

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended.....September 30, 1999

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 0-19437

CELLULAR TECHNICAL SERVICES COMPANY, INC.
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE

11-2962080

(State or Other Jurisdiction of
Incorporation or Organization)

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

2401 FOURTH AVENUE, SEATTLE, WASHINGTON 98121
(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: (206) 443-6400

NOT APPLICABLE

(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 the filing requirements for the past 90 days. Yes X No

2,281,493 Common Shares were outstanding as of November 12, 1999.

CELLULAR TECHNICAL SERVICES COMPANY, INC.

TABLE OF CONTENTS FOR FORM 10-Q

PART I. FINANCIAL INFORMATION.....	3
ITEM 1. FINANCIAL STATEMENTS.....	3
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.....	7
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.....	15
PART II. OTHER INFORMATION	
ITEM 1. LEGAL PROCEEDINGS.....	15
ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.....	15

CELLULAR TECHNICAL SERVICES COMPANY, INC.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BALANCE SHEETS

(in 000's, except per share amounts)

	SEPTEMBER 30, 1999 (unaudited)	DECEMBER 31, 1998 (audited)
	-----	-----
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 5,578	\$ 1,567
Accounts receivable, net of allowances of \$5 in 1999 and \$72 in 1998	1,222	2,860
Inventories, net	670	1,014
Prepaid expenses and other current assets	183	185
	-----	-----
Total Current Assets	7,653	5,626
PROPERTY AND EQUIPMENT, net	1,031	1,941
SOFTWARE DEVELOPMENT COSTS, net	236	535
	-----	-----
TOTAL ASSETS	\$ 8,920	\$ 8,102
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 971	\$ 1,358
Payroll related liabilities	527	470
Taxes (other than payroll)	31	128
Deferred revenue and customers' deposits	2,324	3,074
	-----	-----
Total Current Liabilities	3,853	5,030
STOCKHOLDERS' EQUITY		
Preferred Stock, \$0.01 par value per share, 5,000 shares authorized, none issued and outstanding		
Common Stock, \$0.001 par value per share, 30,000 shares authorized, 2,281 shares issued and outstanding at Sept. 30, 1999 and Dec. 31, 1998	23	23
Additional paid-in capital	29,931	29,931
Accumulated Deficit	(24,887)	(26,882)
	-----	-----
Total Stockholders' Equity	5,067	3,072
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 8,920	\$ 8,102
	=====	=====

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

CELLULAR TECHNICAL SERVICES COMPANY, INC.

STATEMENTS OF OPERATIONS

(in 000's, except per share amounts)
(unaudited)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	1999	1998	1999	1998
REVENUES				
Systems	\$ 421	\$ 516	\$ 1,597	\$ 3,839
Services	2,155	1,900	6,534	5,423
Total Revenues	2,576	2,416	8,131	9,262
COSTS AND EXPENSES				
Cost of systems and services	886	3,373	2,999	10,515
Sales and marketing	176	124	517	762
General and administrative	544	516	1,696	1,920
Research and development	402	862	1,241	3,941
Total Costs and Expenses	2,008	4,875	6,453	17,138
INCOME (LOSS) FROM OPERATIONS	568	(2,459)	1,678	(7,876)
OTHER INCOME, net	112	(5)	128	(334)
INTEREST INCOME, net	116	17	214	56
INCOME (LOSS) BEFORE INCOME TAXES	796	\$ (2,447)	2,020	\$ (8,154)
PROVISION FOR INCOME TAXES	12		28	
NET INCOME (LOSS)	\$ 784	\$ (2,447)	\$ 1,992	\$ (8,154)
EARNINGS (LOSS) PER SHARE:				
Basic	\$ 0.34	\$ (1.07)	\$ 0.87	\$ (3.57)
Diluted	\$ 0.34	\$ (1.07)	\$ 0.87	\$ (3.57)
WEIGTED AVERAGE SHARES OUTSTANDING:				
Basic	2,281	2,281	2,281	2,281
Diluted	2,298	2,281	2,287	2,281

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

CELLULAR TECHNICAL SERVICES COMPANY, INC.

STATEMENTS OF CASH FLOWS

(in 000's)
(unaudited)

	NINE MONTHS ENDED SEPTEMBER 30,	
	1999	1998
OPERATING ACTIVITIES		
Net income (loss)	\$ 1,992	\$ (8,154)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization of property and equipment	672	1,120
Amortization and write off of software development costs	298	2,540
Loss on disposal of assets	232	334
Provision for accounts receivable reserves	0	(58)
Provision for inventory reserves	165	2,685
Other non cash charges	(7)	42
Changes in operating assets and liabilities:		
Decrease in accounts receivable	1,639	1,639
Decrease in inventories	180	868
Decrease in prepaid expenses and other current assets	2	21
(Decrease) in accounts payable and accrued liabilities	(387)	(1,342)
Increase (Decrease) in payroll related liabilities	59	(439)
(Decrease) in taxes (other than payroll and income)	(97)	(485)
(Decrease) increase in deferred revenue and customers' deposits	(750)	330
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	3,998	(899)
INVESTING ACTIVITIES		
Purchase of property and equipment	(4)	(159)
Proceeds from sale of assets	17	156
Capitalization of software development costs	0	(570)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	13	(573)
FINANCING ACTIVITIES	0	0
NET CASH PROVIDED BY FINANCING ACTIVITIES	0	0
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,011	(1,472)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,567	3,448
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 5,578	\$ 1,976

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

CELLULAR TECHNICAL SERVICES COMPANY, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE A - BASIS OF PRESENTATION:

The accompanying unaudited financial statements of Cellular Technical Services Company, Inc. (the "Company"), including the December 31, 1998 balance sheet which has been derived from audited financial statements, have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The operating results for the three and nine month periods ended September 30, 1999 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 1999. The Company does not separately disclose comprehensive income because it does not have any components of comprehensive income other than net income. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 1998.

NOTE B - INVENTORIES:

Inventory consists of the following (in 000's):

	SEPTEMBER 30, 1999	DECEMBER 31, 1998
	-----	-----
Inventory, primarily service parts	\$ 3,700	\$ 3,815
Less inventory reserves	(3,030)	(2,801)
	-----	-----
	\$ 670	\$ 1,014
	=====	=====

NOTE C - CONTINGENCIES:

The following legal matters are outstanding as of September 30, 1999:

In January 1998, Communications Information Services, Inc. filed an action against the Company and AirTouch Communications, Inc. for alleged infringement of United States Patent No. 5,329,591 ("the '591 patent") in the United States District Court for the Northern District of Georgia at Atlanta. In January 1999, the Court granted the Company's motion to transfer this lawsuit to the United States District Court for the Western District of Washington. The complaint asserts that the plaintiff is the exclusive licensee of all rights under the '591 patent, alleges that the Company's cellular telephone fraud prevention technology infringes the '591 patent, and seeks damages in unspecified amounts. The Company believes this lawsuit is without merit and is vigorously defending against it. Although no estimate of any outcome of this action can currently be made, an unfavorable resolution of this lawsuit could have a material adverse effect on the Company's liquidity, financial condition and results of operations.

From time to time, the Company is also a party to other legal proceedings in the ordinary course of business and/or which management believes will be resolved without a material adverse effect on the Company's liquidity, financial condition or results of operations.

NOTE D - REVERSE STOCK SPLIT:

On January 5, 1999, the Company implemented a one-for-ten stock combination (reverse stock split) pursuant to the stockholders' approval at the Company's annual meeting of stockholders on December 14, 1998. All outstanding common shares and per share amounts in the accompanying financial statements have been retroactively adjusted to give effect to the one-for-ten stock combination.

NOTE E - EARNINGS (LOSS) PER SHARE:

The calculation of basic and diluted earnings per share is as follows (in 000's, except per share amounts):

	THREE MONTHS ENDED SEPT. 30,		NINE MONTHS ENDED SEPT. 30,	
	1999	1998	1999	1998
Net income (loss)	\$ 784	\$ (2,447)	\$ 1,992	\$ (8,154)
Weighted average number of shares:				
for basic earnings per share	2,281	2,281	2,281	2,281
Effect of dilutive securities:				
Employee stock options	17	-	6	-
Weighted average number of shares:				
for diluted earnings per share	2,298	2,281	2,287	2,281
Net income (loss) per share - Basic	\$ 0.34	\$ (1.07)	\$ 0.87	\$ (3.57)
Net income (loss) per share - Diluted	\$ 0.34	\$ (1.07)	\$ 0.87	\$ (3.57)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of the Company's results of operations and financial condition. The discussion should be read in conjunction with the financial statements and notes thereto.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q for Cellular Technical Services Company, Inc. (the "Company") contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that reflect the Company's views with respect to future events and financial performance. The Company uses words and phrases such as "anticipate," "expect," "intend," "the Company believes," "future," and similar words and phrases to identify forward-looking statements. Reliance should not be placed on these forward-looking statements. These forward-looking statements are based on current expectations and are subject to risks, uncertainties and assumptions that could cause, or contribute to causing, actual results to differ materially from those expressed or implied in the applicable statements. Readers should pay particular attention to the descriptions of risks and uncertainties described in the Company's Annual Report on Form 10-K for the year ended December 31, 1998 and in the Company's other filings with the Securities and Exchange Commission. All forward-looking statements included in this report are based on information available to the Company on the date of this report. The Company assumes no obligation or duty to update any such forward-looking statements.

OVERVIEW

The Company's goal is to be a premier provider of real-time information processing and information management solutions for the wireless communications industry. Over the past 11 years, the Company has used its extensive experience with real-time wireless call processing to create technologically advanced solutions for this industry.

Today, the Company develops, markets and supports both software and hardware as part of its integrated solution for wireless communications fraud management. The Company's radio frequency ("RF") based suite of platform solutions include the Blackbird'r' Platform, PreTect™ cloning-fraud prevention application, No Clone Zone™ roaming-fraud prevention service and related application products and services ("Blackbird Platform Products"). The Blackbird Platform Products are currently used to address the wireless communications industry's need to more effectively combat "cloning fraud." This term is used to describe the illegal activity of using a scanning device to steal the electronic serial number and mobile identification number of a legitimate wireless telephone while in use, then reprogramming the stolen numbers into

other phones. These reprogrammed phones, or "clone phones," are then used to make illegal calls on a wireless communications network, without payment for the wireless services rendered.

The Company's Blackbird Platform is also designed to support a broad range of products and services for the wireless communications industry, including both fraud and non-fraud products and services. The Company believes that the open, scalable architecture of the Blackbird Platform allows it and others to develop applications that run on or exchange information with the Blackbird Platform to meet the needs of this industry.

Over the past three years, the Company has entered into agreements with AirTouch Cellular and certain affiliates, Bell Atlantic Mobile and certain affiliates, GTE Mobilnet of California Limited Partnership, GTE Wireless Service Corp., Ameritech Mobile Communications, Inc. and SNET Mobility to deploy and support Blackbird Platform Products. In 1998, revenue from Blackbird Platform Products represented substantially all of the Company's total revenue, and the Company anticipates that revenue from Blackbird Platform Products will continue to represent substantially all of the Company's total revenue in 1999. Until the Company's launch of the Blackbird Platform Products in 1996, the Company's revenue had been derived primarily from the Company's Hotwatch'r' Platform and related application products and services ("Hotwatch Platform Products"), which provide credit management and prepaid billing applications and services to the wireless communications industry.

As previously reported, the Company implemented an aggressive restructuring plan during 1998 after incurring significant operating losses during 1996 and 1997. The restructuring plan had three specific objectives: reduce expenses, achieve positive cash flow by the end of 1998 and return the Company to sustainable profitability in 1999. The plan called for a significant reduction in workforce and related expenses, a consolidation of facilities and equipment, the sale of underutilized assets, and management changes. These restructuring initiatives began to yield positive results in the third and fourth quarters of 1998. As reflected in this report, the Company's financial position continued to improve during the first three quarters of 1999, achieving both profitability and positive cash flow during the periods.

REVENUE GENERATION

The Company currently generates revenue through two sources: systems revenue and service revenue.

Systems revenue is generated from licensing and sales of the Company's proprietary software and hardware products, the sale of third-party products sold in connection with the Company's proprietary products and, to a lesser extent, fees earned in connection with the installation and deployment of these products. Revenue is recognized when all of the following conditions are met:

- (i) persuasive evidence of an arrangement exists;
- (ii) delivery has occurred and all contractual obligations and other elements that are essential to the functionality of the delivered products have been satisfied;
- (iii) the amount is fixed and determinable; and
- (iv) collectability is probable.

Revenue is deferred for non-essential undelivered elements, based on vendor specific objective evidence ("VSOE") of the fair value for all elements of the arrangement. VSOE is typically based on the price charged when an element is sold separately, or in the case of an element not yet sold separately, the price established by authorized management, if it is probable that the price, once established, will not change before market introduction. Elements included in multiple element arrangements could consist of software products, upgrades, enhancements, customer support services, or consulting services.

Service revenue is derived primarily from hardware and software maintenance programs, No Clone Zone roaming fraud prevention service, Blackbird Platform Monitoring service and related professional services provided in support of the Company's currently deployed product base. Service revenue is recognized ratably over the period that the service is provided. Hardware and software maintenance generally begins after system acceptance. Prepaid or allocated maintenance and services are recorded as deferred revenue.

Revenue recognition for the Company's systems varies by customer and by product. Every element of a contract must be identified and valued based upon VSOE, regardless of any stated price in the contract. Revenue from any undelivered elements of a contract is deferred. However, any undelivered element essential to the functionality of the delivered product will cause a 100% deferral of the sale. Amounts billed and received on sales contracts before products are delivered or before revenue is recognized or recognizable are recorded as customer deposits or deferred revenue. The significant factors used in determining revenue recognition generally include physical hardware and software delivery, definitions of system delivery and customer acceptance. For those agreements which provide for payment based upon meeting actual performance criteria, the Company may record a portion of the systems revenue and the majority of the systems costs at shipment or during the early stages of a system deployment. In certain cases no systems revenue may be recorded at time of shipment, while certain operating costs may be recorded during the deployment process. Accordingly, revenue and direct margin recorded by the Company can be expected to be lower in earlier periods of deployment and inconsistent from quarter to quarter, especially during the initial market deployments under new agreements. The resulting deferral of revenue is recognized in subsequent periods upon meeting the performance criteria specified in the applicable agreement. The Company does not operate with a significant revenue backlog.

COSTS AND EXPENSES

Costs of systems and services are primarily comprised of the costs of: (i) equipment, which includes both proprietary and third-party hardware and, to a lesser extent, manufacturing overhead and related expenses; (ii) amortization of capitalized software development costs; (iii) system integration and installation; (iv) royalty fees related to the licensing of intellectual property rights from others; (v) customer support; and (vi) activities associated with the evaluation, repair and testing of parts returned from the field in connection with the Company's ongoing hardware maintenance service activities.

Research and development expenditures include the costs for research, design, development, testing, preparation of training and user documentation and fixing and refining features for the software and hardware components included in the Company's current and future product lines.

The Company expects that its costs and expenses in these and other areas will be lower in 1999 than in 1998, but will continue to be incurred in the future, due to the ongoing need to: (i) make investments in research and development; (ii) enhance its sales and marketing activities; (iii) enhance hardware maintenance processes; (iv) enhance its customer support capabilities; and (v) enhance its general and administrative activities.

THREE MONTHS ENDED SEPTEMBER 30, 1999 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 1998

Overview

Total revenue increased 7% to \$2,576,000 in 1999 from \$2,416,000 in 1998. Net income was \$784,000, or \$0.34 per share, in 1999 compared to a loss of \$2,447,000, or \$1.07 per share, in 1998. The Company recognized an alternative minimum tax expense of \$12,000 during the 1999 period.

The Company attributes the increase in revenue to: (i) completion of the major portion of a Blackbird system upgrade for a key customer during the third quarter of 1999; and (ii) increased service and monitoring revenue from the Company's Blackbird Platform Products. The improved operating results are attributable to: (a) cost reductions resulting from the Company's 1998 restructuring plan that included, among other initiatives, streamlining the Company's operations, reducing its workforce and consolidating its facilities; (b) increased service revenue originating from a larger installed base of systems; and (c) revenue from additional recurring services provided by the Company.

Revenue

Systems revenue decreased 18% to \$421,000 in 1999 from \$516,000 in 1998 due to (i) a reduction in domestic market opportunities for the Company's cloning fraud prevention technology due to the deployment of authentication-based products to combat cloning fraud; (ii) lower market penetration than originally planned of Blackbird Platform Products; and (iii) the lack of additional new sales of the Company's cloning fraud prevention technology in 1999. All of such revenue was from customers of the Company's Blackbird Platform Products.

Service revenue increased 13% to \$2,155,000 in 1999 from \$1,900,000 in 1998. Approximately 96% and 93%, respectively, of the 1999 and 1998 total service revenue was derived from the Blackbird Platform Products. This increase is attributable to growing service revenue originating from a larger installed base of Blackbird Platform Products in the current period as compared to 1998 and to a reduction in revenue from the Hotwatch Products.

Costs of Systems and Services

Costs of systems and services, the majority of which relate to the Company's Blackbird Platform Products, decreased 74% to \$886,000 in 1999 from \$3,373,000 in 1998. Costs of systems and services, as a percent of total revenue, were 34% and 140% for the 1999 and 1998 periods, respectively. The decrease in the amounts and/or percentages of costs for 1999 relative to 1998 reflects:

- (i) cost reductions implemented in 1998 in connection with the Company's 1998 restructuring plan;
- (ii) reduced inventory reserve additions and capitalized software amortization;
- (iii) increased service revenue in 1999, resulting from an increased leveraging of its fixed customer support operating expenses; and
- (iv) lower costs associated with the decrease in systems revenue in 1999 as discussed above.

Operating Expenses

Sales and marketing expenses increased 42% to \$176,000 in 1999 from \$124,000 in 1998. The increase in sales and marketing expenses is primarily attributable to rebuilding the sales and marketing organizations in the 1999 period.

General and administrative expenses increased 5% to \$544,000 in 1999 from \$516,000 in 1998 primarily due to increased legal expenses and accruals with respect to the Company's 1999 profit sharing plan.

Research and development costs decreased 53% to \$402,000 in 1999 from \$862,000 in 1998. The decrease in expenditures in 1999 was primarily attributable to reduced staffing levels in connection with the Company's 1998 restructuring plan and was partially offset by spending on product enhancements and new product research.

Other Income, net

Other income was \$112,000 in 1999 compared to a loss of \$5,000 in 1998. A net state sales tax refund of \$357,000 was received in the 1999 period. Net losses on dispositions of fixed assets were \$245,000 in 1999 and \$5,000 in 1998.

Interest Income, net

Interest income increased 582% to \$116,000 in 1999 from \$17,000 in 1998, and resulted from higher average cash balances, interest income earned on customer account balances and interest earned on a state sales tax refund received in the 1999 period.

NINE MONTHS ENDED SEPTEMBER 30, 1999 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 1998

Overview

Total revenue decreased 12% to \$8,131,000 in 1999 from \$9,262,000 in 1998. Net income was \$1,992,000, or \$0.87 per share, in 1999 compared to a loss of \$8,154,000, or \$3.57 per share, in 1998. The Company recognized an alternative minimum tax expense of \$28,000 during the 1999 period.

While the Company enjoyed increased service revenue as described below, the Company attributes the total lower revenue to: (i) a reduction in domestic market opportunities for the Company's cloning fraud prevention technology due to the deployment of authentication-based products to combat cloning fraud; (ii) lower market penetration than originally planned of Blackbird Platform Products; and (iii) the lack of additional new sales of the Company's cloning fraud prevention technology in 1999.

The improved operating results are attributable to: (i) cost reductions attributable to the benefits of the Company's 1998 restructuring plan, that included, among other initiatives, streamlining the Company's operations, reducing its workforce and consolidating its facilities; (ii) increased service revenue originating from an increased installed base of systems; and (iii) additional recurring services provided by the Company.

Revenue

Systems revenue decreased 58% to \$1,597,000 in 1999 from \$3,839,000 in 1998 due to the factors discussed above, and represents revenue from customers of the Company's Blackbird Platform Products.

Service revenue increased 20% to \$6,534,000 in 1999 from \$5,423,000 in 1998. Approximately 96% and 93%, respectively, of the 1999 and 1998 total service revenue was derived from the Blackbird Platform Products. This increase is attributable to increased service revenue originating from a larger installed base of Blackbird Platform Products in the current period as compared to 1998 and additional recurring services performed in the current period as compared to 1998, offset by a reduction in revenue from the Hotwatch Products.

Costs of Systems and Services

Costs of systems and services, which primarily relate to the Company's Blackbird Platform Products, decreased 71% to \$2,999,000 in 1999 from \$10,515,000 in 1998. Costs of systems and services, as a percent of total revenue, were 37% and 114% for the 1999 and 1998 periods, respectively. The decrease in the amounts and/or percentages of costs for 1999 relative to 1998 reflects:

- (i) cost reductions implemented in 1998 in connection with the Company's 1998 restructuring plan;
- (ii) reduced inventory reserve additions and capitalized software amortization;
- (iii) increased service revenue in 1999, resulting from an increased leveraging of its fixed customer support operating expenses; and
- (iv) lower costs associated with the decrease in systems revenue in 1999 as discussed above.

Operating Expenses

Sales and marketing expenses decreased 32% to \$517,000 in 1999 from \$762,000 in 1998. Sales and marketing expenses, as a percent of total revenue, decreased to 6% in 1999 from 8% in 1998. Both the dollar and percentage decreases in sales and marketing expenses are attributable primarily to reductions in average staffing levels and related expenses in connection with the Company's 1998 restructuring plan.

General and administrative expenses decreased 12% to \$1,696,000 in 1999 from \$1,920,000 in 1998 and primarily reflect a reduction in staffing levels and related expenses in connection with the Company's 1998 restructuring plan.

Research and development costs decreased 69% to \$1,241,000 in 1999 from \$3,941,000 in 1998. The decrease in expenditures in 1999 was primarily attributable to reduced staffing levels in connection with the Company's 1998 restructuring plan and was partially offset by spending on product enhancements and new product research.

Other Income, net

Other income was \$128,000 in 1999 compared to a loss of \$334,000 in 1998. A net state sales tax refund of \$357,000 was received in the 1999 period. Net losses on dispositions of fixed assets were \$232,000 in 1999 and \$334,000 in 1998.

Interest Income, net

Interest income increased 282% to \$214,000 in 1999 from \$56,000 in 1998, and resulted from higher average cash balances, interest income earned on customer accounts and interest earned on a state sales tax refund received in the 1999 period.

LIQUIDITY AND CAPITAL RESOURCES

Overview

The Company's capital requirements have consisted primarily of funding software and hardware research and development, property and equipment requirements, working capital and the Company's operating expenses. The Company historically has funded these requirements through issuance of common stock (including proceeds from the exercise of warrants and options) and from operating profits in certain periods. On September 30, 1999, the Company's cash balance was \$5,578,000 as compared to \$1,567,000 on December 31, 1998. The Company's working capital increased to \$3,800,000 at September 30, 1999 from \$596,000 at December 31, 1998.

Cash Provided by Operating Activities

Cash provided by operating activities amounted to \$3,998,000 in 1999, as compared to cash used in operating activities of \$899,000 in 1998. The major factor contributing to the Company's increased cash flow from operating activities in the 1999 period was the \$1,992,000 net income recorded in 1999 as compared to a \$8,154,000 net loss in 1998. Additionally, non-cash charges including depreciation, amortization and changes in balance sheet accounts contributed to the 1999 increase in operating cash flow when compared to the prior year period.

Cash Provided by Investing Activities

Cash provided by investing activities totaled \$13,000 in 1999, compared to cash used in investing activities of \$573,000 in 1998. The amounts in the 1998 period were primarily for capitalization of software development of the Blackbird Platform Products, which ceased during the second quarter of 1998. At September 30, 1999, the Company had no significant commitments for capital expenditures.

Operating Trends

The Company earned \$1,992,000 in the first three quarters of 1999, compared to operating losses of \$10,860,000 and \$5,046,000 for the years ended December 31, 1998 and 1997, respectively. Net non-cash charges included in the operating losses were \$1.4 million in the first three quarters of 1999, \$9.9 million for the twelve months ended December 31, 1998 and \$5.5 million for the twelve months ended December 31, 1997. As of September 30, 1999, the Company had an accumulated deficit of \$24,887,000, which primarily accumulated during the three years ended December 31, 1998. During 1998, in response to such unfavorable operating results, the Company implemented its 1998 restructuring plan, which is described elsewhere in this report. Through the end of the first three quarters of 1999, the results of the Company's 1998 plan showed significant improvement in profitability and cash flow, as reflected in the following table:

Unaudited operating information for the past six quarters (in 000's)

THREE MONTHS ENDED:	REVENUE	NET INCOME (LOSS)	CASH PROVIDED BY (USED IN) OP. ACTIVITIES	EBITDA+
June 30, 1998	\$3,423	(\$3,916)	\$1,185	(\$527)
September 30, 1998	2,416	(2,447)	(634)	34
December 31, 1998	2,712	(2,706)	(530)	532
March 31, 1999	2,764	515	927	964
June 30, 1999	2,791	694	1,459	957
September 30, 1999	2,576	784	1,612	1,222

The EBITDA+ information shown above reflects earnings (loss) before interest and taxes, and certain non-cash charges to operations for depreciation, amortization, losses on disposal of assets and inventory reserves. This is one of the Company's important cash flow monitoring tools in evaluating the effectiveness of its 1998 restructuring plan and its current operations. The positive trends experienced during each of the last six quarterly periods show the effectiveness of the 1998 restructuring plan towards achieving the Company's goals of both positive cash flow by the end of 1998 and profitability during 1999. However, there can be no assurance that the Company's operations will be profitable on a quarterly or annual basis in the future or that existing revenue levels can be enhanced or sustained. Past and existing revenue levels should not be considered indicative of future operating results. While the Company believes that its current cash reserves and projected cash flow from operations provide sufficient cash to fund its operations for at least the next twelve months, unanticipated changes in customer needs and/or other external factors may require additional financing and/or further expense reductions.

Year 2000 Compliance

The Company is currently utilizing internal resources and, where appropriate, outside resources to comprehensively identify, evaluate and resolve, in a timely manner, the potential impact of the year 2000 and beyond processing of date-sensitive information as it applies to the Company's business. Generally, year 2000 processing issues are the result of systems that use two digits (rather than four digits) to define the applicable year. Thus, for example, any system that utilizes date-sensitive coding may recognize a date using "00" as the year 1900 rather than the year 2000. Year 2000 processing issues also may arise in other contexts, such as certain leap year calculations and in systems that use certain dates to provide special functionality. Any of these year 2000 processing issues could result in miscalculations or system failures causing disruptions to products, services, or operations.

To address year 2000 processing issues, the Company formed a cross-functional task force, headed by senior management, to evaluate the risks and implement appropriate remediation and contingency plans. As part of its efforts, the Company divided its systems that process date-sensitive information into the following three categories: (i) Blackbird Platform Products; (ii) Hotwatch Platform Products; and (iii) systems used in the Company's internal operations. Each of these categories may include internally-developed applications, third-party applications, operating systems, outsourced systems and interfaces with external systems. Overall, the Company believes that its year 2000 compliance projects will be completed in a timely manner. The general status of each of these categories is described below.

Blackbird Platform Products - The Company has substantially completed its assessment of year 2000 compliance for its Blackbird Platform Products. The Company believes that its software incorporated in these products is year 2000 compliant, so long as all necessary software and hardware with which it operates is also year 2000 compliant. With respect to third-party software incorporated in or operating with these products, all vendors of such software have indicated that their software is year 2000 compliant, and the Company either has or is in the process of installing software upgrades, as appropriate. In addition, the Company has conducted internal tests which indicate that the Blackbird Platform Products, when used in conjunction with such third-party software, is year 2000 compliant in all material respects. As the vendors of such third-party software continue to evaluate year 2000 processing issues for their own products, several have uncovered new or additional problems relating to their products from time to time, resulting in a change of their stated year 2000

compliant versions. In some cases, these new or additional problems have necessitated additional software upgrades or testing by the Company. The Company plans to continue monitoring the status of such third-party software for year 2000 readiness and perform appropriate software upgrades, if necessary.

Hotwatch Platform Products - The Company's Hotwatch Platform Products, which revenue is not currently material to the Company's financial position, results of operations, or cash flows, are not currently year 2000 compliant. All customer use of Hotwatch Platform Products is scheduled to be phased out before the end of 1999. The Company has identified the aspects of these products that would require enhancements to become year 2000 compliant. If the Company identifies an opportunity for the sale or license of Hotwatch Platform Products in the future, the Company expects that any year 2000 compliance project for these products, if initiated, will be completed in a timely manner and that all related costs will be borne by its future customer(s) of these products.

Internal Systems - The Company continues to assess the systems used in the Company's internal operations for year 2000 compliance. To date, nearly all of these systems have been confirmed to be either presently year 2000 compliant in all material respects, or year 2000 compliant with the purchase of readily-available software upgrades or alternatives that are currently identified to be year 2000 compliant. For these internal systems, the Company either has or is in the process of installing software upgrades and/or implementing alternatives, as appropriate. As the vendors of third-party systems and software continue to evaluate year 2000 processing issues for their own products, several have uncovered new or additional problems relating to their products from time to time, resulting in a change of their stated year 2000 compliant versions. In some cases, these new or additional problems have necessitated additional software upgrades or testing by the Company for its internal systems. The Company plans to continue monitoring the status of such third-party systems and software for year 2000 readiness and perform appropriate upgrades, if necessary. The Company expects that its year 2000 compliance projects for internal systems will be completed in a timely manner.

The Company has developed contingency plans for its critical operational departments to address the impact to the Company in the event its suppliers, products, or internal systems are not year 2000 compliant. These plans are designed to enable the Company to continue its operations, based upon different scenarios which may or may not be within the Company's span of control. These plans address internal remediation procedures, use of alternative suppliers or operating methods where possible, and required staffing levels during critical periods. Evaluation of year 2000 processing issues and appropriate contingency planning is continuing. Despite the Company's efforts to address these issues, there can be no assurance that additional year 2000 processing issues, not presently known by the Company, will not arise or that third party systems or products on which the Company relies will be year 2000 compliant.

Costs incurred to date for year 2000 compliance issues have not been significant and costs to complete are not currently expected to have a material adverse impact on the Company's financial position, results of operations, or cash flows in future periods. If, however, the Company, its customers, or its vendors are unable to adequately resolve any year 2000 compliance issues not yet addressed in a timely manner, the Company's business, financial condition and results of operations may be adversely affected. In addition, the Company has on occasion agreed to warrant and/or indemnify certain of its customers for claims and losses arising out of the failure of its products to be year 2000 compliant. There can be no assurance that the Company's current and future products and internal systems do not contain undetected errors related to year 2000 processing that may result in material additional costs or liabilities that could have a material adverse effect on the Company's business, financial condition and results of operations. Further, to the extent that the Company is not able to test the technology provided to it by third parties for its own use or for redistribution, or to obtain adequate assurances from such third parties that their products are year 2000 compliant, the Company may experience additional costs or liabilities that could have a material adverse effect on the Company's business, financial condition and results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

None.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In January 1998, Communications Information Services, Inc. filed an action against the Company and AirTouch Communications, Inc. for alleged infringement of United States Patent No. 5,329,591 ("the '591 patent") in the United States District Court for the Northern District of Georgia at Atlanta. In January 1999, the Court granted the Company's motion to transfer this lawsuit to the United States District Court for the Western District of Washington. The complaint asserts that the plaintiff is the exclusive licensee of all rights under the '591 patent, alleges that the Company's cellular telephone fraud prevention technology infringes the '591 patent, and seeks damages in unspecified amounts. The Company believes this lawsuit is without merit and is vigorously defending against it. Although no estimate of any outcome of this action can currently be made, an unfavorable resolution of this lawsuit could have a material adverse effect on the Company's liquidity, financial condition and results of operations.

From time to time, the Company is also a party to other legal proceedings in the ordinary course of business and/or which management believes will be resolved without a material adverse effect on the Company's liquidity, financial condition or results of operations.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) EXHIBITS

27 Financial Data Schedule - filed only with EDGAR submission

b) REPORTS ON FORM 8-K

None.

SIGNATURES

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

CELLULAR TECHNICAL SERVICES COMPANY, INC.

By: /s/Bruce R. York

Bruce R. York
Vice President and Chief Financial Officer
November 12, 1999

STATEMENT OF DIFFERENCES

The trademark symbol shall be expressed as.....'TM'
The registered trademark symbol shall be expressed as..... 'r'
The service mark symbol shall be expressed as.....'sm'

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE ACCOMPANYING FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000

9-MOS
 DEC-31-1999
 JAN-01-1999
 SEP-30-1999

5,578

0

1,227

5

670

7,653

4,281

3,250

8,920

3,853

0

0

0

23

5,044

8,920

1,597

8,131

2,999

6,453

0

0

0

2,020

28

1,992

0

0

0

1,992

0.87

0.87