October 1, 2004. Total charges related to this reduction of space are estimated at \$2.0 million and will be recognized on the statement of operations in the fourth quarter of 2004.

Interest income, net and other. During the quarter ended September 30, 2004, interest income, net and other, was \$267,000, up from \$257,000 for the quarter ended September 30, 2003. Year to date interest income, net and other was \$773,000, down from \$1.1 million for the same period in 2003. This decrease in year-to-date investment earnings was due to the reinvestment of matured securities into similar type securities at lower market interest yields and also due to the lower average cash balances. We expect interest income, net and other, to decline further to around \$240,000 in the fourth quarter of 2004 due to lower cash balances, because of the COMPENDIT acquisition, as of the end of the third quarter of 2004 relative to prior quarters.

Income tax expense. Inforte's effective tax rate for the September 2004 quarter was 40.0% compared to a rate of 12.8% for the September 2003 quarter. The unusually low effective tax rate in 2003 resulted from our reduction of income tax expense by \$125,000 in the September 30, 2003 quarter to account for an estimated reduction of income tax liabilities. The effective tax rate of 40% in the third quarter of 2004 approximates our blended statutory tax rate, reflecting immaterial permanent differences between taxable income for financial reporting and tax purposes. The 2004 year-to-date effective tax rate was 40.0% compared to 11.0% for the same period in 2003. During the year-to-date period to September 30, 2003 we reduced income tax expense by \$375,000 to account for an estimated reduction of income tax liabilities.

Liquidity and capital resources. Cash and cash equivalents increased from \$17.8 million on June 30, 2004 to \$18.9 million on September 30, 2004. Short-term marketable securities increased from \$22.3 million to \$25.5 million over the same period. Long-term marketable securities decreased from \$18.4 million to \$14.1 million during the third quarter of 2004. In total, cash and cash equivalents, short-term and long-term marketable securities stayed at the same level of \$58.5 million on September 30, 2004 compared to June 30, 2004. Short-term and long-term marketable securities are available-for-sale securities consisting of commercial paper, U.S. government or municipal notes and bonds, corporate bonds and corporate auction preferreds.

During the September 2004 quarter, Inforte's cash flow from operations was \$409,000 and capital expenditures were \$431,000, resulting in negative \$22,000 free cash flow (cash flow from operation minus capital expenditures). Additionally, financing activities resulted in a cash inflow of \$178,000 from employees participating in stock purchase and stock option plans.

Year-to-date cash and cash equivalents dropped by \$5.2 million from \$24.1 million on December 31, 2003 to \$18.9 million on September 30, 2004. Short-term marketable securities stayed at the same level at \$25.5 million on December 31, 2003 and September 30, 2004. Long-term marketable securities dropped by \$4.1 million from \$18.2 million on December 31, 2003 to \$14.1 million on September 30, 2004.

Cash flow from operations for the nine months ending September 30, 2004 was negative \$2.6 million. Capital expenditure for the nine months ending September 30, 2004 was \$841,000, resulting in a free cash flow of negative \$3.5 million.

Edgar Filing: INFORTE CORP - Form 10-Q

Additionally, financing activities resulted in a cash inflow of \$593,000 from employee participating in stock purchase and stock option plans.

Our board of directors approved a \$25.0 million stock repurchase program on January 24, 2001 and as of August 2002, the entire amount authorized was repurchased. The board of directors approved an additional \$5.0 million stock repurchase program on August 22, 2002, although we stated at that time that we had no present plans to make additional repurchases of stock. The entire \$5.0 million remains authorized for repurchase as of September 30, 2004. At quarter end, Inforte had 11,065,218 shares outstanding and \$58.5 million in cash and marketable securities, resulting in \$5.29 of cash and marketable securities per basic share. As of September 30, 2004, the public float (shares not held by

10

executive officers and directors) totaled 7.1 million shares or 64% of total outstanding shares.

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

All highly liquid investments with maturities of three months or less when purchased are considered cash equivalents. Cash and cash equivalent balances consist of obligations of U.S. and other overseas banks, high-grade commercial paper and other high quality, short-term obligations of U.S. companies. Short-term and long-term marketable securities are available-for-sale securities that are recorded at fair market value. The difference between amortized cost and fair market value, net of tax effect, is shown as a separate component of stockholders' equity. The cost of available-for-sale securities is adjusted for amortization of premiums and discounts to maturity. Interest and amortization of premiums and discounts for all securities are included in interest income.

As of September 30, 2004, Inforte had a total of up to \$6.3 million in deferred business acquisition obligations payable in cash in January 2005 and 2006. Inforte believes that it will have sufficient funds to satisfy obligations related to the deferred consideration. We expect to fund these contingent payments, primarily from the cash generated from the operations of the acquired business. In addition to the purchase price obligation for the COMPENDIT acquisition, Inforte assumed two operating leases from COMPENDIT, related to office space.

Inforte has several operating leases that have contractual cash obligations for future payments. There are no other contractual obligations that require future cash obligations or other commitments. The table below identifies all future commitments.

Contractual Obligations	Payments Due by Period (in thousands)		
	Total	Q4 2004	2005
Long-term debt	0	0	0
Capital lease obligations	0	0	0
Operating leases	5,126	721	2,876
Unconditional purchase obligations	0	0	0

Edgar Filing: INFORTE CORP - Form 10-Q

Other long-term obligations	0	0	0
Total contractual cash obligations	5,126	721	2,876

11

Critical Accounting Policies

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions, which it believes are reasonable. If actual amounts are ultimately different from these estimates, the revisions are included in the Company's results of operations for the period in which the actual amounts become known. Accounting policies are considered critical when they require management to make assumptions about matters that are highly uncertain at the time the estimate is made and when different estimates than management reasonably could have used have a material impact on the presentation of our financial condition, changes in financial condition or results of operations.

Revenue recognition, losses on fixed-price contracts, deferred revenue. We recognize revenue when all of the following four criteria are met: persuasive evidence exists that we have an agreement, service has been rendered, our price is fixed or determinable and collectibility is reasonably assured. We recognize net revenue from fixed-price contracts based on the ratio of hours incurred to total estimated hours. The cumulative impact of any change in estimated hours to complete is reflected in the period in which the changes become known. We recognize time-and-materials net revenue as we perform the services. In November 2001, the Financial Accounting Standards Board's Emerging Issues Task Force issued Topic 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred" stating these costs should be characterized as revenue in the income statement if billed to customers. For each quarter beginning with the March 31, 2002 quarter, we included reimbursable expenses in revenue and expense and we have reclassified prior periods in the comparative consolidated financial statements as required by the Financial Accounting Standards Board. This reclassification had no effect on current or previously reported net income (loss) per share. For presentation purposes, we show two components of total revenue: 1) revenue before reimbursements, which we call net revenue, consisting of revenue for performing consulting services; and 2) reimbursements, consisting of reimbursements we receive from clients for out-of-pocket expenses incurred. We believe net revenue is a more meaningful representation of our economic activity than total revenue since it excludes pass-through, zero-margin expense reimbursements.

Financial Instruments. Short-term and long-term marketable securities are available-for-sale securities which are recorded at fair market value. The difference between amortized cost and fair market value, net of tax effect, is shown as a separate component of stockholders' equity. The cost of securities available-for-sale is adjusted for amortization of premiums and discounts to maturity. Interest and amortization of premiums and discounts for all securities are included in interest income.

Allowance for doubtful accounts. An allowance for doubtful accounts is

Edgar Filing: INFORTE CORP - Form 10-Q

maintained for potential credit losses. The amount of the reserve is established analyzing all client accounts to determine credit risk. In establishing a client's creditworthiness we consider whether the client has a deteriorating or poor financial condition, limited financial resources, poor or no payment history, a large relative accounts receivable balance or a non-U.S. location.

Stock compensation. We account for stock-based employee compensation in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and have adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123") related to options issued to employees. All options granted under our plans had an exercise price equal to the market value of the underlying common stock on the date of grant, except for the option grants related to the acquisition of COMPENDIT.

Bonus accruals. We have several bonus programs that are based on individual and company performance. Revenue bonuses are earned based on individual or roll up revenue credit assigned to salespeople, client executives, other senior delivery personnel and senior management. Margin bonuses are earned by all employees based on company or business unit operating income performance. In addition, senior management may award discretionary bonuses. All of these bonuses are expensed in the period in which they are earned. A corresponding accrual is included on the balance sheet in accrued expenses until the bonus is paid.

12

Income Taxes. We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes ("SFAS 109"), which requires the recognition of deferred income taxes based upon the tax consequences of temporary differences between financial reporting and income tax reporting by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion of the deferred tax asset will not be realized.

In connection with the preparation of our consolidated financial statements, we are required to estimate our income tax liability for each of the tax jurisdictions in which we operate. This process involves estimating our actual current income tax expense and assessing temporary differences resulting from differing treatment of certain income or expense items for income tax reporting and financial reporting purposes. We also recognize as deferred tax assets the expected future tax benefits of net operating loss carry forwards. In evaluating the realizability of deferred tax assets associated with net operating loss carry forwards, we consider, among other things, expected future taxable income, the expected timing of the reversals of existing temporary reporting differences, and the expected impact of tax planning strategies that may be implemented to prevent the potential loss of future tax benefits. Changes in, among other things, income tax legislation, statutory income tax rates or future taxable income levels could materially impact the valuation of income tax assets and liabilities and could cause our income tax provision to vary significantly among financial reporting periods.

Risk Factors

In addition to other information in this Form 10-Q, the following risk factors should be carefully considered in evaluating Inforte and its business because such factors currently may have a significant impact on Inforte's business, operating results and financial condition. As a result of the risk factors set

Edgar Filing: INFORTE CORP - Form 10-Q

forth below and elsewhere in this Form 10-Q, and the risk factors discussed in Inforte's other Securities and Exchange Commission filings, actual results could differ materially from those projected in any forward-looking statements.

If we fail to identify and successfully transition to the latest and most demanded solutions or keep up with an evolving industry, we will not compete successfully for clients and our profits may decrease. If we fail to identify the latest solutions, or if we identify but fail to successfully transition our business to solutions with growing demand, our reputation and our ability to compete for clients and the best employees could suffer. If we cannot compete successfully for clients, our revenues may decrease. Also, if our projects do not involve the latest and most demanded solutions, they would generate lower fees. Because our market changes constantly, some of the most important challenges facing us are the need to:

- o develop new services that meet changing customer needs;
- o identify and effectively market solutions with growing demand during a period of slower technological advancement and adoption;
- o enhance our current services;
- o continue to develop our strategic expertise;
- o effectively use the latest technologies; and
- o influence and respond to emerging industry standards and other technological changes.

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

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

13

We may be unable to hire and retain employees who are highly skilled, which would impair our ability to perform client services, generate revenue and maintain profitability. If we are unable to hire and retain highly-skilled individuals, our ability to retain existing business and compete for new business will be harmed. Individuals who have successfully sold and delivered services similar to those we provide to our clients are limited and competition for these individuals is intense. Further, individuals who were previously successful in a different business environment may no longer be successful. Identifying individuals who will succeed in this environment is extraordinarily difficult. To attract and retain these individuals, we invest a significant amount of time and money. In addition, we expect that both bonus payments and equity ownership will be an important component of overall employee compensation. In the current economic and market environment, overall bonus payments have been below target, increasing the risk that key employees will leave Inforte. Also, if our stock price does not increase over time, it may be more difficult to retain employees who have been compensated with stock options. Options granted to employees from the IPO date, February 17, 2000, through September 30, 2004 have exercise prices of \$2.90 to \$71.81. The average exercise price of all options outstanding at September 30, 2004 is \$11.97. Since the

Edgar Filing: INFORTE CORP - Form 10-Q

market price for Inforte stock has recently been below this average strike price, it may be more difficult to retain employees. If key employee turnover rates grow to unacceptable levels because compensation is not at competitive rates, Inforte may increase the level of stock option grants or cash compensation. These actions would reduce net income per share and may cause Inforte to become unprofitable.

If the new proposal on stock option expensing is adopted our reported earnings will be negatively impacted. If we expense stock options, our earnings will be reduced and we may be unable to stay profitable. In addition we may decide to change our compensation practices to further reduce the granting of stock options, this could lead to increased cash compensation expense and could also impact our ability to attract and retain key employees and executives.

If we fail to adequately manage rapid changes in demand, our profitability and cash flow may be reduced or eliminated. If we cannot keep pace with the rapid changes in demand, we will be unable to effectively match resources with demand, and maintain high client satisfaction, which may eliminate our profitability and our ability to achieve positive free cash flow. Our business grew dramatically from 1993 through 2000. For example, our net revenue increased by 100% or more for seven consecutive years, reaching \$63.8 million in 2000. As a result of the pricing pressures from competitors and from clients facing pressure to control costs, net revenue has declined in each of the last three years, dropping to \$32.7 million in 2003. If our revenues decline further, we may not be profitable or achieve positive free cash flow. If, on the other hand, our growth exceeds our expectations, our current resources and infrastructure may be inadequate to handle the growth.

If our marketing relationships with software vendors deteriorate, we would lose their client referrals. If these vendors continue to increase their professional services revenue, our revenue could be adversely affected. We currently have marketing relationships with software vendors, including SAP, Siebel Systems, Inc., Vignette and Unica. Although we have historically received a large number of business leads from these and other software vendors to implement their products, they are not required to refer business to us and they may terminate these relationships at any time. If our relationships with these software vendors deteriorate, we may lose their client leads and our ability to develop new clients could be negatively impacted. Any decrease in our ability to obtain clients may cause a reduction in our net revenues. Historically our software partners have primarily relied on licensing fees and maintenance contracts to generate revenue. However, more recently as software licensed sales have declined, software vendors have sought to supplement their revenue through increased implementation services for their software. This business strategy puts us in competition with our software partners on some deals, reducing client leads and our ability to develop new clients and revenue. We no longer receive a significant portion of our leads through our software vendor relationships.

If we are unable to rapidly integrate third-party software, we may not be able to deliver solutions to our clients on a timely basis, resulting in lost revenues and potential liability. In providing client services, we recommend that our clients use software applications from a variety of third-party vendors. If we are unable to implement and integrate this software in a fully functional manner for our clients, we may experience difficulties that could delay or prevent the successful development, introduction or marketing of services. Software often contains errors or defects, particularly when first introduced or when new versions or enhancements are released. Despite internal testing and testing by current and potential clients, our current and future solutions may contain serious defects due to third-party software or software we

Edgar Filing: INFORTE CORP - Form 10-Q

develop or customize for clients. Serious defects or errors could result in liability for damages, lost revenues or a delay in implementation of our solutions.

Our revenues could be negatively affected by the loss of a large client or our failure to collect a large account receivable. At times, we derive a significant portion of our revenue from large projects for a limited number of varying clients. During the third quarter of 2004 our five largest clients accounted for 34% of net revenue and our ten largest clients accounted for 52% of net revenue. In the same quarter we had one client contributing more than 10% of quarterly net revenue. Although these large clients vary from time to time and our long-term revenues do not rely on any one client, our revenues could be negatively affected if we were to lose one of our top clients or if we were to fail to collect a large account receivable. In addition, many of our contracts are short-term and our clients may be able to reduce or cancel our services without incurring any penalty. If our clients reduce or terminate our services, we would lose revenue and would have to reallocate our employees and our resources to other projects to attempt to minimize the effects of that reduction or termination. Accordingly, terminations, including any termination by a major client, could adversely impact our revenues. We believe the uncertain economic environment increases the probability that services may be reduced or canceled.

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

Fluctuations in our quarterly revenues and operating results due to cyclical client demand may lead to reduced prices for our stock. Our quarterly revenues and operating results have fluctuated significantly in the past and we expect them to continue to fluctuate significantly in the future. Historically, we have experienced our greatest sequential growth during the first and second quarters. We typically experience significantly lower sequential growth in the third and fourth quarters. We attribute this to the budgeting cycles of our customers, most of whom have calendar-based fiscal years and as a result are more likely to initiate projects during the first half of the year. In 2001, this traditional seasonal pattern was overwhelmed by a cyclical decline in information technology spending, causing our net revenue to decline sequentially in each quarter of 2001. In February and March 2002, we did experience an increase in demand which did allow our net revenue in the second quarter 2002 to exceed the first quarter 2002 level. We believe that increase in demand was due to positive seasonal effects, while the subsequent lower revenue in the third quarter 2002 was due to negative seasonal effects. In 2003, our net revenue declined sequentially for the first three quarters of the year. We believe our traditional seasonal pattern was overwhelmed by geopolitical events that took place early in 2003, the most notable of these events being the war in Iraq. In the beginning of 2004 there was increased demand due to our development of new service offerings and a general pick-up in the economy, the third quarter of 2004 was impacted by normal seasonal effects and the commoditization of one of our service offerings. This existence of seasonal, cyclical and service offering effects makes it more difficult to predict demand, and if we are unable to predict client demand accurately in a slower growth or distressed economic environment, our expenses may be disproportionate to our revenue on a quarterly basis and our stock price may be adversely affected.

Others could claim that we infringe on their intellectual property rights, which may result in substantial costs, diversion of resources and management attention, and harm to our reputation. A portion of our business involves the development of software applications for specific client engagements. Although we believe that our services do not infringe on the intellectual property rights of others, we may be the subject of claims for infringement, which even if successfully defended could be costly and time-consuming. An infringement claim against us could materially and adversely affect us in that we may:

- o experience a diversion of our financial resources and management attention;
- o incur damages and litigation costs, including attorneys' fees;
- o be enjoined from further use of the intellectual property;
- o be required to obtain a license to use the intellectual property, incurring licensing fees;
- o need to develop a non-infringing alternative, which could be costly and delay projects; and
- o have to indemnify clients with respect to losses incurred as a result of our infringement of the intellectual property.

Because we are newer and smaller than many of our competitors, we may not have the resources to effectively compete, causing our revenues to decline. Many of our competitors have longer operating histories, larger client bases, longer relationships with clients, greater brand or name recognition, and significantly greater financial, technical, marketing, and public relations resources than we do. We may be unable to compete with full-service consulting companies, including the former consulting divisions of the largest global accounting firms, who are able to offer their clients a wider range of services. If our clients decide to take their strategy and technology projects to these companies, our revenues may decline. It is possible that in uncertain economic times our clients may prefer to work with larger firms to a greater extent than normal. In addition, new professional services companies may provide services similar to ours at a lower price, which could cause our revenues to decline.

Our expansion and growth internationally could negatively affect our business. For the third quarter of 2004, our international net revenue was 25% of total net revenue. There are additional risks associated with international operations, which we do not face domestically and we may assume even higher levels of such risk as we expand our ventures in Europe and India. Risk factors associated with international operations include longer customer payment cycles, adverse taxes and compliance with local laws and regulations. Further, the effects of fluctuations in currency exchange rates may adversely affect the results of operations. Finally, as the U.S. economic slowdown has spread to the rest of the world, our ability to obtain international revenues may be reduced in the future. These risk factors, among others not cited here, may negatively impact our business.

As offshore development becomes accepted as a viable alternative to doing work domestically, our pricing and revenue may be negatively affected. Gradually, over the past several decades, numerous IT service firms have been founded in countries such as India, which have well-educated and technically trained English-speaking workforces available at wage rates that are only a fraction of U.S. and European wages rates. Additionally, some larger clients have established internal IT operations at offshore locations. While traditionally we have not competed with offshore development, presently this form of development is seeing rapid and increasing acceptance in the market, especially for routine and repetitive types of development. While offshore development has greater risk

Edgar Filing: INFORTE CORP - Form 10-Q

due to distance, geopolitical and cultural issues, we believe its lower cost advantage will likely overwhelm these risks. If we are unable to evolve our service offerings to a more differentiated position or if the rate of acceptance of offshore development advances even faster than we anticipate, then our pricing and our revenue may be negatively affected. Moreover, we have recently established an offshore development capability in New Delhi, India. If we are unable to adequately manage the additional complexity of these operations and this model for project delivery it may impact project quality and overall company profitability.

Current or future legislative and regulatory requirements, such as the Sarbanes-Oxley Act of 2002, may lead to increased insurance, accounting, legal and other costs, which may cause our profitability to decline. We have already switched some supplier relationships, including our audit and tax advisor relationship to mitigate these cost increases, and other relationships are under review. On September 8, 2003, the Audit Committee of the Board of Directors approved (1) the dismissal of Ernst & Young LLP (E&Y) as the Company's independent accountants, effective November 15, 2003, and (2) the replacement of E&Y with Grant Thornton LLP as the Company's independent accountants, commencing upon the dismissal of E&Y. The replacement of E&Y with Grant Thornton LLP was based on economic reasons related to possible future fees escalation in current

16

and forthcoming engagements of the Company's independent accountants. In addition, the implementation of the Sarbanes-Oxley Act, particularly Section 404 with respect to management reporting and certification of disclosure of internal control over financial reporting, will be a significant new expense for the balance of 2004 and for 2005 and will also increase our ongoing audit costs by a large amount. This may lead to a decline in profitability especially if our revenue does not continue to grow.

We may not be able to integrate successfully the business of recently acquired COMPENDIT, Inc. with Inforte's business. While we believe that our recently closed acquisition of COMPENDIT, Inc., a leading provider of SAP Business Intelligence implementation consulting services, will enhance our ability to offer analytics and business intelligence solutions to our customers, the Inforte and COMPENDIT businesses may not be integrated successfully. It could lead to the loss of key employees, customers or service partners or other negative impacts. Failure to integrate COMPENDIT's business successfully could result in an inability to maintain revenue levels or to realize certain synergies of the acquisition, which, in turn, may negatively impact our operating results.

RISKS RELATED TO OUR INDUSTRY

If the rate of adoption of advanced information technology slows substantially, our revenues may decrease. We market our services primarily to firms that want to adopt information technology that provides an attractive return on investment or helps provide a sustainable competitive advantage. Our revenues could decrease if companies decide not to integrate the latest technologies into their businesses due to economic factors, governmental regulations, financial constraints or other reasons. Inforte's market research suggests that the level of information technology spending in the United States is closely linked with the growth rate of the Gross Domestic Product (GDP). The slowdown in the U.S. GDP growth rate that began in the second half of 2000 has caused a slower rate of adoption of advanced information technology by our target clients. We expect information technology spending and Inforte revenue to be highly dependent on the health of the U.S. economy. We believe that corporate revenue-driven profit growth must resume for IT spending to improve. If the overall level of business

Edgar Filing: INFORTE CORP - Form 10-Q

capital investment remains depressed or declines further, this may cause our revenue to decline further.

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

Geopolitical instability may cause our revenues to decrease. Our clients often avoid large spending commitments during periods of geopolitical instability and economic uncertainty. The possibility of terrorists attacking United States' interests or geopolitical concerns in other areas such as the Middle East, south Asia and North Korea may cause clients to freeze or slow their decision making processes. This would slow demand for our services and would negatively impact our revenue.

RISKS RELATED TO THE OWNERSHIP OF OUR COMMON STOCK

Our stock price could be extremely volatile, like many technology stocks. The market prices of securities of technology companies, particularly professional services companies, have been highly volatile. We expect continued high volatility in our stock price, with prices at times bearing no relationship to Inforte's operating performance. Inforte's average trading volume during the third quarter of 2004 averaged approximately 41,000 shares per day. On any particular day, Inforte's trading volume can be less than 5,000 shares, increasing the potential for volatile stock prices.

Volatility of our stock price could result in expensive class action litigation. If our common stock suffers from volatility like the securities of other technology companies, we have a greater risk of further securities class action litigation claims. One such claim is pending presently. Litigation could result

17

in substantial costs and could divert our resources and senior management's attention. This could harm our productivity and profitability.

Officers and directors own a significant percentage of outstanding shares and, as a group, may control a vote of stockholders. As of September 30, 2004 our executive officers and directors beneficially own over 36% of the outstanding shares of our common stock. The largest owners and their percentage ownership are set forth below:

- o Philip S. Bligh 21.4%
- o Stephen C.P. Mack 13.1%

If the stockholders listed above act or vote together with other employees who own significant shares of our common stock, they may have the ability to control the election of our directors and the approval of any other action requiring stockholder approval, including any amendments to the certificate of incorporation and mergers or sales of all or substantially all assets, even if

Edgar Filing: INFORTE CORP - Form 10-Q

the other stockholders perceive that these actions are not in their best interests. Our stock repurchase program has had the effect of increasing the concentration of insider ownership. If we make further repurchases, the percentage of insider ownership could increase further. Over time, the influence or control executive officers have on a stockholder vote may decrease as officers supplement below market salaries and diversify overall equity wealth with sales of Inforte stock. As permitted by SEC Rule 10b5-1, Inforte executive officers have or may set up a predefined, structured stock trading program. The trading program allows brokers acting on behalf of company insiders to trade company stock during company blackout periods or while the insiders may be aware of material, nonpublic information, if the transaction is performed according to a pre-existing contract, instruction or plan that was established with the broker during a non-blackout period and when the insider was not aware of any material, non-public information. Inforte executive officers may also trade company stock outside of plans set up under SEC Rule 10b5-1; however, such trades would be subject to company blackout periods and insider trading rules.

The authorization of preferred stock, a staggered board of directors and supermajority voting requirements will make a takeover attempt more difficult, even if the takeover would be favorable for stockholders. Inforte's certificate of incorporation and bylaws may have the effect of deterring, delaying or preventing a change in control of Inforte. For example, our charter documents provide for:

- o the ability of the board of directors to issue preferred stock and to determine the price and other terms, including preferences and voting rights, of those shares without stockholder approval;
- o the inability of our stockholders to act by written consent or to call a special meeting;
- o advance notice provisions for stockholder proposals and nominations to the board of directors;
- o a staggered board of directors, with three-year terms, which will lengthen the time needed to gain control of the board of directors; and
- o supermajority voting requirements for stockholders to amend provisions of the charter documents described above.

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

18

Item 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

In all categories of cash, cash equivalents and short-term and long-term marketable securities, Inforte invests only in highly liquid securities of high credit quality. All short-term investments bear a minimum Standard & Poor's rating of A1 or Moody's investor service rating of P1. All long-term investments bear a minimum Standard & Poor's rating of A or Moody's investor service rating of A2.

Inforte has a large cash and marketable securities balance that generates substantial interest income. During 2003 and year-to-date in 2004, a considerable portion of Inforte's pretax income was from interest income.

Edgar Filing: INFORTE CORP - Form 10-Q

Declining short-term market interest rates will have a significant impact on Inforte's profitability as interest income drops. Thus, a drop in short-term market interest rates will increase the revenue level required to be profitable, and increases the risk that Inforte will lose money.

Item 4. CONTROLS AND PROCEDURES

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934, Inforte's management, including Inforte's Chief Executive Officer and Chief Financial Officer, conducted an evaluation, as of the end of the period covered by this report, of the effectiveness of Inforte's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on that evaluation, Inforte's Chief Executive Officer and Chief Financial Officer concluded that Inforte's disclosure controls and procedures were effective as of the end of the period covered by this report. As required by Rule 13a-15(d) under the Securities Exchange Act of 1934, Inforte's management, including Inforte's Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of Inforte's internal control over financial reporting to determine whether any changes occurred during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, Inforte's internal control over financial reporting. Based on that evaluation, there has been no such change during the quarter covered by this report.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Inforte, Philip S. Bligh, an officer of Inforte, and Stephen C.P. Mack and Nick Padgett, both former officers of Inforte, have been named as defendants in *Mary C. Best v. Inforte Corp.; Goldman, Sachs & Co.; Salomon Smith Barney, Inc.; Philip S. Bligh; Stephen C.P. Mack and Nick Padgett*, Case No. 01 CV 10836, filed on November 30, 2001 in Federal Court in the Southern District of New York (the "Case"). The Case is among more than 300 putative class actions against certain issuers, their officers and directors, and underwriters with respect to such issuers' initial public offerings, coordinated as *In re Initial Public Offering Securities Litigation*, 21 MC 92 (SAS) (collectively, the "Multiple IPO Litigation"). An amended class action complaint was filed in the Case on April 19, 2002. The amended complaint in the Case alleges violations of federal securities laws in connection with Inforte's initial public offering occurring in February 2000 and seeks certification of a class of purchasers of Inforte stock, unspecified damages, interest, attorneys' and expert witness fees and other costs. The amended complaint does not allege any claims relating to any alleged misrepresentations or omissions with respect to our business. The individual defendants (Messrs. Bligh, Mack and Padgett) have been dismissed from the case without prejudice pursuant to a stipulated dismissal and a tolling agreement. We have moved to dismiss the plaintiff's case. On February 19, 2002, the Court granted this motion in part, denied it in part and ordered that discovery in the case may commence. The Court dismissed with prejudice the plaintiff's purported claim against Inforte under Section 10(b) of the Securities Exchange Act of 1934, but left in place the plaintiff's claim under Section 11 of the Securities Act of 1933.

Inforte has entered into a Memorandum of Understanding (the "MOU"), along with most of the other defendant issuers in the Multiple IPO Litigation, whereby such issuers and their officers and directors (including Inforte and Messrs. Bligh, Mack and Padgett) will be dismissed with prejudice from the Multiple IPO Litigation, subject to the satisfaction of certain conditions. Under the terms of the MOU, neither Inforte nor any of its formerly named individual defendants admit any basis for liability with respect to the claims in the Case. The MOU provides that insurers for Inforte and the other defendant issuers participating in the settlement will pay approximately \$1 billion to settle the Multiple IPO Litigation, except that no such payment will occur until claims against the

Edgar Filing: INFORTE CORP - Form 10-Q

underwriters are resolved and such payment will be paid only if the recovery against the underwriters for such claims is less than \$1 billion and then only to the extent of any shortfall. Under the terms of the MOU, neither Inforte nor any of its named directors will pay any amount of the settlement. The MOU

19

further provided that participating defendant issuers will assign certain claims they may have against the defendant underwriters in connection with the Multiple IPO Litigation. The MOU is subject to the satisfaction of certain conditions, including, among others, approval of the Court. Pursuant to the MOU, the parties have filed motions with the Court seeking certification of the class and approval of the settlement contemplated by the MOU. The Court has not yet ruled on the motions.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

In January 2001, Inforte announced that the board of directors approved a stock repurchase program that allows Inforte to buy up to \$25 million of Inforte shares. The program was completed in August 2002. The board of directors approved an additional \$5.0 million stock repurchase program on August 22, 2002. We stated at that time that we had no present plans to make additional repurchases of stock, and as of September 30, 2004, we have made no repurchases under this second program.

Item 3. Defaults upon Senior Securities

None

Item 4. Submission of Matter to a Vote of Security Holders

None

Item 5. Other Information

Effective August 9, 2004, John Morphy resigned as a director of Inforte. There are no disagreements between Mr. Morphy and Inforte relating to Inforte's operations, policies or practices.

20

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit Number -----	Exhibit -----
31.1	Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and Rule 13a-14(a) and 15d-14(a) under the

Edgar Filing: INFORTE CORP - Form 10-Q

Securities and Exchange Act
of 1934.

32

Written statement of the Chief
Executive Officer and Chief Financial
Officer pursuant to 18 U.S.C. ss.1350.

(b) Reports on Form 8-K

In a Report on Form 8-K furnished on July 27, 2004, Inforte reported, under Item 12, "Results of Operation and Financial Condition," the issuance of a press release regarding earnings for the second quarter of 2004.

In a report on Form 8-K, filed on August 31, 2004, Inforte reported, under Item 1.01 "Entry into a Material Definitive Agreement," the modification of the earn-out provisions of the Agreement of Merger, dated March 4, 2004, among Inforte, INFC Acquisition Corp. and the Stockholder Representative. Inforte has agreed to eliminate as a condition to its obligation to pay the full \$6.3 million cash earn-out amount under the Original Merger Agreement the achievement of specific 2004 net revenue levels by the Compendit business.

21

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Inforte Corp.

By: /s/ Nick Heyes

November 15, 2004

Nick Heyes,
Chief Financial Officer

22