

VERTICALNET INC
Form 10-K
April 02, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

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

Commission File Number 000-25269

VERTICALNET, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

23-2815834
(I.R.S. Employer
Identification No.)

400 CHESTER FIELD PARKWAY

MALVERN, PENNSYLVANIA
(Address of principal executive offices)

19355
(Zip Code)

Registrant's telephone number, including area code: (610) 240-0600

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$.01 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of June 30, 2006 (the last day of our most recently completed second quarter), the aggregate market value of the common stock held by non-affiliates of the registrant was \$6,692,725. Such aggregate market value was computed by reference to the closing sale price per share of \$1.29 as reported on The Nasdaq Capital Market on such date. For purposes of making this calculation only, the registrant has defined affiliates as including all officers, directors, and beneficial owners of more than five percent of the common stock of the registrant. In making such calculation, the registrant is not making a determination of the affiliate or non-affiliate status of any holders of shares of the registrant's common stock.

The number of shares outstanding of the registrant's common stock as of March 10, 2007 was 10,692,817.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement relating to its 2007 Annual Meeting of the Shareholders are incorporated herein by reference in Part III hereof, unless the definitive Proxy Statement is not to be filed by April 30, 2007, in which case registrant will amend the Form 10-K to provide the omitted information.

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VERTICALNET, INC.

FORM 10-K

For the Fiscal Year Ended December 31, 2006

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The information in this report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Any statements contained in this report that are not statements of historical fact may be deemed forward-looking statements. Words such as may, might, will, would, should, could, project, estimate, pro forma, predict, potential, strategy, anticipate, plan to, believe, continue, intend, expect, and words of similar expression (including the negative of any of the foregoing) are intended to identify forward-looking statements. Additionally, forward-looking statements in this report include statements relating to the design, development, and implementation of our products; the strategies underlying our business objectives; the benefits to our customers, and their trading partners, of our products; our liquidity and capital resources; and the impact of our acquisitions and investments on our business, financial condition, and operating results.

Our forward-looking statements are not meant to predict future events or circumstances and may not be realized because they are based upon current expectations that involve risks and uncertainties. Actual results and the timing of certain events may differ materially from those currently expected as a result of these risks and uncertainties. Factors that may cause or contribute to a difference between the expected or desired results and actual results include, but are not limited to, the availability of and terms of equity and debt financing to fund our business; our reliance on the development of our enterprise software business; our ability to continue to remain listed on The Nasdaq Capital Market; competition in our target markets; economic conditions in general and in our specific target markets; our ability to use and protect our intellectual property; and our ability to attract and retain qualified personnel, as well as the risks discussed in Item IA of this report entitled Risk Factors. Given these uncertainties, investors are cautioned not to place undue reliance on our forward-looking statements. We disclaim any obligation to update these factors or to announce publicly the results of any revisions to any of the forward-looking statements contained in this report to reflect future events or developments.

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PART I

Item 1. Business

Description of the Company

Verticalnet, Inc., which was incorporated on July 28, 1995 under the laws of Pennsylvania, is referred to throughout this report as Verticalnet, the Company, we, us, or through similar expressions.

We are a provider of On-Demand Supply Management solutions to companies ranging in size from mid-market to the Global 2000. We provide a full scope of Supply Management software, services, and domain expertise in areas that include: Program Management, Spend Analysis, eSourcing, Contract Management, and Supplier Performance Management. Our solutions help our customers to save money on the goods and services they buy.

Historically, we derived our revenue primarily from the licensing of our software, as well as implementation and development services. As a result of the January 2004 acquisition of Tigris Corp. (Tigris), in 2004 we began generating revenues from spend analysis and other supply chain consulting services and, since our July 2004 acquisition of B2eMarkets, Inc. (B2eMarkets), we have seen an increase in the amount of our revenue from the licensing of our software products and maintenance of those products. In July 2005, we acquired Digital Union Limited (Digital Union), a provider of eSourcing and eProcurement software based in the United Kingdom, and as a result we expect to see a continued increase in the proportion of our revenues from software and software related revenues. We anticipate seeing an increase in the proportion of our revenue coming from the licensing of our products and maintenance, primarily on a subscription-based on-demand basis. See Management's Discussion and Analysis of Financial Condition and Results of Operations Company Overview for a discussion of the significant changes in our business in 2006.

Our business has one operating segment. Financial information regarding our geographic areas is presented in Note 17 to our consolidated financial statements included in this Annual Report on Form 10-K.

Competitive Advantage

We believe our solutions are differentiated by the breadth of our Supply Management offering, our on-demand delivery model, the depth of our consulting and services expertise and our category specific strategic collaborative sourcing solutions.

Supply Management Suite We believe that we offer a complete suite of supply management solutions to help our customers to automate the full lifecycle of the strategic sourcing process from opportunity identification, through supplier negotiation, contract management, performance management, and compliance measurement.

On-Demand We believe that we deliver the broadest suite of supply management solutions on-demand. Verticalnet On-Demand enables companies to achieve and sustain one of lower total cost of ownership by enabling them to access Verticalnet XE applications over the Internet with no software installation required. We believe that Verticalnet On-Demand significantly reduces the risk associated with implementing a strategic supply management solution as well as delivers the fastest results with the lowest total cost of ownership. With Verticalnet On-Demand, there is no software to install, maintain, and support and no prohibitive up-front costs. Verticalnet manages all of the infrastructure management and support services, including buyer and supplier enablement.

Services We offer a services approach across all of our solutions for companies that are looking for business process improvement or assistance with complex data problems. Our services teams have focused skill sets and experience which enable them to address highly complex client sourcing needs. We believe our service capabilities are an advantage versus most of our installed software-focused competitors.

Collaborative Sourcing We believe that Verticalnet's category-specific collaborative sourcing solutions are unique among other broad supply management competitors. XE Collaborative Sourcing, a combination of technology and consulting services, are tailored towards specific categories, such as transportation, packaging, industrial maintenance, repair, and operations (MRO), and commercial printing. We believe that this offering provides significant differentiation versus our traditional competitors and often provides an additional solution to sell to companies that may have already purchased software from a competitor.

Our Solutions

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Our solutions consist of a tailored mix of software, services, and process expertise designed to meet the specific needs of our customers. Supply Management encompasses the lifecycle of strategic sourcing and procurement. Our Verticalnet XE suite of on-demand software solutions consist of six modules: Program Manager, Spend Manager, Negotiation Manager, Contract Manager, Procurement Manager, and Performance Manager. Our software is licensed by module, with our customers selecting the modules that are appropriate for their business. Additionally, we offer technology enabled, category-specific Strategic Sourcing services on demand.

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Verticalnet XE Supply Management Suite

Verticalnet XE Supply Management Suite is an end-to-end on-demand supply management suite that enables sourcing and procurement organizations to balance price, performance, and risk to achieve a lower total cost of ownership. The following six modules that comprise our Verticalnet XE suite of software solutions are available on-demand as an independent or integrated offering.

Verticalnet Program Manager facilitates the rollout of re-usable program and process management to ensure that strategic sourcing processes are applied across the supply management lifecycle.

Verticalnet Spend Manager provides a fast, intelligent, repeatable, and straightforward solution to analyze spending patterns to monitor compliance and identify sourcing opportunities.

Verticalnet Negotiation Manager is a comprehensive solution for creating, collaborating, publishing, negotiating, and analyzing auctions, requests for proposal and/or requests for quote.

Verticalnet Contract Manager provides the tracking, management, and negotiation capabilities necessary to negotiate and provide enterprise-wide access to contracts.

Verticalnet Procurement Manager provides control over the procurement process to help companies realize the maximum cost savings identified through supplier sourcing and negotiation.

Verticalnet Performance Manager provides effective management of performance and compliance, and then the ability to immediately remedy problem areas.

Verticalnet XE Collaborative Sourcing

Verticalnet XE Collaborative Sourcing (XECS) combines Verticalnet technology, services, and category expertise to enable companies to drive additional value from strategic, complex categories. XECS solutions include:

Transportation

Packaging

Industrial MRO

Commercial printing

Temporary labor

On-Demand Services

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Verticalnet On-Demand enables companies to rapidly achieve and sustain lower total cost of ownership by enabling them to access Verticalnet XE applications over the Internet with no software installation required. We believe that Verticalnet On-Demand significantly reduces the risk associated with implementing a strategic supply management solution. With Verticalnet On-Demand, there is no software to install, maintain, and support and no prohibitive up-front costs. Verticalnet manages all of the infrastructure management and support services, including buyer and supplier enablement. Verticalnet's On-Demand services include:

Community Support

Event support

Proxy bidding

Trading floor management

Application usage support

Infrastructure Management

Application hosting

Hardware and software management

Application performance management

Education and Training

Consulting Services

Verticalnet's consulting organization has completed hundreds of supply management consulting engagements with Global 2000 enterprises and mid market companies. Our consultants have particular expertise at managing large volumes of customer data to perform spending analysis and complete strategic sourcing engagements for large, complex purchasing categories such as packaging; transportation; maintenance, repair and operational; services; and commercial printing.

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Our consultants have also performed many supply chain optimization consulting engagements for large clients. As of March 30, 2007, our consulting organization consists of 28 consultants based out of our Guildford (United Kingdom), New York, Chicago, and Malvern offices. Our consulting personnel possess both real world experience and strong academic backgrounds in the fields of engineering, operations research, and computer science which enable them to deliver rigorous data-driven approaches for solving complex sourcing problems.

Our consultants also help customers plan, implement, and manage our software products so that they achieve their business objectives. At the heart of our implementation services are straightforward methodologies and tools that make software implementations smooth and efficient. Our methodology approaches implementation in well-defined, manageable phases rolling out categories, suppliers, and customers over discrete intervals and targets. Customer generally go-live in less than 90 days.

Custom Development

We offer custom development for customers that desire to build additional capabilities into our applications. Our Solution Center works with clients to define custom development requirements and build the required functionality on top of our Collaborative Supply Chain Foundation. Often, new capabilities developed for customers can be incorporated into future versions of our software.

Our software platform was built to be flexible and extensible. Our customers find that many of their complex supply chain problems often can be solved by taking advantage of the features of the platform. Our Solution Center approach generally allows us to complete customization projects more quickly and cost effectively than internal IT organizations or traditional custom development firms. Typically the resulting custom developed applications are fully integrated with, and built on the same data model as, the customer's existing Verticalnet implementation.

Customers

We have two customers, Premier, Inc. and A.T. Kearney, which together represent approximately 23.8% of our total revenue for the year ended December 31, 2006. The termination or material reduction of our relationship by either of these customers could have a material adverse effect on our business, operating results, and financial condition.

Sales and Marketing

Our direct sales organization focuses on selling supply management solutions to large companies, typically with over \$1 billion in revenues, as well as mid-market companies with revenues from \$250 million to \$1 billion. We typically target companies in manufacturing, consumer products, pharmaceuticals, and retail where supply management is a critical driver of corporate profitability. Our sales team members have deep experience in either enterprise software sales or in solution-based sales. Our direct sales force is teamed with pre-sales consultants that work with prospects to select the proper solution to meet customer requirements and deliver the greatest value. Account executives are split into two organizations, one focused on new account sales, and the other focused on uncovering new business opportunities with existing customers.

We also use selective indirect sales channels, such as third-party alliances, to market our solutions, and to increase the market penetration of our solutions through joint marketing and sales activities. Such relationships allow us to extend the reach of our sales efforts without increasing headcount.

We support our sales activities by conducting a variety of marketing programs and participate in industry conferences. We maintain relationships with recognized industry analysts, including AMR Research and the Aberdeen Group. These firms advise our target client base, as well as provide us with critical feedback into our product management process. We also conduct lead-generation programs, including telesales, web seminars, advertising, direct mail, email marketing, public relations, ongoing client communication programs, and Verticalnet-moderated conferences and seminars.

Proprietary Rights

We regard our software as proprietary and rely on a combination of trade secret, patent, copyright and trademark laws, license agreements and other contractual arrangements, and confidentiality and non-disclosure agreements with our employees, our clients, consulting partners, and others to help protect proprietary rights in our products. We distribute our supply management applications under software license agreements, which typically grant clients perpetual or term-based nonexclusive, nontransferable licenses to our software products. Under such typical license agreements, we retain all ownership rights to our products.

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Use of the licensed software is usually restricted to the client's internal operations and to designated users. Use is subject to terms and conditions that prohibit unauthorized reproduction or transfer of the software. We also seek to protect the source code of our software as a trade secret and as an unpublished, copyrighted work. We have also licensed to select customers the right to access the source code of several of our legacy, non-strategic software products and to allow those customers to create derivative works of those products.

We typically enter into master service or professional service agreements and/or statements of work with our customers who purchase our services. These agreements also have similar provisions to protect our intellectual and proprietary rights to the tools we may use to provide our services.

Research and Development

We direct our efforts in research and development to new products, enhancements of the capabilities in existing products, and expansion of our supply management capabilities. Our internal research and development team has developed most of our current products. In addition, we obtained some underlying technology through acquisitions. In developing new products or enhancements, we work closely with current and prospective clients, as well as with industry experts, to ensure that our products address the critical supply chain needs of today's businesses. We believe that this collaboration is necessary to develop and improve our software and products. Our product group works closely with our marketing, sales, and services groups to develop products that meet real customer needs. As of March 1, 2007, our research and development staff consisted of 20 employees.

In August 2003, we entered into an agreement with Symphony Service Corp., a U.S. based company, to provide software development services and customer support services at a global development center in Bangalore, India. As of March 1, 2007, there were 19 software developers and 4 customer service representatives in Bangalore, India.

Competition

The markets for our solutions are highly competitive. Our competitors are diverse and offer a variety of solutions targeting various segments of the extended supply chain, as well as the enterprise as a whole. More specifically, we compete with:

Large enterprise resource planning (ERP) software vendors, including Oracle and SAP, who have added or are attempting to add capabilities for strategic sourcing to their products;

e-Sourcing solution providers, such as Ariba, Emptoris, Katera Technologies, Perfect Commerce, Procuri, and a number of privately held solution providers, and

Internal efforts by corporate information technology departments or procurement organizations.

We believe that the principal competitive factors affecting our market include breadth and depth of solutions, depth of industry or category expertise, specific product features and performance, ability to implement solutions, value of solutions, corporate viability, and a base of reference customers. Although we believe that our solutions currently compete favorably with respect to these factors, our market is evolving rapidly, and we may not be able to maintain our competitive position against current and potential competitors, especially those with greater financial, marketing, service, support, technical, and other resources.

Many of our current and potential competitors have longer operating histories, significantly greater current and potential financial, technical, marketing and other resources, significantly greater name recognition, and a larger installed base of customers than we do. Some of these vendors have and may continue to introduce supply management modules that are included as part of broader enterprise applications at little or no cost. In addition, many of our competitors have well-established relationships with our current and potential customers and have extensive knowledge of our industry. In the past, we have lost potential customers to competitors for various reasons, including lower prices and other incentives not matched by us. In addition, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to increase the ability of their products to address customer needs. Accordingly, it is possible that new competitors or alliances among competitors may emerge and rapidly acquire significant market share. We also expect that competition will increase as a result of industry consolidations. As a result, we may not be able to successfully compete against our current and future competitors.

Employees

As of March 1, 2007, we had 88 employees. We consider our relationship with our employees to be good. None of our employees are covered by collective bargaining agreements.

Website Disclosures

We maintain a website at www.verticalnet.com and make available free of charge on this website our annual report on Form 10-K,

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quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission (SEC). The material on our website is not part of this report.

Item 1A. Risk Factors

We will require additional capital to fund our operations and obligations.

We believe that we will be able to finance our capital requirements and operations through, at least, March 31, 2008, assuming that (i) we are able to repay a portion of our senior secured convertible promissory notes due July 2, 2007, which we refer to as the convertible notes, with our common stock as discussed below, (ii) the convertible notes and our \$5.5 million senior subordinated discounted promissory notes, which we refer to as the discount note, are not declared in default within this timeframe, and (iii) our actual revenues and expenses are within our current projected estimates.

As of December 31, 2006, we had cash and cash equivalents of \$2.8 million. Under the terms of our convertible notes, we are required to maintain a cash balance of at least \$1.5 million. As of December 31, 2006, the outstanding payments to be made under the convertible notes are \$2.1 million, plus interest, and the amount of each remaining monthly principal payments under the convertible notes are as follows: \$317,500 in January and February 2007; \$305,450 in March 2007; and \$292,500 from April 2007 through July 2007.

As of December 31, 2006, the outstanding principal amount of \$5.5 million was due on April 1, 2008 under our amended discount note and interest payments of \$165,000 are payable under the discount note quarterly until the maturity date. As of March 28, 2006, we entered into an agreement to further amend the discount note to give us the option to extend the stated maturity date of the discount note from April 1, 2008 to September 30, 2008. We have until December 31, 2007 to exercise this option and if we elect to exercise the option, the outstanding principal amount of the discount note will automatically increase by \$575,000. Under the terms of the amended discount note, we are required to pay the discount note holder an amount equal to 25% of the gross proceeds raised in any equity financing transaction completed while the discount note is outstanding, which amount will be applied as payment toward the then outstanding principal amount of the discount note. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Developments for a more detailed description of the amendments to the discount note.

Given our cash level and debt repayment schedules, we are seeking to obtain additional debt or equity financing and/or seeking to restructure or refinance our existing indebtedness, subject to obtaining any required consent from our debt holders, which may result in the issuance of additional debt or equity securities that will further dilute our existing shareholders. In addition, we are exploring the licensing of certain non-strategic technology assets to enhance our liquidity and further reduce our cost structure, as well as the sale of specific non-strategic technology assets redundant with our core technology products, subject to obtaining the consent of our debt holders to sell such assets. In the event that we are successful in the sale or licensing of these non-strategic assets, we may be required to use the proceeds to reduce the outstanding balance of the convertible notes or the discount note.

In addition, if we are ultimately unable, for any reason, to receive cash payments expected from our customers, our business, financial condition, and results of operations may be materially and adversely affected.

Our indebtedness and debt service obligations may adversely affect our cash flows.

Should we be unable to satisfy our interest and principal payment obligations under our convertible notes through the issuance of shares of our common stock, we will be required to pay those obligations in cash. If we are unable to generate sufficient cash to meet these obligations as well as our obligations under our discount note, we may have to restructure or limit our operations.

Under the terms of the discount note, we are prohibited from paying the monthly principal and interest payments under the convertible notes in cash to the extent we can make such payments in shares of our common stock in accordance with the terms of the convertible notes. However, the terms of the convertible notes impose limitations on the number of shares we can use to make principal and interest payments based on the trading price and volume of our common stock. As a result, during periods when the trading price and volume of our common stock has declined, we have not been able to make the entire principal and interest payments under the convertible notes in shares of common stock. Historically, we have made at least a portion of the monthly principal and interest payments on the convertible notes in shares of common stock. If we cannot make principal and interest payments under the convertible notes with shares of common stock, we will have to use our available cash to make such payments.

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In February 2007, our registration statement registering 2,500,000 shares of common stock for resale was declared effective, which was our estimate of the number of shares of common stock issuable as payment for the remaining principal and interest payments on the convertible notes or upon conversion of the convertible notes. We may also be required to make monthly principal and interest payments on the convertible notes in cash instead of shares of common stock if this registration statement later ceases to remain effective. As of March 30, 2007, approximately 2.2 million shares of common stock remain available for issuance under the registration statement.

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Our indebtedness could have significant additional negative consequences, including, but not limited to:

requiring the dedication of a substantial portion of our expected cash flow from operations to service the indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures;

increasing our vulnerability to general adverse economic and industry conditions;

limiting our ability to obtain additional financing;

limiting our flexibility to plan for, or react to, changes in our business and the industry in which we compete; and

placing us at a possible competitive disadvantage to competitors with less debt obligations and competitors that have better access to capital resources.

Our convertible notes and discount note provide that upon the occurrence of various events of default and change of control transactions, the holders would be entitled to require us to prepay the notes for cash, which could leave us with little or no working capital for operations or capital expenditures.

Our convertible notes and discount note allow the holders thereof to require us to prepay the notes upon the occurrence of various events of default, such as the failure to list our shares on the OTC Bulletin Board or another acceptable exchange if we are delisted from The Nasdaq Capital Market or our receiving a qualification from our auditors as to our ability to continue as a going concern. The convertible notes and the discount note contain cross-default provisions, which means that a default under either instrument results in a default under the other instrument. If we are unable to comply with the covenants under the convertible notes or the discount note, the holders of the convertible notes and the discount note may declare us in default and may declare all amounts due under the notes, including any accrued interest and penalties. As of December 31, 2006 and the date of this filing, we were in compliance with the covenants under the convertible notes and the discount note. We expect to remain in compliance with the covenants of the convertible notes and discount note. However, no assurance is made that we will remain in compliance with all of the covenants under the convertible notes and the discount note.

We may also be required to prepay the convertible notes and the discount note upon the occurrence of specified change of control transactions. If an event of default or a change in control occurs, we may be unable to prepay the entire amount due under the convertible notes and the discount note in cash. Even if we were able to prepay the entire amount in cash, any such prepayment could leave us with little or no working capital for our business. We have not established a sinking fund for payment of our obligations under our notes, nor do we anticipate doing so.

We may not generate an operating profit.

As of December 31, 2006, our accumulated deficit was approximately \$1.2 billion. We may never again generate an operating profit or, even if we do become profitable from operations at some point, we may be unable to sustain that profitability.

We generate a significant portion of our revenues and accounts receivable from two customers.

For the year ended December 31, 2006, two customers accounted for \$3.8 million or 23.8% of our total revenues. For 2005, these same two customers accounted for \$8.7 million or 42.0% of our total revenue, and for 2004, they accounted for \$11.2 million or 48.9% of our total revenues.

As of December 31, 2006, these two customers accounted for \$243,000 or 6.3% of our accounts receivable balance, of which \$168,000 has been collected as of March 1, 2007. Although we have had a successful collection history with these customers, and do not foresee any collection issues, there can be no assurance that we will be able to collect outstanding balances and future invoices from them.

We have contractual obligations to provide consulting services over many periods.

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We maintain a professional services and consulting workforce to fulfill contracts that we enter into with our customers that may extend over multiple periods. Our profitability is largely a function of performing against customer contractual arrangements within the estimated costs to perform these obligations. If we exceed these estimated costs, our profitability under these contracts may be negatively impacted. In addition, if we are not able to obtain sufficient work to keep all of our professionals on revenue generating projects, our business, financial condition, and results of operations may be adversely affected.

If we fail to meet client expectations in the performance of our services, our business could suffer.

Our failure to meet client expectations in the performance of our services, including the quality, cost, and timeliness of our services, may adversely affect our ability to attract and retain clients. If a client is not satisfied with our services, we will generally spend additional human and other resources at our own expense to ensure client satisfaction. Such expenditures will typically result in a lower margin on such engagements and could have a material adverse effect on our business, financial condition, and results of operations.

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We may be unable to maintain our listing on The Nasdaq Capital Market, which could cause our stock price to fall and decrease the liquidity of our common stock.

Our common stock is currently listed on The Nasdaq Capital Market, or Nasdaq. Continued listing on Nasdaq requires us to meet certain qualitative standards, including maintaining a certain number of independent Board members and independent audit committee members, and certain quantitative standards, including that we maintain at least \$2.5 million in shareholders' equity and that the closing price of our common stock not be less than \$1.00 per share for 30 consecutive trading days.

On September 27, 2006, we received written notification, or the notice, from Nasdaq that for 30 consecutive trading days the bid price of our common stock had closed below the minimum \$1.00 per share required for continued listing under Nasdaq Marketplace Rule 4310(c)(4), or the rule. We were provided an initial period of 180 calendar days, or until March 26, 2007, to regain compliance with the rule. The notice states the Nasdaq staff, or the staff, will provide written notification that we have achieved compliance with the rule if at any time before March 26, 2007, the bid price of our common stock closes at \$1.00 per share or more for a minimum of 10 consecutive business days, although the notice also states that the staff has the discretion to require compliance for a period in excess of 10 consecutive business days, but generally no more than 20 consecutive business days, under certain circumstances.

On March 27, 2007, we received written notification, or the second notice, from Nasdaq that the staff had determined that we did not regain compliance with the rule and that we were not eligible for an additional 180 day compliance period because we did not meet the Nasdaq Capital Market initial listing criteria set forth in Marketplace Rule 4310(c). Specifically, we did not meet The Nasdaq Capital Market initial listing criteria of (i) having shareholders' equity of at least \$5 million, having a market value of listed securities of at least \$50 million or having net income from continuing operations of \$750,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years, and (ii) having a market value of listed securities of at least \$5 million. The second notice stated that as a result our stock will be delisted on April 5, 2007, unless we request an appeal of the staff's determination to a Nasdaq Listing Qualifications Panel by April 3, 2007. On April 2, 2007, we requested an appeal of the staff's determination to delist our securities to a Nasdaq Listing Qualifications Panel. As of April 2, 2007, we have not received a hearing date to consider our appeal.

There can be no assurance that the Nasdaq Listing Qualifications Panel will grant our request for continued listing.

If our stock is delisted from The Nasdaq Capital Market, we will be obligated to make monthly payments, in cash, of approximately \$88,000 per month to the holders of our convertible notes, which could have a material adverse effect on our business, financial condition, and results of operations and may leave us with little or no working capital for our business.

Under the terms of the registration rights agreement we entered into with the holders of the convertible notes in August 2005, if our common stock is delisted from The Nasdaq Capital Market for any reason for more than three business days, we are obligated to pay the holders of our convertible notes in cash an aggregate amount equal to 1.5% of the original principal amount of the convertible notes for the first calendar month and each additional calendar month after delisting until the convertible notes are no longer outstanding. Based on the original principal amount of the convertible notes, this penalty would be approximately \$88,000 per month. If we are required to make these monthly payments in cash, our business, financial condition, and results of operations may be materially and adversely affected and may leave us with little or no working capital for our business.

If our stock is delisted from The Nasdaq Capital Market or our share price declines significantly, then our stock may be deemed to be penny stock.

If our common stock is considered penny stock, it would be subject to rules that impose additional sales practices on broker-dealers who sell our securities. Because of these additional obligations, some brokers may be unwilling to effect transactions in our stock. This could have an adverse effect on the liquidity of our common stock and the ability of investors to sell their common stock. For example, broker-dealers must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to sale. Also, a disclosure schedule must be prepared prior to any transaction involving a penny stock and disclosure is required about sales commissions payable to both the broker-dealer and the registered representative and current quotations for the securities. Monthly statements are required to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stock.

If our stock is delisted from The Nasdaq Capital Market, we may be unable to license our products and sell our services to prospective or existing customers.

If our stock is delisted, our prospective and existing customers may lose confidence that we can continue as a viable business to provide support necessary to further develop our solutions and provide ongoing maintenance and consulting services. Prospective and existing customers could

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consider alternative solutions or significantly reduce the value they are willing to pay for our solutions to compensate for the potential added risk to their business. If our stock is delisted, our ability to meet our revenue goals could be adversely impacted, resulting in deterioration of the financial condition of our business.

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Our success depends on our ability to retain key management personnel, whom we may not be able to retain.

We believe that our success depends on the continued employment of our senior management team. If one or more members of our senior management team were unable or unwilling to continue in their present positions, our success could be adversely affected.

We may not be able to hire or retain enough additional personnel to meet our hiring needs.

Our success also depends on having highly trained professional services and software development personnel. If we are unable to retain our personnel, it could limit our ability to service our customers and design and develop products, which could reduce our attractiveness to potential customers, investors, or acquirers. We may need to hire additional personnel if our business grows. A shortage in the number of trained consultants and developers could limit our ability to implement our software if we are able to license software to new customers or if our present customers ask us to perform more services for them. Competition for personnel, particularly for employees with technical expertise, could be strong. Our business, financial condition, and operating results will be materially adversely affected if we cannot hire and retain suitable personnel.

Our cost containment and cost reduction initiatives may yield further unintended consequences, such as reduced employee morale, decreased productivity and disclosures of confidential information about us by employees that seek employment with others in violation of their confidentiality agreements with us.

Fluctuations in our quarterly operating results may cause our stock price to decline.

Our quarterly operating results are difficult to forecast and could vary significantly. If our operating results in a future quarter or quarters do not meet the expectations of securities analysts or investors, the price of our common stock may fall. Our quarterly operating results will be substantially dependent on software licenses and professional services booked and delivered in that quarter. Any delay in the recognition of revenue for any of our license transactions or professional services could cause significant variations in our quarterly operating results and could cause our revenues to fall significantly short of anticipated levels. Our quarterly operating results could fluctuate significantly due to other factors, many of which are beyond our control, including:

anticipated lengthy sales cycle for our products;

the size and timing of individual license transactions;

intense and increased competition in our target markets;

our ability to develop, introduce, and bring to market new products and services, or enhancements to our existing products and services, on a timely basis; and

risks associated with past acquisitions.

If we are able to grow our business, we may not be able to manage the growth successfully.

If we are able to grow our business, such growth could place a significant strain on our resources and systems. To manage our growth, we must implement systems and train and manage our employees. In addition, we may not be able to limit our exposure to non-creditworthy customers.

We may issue our securities in capital raising or acquisition transactions, which could dilute our existing shareholders.

From time to time, we consider potential acquisitions in an attempt to grow our business. In addition, we may seek to raise additional capital. We may be required to incur debt or issue equity securities to pay for acquisitions or to raise additional capital, which may be dilutive to our existing shareholders.

New versions and releases of our products may contain errors or defects.

Our software products may contain undetected errors or failures when first introduced or as new versions are released. This may result in loss of, or delay in, market acceptance of our products. Errors in new releases and new products after their introduction could result in delays in release, lost revenues and customer frustration during the period required to correct these errors. We may in the future discover errors and defects in new releases or new products after they are shipped or released.

We utilize third-party software that we incorporate into and include with our products and solutions, and impaired relations with these third-parties, defects in third-party software, or their inability or failure to enhance their software over time could have a material adverse effect on our operating performance and financial condition.

We incorporate and include third-party software into and with our products and solutions. We are likely to incorporate and include additional third-party software into and with our products and solutions as we expand our product offerings. If our relations with any of these third-party software providers become impaired, and if we are unable to obtain or develop a replacement for the software, our business could be harmed. Our products may be impacted if errors occur in the third-party software that we utilize. It may be more difficult for us to correct any defects in third-party software because the software is not within our control. Accordingly, our business could be adversely affected in the event of any errors in this software. There can be no assurance that these third-parties will continue to invest the appropriate levels of resources in their products and services to maintain and enhance the capabilities of their software.

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We have shifted a significant portion of our product development operations to India, which poses significant risks.

Since September 2003, an unrelated third-party has provided us with software development services in Bangalore, India. We have increased the proportion of our product development work being performed by contractors in India in order to take advantage of cost efficiencies associated with India's lower wage scale. However, we may not achieve the cost savings and other benefits we anticipate from this program and we may not be able to find sufficient numbers of developers with the necessary skill sets in India to meet our needs. We have a heightened risk exposure to changes in the economic, security, and political conditions of India. Economic and political instability, military actions, and other unforeseen occurrences in India could impair our ability to develop and introduce new software applications and functionality in a timely manner, which could put our products at a competitive disadvantage whereby we lose existing customers and/or fail to attract new customers.

Our target markets are evolving and characterized by rapid technological change, with which we may not be able to keep pace.

The markets for our products and services are evolving and characterized by rapid technological change, changing customer needs, evolving industry standards, and frequent new product and service announcements. The introduction of products employing new technologies and emerging industry standards could render our existing products or services obsolete or unmarketable. If we are unable to respond to these developments successfully or do not respond in a cost-effective way, our business, financial condition, and operating results will suffer. To be successful, we must continually improve and enhance the responsiveness, services, and features of our software products and introduce and deliver new product and service offerings and new releases of existing products. We may fail to improve or enhance our software products or fail to introduce and deliver new releases or new offerings on a timely and cost-effective basis or at all. If we experience delays in the future with respect to our software products, or if our improvements, enhancements, offerings, or releases to these products do not achieve market acceptance, we could experience a delay or loss of revenues and customer dissatisfaction. Our success will also depend in part on our ability to acquire or license third-party technologies that are useful in our business, which we may not be able to do.

We may ultimately be unable to compete in the markets for the products and services we offer.

The markets for our software products and services are intensely competitive, which may result in low or negative profit margins and difficulty in achieving market share, either of which could seriously harm our business. We expect the intensity of competition to increase. Our software products and services face competition from software companies whose products or services compete with a particular aspect of the solution we provide, as well as several major enterprise software developers and consulting firms. Many of our competitors have longer operating histories, greater brand recognition, and greater financial, technical, marketing, and other resources than we do, and may have well-established relationships with our existing and prospective customers. This may place us at a disadvantage in responding to our competitors' pricing strategies, technological advances, advertising campaigns, strategic partnerships, and other initiatives. Our competitors may also develop products or services that are superior to or have greater market acceptance than ours. If we are unable to compete successfully against our competitors, our business, financial condition, and operating results would be negatively impacted.

If we do not develop the Verticalnet brand in the supply management solution industry, our revenues might not increase.

We must establish and continuously strengthen the awareness of the Verticalnet brand in the supply management solution industry. If our brand awareness as a maker of supply management solution software does not develop, or if developed, is not sustained as a respected brand, it could decrease the attractiveness of our products and services to potential customers, which could result in decreased revenues.

We may not be able to protect our proprietary rights and may infringe the proprietary rights of others.

Proprietary rights are important to our success and to our competitive position. We may be unable to register, maintain, and protect our proprietary rights adequately. Although we file copyright registrations for the source code underlying our software, enforcement of our rights might be too difficult and costly for us to pursue effectively. Effective patent, copyright, and trade secret protection of our software may be unavailable or limited in certain countries. In addition, third parties may claim that our current or potential future products infringe their intellectual property rights. Any claims, with or without merit, could be time-consuming, result in costly litigation, cause product and service delivery delays or require us to enter into royalty or licensing agreements, which, if required, may not be available on terms acceptable to us or at all, which could seriously harm our business.

Several lawsuits have been brought against us and the outcome of these lawsuits is uncertain.

Several lawsuits have been brought against us and the underwriters of our stock in our initial public offering. These lawsuits allege, among other things, that the underwriters engaged in sales practices that had the effect of inflating our stock price, and that our prospectus for that offering was materially misleading because it did not disclose these sales practices. We intend to vigorously defend

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ourselves against these lawsuits; however, no assurance can be given as to the outcome of these lawsuits. In addition, other lawsuits may be brought against us. We may be required to defend such lawsuits, thus incurring expenses which we may not be able to bear, or which we may not be successful in defending.

Shares eligible for future sale by our current or future shareholders may cause our stock price to decline.

If our shareholders, option holders, warrant holders, or holders of the convertible notes sell substantial amounts of our common stock in the public market, including shares issued in completed or future acquisitions, upon the exercise of outstanding options and warrants, or upon conversion of the convertible notes, then the market price of our common stock could fall. We also have filed registration statements to register shares of common stock under our equity compensation and employee stock purchase plans. Shares issued pursuant to existing or future shelf registration statements, upon exercise of stock options and warrants, upon conversion of the convertible notes, and in connection with our equity compensation and employee stock purchase plans will be eligible for resale in the public market without restriction.

Anti-takeover provisions and our right to issue preferred stock could make a third-party acquisition of us difficult.

Verticalnet is a Pennsylvania corporation. Anti-takeover provisions of Pennsylvania law could make it more difficult for a third party to acquire control of us, even if such change in control would be beneficial to our shareholders. Our articles of incorporation provide that our Board of Directors may issue preferred stock without shareholder approval. In addition, our bylaws provide for a classified board, with each board member serving a staggered three-year term. The issuance of preferred stock and the existence of a classified board could make it more difficult for a third party to acquire us.

Our common stock price is likely to remain highly volatile.

The market for stocks of technology companies has been highly volatile since our initial public offering in 1999. Throughout this period, the market price of our common stock has reached extreme highs and lows, and our daily trading volume has been, and will likely continue to be, highly volatile. Investors may not be able to resell their shares of our common stock following periods of price or trading volume volatility because of the market's adverse reaction to such volatility. Factors that could cause volatility in our stock price and trading volume, in some cases regardless of our operating performance, include, among other things:

general economic conditions, including suppressed demand for technology products and services;

actual or anticipated variations in quarterly operating results;

announcements of technological innovations;

new products or services;

changes in the market valuations of other software or technology companies;

failure to meet analysts' or investors' expectations;

announcements by us or our competitors of significant acquisitions, strategic partnerships, or joint ventures;

our cash position and cash commitments;

use of our common stock to pay the monthly principle and interest on our senior convertible promissory notes;

our prospects for software sales and new customers; and

additions or departures of key personnel.

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Acquisitions may disrupt or otherwise have a negative impact on our business.

We have made, and plan to continue to make, investments in and acquisitions of complementary companies, technologies, and assets. Future and past acquisitions are subject to the following risks:

acquisitions may cause a disruption in our ongoing business, distract our management and other resources, and make it difficult to maintain our standards, controls, and procedures;

we may acquire companies in markets in which we have little experience;

we may not be able to successfully integrate the services, products, and personnel of any acquisition into our operations;

we may be required to incur debt or issue equity securities, which may be dilutive to existing shareholders, to pay for the acquisitions;

we may be exposed to unknown or undisclosed liabilities; and

our acquisitions may not result in any return on our investment and we may lose our entire investment.

Interruptions or delays in service from our third-party Web hosting facilities could impair the delivery of our service and harm our business.

We provide some of our services through computer hardware that is currently located in a third-party web hosting facility in Philadelphia, Pennsylvania operated by SunGard, Inc. We do not control the operation of this facility, and it may be subject to damage or interruption from floods, fires, power loss, telecommunications failures, and similar events. It may also be subject to break-ins, sabotage, intentional acts of vandalism, and similar misconduct. Despite precautions taken at the facility, the occurrence of a natural disaster, a decision to close a facility without adequate notice, or other unanticipated problems at a facility could result in lengthy interruptions in our service. In addition, the failure by a facility to provide our required data communications capacity could result in interruptions in our service. While we are not aware of any such interruptions, if an actual or perceived interruption of our applications occurred or if our applications become unstable or unavailable, the perception by existing or potential customers of our applications could be harmed and we could lose sales and customers. In addition, we may be subject to service level penalties, which could materially and adversely affect our business, financial condition, and operating results.

If our security measures are breached and unauthorized access is obtained to a customer's data, our on-demand applications may be perceived as not being secure and customers may curtail or stop using our service.

Our on-demand supply management model involves the storage, analysis, and transmission of customers' proprietary information, and security breaches could expose us to a risk of loss or corruption of this information, litigation, and possible liability. If our security measures are breached as a result of third-party action, employee error, malfeasance, or otherwise, and, as a result, an unauthorized party obtains access to one or more of our customers' data, our reputation could be damaged, our business may suffer, and we could incur significant liability. Because techniques used to obtain unauthorized access or to sabotage computer systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. While we are not aware of any such breach, if an actual or perceived breach of our security occurs, the perception by existing or potential customers of the effectiveness of our security measures could be harmed and we could lose sales and customers.

If our software or the third-party software we use to support and enable our applications is subject to intrusion or corruption by third parties, our applications could become unstable or unavailable to our customers.

We use our own as well as third-party software to support or enable our applications and which may be subject to intrusion or corruption by third parties, which may render our on-demand applications unstable or unavailable to our customers. While we are not aware of any such

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intrusion, if an actual or perceived intrusion or corruption of our software or third-party software which we use to support or enable our applications occurs, and our applications become unstable or unavailable, the perception by existing or potential customers of our applications could be harmed and we could lose sales and customers.

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If our on-demand application model is not widely accepted, our operating results will be harmed.

We expect to derive an increasing portion of our software revenues from subscriptions to our on-demand applications. As a result, widespread acceptance of our on-demand supply management applications is critical to our future success. Factors that may affect market acceptance of our on-demand applications include:

reluctance by enterprises to migrate to an on-demand application model;

the price and performance of our on-demand applications;

the level of customization we can offer;

the availability, performance, and price of competing products and services; and

potential reluctance by enterprises to trust third parties to store and manage their internal data.

Many of these factors are beyond our control. The inability of our on-demand applications model to achieve widespread market acceptance would harm our business.

Because we will recognize revenue from our on-demand applications over the term of the agreement, downturns or upturns in sales may not be immediately reflected in our operating results.

We will recognize revenue from customers with hosted term-based licenses over the term of their agreements, which are typically 12 to 24 months, although terms can range from one to 36 months. As a result, a portion of the revenue we report in each quarter will be from agreements entered into during previous quarters. Consequently, a decline in new or renewed agreements in any one quarter will not necessarily be fully reflected in the revenue in that quarter and may negatively affect our revenue in future quarters. In addition, we may be unable to adjust our cost structure to reflect these reduced revenues. Accordingly, the effect of significant downturns in sales and market acceptance of our service may not be fully reflected in our results of operations until future periods. Our on-demand application model will also make it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable agreement term.

We do not have an adequate history with our on-demand application model to predict the rate of customer renewals and the impact these renewals will have on our revenue or operating results.

Our customers have no obligation to renew their agreements for our service after the expiration of their initial contract period and some customers have elected not to do so. In addition, our customers may decide not to renew unless we offer lower prices or agree to reduce the number of users. We have limited historical data with respect to rates of customer renewals, so we may not be able to accurately predict customer renewal rates. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their dissatisfaction with our applications or the customers' ability to continue their operations and spending levels. If our customers do not renew their agreements for our on-demand supply management applications, our revenue may decline and our business may suffer.

Our future success also depends in part on our ability to sell additional features or functions of our applications, additional applications, or additional services to our current customers. This may require increasingly sophisticated and costly sales efforts that are targeted at our customers' senior management. If these efforts are not successful, our business may suffer.

A failure to adequately expand our direct sales force may impede our growth.

We expect to be substantially dependent on our direct sales force to obtain new customers, particularly large enterprise customers, and to manage our customer base. We believe that there is significant competition for direct sales personnel with the advanced sales skills and technical

knowledge we need. Our ability to achieve significant growth in revenue in the future will depend, in large part, on our success in recruiting, training, and retaining sufficient direct sales personnel. New hires require significant training and may, in some cases, take more than a year before they achieve full productivity. Our recent or future hires may not become as productive as we would like, and we may be unable to hire sufficient numbers of qualified individuals in the future in the markets where we do business. If we are unable to hire and develop sufficient numbers of productive sales personnel, sales of our products and services may suffer. We have also reduced our sales force as part of our cost containment and cost reduction initiatives. Our failure to field an effective sales organization could have a material adverse effect on our operating performance and financial condition.

If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.

Under U.S. generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, future cash flows, and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined resulting in an impact on our results of

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operations. In June 2006, based on our market capitalization as well as other business indicators (including our decreasing relationship with one of our largest customers), we concluded that we were required to assess whether any portion of our recorded goodwill balance or amortizable intangible assets were impaired. We concluded that goodwill was impaired in the amount of \$9.9 million. If our market value continues to decline, we may get to a point where an additional impairment charge would be necessary. At that time, we may be required to record a significant charge to earnings in our financial statements during the period in which the amount of the impairment of our goodwill or amortizable intangible assets is determined.

Changes in the value of the U.S. dollar, in relation to the currencies of foreign countries where we transact business, could harm our operating performance and financial condition.

International operations represent an increasing portion of our revenues. We expect to continue to commit significant resources to our international sales and marketing activities. For international sales and expenditures denominated in foreign currencies, we are subject to risks associated with currency fluctuations, particularly as a result of the decline in the value of the U.S. dollar compared to other foreign currencies. Although such international revenues are increasing, we have not to date hedged our risks associated with foreign currency transactions in order to minimize the impact of changes in foreign currency exchange rates on earnings. In the event we do begin hedging activities, there is no guarantee our hedging strategy will be successful and that currency exchange rate fluctuations will not have a material adverse effect on our operating results.

Issuance of shares of common stock upon conversion or repayment of our convertible notes and exercise of warrants will dilute the ownership interest of existing shareholders and could adversely affect the market price of our common stock.

We may issue shares of common stock (i) upon conversion of some or all of our convertible notes, (ii) in satisfaction of our principal and interest payment obligations under the convertible notes, in lieu of cash payments, and (iii) upon exercise of warrants. Any of these issuances will dilute the ownership interests of existing shareholders. Any sales in the public market of this common stock could adversely affect prevailing market prices of the common stock. In addition, the existence of these convertible notes and warrants may encourage short selling by market participants.

Our convertible notes and discount note are secured by substantially all of our assets.

The holders of convertible notes and discount note have a security interest in and a lien on substantially all of our assets, including our existing and future accounts receivable, cash, general intangibles (including intellectual property) and equipment. As a result of this security interest and lien, if we fail to meet our payment or other obligations under the convertible notes or the discount note, the holders of the convertible notes or the discount note would be entitled to foreclose on and liquidate substantially all of our assets. Under those circumstances, we may not have sufficient funds to service our day-to-day operational needs. Any foreclosure by the holders of the convertible notes or the discount note would have a material adverse effect on our financial condition.

Item 1B. Unresolved Staff Comments

None

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Our corporate headquarters is located in Malvern, Pennsylvania. We maintain other locations throughout the United States and in Europe. The locations of these facilities and their respective size and lease status are as follows:

Location	Type of Facility	Size (in sq/ft)	Ownership Status	Lease Expiration Date
Malvern, Pennsylvania	Headquarters	7,947	Leased	November 2010
Endicott, New York	Development	7,700	Leased	November 2008
New York, New York	Office (a)	6,900	Leased	December 2010
Chicago, Illinois	Office (a), (b)	4,132	Leased	March 2008
Rockville, Maryland	Office (c)	10,582	Leased	August 2008
San Jose, California	Office (c), (d)	4,700	Leased	January 2007
Guildford, United Kingdom	Office (e)	4,607	Leased	October 2007

- (a) Acquired as part of the Tigris acquisition on January 30, 2004. See Note 3 to the consolidated financial statements regarding this event.
- (b) We currently lease two offices at this property through March 2007. We occupy 4,132 sq. ft. of this property and are subleasing 4,168 sq. ft. of this property to an unrelated third party. In December 2006, we entered into a new one year lease for the 4,132 sq. ft. office commencing April 1, 2007.
- (c) Acquired as part of the B2eMarkets acquisition on July 19, 2004. See Note 3 to the consolidated financial statements regarding this event.
- (d) We sublet this property to an unrelated third party through January 2007. The lease expired in January 2007.
- (e) Acquired as part of the Digital Union acquisition on July 22, 2005. See Note 3 to the consolidated financial statements regarding this event.

Item 3. Legal Proceedings

On June 12, 2001, a class action lawsuit was filed against us and several of our officers and directors in U.S. Federal Court for the Southern District of New York (the District Court). Also named as defendants were four underwriters involved in the issuance and initial public offering (IPO) of our common stock in February 1999. The complaint alleges violations of federal securities law based on, among other things, claims that the underwriters (i) awarded material portions of the initial shares to certain favored customers in exchange for excessive commissions and (ii) engaged in a practice known as laddering, whereby the clients or customers agreed that in exchange for IPO shares they would purchase additional shares at progressively higher prices after the IPO. With respect to Verticalnet, the complaint alleges that Verticalnet and its officers and directors failed to disclose in the prospectus and the registration statement the existence of these purported excessive commissions and laddering agreements. After the initial complaint was filed, several copycat complaints with nearly identical allegations were filed by other plaintiffs in the District Court. All of the suits were consolidated into a single amended complaint containing additional factual allegations concerning the events set forth in the original complaints filed with the District Court in April 2002. In October 2002, the District Court entered an order dismissing, without prejudice, the claims against the individual Verticalnet officers and directors who had been named as defendants in the various complaints. In February 2003, the District Court entered an order denying a motion made by the defendants to dismiss the actions in their entirety, but granting the motion as to certain of the claims against some defendants. However, the District Court did not dismiss any claims against Verticalnet. In June 2003, Verticalnet's counsel, with the approval of Verticalnet's directors, executed a memorandum of understanding on behalf of Verticalnet with respect to a proposed settlement of the plaintiffs' claims against Verticalnet. The proposed settlement, if finally approved by the District Court, would result in, among other things, the dismissal of all claims against Verticalnet and its officers and directors. Under the present terms of the proposed settlement, Verticalnet would also assign its claims against the underwriters to the plaintiffs in the consolidated actions. In February 2005, the District Court preliminarily approved the proposed settlement. In April 2006, the District Court held a final fairness hearing on the proposed settlement but reserved its final approval.

On December 5, 2006, the Second Circuit Court of Appeals vacated the District Court's certification of the class action and remanded the case to the District Court for further proceedings. It is uncertain what effect the ruling by the Second Circuit Court of Appeals will have upon the proposed settlement or on the underlying litigation. The Company believes that the outcome of this uncertainty will not have a material impact on our financial statements.

On September 30, 2004, the Company was served with a complaint (the Complaint) filed against the Company and several of its former officers and directors in the U.S. District Court for the Eastern District of Pennsylvania in an action captioned Jodek Charitable Trust, R.A., Individually and as Assignee of Zvi Schreiber, LLC et al. (Jodek) v. Vertical Net Inc., et al., C.A. No. 04-4455 (Jodek Case). The Complaint alleged that, with regards to the issuance of the Company's stock to the plaintiff's predecessors in interest in connection with the Company's acquisition of

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Tradeum, Inc. in March 2000, the plaintiff was damaged by the defendants' delays in registering stock, updating the registration of stock, releasing stock from lock-ups and releasing stock from escrows. On May 5, 2006, the Company was informed that its insurer was largely denying the Company's claim for coverage under the Company's directors and officers insurance policy (the D&O Policy). On August 11, 2006, the Company and Jodek entered into a Settlement Agreement (the Settlement Agreement), that provided for the settlement of the Jodek Case. Pursuant to the Settlement Agreement: (i) the settlement

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amount was fixed at \$5,563,000; (ii) the Company agreed to pay the balance of its \$500,000 retention obligation under the D&O Policy (less than \$100,000) to the plaintiff (which amount has been paid); (iii) the Company agreed to prosecute an action, at the plaintiff's expense, against the Company's insurer to require the insurer to pay the balance of the settlement amount for the benefit of plaintiff; and (iv) the plaintiff agreed to release the Company of all claims. Pursuant to the Settlement Agreement, the Company will only be required to pay the balance of the settlement amount (\$5,563,000) if any of the Company's claim is collected from the insurer to the extent of the amount collected; therefore, this amount is not recorded as a liability in the accompanying consolidated balance sheet. On August 22, 2006, the U.S. District Court for the Eastern District of Pennsylvania entered an order approving the Settlement Agreement and entering it as an order of the Court. On September 22, 2006, in accordance with the Settlement Agreement, the Company instituted an action in the U.S. District Court for the Eastern District of Pennsylvania captioned Verticalnet, Inc. v. U.S. Specialty Insurance Company at Civil Action No. 06-4245 (the Second Jodek Case). Pursuant to the Settlement Agreement, the attorney representing the Company in the Second Jodek Case was selected by and is being paid for solely by Jodek.

On May 9, 2006, CombineNet, Inc. (CombineNet) and Verticalnet entered into a Settlement Agreement and Release (the CombineNet Settlement Agreement) that resolved certain litigation commenced by CombineNet. The CombineNet Settlement Agreement provided, among other things, that (i) the Company pay CombineNet (a) \$125,000 upon execution of the agreement; (b) \$125,000 on July 31, 2006; and (c) beginning October 31, 2006, \$50,000 per quarter for eight consecutive quarters; provided that this obligation will continue for so long as Verticalnet decides to continue offering certain optimization products; (ii) CombineNet granted Verticalnet a limited license to use the CombineNet's technology through July 2006 in order to complete existing certain contracts; (iii) Verticalnet would permit an expert to review Verticalnet's Advanced Sourcing RFX to determine whether certain elements of the RFX used or were derived from CombineNet's technology; (iv) Verticalnet would permit the expert to review certain future Verticalnet optimization products to determine whether the new products used or were derived from CombineNet's technology; and (v) that Verticalnet would pay the expert's fees, both for an original review and for the future reviews set forth in sections (iii) and (iv) above. On June 16, 2006, the expert rendered his final report, and found that neither Verticalnet's Advanced Sourcing RFX nor its new optimization products were derived from CombineNet's CEDL technology. During the year ended December 31, 2006, the Company recorded \$730,000 in litigation and settlement costs for the CombineNet Settlement Agreement and related costs. As of December 31, 2006, the Company has paid \$300,000 of the total settlement obligation.

We are also a party to various lawsuits and claims that arise in the ordinary course of business. In the opinion of management, the ultimate resolutions with respect to all of the above actions will not have a material adverse effect on our financial position, liquidity, or results of operations.

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

- (a) None
- (b) Pursuant to Instruction 3 to Item 4 of Form 10-K, no response is required.
- (c) None
- (d) None

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is traded on The Nasdaq Capital Market under the symbol VERT. The table below sets forth, for the periods indicated, the range of the high and low closing sales prices of our common stock as reported by NASDAQ. Please note that on June 12, 2006 (the second quarter of 2006), we effected a one-for-seven reverse stock split of our outstanding shares of common stock. The stock prices for all periods before June, 12, 2006, reflect the one-for-seven reverse stock split.

	High	Low
Fiscal Year 2006:		
First Quarter	\$ 5.04	\$ 3.36
Second Quarter	3.36	1.01
Third Quarter	1.29	0.86
Fourth Quarter	1.06	0.62
Fiscal Year 2005:		
First Quarter	\$ 11.20	\$ 5.88
Second Quarter	6.72	4.41
Third Quarter	5.67	3.92
Fourth Quarter	4.90	2.59

As of March 1, 2007, we had 844 shareholders of record, which excludes shareholders whose shares are held in nominee or street name by brokers.

We have never declared or paid any cash dividends on our common stock. We do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain future earnings, if any, to finance our operations and expand our business. Any future determination to pay cash dividends will be at the discretion of the board of directors and will be dependent upon our financial condition, operating results, capital requirements, and other factors the board of directors deems relevant. In addition, the terms of the convertible notes and discount note prohibit us from issuing dividends on our common stock.

The following information of Part II Item 5 is being furnished and shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that Section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such a filing.

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Stock Performance Graph

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The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the related notes thereto (see Item 8 of this report), as well as Management's Discussion and Analysis of Financial Condition and Results of Operations (see Item 7 of this report).

<i>(in thousands, except per share data)</i>	Year Ended December 31,				
	2006	2005	2004	2003	2002
Consolidated Statement of Operations Data:					
Revenues	\$ 16,164	\$ 20,650	\$ 22,925	\$ 9,633	\$ 43,724
Loss from continuing operations (a)(d)(e)	(24,472)	(13,720)	(9,720)	(11,015)	(30,859)
Basic income (loss) per common share from continuing operations	\$ (3.09)	\$ (2.18)	\$ (2.30)	\$ (4.92)	\$ 38.64
Diluted loss per common share from continuing operations (b)	\$ (3.09)	\$ (2.18)	\$ (2.30)	\$ (4.92)	\$ (17.92)
Balance Sheet Data:					
Cash and cash equivalents	\$ 2,809	\$ 4,576	\$ 9,370	\$ 4,408	\$ 7,979
Accounts receivable, net	3,877	5,188	5,902	2,438	1,586
Working capital (Deficit) (c)	(4,160)	681	7,863	2,683	3,939
Total assets	20,693	36,044	40,345	9,123	18,453
Deferred revenue	4,613	3,610	3,147	992	279
Long-term debt	5,270	2,041	42		7,293
Total stockholders' equity	2,942	22,396	31,888	4,421	1,642

- (a) Effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. See Note 1 to the consolidated financial statements.
- (b) Diluted loss per common share for the year ended December 31, 2002 excludes preferred stock dividends and the impact from the redemption of our preferred stock, which resulted in basic income per share from continuing operations.
- (c) Working capital is defined as total current assets less total current liabilities.
- (d) In June 2006, the Company recorded a Goodwill Impairment charge of \$9.9 million.
- (e) Effective January 1, 2006, the Company adopted SFAS No. 123R, Shared-Based Payment and as a result the Company recorded an additional compensation expense of \$645,000.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with Selected Financial Data appearing in Item 6 of this report and our consolidated financial statements and related notes appearing under Item 8 of this report. This discussion and analysis contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements, as described under Cautionary Statement Regarding Forward-Looking Statements in this report.

Company Overview

We are a provider of Supply Management solutions to Global 2000 companies. We provide a full scope of Supply Management software and services in areas that include: Program Management, Spend Analysis, eSourcing, Advanced Sourcing, Contract Management, and Supplier Performance Management and e-procurement. Our solutions help our customers to save money on the goods and services they buy and allow our customers to ensure that both buyers and suppliers comply with contracts that have been negotiated.

Verticalnet's software customers license our software pursuant to either a time-based license or a perpetual license. Our software is licensed by module, with our customers selecting from modules that include: Spend Manager, Program Manager, Negotiation Manager, Contract Manager, Procurement Manager and Performance Manager. Verticalnet employs technical consultants to provide project management and training during software implementation. In addition to traditional software installation and Application Service Provider (ASP) hosting, Verticalnet offers the majority of its software products in an On-Demand delivery model. On-Demand delivery enables our customers to pay a single annual fee that includes software license, maintenance, application hosting, customer/community support. The Company believes that its On-Demand delivery model mitigates the software implementation costs for its customers, and reduces the obstacles to a successful supply management initiative.

In addition to implementation services, our consultants provide customers with supply management business process consulting, primarily in the areas of spend analysis, sourcing enablement and complex category sourcing. Our customers typically pay for professional services at an hourly rate for the time it takes us to complete the project. Many stand-alone professional services engagements also include short-term licenses of Verticalnet technology required to complete the engagement. Examples of such technology include our Advanced Bid Collection and Bid Analysis Optimization software.

In addition to our packaged applications and implementation services, Verticalnet offers custom software development for customers that desire to build additional supply management capabilities. Verticalnet's Solution Center works with clients to define custom development requirements and build out the required functionality. Verticalnet offers a flexible software platform that enables rapid, cost effective custom development for customers with advanced, complex requirements.

Historically, we derived our revenue primarily from the licensing of our software, as well as implementation and development services. As a result of the January 2004 acquisition of Tigris, we also generate revenues from spend analysis and services relating to complex category sourcing and, as a result of the July 2004 acquisition of B2eMarkets, Inc. (B2eMarkets), we have seen an increase in the amount of our revenue from the licensing of our software products and maintenance of those products through time-based software licenses. In July 2005, we acquired Digital Union Limited (Digital Union), a company headquartered in the United Kingdom, and as a result we expect to see a continued increase in the proportion of our revenues from both the United Kingdom and the European Union.

Our solutions have been highly rated in independent studies by third party analyst and consulting organizations. In 2006, Forrester Research rated Verticalnet's product functionality in the top three versus a broad range of competitors. Also in 2006, Capgemini Europe, a major consultancy, rated our technology first among over twenty potential European competitors. These ratings provide potential buyers with an initial list of potential vendors and have been important in helping to drive qualified leads in our business. We believe that we have the broadest, most integrated supply management solution suite capable of being fully delivered on-demand. This proves to be a differentiator for us in competitive sales cycles.

Over the period from 2002 through 2006 we have undertaken to build a leading solution provider in the supply management space while migrating away from legacy revenue streams and several large accounts which were associated with legacy products. As a basis of measurement: in 2004, 23% of total revenue was derived from our XE supply management suite or from strategic services relating to our emerging supply management focus. Our two largest legacy accounts represented 48.9% of total revenue, all of which related to legacy offerings. In 2006, 73% of revenue was derived from our XE supply management suite or from strategic services. Only 24.8% of revenue was derived from the same two legacy accounts. In the fourth quarter of 2006, revenue from these two accounts represented only 8.8% of total revenue.

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Currently software customers operating on our XE Suite represent over 80% of all software customers. Increasingly customers are contracting for more than one module of software at the time of initial selection with the number of customers selecting the full suite continuing to increase. Our renewal rate for customers operating on the XE Suite was over 90% since the beginning of 2006.

Between 2004 and 2005 Verticalnet integrated the operations of three acquisitions including Tigris Corp., B2eMarkets, and Digital Union in order to assemble the components of what is today our XE Suite, a market leading supply management solution. In bringing these components together, we invested heavily through late 2005 in integrating these products into one coherent solution architecture. In addition, through the combination of these entities, we absorbed revenue streams and products which were not strategic to our core vision but which had both customers and revenue associated with them. Over the past eighteen months beginning with the release of our integrated XE Suite, we have undertaken to reduce costs and simplify the business through the elimination of products not deemed strategic. This has resulted in a reduction of headcount from over 170 in mid-2005 to fewer than 100 at the end of 2006. In conjunction with this direct staff reduction we have expanded our use of India-based offshore resources to provide additional customer support and consulting support with the number of off-shore resources now numbering 23 as of March 1, 2007.

As a result of the actions above, our cost structure has been significantly reduced and our business complexity has been streamlined. All cost actions taken in 2006 are not fully reflected in 2006 financials and the full impact of these reductions will be seen in the first quarter of 2007 with the remainder to be seen by the second quarter of 2007. We believe that we have the resources to support both our existing customer requirements and our efforts to grow this base of customers while continuing to drive innovation in our XE Suite, our core product suite.

RECENT DEVELOPMENTS

PERPETUAL LICENSE TRANSACTION

During the fourth quarter of 2006, the Company entered into an agreement with one of our customers, which allowed the customer access to the source code and object code to a Company's legacy software platform, and provided for the transfer of the employment of several of the Company's software developers and various hardware and software assets for \$1.4 million. As part of the transaction, Verticalnet granted the customer an irrevocable, perpetual, worldwide, non-exclusive, non-transferable, fully paid-up, right and license of a legacy software, in both source code and object code forms. It was determined that the transaction did not satisfy the definition of revenue but was a sale of assets. Therefore, the Company recorded this transaction as part of Interest and other (income) expense, net (see Note 15 to the consolidated financial statements).

SENIOR SECURED CONVERTIBLE PROMISSORY NOTES

On August 16, 2005, the Company issued the convertible notes in the aggregate principal amount of \$6.6 million to various independent institutional investors. The convertible notes are secured by a security interest in all the assets of the Company, subject to existing liens, and are convertible into shares of Verticalnet's common stock, at the option of the convertible note holders, at a fixed conversion price of \$4.90 per share, subject to adjustment upon certain conditions, including certain issuances of stock at a price below \$4.90 per share, stock dividends, or splits, and distributions of equity, debt, or assets (See Note 7 to the consolidated financial statements).

Consent, Waiver and Amendment No. 1 to Warrant

On December 19, 2006, the Company entered into a Consent, Waiver and Amendment No. 1 to Warrant (the "Consent Agreement") with the remaining holders of the convertible notes. Pursuant to the Consent Agreement, the Company reduced the exercise price of each warrant to purchase shares of the Company's common stock held by the remaining convertible note holders from \$5.39 per share to \$0.88 per share, which was equal to the \$0.80 closing price of the Company's common stock on The Nasdaq Capital Market on December 19, 2006, plus 10% (the "Warrant Repricing"). In consideration for the Warrant Repricing, each of the remaining convertible note holders gave their consent to permit the Company to grant a subordinated lien and security interest in all of the Company's assets and the assets of the Company's subsidiaries to the holder of the discount note. As a result, the discount note holder no longer had the right under the discount note to declare the discount note due prior to its November 18, 2007 scheduled maturity date, unless an event of default occurs or the Company consummates a fundamental transaction, which is defined to include a sale of the Company. As a result of the Warrant Repricing, the Company recorded additional interest expense of \$122,000 during the fourth quarter of 2006.

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SENIOR SUBORDINATED DISCOUNT PROMISSORY NOTE

On May 15, 2006, the Company entered into a Note Purchase Agreement (Purchase Agreement) with an institutional investor. Under the terms of the Purchase Agreement, the investor agreed to loan the Company \$4.0 million and the Company agreed to issue to the investor the discount note in the principal amount of \$5.3 million. The difference between the loan amount and the principal amount has been recorded as a debt discount in the accompanying consolidated balance sheet.

Security Agreement

On December 19, 2006, the Company and its domestic subsidiaries entered into a Security Agreement with the holder of the discount note (the Security Agreement) whereby the Company and its domestic subsidiaries granted the discount note holder a security interest in all of the Company s and its domestic subsidiaries assets to secure the Company s obligations under the discount note. By entering into the Security Agreement, the Company satisfied its obligation under the discount note to obtain the consent of the convertible note holders to grant the security interest to the discount note holder. As a result, the discount note holder no longer had the right under the discount note to declare the discount note due prior to its November 18, 2007 scheduled maturity date, unless an event of default occurs or the Company consummates a fundamental transaction, which is defined to include a sale of the Company.

Subordination and Intercreditor Agreement

On December 19, 2006, the Company, the convertible note holders and the discount note holder entered into a Subordination and Intercreditor Agreement (the Intercreditor Agreement). The Intercreditor Agreement provides, among other things: (i) for the subordination of the discount note to the convertible notes; (ii) that the Company may make payments of interest to the discount note Holder when due pursuant to the discount Note, except in the event of a default under the convertible notes; and (iii) for certain limitations on the discount note holder s rights to accelerate payment of amounts due under the discount note or to take any legal action in relation thereto for a period of 180 days if the convertible note holders have given notice of an event of default.

Guaranty and Suretyship Agreement

Also on December 19, 2006, all of the domestic subsidiaries of the Company executed a Guaranty and Suretyship Agreement in favor of the discount note holder (the Guaranty Agreement), whereby, among other things, all of the domestic subsidiaries of the Company guaranteed the Company s obligations under the discount note.

Amendment Number 1 to Senior Subordinated Discount Note

On December 20, 2006, the Company and the discount note holder entered into an Amendment Number 1 to Senior Subordinated Discount Note, whereby the Company and the discount note holder agreed to extend the maturity date of the Discount Note from November 18, 2007 to April 1, 2008 and also agreed to increase the principal amount of the discount note from \$5.3 million to \$5.5 million. Interest on the outstanding principal amount of the discount note continues to accrue at 12% per annum and is payable quarterly in arrears on the first day of January, April, July and October of each year until the April 1, 2008 maturity date. All other terms of the discount note also remained unchanged.

Amendment Number 2 to Senior Subordinated Discount Note

On March 28, 2007, the Company and the discount note holder entered into an Amendment Number 2 to Senior Subordinated Discount Note, whereby the Company and the discount note holder agreed to amend the discount note to give the Company the option to extend the stated maturity date of the discount note from April 1, 2008 to September 30, 2008. The Company can exercise the option at any time on or before December 31, 2007. If the Company exercises the option, the outstanding principal amount of the discount note will automatically increase by \$575,000. In addition, if the Company completes a qualified equity financing transaction and the convertible notes have been paid in full, the Company is required to pay the discount note holder an amount equal to 25% of the gross proceeds raised in such qualified equity financing transaction, which will be applied as payment toward the then outstanding principal amount of the discount note. In consideration for the discount note holder granting the Company the option to extend the stated maturity date of the discount note, the Company agreed to pay the discount note holder \$58,750 upon the date that the convertible notes are paid in full or the maturity date of the discount note, whichever happens first. All other terms of the Discount Note remained unchanged, including the term that the discount note becomes due and payable in full if the Company consummates a fundamental transaction, which is defined to include a sale of the Company.

Table of Contents**REGISTRATION STATEMENT**

In February 2007, we filed a registration statement registering 2,500,000 shares of common stock for resale, which was our estimate of the number of shares of common stock issuable as payment for the remaining principal and interest payments on the convertible notes or upon conversion of the convertible notes. The 2007 registration statement was declared effective in February 2007. As of March 30, 2007, we had approximately 2.2 million shares of common stock remaining available for issuance under the registration statement.

ACQUISITIONS***Tigris Corp.***

In January 2004, we acquired all of the outstanding capital stock of Tigris, a privately-held strategic sourcing and supply chain consultancy company based in New York City. The acquisition brought together Verticalnet's spend analysis and supply management software with Tigris' extensive spend analysis and strategic sourcing expertise. The aggregate purchase price was approximately \$12.1 million, including transaction costs of approximately \$300,000. The consideration included \$3.5 million in cash, 267,208 shares of our common stock valued at approximately \$5.7 million, issuance of employee options to purchase 107,382 shares of our common stock valued at \$2.2 million and assumed debt of approximately \$346,000.

B2eMarkets, Inc.

In July 2004, we merged with B2eMarkets, a privately-held provider of strategic sourcing software solutions. The aggregate purchase price of the B2eMarkets acquisition was \$12.9 million, including transaction costs of approximately \$2.4 million, which primarily consisted of fees paid for investment banking, legal, and professional services. The consideration included the issuance of 728,572 shares of common stock, valued on the date of closing at approximately \$6.6 million, and a promissory note in the principal amount of \$5.9 million, which was valued at \$3.9 million on the date of closing. The note was to pay interest at a stated rate of 8% per annum. The value of the Verticalnet stock issued to the B2eMarkets' shareholders was based on \$1.29 per share, which was the average of the closing price of the Company's common stock over a five day period that included the two days prior to, the day of, and two days subsequent to the signing of the merger agreement. The note plus interest was converted into 432,738 shares of Verticalnet common stock, after the conversion of the note was approved by Verticalnet's shareholders at the November 2004 annual shareholders meeting. If the note had not been converted, half of the principal amount would have been due and payable on July 16, 2007 and the remaining half would have been due and payable on July 16, 2008. The promissory note had an effective interest rate of 16.6% per annum. The interest expense was recorded as a non-cash item on our statement of cash flows since the accrued interest was not paid in cash when the note was converted.

On December 16, 2005, we entered into a Settlement Agreement and Mutual Release (the "B2eMarkets Settlement Agreement") with FBR Investment Management, Inc., on behalf of, and in its capacity as the exclusive agent and attorney-in-fact of, the former holders of preferred stock of B2eMarkets, Inc., (the "Former Stockholders"). The B2eMarkets Settlement Agreement was entered into to settle certain claims for indemnification made by Verticalnet arising under that certain Agreement of Merger, dated as of July 16, 2004, with B2eMarkets. As a result the Former Stockholders forfeited, surrendered and released all rights to the 100,419 shares that were held in escrow (see Note 3 to the consolidated financial statements).

Digital Union Limited

On July 22, 2005, we entered into a Share Purchase Agreement (the "Share Purchase Agreement") with Patrick Lawton ("Lawton"), Brent Summers, Peter Linsell, Andrew Knotts, Colin Robertson and Alphen Trading Limited (collectively, the "Shareholders"). Pursuant to the Share Purchase Agreement, Verticalnet acquired all of the outstanding capital stock of Digital Union, a private limited company registered in England, from the Shareholders. Digital Union was a privately-held provider of on-demand sourcing and procurement solutions based in Guildford, Surrey, United Kingdom. Digital Union became a wholly-owned subsidiary of Verticalnet subsequent to the acquisition. In exchange for the outstanding capital stock of Digital Union, Verticalnet issued the Shareholders an aggregate of 636,956 shares of Verticalnet common stock. Under the Share Purchase Agreement, certain Shareholders were eligible to receive up to an additional 500,000 shares of Verticalnet common stock in the aggregate if certain revenue based milestones are achieved within the first year after the closing of the transaction. These milestones were not achieved and therefore no additional shares were issued. Digital Union's results have been included in the Company's results since July 23, 2005. The consideration for the purchase transaction was approximately \$3.5 million, including transaction costs of approximately \$500,000, which primarily consisted of fees paid for professional services. Pursuant to the Share Purchase Agreement, Verticalnet agreed to issue an aggregate amount of 636,956 shares of common stock, valued on the date of closing at approximately \$3.0 million. A total of 95,544 shares were being held in escrow, of which 47,250 shares were released on July 22, 2006 and 48,294 were released in the first quarter 2007. The value of the Verticalnet stock issued to the Shareholders was based on \$4.69 per share, which represented the average closing price of the Company's

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common stock over a three day period that included the two days prior to and the day the Share Purchase Agreement was signed.

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Pursuant to a Registration Rights and Lockup Agreement between the Shareholders and us dated July 22, 2005, 383,914 of the shares issued to the Shareholders (the Lockup Shares) were subject to lockup restrictions. The lockup restrictions expired on a portion of the Lockup Shares July 22, 2006 and such restrictions are due to expire on the remainder of the Lockup Shares on July 22, 2007. We have agreed with Lawton that on April 1, 2007, the 86,164 of the Lockup Shares held by Lawton shall be released from the remaining lockup restrictions.

Critical Accounting Policies and Estimates

Accounting policies, methods, and estimates are an integral part of the consolidated financial statements prepared by management and are based upon management's current judgments. Those judgments are normally based on knowledge and experience with regard to past and current events and assumptions about future events. Certain accounting policies, methods, and estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ from management's current judgments. While there are a number of accounting policies, methods, and estimates affecting our financial statements as described in Note 1 to the consolidated financial statements, areas that are particularly significant include revenue recognition policies including estimates used for the percentage-of-completion on revenue contracts, the assessment of the recoverability of long-lived assets and non-publicly traded investments, and the recording of accruals for contingencies, including tax contingencies. Management has reviewed these critical accounting policies and estimates with the audit committee.

Revenue Recognition

Software and software related revenues

Software and software related revenues have been principally derived from the licensing of our products, from maintenance and support contracts, and from hosting services. Customers who license our products also generally purchase maintenance contracts which provide software updates and technical support over a stated term, which is usually a twelve-month period. As part of licensing our products, a customer may also purchase custom development and implementation services from us.

Our products are either acquired under a perpetual license model or under a time-based license model. The license agreements for our products do not provide for a right of return other than during the warranty period, and historically product returns have not been significant. We do not recognize revenue for agreements with cancellation rights or refundable fees until such rights to refund or cancellation have expired.

We recognize revenue related to perpetual software arrangements in accordance with Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery of the product has occurred; the fee is fixed or determinable; and collectibility is probable. We consider all arrangements with payment terms extending beyond one year to not be fixed or determinable, and revenue under these agreements is recognized as payments become due from the customer. If collectibility is not considered probable, revenue is recognized when the fee is collected.

The Company recognizes revenue from the commissions on third-party reseller arrangements upon delivery of the related license to the end user customer by the software vendor, as well as compliance with the other revenue recognition criteria. During 2006 and 2005, the Company recorded \$902,000 and \$3,000, respectively, in third-party software reseller commissions, primarily as a result of our relationship with IBM in the United Kingdom. The Company did not record any third-party software reseller commissions during 2004.

During 2006, the Company recognized \$800,000 in software and software related revenue pertaining to a perpetual licensing agreement. The agreement grants the customer access to, and use of, the source code of our Metaprise Private Exchange Platform.

SOP 97-2, as amended, generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements. Our determination of fair value of each element in multi-element arrangements is based on vendor-specific objective evidence (VSOE). We limit our assessment of VSOE of fair value for each element to either the price charged when the same element is sold separately or the price established by management, having the relevant authority to do so, for an element not yet sold separately.

If evidence of fair value for all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. Revenue allocated to maintenance and support is recognized ratably over the maintenance term and revenue allocated to training and other service elements is recognized as the services are performed. The proportion of revenue recognized upon delivery of the software may vary from quarter to quarter depending upon the relative mix of licensing arrangements,

the extent of services that will be required to implement the software, and whether VSOE of fair value exists for all of the undelivered elements.

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Software arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of the software elements of the arrangement. When services are not considered essential, the revenue allocable to the professional services is recognized as the services are performed. If we provide professional services that are considered essential to the functionality of the software products, both the software product revenue and professional service revenue are recognized in accordance with the provisions of SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. To date, most of our professional services provided in connection with software arrangements have been considered essential to the functionality of the software and therefore, the majority of our contracts that involved licenses and professional services have been recognized on a percentage of completion basis.

Hosted term-based licenses, where the customer does not have the contractual right to take possession of the software, are accounted for in accordance with Emerging Issues Task Force (EITF) Issue No. 00-3, Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware. Revenues related to such arrangements are recognized on a monthly basis over the term of the contract. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Arrangements that include professional services sold with hosted term-based licenses and support offerings are evaluated under EITF Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, and the Securities and Exchange Commission's Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. To the extent the professional services have value to the customer on a stand-alone basis and there is objective and reliable evidence of fair value of the undelivered elements, the consideration from the arrangement is allocated among the separate elements based upon their relative fair values and professional services revenues are recognized as the services are rendered. Hosted term-based licenses, as well as any professional services that do not meet the above criteria, which have historically been the majority of the Company's services, are recognized ratably over the term of the agreement.

Services revenues

Consulting contracts with fixed-priced arrangements are recognized using the percentage-of-completion method. Percentage-of-completion accounting involves calculating the percentage of services provided during the period compared to the total estimated services to be provided over the duration of the contract. This method is followed where reasonably dependable estimates of the revenues and costs applicable to various elements of a contract can be made. Estimates of total contract revenues and costs are continuously monitored during the term of the contract, and recorded revenues and costs are subject to revision as the contract progresses. Such revisions may result in increases or decreases to revenues and results of operations and are reflected in the consolidated financial statements in the period in which they are first identified. Consulting services with fees based on time and materials or cost-plus are recognized in accordance with SAB No. 104 as the services are performed (as measured by time incurred) and amounts earned.

We consider amounts under consulting contracts to be earned once evidence of an arrangement has been obtained, services are delivered, fees are fixed or determinable, and collectibility is reasonably assured. In such contracts, our efforts, generally measured by time incurred, typically is reflective of progress against the contractual milestones or output measure, which is the contractual earnings pattern. Contingent or incentive revenues relating to consulting contracts are recognized when the contingency is satisfied and we conclude the amounts are earned.

Recoverability of Long-Lived Assets

As discussed in Note 1 to the consolidated financial statements, we regularly perform reviews to determine whether events or circumstances indicate that the carrying value of long-lived assets, including goodwill and intangible assets, may not be recoverable. Factors we consider important that could trigger an impairment review include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of the acquired assets or the strategy for our overall business, significant negative industry or economic trends, a significant decline in our stock price for a sustained period, and our market capitalization relative to net book value. When we determine that an impairment review is necessary for long-lived assets, other than goodwill, based upon the existence of one or more of the above indicators of impairment, we perform an undiscounted cash flow analysis to evaluate whether future cash flows from the long-lived asset are less than the current carrying value of the asset. If the result from this analysis indicates that an impairment charge is required for the asset, we measure the impairment based on a projected discounted cash flow method using a discount rate commensurate with the risk inherent in our current business model. Significant judgment is required in the development of projected cash flows for these purposes, including assumptions regarding the appropriate level of aggregation of cash flows, the discount rate to be used, as well as the underlying forecasts of expected future revenue and expense. For goodwill, in addition to testing for impairment if the above indicators of impairment are present, the Company is also required to perform an annual impairment test, by comparing the total market value of the Company, including a control premium, to the carrying value of the net assets of the Company. To the extent impairment is

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indicated for goodwill, we measure impairment based on a comparison of the implied fair value of goodwill with its carrying value. The implied fair value of goodwill would be determined in the same manner as the amount of goodwill recognized in a business combination is determined. That is, we would allocate the fair value of the Company to all of the assets and liabilities (including any unrecognized intangible assets) as if the Company had been acquired in a business combination and the fair value was the price paid to acquire the Company. The excess of the fair value of the Company over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. Significant judgment is required in the development of the fair values to be assigned to assets and liabilities, as well as the estimated fair value of the Company.

We perform the annual goodwill impairment test in the fourth quarter of each fiscal year. In June 2006, based on our then current market capitalization as well as other business indicators (including the Company's decreasing relationship with one of the Company's largest customers), we concluded we were required to assess whether any portion of our recorded goodwill balance was impaired. This test requires a comparison of the fair value of a reporting unit with its carrying amount, including goodwill. The Company consists of one reporting unit. For purposes of the impairment test, we consider the market capitalization of the Company, to be representative of its fair value. Accordingly, we estimated the fair value of the Company based on the total number of shares outstanding multiplied by the closing stock price on June 30, 2006, and compared such amount to the carrying value of the Company's net assets at that time. Based on our analysis, the Company's fair value was less than the carrying value of the Company's net assets, thereby necessitating that we assess our recorded goodwill for impairment. As required by SFAS No. 142, in measuring the amount of goodwill impairment, we made a hypothetical allocation of the estimated fair value of the Company to the tangible and intangible assets (other than goodwill) and liabilities. Based on this allocation, we concluded that goodwill was impaired in the amount of \$9.9 million.

We have recorded significant impairment charges for goodwill and intangible assets in the past and to the extent that events or circumstances cause our assumptions to change, additional charges may be required in future periods and such charges could be material. As of March 30, 2007, the fair value of the Company (based upon market capitalization) was greater than the carrying value of the Company's net assets.

Derivative Liabilities

In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and related amendments and guidance, the conversion and prepayment feature of the convertible notes are considered derivative instruments and are required to be bifurcated from the debt instrument and accounted for separately. In addition, the warrants issued with the convertible notes are accounted for as a liability due to the existence of certain provisions in the instruments. Changes in the fair value of the derivative liabilities are primarily measured using the Black-Scholes valuation model and are recorded in the consolidated statement of operations. The fair value of the derivatives are directly affected by the change in the market value of the Company's common stock. In addition, significant judgment is required in the development of the assumptions used in the valuation models, including assumptions regarding the future volatility of the Company's common stock and the probability of certain events related to the convertible notes occurring or not occurring in the future. As of December 31, 2006, the fair value of the derivative liabilities for the conversion and prepayment feature and the warrants was \$119,000 and \$110,000, respectively. As of December 31, 2005, the fair value of the derivative liabilities for the conversion and prepayment feature and the warrants was \$481,000 and \$840,000, respectively.

Contingencies

The Company is involved in various claims and legal proceedings (see Note 9 to the consolidated financial statements). The Company records accruals for contingencies when it is probable that a liability has been incurred and the amount can be reasonably estimated. These accruals are adjusted periodically as the assessments change or additional information becomes available. In addition, significant judgment is required in evaluating the Company's tax positions. The Company establishes reserves for tax contingencies when certain tax related positions are likely to be challenged and may not succeed (see Notes 4 and 13 to the consolidated financial statements). The Company adjusts these reserves in light of changing facts and circumstances, such as the closing of a tax audit. Although it is not possible to predict with certainty the outcome of these matters or the ultimate costs, management does not believe that there are any probable expenditures that may be incurred in excess of the liabilities accrued. Management also does not believe that these expenditures would result in a material adverse effect on the Company's financial position, results of operations, liquidity or capital resources for any year; however, should circumstances change due to new developments related to these matters, changes in our estimates may need to be made and recorded amounts and costs may be material.

Table of Contents**RESULTS OF CONTINUING OPERATIONS**

The following table sets forth statement of operations data expressed as a percentage of total revenue for the periods indicated:

	2006	2005	2004
Revenues:			
Software and software related	49.3%	33.2%	18.5%
Services	50.7%	66.8%	81.5%
Total revenues	100.0%	100.0%	100.0%
Cost of revenues:			
Cost of software and software related	13.1%	13.7%	10.1%
Cost of services	33.1		