

INVESTOOLS INC  
Form 10-Q  
August 04, 2006

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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

**FOR QUARTER ENDED June 30, 2006**

**Commission File Number: 000-52012**

**INVESTOOLS INC.**

(Exact name of Registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**76-0685039**

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

**13947 South Minuteman Drive  
Draper, UT**

(Address of principal executive offices)

**84020**

(Zip Code)

Registrant's telephone number, including area code:

**(801) 816-6918**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Edgar Filing: INVESTTOOLS INC - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

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

\$0.01 par value per share Common Stock: 45,111,258 as of August 1, 2006

---

**INVESTTOOLS INC. AND SUBSIDIARIES**

Report on Form 10-Q

Quarter Ended June 30, 2006

**PART I - FINANCIAL INFORMATION**

<u>ITEM 1.</u>	<u>CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)</u>
<u>ITEM 2.</u>	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>
<u>ITEM 3.</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>
<u>ITEM 4.</u>	<u>CONTROLS AND PROCEDURES</u>

**PART II - OTHER INFORMATION**

<u>ITEM 1.</u>	<u>LEGAL PROCEEDINGS</u>
<u>ITEM 1a.</u>	<u>RISK FACTORS</u>
<u>ITEM 2.</u>	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>
<u>ITEM 3.</u>	<u>DEFAULTS UPON SENIOR SECURITIES</u>
<u>ITEM 4.</u>	<u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>
<u>ITEM 5.</u>	<u>OTHER INFORMATION</u>
<u>ITEM 6.</u>	<u>EXHIBITS</u>

**PART I - FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****INVESTTOOLS INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets****(in thousands)****(unaudited)**

	<b>June 30, 2006</b>	<b>December 31, 2005</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 20,969	\$ 11,466
Marketable securities	37,662	16,871
Accounts receivable, net of allowance (\$73 and \$55)	2,927	3,353
Current portion of restricted cash		4,722
Other current assets	4,800	3,133
<b>Total current assets</b>	<b>66,358</b>	<b>39,545</b>
Long-term restricted cash	371	366
Goodwill	18,085	18,085
Intangible assets, net of accumulated amortization (\$3,141 and \$1,891)	3,949	5,199
Furniture and equipment, net of accumulated depreciation (\$3,470, and \$2,403)	12,365	8,890
Other long-term assets	1,229	614
<b>Total assets</b>	<b>\$ 102,357</b>	<b>\$ 72,699</b>
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
Current liabilities:		
Current portion of deferred revenue	\$ 112,268	\$ 68,215
Accounts payable	4,458	3,210
Accrued payroll	3,850	3,522
Accrued tax liabilities	9,384	7,359
Other current liabilities	5,891	4,193
Current portion of capitalized lease obligations	171	125
<b>Total current liabilities</b>	<b>136,022</b>	<b>86,624</b>
Other long-term accrued liabilities	265	
Long-term portion of capitalized lease obligations	580	513
Long-term portion of deferred revenue	19,732	9,301
<b>Total liabilities</b>	<b>156,599</b>	<b>96,438</b>
Stockholders' deficit:		
Common stock \$0.01 par value (44,970 and 44,754 shares issued and outstanding, respectively)	450	447
Additional paid-in capital	127,220	131,162
Accumulated other comprehensive loss	(256)	(116)
Deferred stock compensation		(3,742)
Accumulated deficit	(181,656)	(151,490)
<b>Total stockholders' deficit</b>	<b>(54,242)</b>	<b>(23,739)</b>

<b>Total liabilities and stockholders deficit</b>	\$	102,357	\$	72,699
---	----	---------	----	--------

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

3

---

## INVESTTOOLS INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>Revenue</b>	\$ 38,396	\$ 34,162	\$ 77,177	\$ 64,786
<b>Costs and expenses</b>				
Cost of revenue	35,851	25,211	64,550	50,591
Selling expense	12,166	9,329	24,054	17,945
General and administrative expense	8,611	5,915	16,686	11,962
Special charges	2,624	40	2,990	40
Total costs and expenses	59,252	40,495	108,280	80,538
Loss from operations	(20,856 )	(6,333 )	(31,103 )	(15,752 )
<b>Other income (expense)</b>				
Gain (loss) on sale of assets	3	(93 )	10	(93 )
Interest income and other, net	587	166	935	287
Other income	590	73	945	194
<b>Net loss before income taxes and cumulative effect of accounting change</b>	(20,266 )	(6,260 )	(30,158 )	(15,558 )
Income tax expense	28		56	5
<b>Net loss before cumulative effect of accounting change</b>	(20,294 )	(6,260 )	(30,214 )	(15,563 )
Cumulative effect of accounting change			48	
<b>Net loss</b>	\$ (20,294 )	\$ (6,260 )	\$ (30,166 )	\$ (15,563 )
<b>Net loss per common share basic and diluted</b>	\$ (0.45 )	\$ (0.14 )	\$ (0.67 )	\$ (0.35 )
Weighted average common shares outstanding basic and diluted	45,067	45,008	44,943	44,990

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

## INVESTOOLS INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2006	2005
<b>Cash flows from operating activities:</b>		
Net loss	\$ (30,166 )	\$ (15,563 )
Reconciling adjustments:		
Depreciation and amortization	2,316	1,169
Deferred taxes	56	
Stock compensation expense	491	252
Provision for sales return reserve	315	1,083
Provision for lease termination	213	
(Recovery of) provision for bad debt	(35 )	58
(Gain) loss on sale of assets	(10 )	93
Impairment of capitalized software development	1,464	
Changes in operating assets and liabilities, net of the effect of acquired businesses:		
Accounts receivable	461	(981 )
Restricted cash		3
Other assets	(1,659 )	(494 )
Accounts payable	1,248	(1,941 )
Deferred revenue	54,969	22,621
Accrued payroll	328	404
Other current liabilities	600	(2,810 )
Accrued tax liabilities	1,318	688
Net cash provided by operating activities	31,909	4,582
<b>Cash flows from investing activities:</b>		
Purchases of marketable securities	(23,403 )	
Proceeds from the maturity of marketable securities	2,500	4,170
Proceeds from the sale of equipment	10	40
Purchases of furniture, fixtures and equipment	(5,472 )	(4,171 )
Cash paid in business acquisitions, net of cash received		(7,879 )
Net cash used in investing activities	(26,365 )	(7,840 )
<b>Cash flows from financing activities:</b>		
Payments on capital leases	(70 )	(9 )
Changes in long-term restricted cash	4,717	(3,026 )
Repurchase of stock	(1,360 )	
Proceeds from exercise of stock options	672	90
Net cash provided by (used in) financing activities	3,959	(2,945 )
<b>Increase (decrease) in cash and cash equivalents</b>	<b>9,503</b>	<b>(6,203 )</b>
<b>Cash and cash equivalents:</b>		
Beginning of period	11,466	10,736
End of period	\$ 20,969	\$ 4,533
<b>Supplemental non-cash disclosures:</b>		
Equipment financed with capital lease obligations	\$ 183	\$ 675

Edgar Filing: INVESTTOOLS INC - Form 10-Q

Licensing contracts financed with vendors \$ 350 \$

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

5

---



**INVESTTOOLS INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**Basis of Presentation**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

The Condensed Consolidated Financial Statements include the accounts of INVESTools Inc. (the Company or INVESTools ) and its wholly-owned subsidiaries. All intercompany transactions have been eliminated.

The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2005 included in the Company's Annual Report on Form 10-K.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with Rule 10-01 of Regulation S-X for interim financial statements required to be filed with the Securities and Exchange Commission ( SEC ) and do not include all the information and footnotes required by accounting principles generally accepted in the United States. However, in the opinion of management, the information furnished reflects all adjustments, consisting of normal recurring adjustments, which are necessary to make a fair presentation of financial position and operating results for the interim periods. The results of operations for the three and six-month periods ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year.

### **Revenue Recognition**

## Edgar Filing: INVESTOOLS INC - Form 10-Q

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition*, and Financial Accounting Standards Board ( FASB ) Emerging Issues Task Force ( EITF ) No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* ( EITF 00-21 ). Revenue is not recognized until it is realized or realizable and earned. The criteria to meet this guideline are: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the buyer is fixed or determinable, and (iv) collectibility is reasonably assured.

The Company sells its products separately and in various bundles that contain multiple deliverables that include educational workshops, online courses, on-demand coaching services, one-to-many coaching services, and ongoing support and tutorials, along with other products and services. In accordance with EITF 00-21, sales arrangements with multiple deliverables are divided into separate units of accounting if the deliverables in the arrangement meet the following criteria: (i) the product has value to the customer on a standalone basis; (ii) there is objective and reliable evidence of the fair value of undelivered items; and (iii) delivery or performance of any undelivered item is probable and substantially in the Company's control. The fair value of each separate element is generally determined by prices charged when sold separately. In certain arrangements, the Company offers these products bundled together at a discount. The discount is allocated pro rata to each element based on the relative fair value of each element when fair value support exists for each element in the arrangement. If fair value of all undelivered elements in an arrangement exists, but fair value does not exist for a delivered element, then revenue is recognized using the residual method. Under the residual method, the fair value of undelivered elements is deferred and the remaining portion of the arrangement fee (after allocation of 100 percent of any discount to the delivered item) is recognized as revenue. The Company provides some limited rights of return in connection with its arrangements. The Company estimates its returns based on historical experience and maintains an allowance for estimated returns, which has been reflected as an accrued liability. Each transaction is separated into its specific elements and revenue from each element is recognized according to the following policies:

<b>Product</b>	<b>Recognition policy</b>
Workshop/workshop certificate	Deferred and recognized as the workshop is provided or certificate expires
Home study	Recognized upon delivery of home study materials to customer
Online course	Deferred and recognized over the estimated subscription period
Coaching services	Deferred and recognized as services are delivered, or on a straight-line basis over the subscription period
Website subscription and renewals	Deferred and recognized on a straight-line basis over the subscription period
Data licenses	Recognized monthly based on data usage

### **Deferred Revenue**

Deferred revenue arises from subscriptions to the websites, workshops, online courses, and coaching services because the payments are received before the service has been rendered. Deferred revenue is recognized into revenue over the

period that the services are performed or the contract period expires, as shown in the above table.

**Capitalized software development costs**

For internal use software the Company complies with The American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) No. 98-1, *Accounting For Cost of Computer Software Developed or Obtained for Internal Use*, and EITF No. 00-2, *Accounting for Website Development Costs*. In accordance with SOP 98-1, software development costs incurred as part of an approved project plan that result in additional functionality to internal use software are capitalized and amortized on a straight-line basis over the estimated useful life of the software. During the three and six months ended June 30, 2006, the Company capitalized \$0.4 million and \$1.9 million, respectively, related to internal use software related to the development of the Investor Toolbox website.

**Marketable Securities**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

The Company invests excess cash in marketable securities, primarily government backed securities with maturities ranging from one to 34 months. At June 30, 2006, the cost of these securities was \$37.9 million. The Company has classified these marketable securities as available for sale under Statement of Financial Accounting Standards ( SFAS ) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Accordingly, the securities are recorded at fair value and any unrealized gains or losses are included in accumulated other comprehensive loss within stockholders' deficit. Gains are recognized when realized and are recorded in the Company's Condensed Consolidated Statement of Operations in other income. Losses are recognized as realized or when management has determined an other-than-temporary decline in fair value has occurred. There were no realized gains or losses recognized during the three and six months ended June 30, 2006 and 2005. Certain of these securities were purchased at a discount or premium, which are being amortized into interest income over the maturity of the security. The Company recognized interest income of \$0.6 million and \$0.1 million in the three-month periods ended June 30, 2006 and 2005, respectively, and \$0.8 million and \$0.2 million during the six-month periods ended June 30, 2006 and 2005, respectively. The market value of these marketable securities, reflected in the balance sheet at June 30, 2006, was \$37.7 million. Gross unrealized holding losses were \$0.3 million at June 30, 2006 and \$0.1 million at December 31, 2005.

### **Inventories**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

Inventories are stated at the lower of cost or market value (using the first-in, first-out method). The Company's inventories consist of manuals and DVDs that comprise the Company's educational products. At June 30, 2006 and December 31, 2005, \$0.5 million and \$0.9 million, respectively, in net inventories were included as part of other current assets.

### **Amortizable Acquired Intangibles**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

Amortizable acquired intangibles with finite lives as of June 30, 2006 and December 31, 2005 were as follows (in thousands):

	As of June 30, 2006			As of December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Weighted Average Remaining Useful Life	Gross Carrying Amount	Accumulated Amortization	Weighted Average Remaining Useful Life
Existing technology and other	\$ 5,380	\$ (2,466 )	3.1 years	\$ 5,380	\$ (1,407 )	3.2 years
Non competition	890	(675 )	1.5 years	890	(484 )	1.6 years
Total acquired intangibles	\$ 6,270	\$ (3,141 )	3.0 years	\$ 6,270	\$ (1,891 )	3.0 years

For the three and six-month periods ended June 30, 2006, amortization expense was \$0.6 million and \$1.3 million, respectively, as compared to \$0.4 million and \$0.7 million for the same periods in 2005.

Estimated future amortization expense is as follows (in thousands):

2006 Remaining	\$ 1,013
2007	774
2008	653
2009	644
2010	45
Thereafter	
Total estimated amortization expense	\$ 3,129





**Non-Amortizable Acquired Intangibles**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

As a result of the acquisition of Prophet Financial Systems, Inc. ( Prophet ) in January 2005, trademarks and trade names which are not amortized and have indefinite lives as of June 30, 2006 were \$0.8 million.

### **Stock-based Compensation**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

The Company currently administers six stock-based compensation plans. These plans are administered by the Compensation Committee of the Board of Directors, which directly or through delegated authority selects persons eligible to receive awards and determines the number of shares and/or options subject to each award, the terms, conditions, performance measures, and other provisions of the award. Readers should refer to Notes 2 and 11 of the Company's Consolidated Financial Statements in its Annual Report on Form 10-K for the year ended December 31, 2005 for additional information related to these stock-based compensation plans.

### *Stock Options*

#### INVESTools 2001 Stock Option Plan

This plan is the only plan out of which the Company currently can grant options. The plan was approved by stockholders in December 2001. On June 15, 2006 stockholders approved a proposal amending the plan to increase the total number of shares available for grant under this plan for issuance to officers, directors and employees from six million to eight million. Incentive options are typically granted at fair market value of the Company's common stock at the date of grant, and generally expire ten years from the date of grant. The shares are issuable from the Company's authorized but unissued shares, or they may be issued out of treasury stock. Based on awards previously granted to employees and directors, the number of shares available for future stock option grants were 4,092,212 at June 30, 2006.

#### Telescan Stock Option Plans

The Company reserved 427,456 shares of its common stock for issuance under three stock option plans for the employees and former directors of Telescan, Inc., a wholly-owned subsidiary of the Company. No new options are being granted under these plans. Options granted under these plans were granted at fair market value at the date of grant and generally expire ten years from the date of grant. At June 30, 2006, there were 328,616 shares outstanding under this plan.

#### ZiaSun Stock Option Plan

The Company reserved 1,296,600 shares of its common stock for issuance under one stock option plan for the officers, employees and former directors of ZiaSun Technologies, Inc., a wholly-owned subsidiary of the Company. No new options are being granted under this plan. Options granted under this plan were granted at fair market value at the date of grant and generally expire ten years from the date of grant. At June 30, 2006, there were 89,400 shares outstanding under this plan.

Prior to 2003 the Company accounted for stock option grants in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (the intrinsic value method), and accordingly recognized no compensation expense for stock option grants because the options' exercise price equaled the fair market value of the Company's stock price on the measurement date. Beginning in 2003, the Company adopted the fair value expense recognition method available under SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123) in accounting for options granted after 2002. Effective January 1, 2006, the Company adopted SFAS No. 123 (revised), *Share-Based Payment* (SFAS 123(R)) utilizing the modified prospective approach.

Under the modified prospective approach, SFAS 123(R) applies to new awards and to unvested awards that were outstanding on January 1, 2006 that are subsequently exercised, modified, repurchased, or cancelled. In addition, compensation cost recognized in the first quarter of 2006 included compensation cost for all options granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123, and compensation cost for all options granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). The total cost related to the Company's share-based compensation plans, recorded pursuant to the methods then in effect, was \$0.5 million and \$0.3 million for the six months ended June 30, 2006 and 2005, respectively. In accordance with the modified prospective approach, prior periods were not restated to reflect the impact of adopting the new standard.

The Company receives a tax deduction for certain stock option exercises during the period the options are exercised, generally for the excess of the fair market value of the underlying stock on the exercise date, over the exercise price of

the options. Prior to the adoption of SFAS 123(R), the Company reported all tax benefits resulting from the exercise of stock options as cash flows from operating activities in its Condensed Consolidated Statements of Cash Flows. In accordance with SFAS 123(R), beginning January 1, 2006, the Company records in its Condensed Consolidated Statement of Cash Flows the tax benefits from the exercise of stock options as cash flows from financing activities. Net cash proceeds from the exercise of stock options were \$0.7 million and \$0.1 million for the six months ended June 30, 2006 and 2005, respectively. The tax benefit potentially realizable from stock option exercises was \$0.6 million and none for the same respective periods. However, the Company was not able to recognize this tax benefit due to its existing fully-valued net operating loss carryforward. Therefore, until the tax deduction reduces taxes payable, the realization of this tax benefit is not recognized, and cash flows from financing activities presented in the accompanying statement of cash flows do not include the tax effect of the option exercises.

Beginning in 2006, SFAS 123(R) requires the Company to recognize compensation expense related to options based on the estimated number of options that will ultimately vest. Accordingly, we are required to estimate what the forfeitures will be. The estimate of such forfeitures serves to reduce the compensation expense that would otherwise be recorded. Prior to 2006, the Company did not estimate such expense reductions for post-2002 awards, and accounted for forfeitures by reducing the recognized expense as they occurred. Changing this principle of accounting is required by the adoption of SFAS 123(R), and as a result the Company estimated the cumulative amount of potential pre-vesting forfeitures relating to unvested options as of January 1, 2006. The reduction in compensation expense that would have been recognized during prior periods resulting from this change in accounting principle was approximately \$48,000, and was recognized during the three months ended March 31, 2006. The reduction in deferred tax assets associated with decreasing the estimated future tax deduction, which resulted from decreasing the related estimated option exercises, was offset by an equal reduction in the valuation allowance. Accordingly, there was no tax effect recognized.

As a result of adopting SFAS 123(R) on January 1, 2006, the Company's loss before taxes, and its net loss for the six months ended June 30, 2006, were both \$0.1 million lower than if the Company had continued to account for options under the combination of APB Opinion No. 25 and SFAS 123 for its stock option plans. There was no change to basic and diluted loss per share. There were no remaining unrecognized costs that would, during 2006 and later, be included in compensation expense related to pre-2003 grants, and which were previously accounted for under APB Opinion No. 25. In addition, as mentioned in the preceding paragraph, SFAS 123(R) requires the Company to begin estimating forfeitures of options which have yet to fully vest. The effect on expenses of estimating forfeitures relating to the cost of unvested options results in lower compensation costs recognized than if SFAS 123(R) had not been adopted.

The Company was also required to calculate the additional paid-in capital ( APIC ) pool of excess tax benefits available to absorb tax deficiencies, if any, subsequent to the adoption of SFAS 123(R). The Company has elected to use the permitted short-cut method in determining this APIC pool. The result was that the Company has no APIC pool of tax benefits against which to absorb future tax deficiencies. Because of the Company's existing net operating loss carryover as mentioned above, there was no effect on the accompanying statement of cash flows as a result of changing the accounting principle by electing to use the short-cut method.

Another result of adopting SFAS 123(R) is that all unrecognized share-based compensation costs previously included as deferred stock compensation separately presented on the balance sheet has now been reclassified and included in additional paid-in capital.

The following table illustrates the effect on operating results and per share information had the Company accounted for share-based compensation in accordance with SFAS 123 for the three and six-month periods ended June 30, 2005 (in thousands, except per share amounts):

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Net loss as reported	\$ (6,260 )	\$ (15,563 )
Add: Option-based employee compensation reported in net loss, net of taxes	114	252
Deduct: Pro forma option-based compensation under the fair value method, net of taxes	(153 )	(330 )
<b>Pro forma net loss</b>	<b>\$ (6,299 )</b>	<b>\$ (15,641 )</b>
Basic and diluted net income (loss) per share as reported	\$ (0.14 )	\$ (0.35 )
Basic and diluted net income (loss) per share pro forma	\$ (0.14 )	\$ (0.35 )



Edgar Filing: INVESTTOOLS INC - Form 10-Q

The Company uses the Black-Scholes option pricing model to estimate the fair value of option awards with the following weighted average assumptions for the periods indicated (there were no options granted during the three months ended June 30, 2005):

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Dividend yield				
Risk-free factors	5.07	%	5.07	% 3.95
Volatility factors	55.9	%	55.9	% 62.3% - 62.8
Expected lives	6.3 years		6.3 years	7 years
Weighted average fair value of options granted	\$ 5.32	\$	\$ 5.32	\$ 2.42

The assumptions above are based on multiple factors, including historical exercise patterns of employees in relatively homogeneous groups with respect to exercise and post-vesting employment termination behaviors, and the expected future exercising patterns for those same homogeneous groups. During 2006, the Company used the simplified method for determining expected lives. The expected volatility is based upon a blend of the Company's historical volatility of its stock price, and the historical volatility of the stock price of one of the Company's industry peers.

The following table represents stock option activity for the six months ended June 30, 2006:

	Number of shares	Weighted-average exercise price	Weighted-average remaining contract life
Outstanding options at beginning of period	4,052,193	\$ 2.35	
Granted	275,868	\$ 9.00	
Exercised	(493,927)	\$ 1.36	
Expired			
Forfeited	(142,580)	\$ 2.92	
Outstanding options at end of period	3,691,554	\$ 2.96	6.7 years
Outstanding exercisable options at end of period	2,107,891	\$ 1.86	5.5 years

At June 30, 2006, the aggregate intrinsic value of options outstanding was \$19.7 million, and the aggregate intrinsic value of exercisable options was \$13.8 million. The total intrinsic value of options exercised was \$2.4 million and \$0.1 million for the three months ended June 30, 2006 and 2005, respectively. The total intrinsic value of options exercised was \$3.6 million and \$0.2 million for the six months ended June 30, 2006 and 2005, respectively.

At June 30, 2006, there was \$4.3 million of unrecognized compensation cost related to options which is expected to be recognized over a weighted-average period of 1.7 years.

*Restricted Stock*

There are 500,000 shares of Company common stock available for issuance under the 2004 Restricted Stock Plan. The shares of Company common stock awarded under the plan may be either previously authorized but unissued shares or issued shares which have been reacquired by the Company after their original issuance (including but not limited to shares purchased on the open market).

In December 2005, the Company issued 3,000 shares of restricted, forfeitable stock with a fair value of \$5.40 per share to members of its Advisory Board. The restrictions on the restricted stock awards vest all at once at the end of 24 months. The fair value of the restricted stock awards is being amortized to compensation expense as the restrictions lapse and until the members' performance obligation has been completed, in accordance with EITF No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. The amount of unrecognized compensation cost as of June 30, 2006, and amount amortized as expense during the three and six-month periods ended June 30, 2006, is not material to these Condensed Consolidated Financial Statements.



**Stock Repurchase Program**



## Edgar Filing: INVESTTOOLS INC - Form 10-Q

In June 2004, the Board of Directors authorized a stock repurchase program under which the Company can repurchase up to 3.5 million shares of its common stock over a two-year period. In June 2006, the Board of Directors extended the program for an additional two years. In May 2006, the Company repurchased from one of the Directors 160,000 shares for \$1.4 million, or \$8.50 per share, under the terms of the program. The price of the shares was the closing market price on the date of repurchase, less a discount of 5%. During the comparable period of 2005, no shares were repurchased. As of June 30, 2006, a total of 1.6 million shares had been repurchased for a total cumulative cost of \$5.0 million.

### **Special Charges**

During the three months ended June 30, 2006, the Company completed a review of the existing user interface features component of the ongoing Investor Toolbox development project. As a result of feedback from Company instructors and coaches, the Company determined to abandon the component and redevelop it. Accordingly, the Company wrote off the capitalized costs related to the existing user interface component in accordance with SOP 98-1 and SFAS 144. These costs totaled \$1.4 million. In addition, management accrued \$1.0 million as estimated settlement costs involved with ongoing legal matters, and accrued an additional \$0.2 million relating to severance costs.

### **Comprehensive Loss**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

Supplemental information on comprehensive loss is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Net loss	\$ (20,294 )	\$ (6,260 )	\$ (30,166 )	\$ (15,563 )
Unrealized (loss) gain on marketable securities	(96 )	42	(140 )	(30 )
Net comprehensive loss	\$ (20,390 )	\$ (6,218 )	\$ (30,306 )	\$ (15,593 )

### Commitments and Contingencies

Edgar Filing: INVESTTOOLS INC - Form 10-Q

Lease obligations

Equipment and facilities are leased under various non-cancelable operating leases and capital leases expiring at various dates through the year 2010. During the first six months of 2006, the Company added \$0.2 million in equipment financed with capital leases. At June 30, 2006, total assets under capital leases aggregated \$0.9 million.

In January 2006, the Company ceased the use of leased office space in San Rafael, California, and moved all operations to its leased offices in Palo Alto, California, and Draper, Utah. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the Company recorded a liability of \$0.2 million in lease termination costs related to the remaining lease payments, net of estimated sublease rentals. As of June 30, 2006, the Company had subleased the property and reduced the accrued liability by \$19,000.

Future minimum lease payments under non-cancelable operating leases, related subleases, and capital leases at June 30, 2006, are as follows (in thousands):

	Capital leases	Operating leases	Sub-lease income	Net operating leases
For the fiscal years:				
2006 Remaining	\$ 112	\$ 568	\$ (95 )	\$ 473
2007	224	950	(119 )	831
2008	224	790	(40 )	750
2009	224	741		741
2010	93	393		393
Total Lease Payments	877	\$ 3,442	\$ (254 )	\$ 3,188
Less: Amount representing interest (average of 8%)	126			
Present value of lease payments	751			
Less: Current portion	171			
Long-term portion	\$ 580			

Litigation

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

On March 4, 2003, a foreign national filed a complaint in the San Diego Superior Court against ZiaSun Technologies, Inc., one of the Company's wholly-owned subsidiaries. The complaint alleged that certain individuals, who were not parties in the lawsuit, persuaded the plaintiff to purchase shares of ZiaSun common stock and the complaint also alleged a failure to deliver a stock certificate. ZiaSun does not have any ownership or control of the third party brokerage house from whom plaintiff claims to have purchased stock. The plaintiff was seeking unspecified damages for the alleged fraud in the sale of the stock. In February 2005, the court awarded a summary judgment in the Company's favor. In March 2005, the plaintiff filed an appeal to continue to pursue this litigation. The court accepted his appeal in October 2005, and the Company filed a reply in November 2005. In May 2006 the Appellate court decided in favor of the Company. The Company considers it highly unlikely the California Supreme Court will agree to hear any further appeal by the plaintiff.

In October 2005, the Supreme Court of Queensland, ruled on a lawsuit filed on July 9, 2004, by the Australian Securities and Investment Commission (ASIC) against Online Investors Advantage, one of the Company's wholly-owned subsidiaries (OIA). The Court found that most of the claims pursued by ASIC had not been made out against OIA, but found for ASIC in respect to certain claims, all of which hinged on the Court's finding that OIA's website was a financial product, as that term is defined under the Australian Corporations Act. There were no penalties assessed against the Company as a result of this ruling. On October 31, 2005, the Court dismissed ASIC's claim regarding the repayment of money to participants at the workshops. Accordingly, \$0.3 million of funds previously held in escrow were released to the Company. Given OIA's success on the majority of ASIC's claims, ASIC was ordered to pay 80% of OIA's legal costs. Given that ASIC succeeded in respect to a small number of its claims, OIA was ordered to pay 20% of ASIC's legal costs. The Company's legal counsel is presently working to determine the settlement of the respective legal fees, and no amounts have been recorded in the Consolidated Financial Statements. The Company expects these amounts to be settled in the second half of 2006. At this time the net settlement is not estimable, and therefore has not been recorded.

In November 2005, Ross Jardine and True North Academy L.L.C. filed a lawsuit against the Company in the Third Judicial District Court, Salt Lake City, Utah. The lawsuit alleges that the Company abused Mr. Jardine's personal identity under Utah state law, his name and likeness, and appropriated the commercial value of Mr. Jardine's identity and violated his privacy. In January 2006, the Company filed its answer and counterclaim, and in February 2006 it filed a motion for summary judgment. Both parties have filed briefs on the matter, and since June 1, 2006 have been subject to a standstill agreement. The parties are pursuing resolution through mediation.

In February 2006, the Company filed a complaint against Stock Investor.com, LLC, True North Academy, L.L.C., Wade Hallam, Leroy Hartman and Tony Montoya in the Fourth Judicial Court, Utah County, Utah. The complaint alleges breach of contract, tortious interference, violation of the Utah Trade Secrets Act, common law unfair competition, violation of the Utah Unfair Competition Act, common law trademark infringement and trade name infringement, and civil conspiracy. The Company is seeking damages and injunctive relief. The defendants have filed a counterclaim, and since June 1, 2006 the defendants and the Company have been subject to a standstill agreement. The parties are pursuing resolution through mediation.

In April 2006, the Company was contacted by Ablaise Ltd., threatening litigation against the Company's wholly-owned subsidiary, Prophet Financial Systems, Inc., along with other companies, alleging patent infringement. The Company has engaged legal counsel in the matter, believes the claims are without merit, and intends to vigorously defend this action.

In February 2004, the Company entered into an Agreement and Plan of Merger with SES Acquisition Corp., dba 360 Group. Under the terms of the agreement, certain payments were scheduled to be paid during 2005 based on various earn-out performance conditions being met. The sellers filed suit on July 18, 2006 against the Company and 360 Group in the Superior Court of the State of California, alleging that pursuant to the Agreement and Plan of Merger between the

Company, the sellers, and others, the Company was required to pay the sellers earn-out payments for 2005. The Company alleged that no such payments were required. The sellers claim they are entitled to more than \$3 million. The Company intends to vigorously defend this action.

The Company establishes liabilities when a particular contingency is probable and estimable. For contingencies noted above, the Company has accrued amounts considered probable and estimable.

The Company records liabilities for potential sales taxes related to product sales in various states. The effect of recording the potential sales tax liability is to record an accrued liability for the potential sales tax exposure with a corresponding increase to selling expense. The Company is applying for rulings from various states on the taxability of its products to determine if its sales tax policy is supported by the various state taxing jurisdictions. The Company anticipates that the rulings could effectuate a modification to its sales tax collection policy and/or a reversal of a portion of its accrued sales tax liability.

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

**Net Loss Per Share**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

Basic net loss per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net loss per share is computed using the weighted-average number of common shares and dilutive common stock equivalents outstanding during the period. Potential common stock equivalents amounting to 3.7 million for the three and six months ended June 30, 2006, and 2.3 million for the three and six months ended June 30, 2005, respectively, are excluded from the computation because their effect is anti-dilutive.

### **Recently Issued Accounting Standards**

Edgar Filing: INVESTTOOLS INC - Form 10-Q

In July 2006, the FASB issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 provides guidance on recognizing, measuring, presenting and disclosing in the financial statements uncertain tax positions that a company has taken or expects to take on a tax return. FIN 48 is effective for the Company as of January 1, 2007. The Company is currently assessing the impact, if any, of FIN 48 on its consolidated financial statements.

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

In June 2006, the EITF reached a consensus on EITF Issue No. 06-03, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)* ( EITF 06-03 ). EITF 06-03 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The provisions of EITF 06-03 become effective as of January 1, 2007. The Company is currently evaluating the impact of adopting EITF 06-03 on the consolidated financial statements.

13

---



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

**Business Overview**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

Our mission is to educate individual investors to make their own investment decisions by providing them with the service and support they need to successfully achieve their financial goals. We hope to accomplish this by integrating investment approaches, providing web-based tools, offering live and online learning opportunities, and by maintaining support designed to ensure their ongoing success. We have more than 248,000 graduates and 83,700 subscribers to our websites. Our products and services are built around the INVESTools Method , a unique integration of a disciplined investing process, web-based tools, personalized instruction and support. Our investor education products and services are offered in a variety of learning formats with courses ranging from beginning to advanced, thus addressing the needs of all investor levels.

### **Concentration Risk**

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

During the three and six months ended June 30, 2006, we accessed approximately 63% and 58%, respectively, of our sales transaction volume through co-marketing (Success Magazine and NET Marketing Alliance) relationships. While the loss of the relationships with either of these parties could have a material adverse effect on our financial performance in the short-term, we are constantly pursuing new student acquisition channels and believe business from new and existing channels would replace such lost volumes if they were to occur. There can be no assurance that we would be successful in establishing new channels.

### **Revenue**

*Learning Formats*

Edgar Filing: INVESTTOOLS INC - Form 10-Q

**Depending on the brand under which the learning formats are marketed, the content and services available to students, i.e., length of workshop, types of coaching services or length of time over which services are performed, and access to certain Investor Toolbox features, may vary.**

Edgar Filing: INVESTTOOLS INC - Form 10-Q

- **Preview Event** We offer directly or through partners, a free event that introduces attendees to fundamental investing concepts and provides a broad overview of the financial markets. Depending on the brand under which the preview event is marketed, participants may receive a gift for attending. Attendees are offered an opportunity to purchase a more comprehensive, live workshop, and an in-depth online or DVD-based home study program.

Edgar Filing: INVESTTOOLS INC - Form 10-Q

- **Workshops** We offer one and two-day live, instructor-led investing workshops that cover topics ranging from fundamental investing principles to advanced strategies. The workshops provide hands-on experience using our proprietary Investor Toolbox website. The fundamental 5-Step Investing Formula workshop includes a six month subscription to the Investor Toolbox website as part of the workshop fee.

## Edgar Filing: INVESTTOOLS INC - Form 10-Q

- Home Study/Online Courses We also offer most of our courses in an online or DVD-based home study format. The home study programs provide hands-on training using our proprietary Investor Toolbox website. The 5-Step Investing Formula home study course includes a six month subscription to the Investor Toolbox website as part of the home study course fee. Additional online courses on advanced topics are also available.



## Edgar Filing: INVESTTOOLS INC - Form 10-Q

- **Coaching Services** Our coaching service options offer investors individual, on-demand access to coaches via the telephone, or one-to-many online coaching and support. Offered in connection with both fundamental and advanced courses, the sessions allow investors to learn at their own pace and apply what they are learning. On-demand and one-to-many coaching alternatives are subscription products offered in one to sixty-month time periods, depending on the related course. One-to-many coaching services include weekly, topic-driven live webinar sessions (Trading Rooms), advanced strategy-based group discussions (Active Investor Talk), and market-based group instruction (Masters Talk).

Edgar Filing: INVESTTOOLS INC - Form 10-Q

- **Interactive Workshops** Our interactive workshops provide students with an in-depth, personal learning experience and a low student-to-coach ratio. These courses are taught by our most experienced coaches. They include stock, options, and currency training, as well as more advanced active investing courses.

Edgar Filing: INVESTTOOLS INC - Form 10-Q

- Ongoing Support and Tutorials (web subscriptions) As long as alumni maintain an active subscription to the Investor Toolbox website, they have access to student and technical support through a Live Chat online support option and through an 800-number hotline. Alumni can access a series of inexpensive or free topical, recorded online tutorials through our Investor Toolbox website. The click-on-demand tutorials are designed to walk



graduates through the portion of the Investor Toolbox website that relates to the subject being covered.

Edgar Filing: INVESTTOOLS INC - Form 10-Q

	Three Months Ended June 30,			Six Months Ended June 30,		
	2006	2005	% Change	2006	2005	% Change
<b>Initial Education:</b>						
Workshops	\$ 3,268	\$ 4,260	(23 )%	\$ 7,223	\$ 8,079	(11 )%
Coaching services	79	136	(42 )%	142	250	(43 )%
Home study / Online courses	4,887	872	460 %	10,254	1,325	674 %
Initial web time	790	731	8 %	1,630	1,453	12 %
Total initial education sales transaction volume	9,024	5,999	50 %	19,249	11,107	73 %
<b>Continuing Education:</b>						
Workshops	13,232	7,652	73 %	24,503	15,091	62 %
Coaching services	27,738	19,798	40 %	47,933	36,887	30 %
Home study / Online courses	13,311	5,291	152 %	21,107	10,859	94 %
Renewals	8,146	5,686	43 %	15,455	10,911	42 %
Other revenue	1,908	1,308	46 %			