VERTICALNET INC
Form 10-Q
November 14, 2003

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2003

or

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

For the transition period from to

Commission File Number 000-25269

VERTICALNET, INC.

(Exact name of Registrant as specified in its charter)

Pennsylvania	**23-2815834**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

400 Chester Field Parkway

Malvern, Pennsylvania 19355

(Address of principal executive offices)

Registrant s telephone number, including area code:

(610) 240-0600

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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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

The number of shares outstanding of the registrant s common stock as of November 1, 2003 was 19,367,980.

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VERTICALNET, INC.

FORM 10-Q

For the Quarterly Period Ended September 30, 2003

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Part I. Financial Information

Item 1. Consolidated Financial Statements

Verticalnet, Inc.

Consolidated Balance Sheets

(in thousands, except per share data)

	September 30, 2003 (Unaudited)	Pro Forma September 30, 2003 (See Notes 1 and 7) (Unaudited)	December 31, 2002
Assets			
Current assets:			
Cash and cash equivalents	$ 4,217	$ 5,349	$ 7,979
Accounts receivable, net of allowance for doubtful accounts of $0 at September 30, 2003 and $1,684 at December 31, 2002	1,213	1,213	1,586
Prepaid expenses and other current assets	1,097	1,097	3,892
Total current assets	6,527	7,659	13,457
Property and equipment, net	239	239	912
Other investments	606	606	606
Intangible assets, net	1,125	1,125	1,800
Other assets	92	92	1,678
Total assets	$ 8,589	$ 9,721	$ 18,453
Liabilities and Shareholders Equity			
Current liabilities:			
Current portion of long-term debt and convertible notes	$ 801	$ 801	$ 415
Accounts payable and accrued expenses	3,484	3,029	7,652
Deferred revenues	352	352	279
Other current liabilities	302	153	1,172
Total current liabilities	4,939	4,335	9,518
Long-term debt and convertible notes			7,293
Total liabilities	4,939	4,335	16,811
Commitments and contingencies (see Notes 5, 6, and 7)			

Shareholders equity:			
Preferred stock $.01 par value, 10,000,000 shares authorized, none issued at September 30, 2003 and December 31, 2002			
Common stock $.01 par value, 100,000,000 shares authorized, 17,626,106 shares issued at September 30, 2003 (19,426,106 shares pro forma) and 13,708,546 shares issued at December 31, 2002	176	194	137
Additional paid-in capital	1,182,826	1,184,544	1,170,742
Deferred compensation	(435)	(435)	(239)
Accumulated other comprehensive loss	(698)	(698)	(736)
Accumulated deficit	(1,177,414)	(1,177,414)	(1,167,457)
Treasury stock at cost, 65,636 shares at September 30, 2003 and December 31, 2002	(805)	(805)	(805)
Total shareholders equity	3,650	5,386	1,642
Total liabilities and shareholders equity	$ 8,589	$ 9,721	$ 18,453

See accompanying notes to consolidated financial statements.

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Verticalnet, Inc.

Consolidated Statements of Operations (Unaudited)

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2002**	**2003**	**2002**
Revenues:				
Software license	$ 52	$ 4,421	$ 326	$ 15,328
Services and maintenance	1,793	2,163	7,127	5,503
Total revenues	1,845	6,584	7,453	20,831
Cost of revenues:				
Cost of software license	182	193	545	879
Cost of services and maintenance	548	1,275	1,831	4,208
Total cost of revenues	730	1,468	2,376	5,087
Gross profit	1,115	5,116	5,077	15,744
Research and development	916	1,544	2,939	7,901
Sales and marketing	576	1,483	1,841	4,682
General and administrative	1,637	1,260	4,134	7,517
Restructuring and asset impairment charges (reversals)	(180)	28,911	(489)	30,677
Amortization expense				2,112
	2,949	33,198	8,425	52,889
Operating loss	(1,834)	(28,082)	(3,348)	(37,145)
Interest and other expense, net	(5,760)	(4,513)	(6,609)	(11,072)
Loss from continuing operations	(7,594)	(32,595)	(9,957)	(48,217)
Discontinued operations:				
Income from operations of discontinued operations				8,508
Loss on disposal of discontinued operations				(165)
Net loss	(7,594)	(32,595)	(9,957)	(39,874)
Preferred stock dividends and accretion				(3,861)
Repurchase of convertible redeemable preferred stock				101,041
Income (loss) attributable to common shareholders	$ (7,594)	$ (32,595)	$ (9,957)	$ 57,306
Basic income (loss) per common share:				
Income (loss) from continuing operations	$ (0.46)	$ (2.66)	$ (0.69)	$ 4.24

Income from discontinued operations				0.74
Loss on disposal of discountinued operations				(0.01)
Income (loss) per common share	$ (0.46)	$ (2.66)	$ (0.69)	$ 4.97
Diluted income (loss) per common share:				
Loss from continuing operations	$ (0.46)	$ (2.66)	$ (0.69)	$ (4.15)
Income from discontinued operations				0.73
Loss on disposal of discountinued operations				(0.01)
Loss per common share	$ (0.46)	$ (2.66)	$ (0.69)	$ (3.43)
Weighted average common shares outstanding:				
Basic	16,336	12,247	14,482	11,539
Diluted	16,336	12,247	14,482	11,626

See accompanying notes to consolidated financial statements.

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Verticalnet, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Nine Months Ended September 30,	
	2003	**2002**
Cash flows from operating activities:		
Net loss	$ (9,957)	$ (39,874)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,119	7,338
Non-cash restructuring charges (reversals)	(489)	
Inducement expense related to debt conversion	5,707	2,869
Goodwill and intangible asset impairment		27,507
Write-down of investments		11,340
Other non-cash charges	(335)	1,401
Loss (gain) on disposal of property and equipment	8	(83)
Loss on disposal of discontinued operations		165
Gain on BT settlement		(4,804)
Realized gain on investments	(111)	
Change in assets and liabilities:		
Accounts receivable	373	(908)
Prepaid expenses and other assets	742	8,056
Accounts payable and accrued expenses	(3,472)	(15,568)
Deferred revenues	73	(20,315)
Net cash used in operating activities	(6,342)	(22,876)
Cash flows from investing activities:		
Proceeds from sale of cost and equity method investments		1,850
Proceeds from sale of short-term investments	979	
Purchase of cost and equity method investments		(2,959)
Restricted cash	1,685	1,811
Proceeds from sale of assets	292	406
Capital expenditures	(59)	(780)
Discontinued operation - investing activities		2,350
Net cash provided by investing activities	2,897	2,678
Cash flows from financing activities:		
Payments to repurchase convertible redeemable preferred stock		(5,000)
Payments to repurchase convertible notes	(1,289)	(2,393)
Proceeds from issuance of common stock and warrants, net	936	
Settlement of put arrangement involving common stock		(1,014)
Payments to settle BT put and call obligation		(8,374)
Principal payments on long-term debt and obligations under capital leases	(71)	(2,146)
Proceeds from employee stock plans	82	418

Net cash used in financing activities	(342)	(18,509)
Effect of exchange rate fluctuation on cash and cash equivalents	25	245
Net decrease in cash and cash equivalents	(3,762)	(38,462)
Cash and cash equivalents - beginning of period	7,979	50,252
Cash and cash equivalents - end of period	$ 4,217	$ 11,790
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$ 189	$ 2,206
Supplemental schedule of non-cash investing and financing activities		
Issuance of common stock and warrants to repurchase convertible debt	$ 10,815	$ 14,357
Preferred dividends paid through issuance of additional securities		3,861
Issuance of common stock to BT under put/call obligation		2,955

See accompanying notes to consolidated financial statements.

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Verticalnet, Inc.

Consolidated Statement of Shareholders Equity (Unaudited)

(in thousands)

	Common Stock		Additional Paid-In	Deferred	Accumulated Other Comprehensive	Accumulated	Treasury	Total Shareholders
	Shares	Amount	Capital	Compensation	Loss	Deficit	Stock	Equity
Balance, December 31, 2002	13,709	$ 137	$ 1,170,742	$ (239)	$ (736)	$ (1,167,457)	$ (805)	$ 1,642
Exercise of restricted units	9		1					1
Repurchase of convertible debentures	2,694	27	10,788					10,815
Issuance of common stock, net	1,140	11	464					475
Reclassification of warrants			197					197
Exercise of stock options	74	1	80					81
Unearned compensation			554	(554)				
Amortization of unearned compensation				358				358
Net loss						(9,957)		(9,957)
Other comprehensive income					38			38
Balance, September 30, 2003 (Unaudited)	17,626	$ 176	$ 1,182,826	$ (435)	$ (698)	$ (1,177,414)	$ (805)	$ 3,650

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Verticalnet, Inc.

Consolidated Statements of Other Comprehensive Loss (Unaudited)

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2002**	**2003**	**2002**
Net loss	$ (7,594)	$ (32,595)	$ (9,957)	$ (39,874)
Unrealized gain on forward sale		777		2,030
Foreign currency translation adjustment	15	184	13	246
Unrealized gain (loss) on investments	14	(829)	25	(2,038)
Comprehensive loss	$ (7,565)	$ (32,463)	$ (9,919)	$ (39,636)

See accompanying notes to consolidated financial statements.

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Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

(1) Background and Basis of Presentation

Company Overview

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

We are a provider of Strategic Sourcing and Supply Management solutions that enable companies to identify, negotiate, realize, and maintain supply chain savings. Led by our Spend Analysis solution that provides companies with insight into enterprise-wide spending, Verticalnet s full suite of Supply Management solutions enables companies to achieve lower prices, improved contract compliance, better supplier service, and shorter sourcing cycles.

With the completion of the June 2002 sale of our Small/Medium Business (SMB) unit that operated and managed 59 industry-specific online marketplaces, we have completed a business transformation from our origins as an operator of online public vertical communities to a business solely focused on delivering supply chain solutions to enterprise customers. The operating results of the SMB unit through June 28, 2002 have been reflected as a discontinued operation in our consolidated financial statements.

Our consolidated financial statements as of and for the three and nine months ended September 30, 2003 and 2002 have been prepared without audit pursuant to the rules and regulations of the United States Securities and Exchange Commission (SEC). In the opinion of management, the unaudited interim consolidated financial statements that accompany these notes reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our financial position as of September 30, 2003, the results of operations for the three and nine months ended September 30, 2003 and 2002 and the cash flows for the nine months ended September 30, 2003 and 2002. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the SEC s rules and regulations relating to interim financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2002.

Basis of Presentation

Our consolidated financial statements include the accounts of our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Certain prior period amounts have been reclassified for comparability with the current period s financial statement presentation.

On July 1, 2002, the Company announced that its board of directors had approved a one-for-ten reverse stock split effective with the commencement of trading on July 15, 2002. All references in the consolidated financial statements to shares and per share amounts have been adjusted for this split.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include the allowance for doubtful accounts; carrying values for intangible assets and non-publicly held investments; and restructuring charges for abandoned operating leases.

Restricted Cash

Restricted cash represents certificates of deposit held pursuant to building lease agreements and other financing arrangements. At December 31, 2002, we had approximately $1.1 million and $0.5 million of restricted cash classified in current and non-current other assets, respectively, on the consolidated balance sheet. As of September 30, 2003, all restricted cash balances have been released and are now included as part of cash and cash equivalents.

Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

Capitalized Software

Software costs capitalized under Statement of Position (SOP) 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, or Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed, were $0.1 million and $0.7 million for the three and nine months ended September 30, 2002, respectively. There were no software costs capitalized for the three and nine months ended September 30, 2003. Amortization expense related to previously capitalized costs for the three and nine months ended September 30, 2003 was immaterial. Amortization expense related to previously capitalized costs for the three and nine months ended September 30, 2002 was $0.1 million and $0.4 million, respectively. The carrying value of the software is regularly reviewed and impairments are recognized if the value of the estimated undiscounted cash flow benefits related to the asset is less than the remaining unamortized cost. No impairment of capitalized software was recognized during the nine months ended September 30, 2003 or 2002.

Intangible and Other Long-Lived Assets

We adopted SFAS No. 142, Goodwill and Other Intangible Assets, effective January 1, 2002. Under SFAS No. 142, goodwill is no longer amortized but is reviewed for impairment annually, or more frequently if certain indicators arise. We performed a goodwill impairment test as of September 30, 2002 under SFAS No. 142. As a result of this test, the Company recorded a goodwill impairment charge of approximately $27.6 million, which represented the full amount of unamortized goodwill at the time of the test. Long-lived assets, other than goodwill, are reviewed for impairment whenever, in management s judgment, conditions indicate a possible loss. Such impairment tests compare estimated undiscounted cash flows to the reduced value of the asset. If an impairment is indicated, the asset is written down to its fair market value based on an estimate of its discounted cash flows.

Revenue Recognition

Software licensing and related services revenues are principally derived from the licensing of our products, from maintenance and support contracts and from the delivery of professional 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. Customers may also purchase custom development and implementation services from us.

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 refundable fees or agreements with cancellation rights until such rights to refund or cancellation have expired. Our products are either acquired under a perpetual license model or under a time-based license model.

We recognize revenue in accordance with 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.

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 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 of 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 may vary from quarter to quarter depending upon the relative mix of licensing arrangements and the availability of VSOE of fair value for all of the undelivered elements.

Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

Arrangements that include professional services are evaluated to determine whether those services are essential to the functionality of other 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 rendered in connection with the licensing of our software have been considered essential to the functionality of the software product and therefore, the majority of our contracts that involved licenses and professional services were recognized on a percentage of completion basis.

Deferred revenue includes amounts received from customers for which revenue has not been recognized, which in most cases relates to maintenance or license fees that are deferred until they can be recognized. The majority of our deferred revenue at December 31, 2001 was related to license fee payments received from Converge, Inc. (Converge). Such amounts were to be recognized as revenue on a straight-line basis over the contract term, which was scheduled to end on December 31, 2003. This revenue comprised the majority of our revenue (63% and 66%) for the three and nine months ended September 30, 2002, respectively. The Converge license agreement was amended in November 2002, at which time we recognized the remaining deferred revenue related to Converge.

Despite the reduction in revenues we expect to recognize from Converge in 2003, as compared to those we recognized in 2002, we do not believe such reduction will materially affect out future operating results, as we have obtained other sources of revenue, and have significantly reduced our overall cost structure.

Stock Options

Stock-based employee compensation is recognized using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Under the intrinsic value method, compensation expense is recorded on the date of grant only if the current market price of the stock exceeded the exercise price. For disclosure purposes, pro forma net income (loss) attributable to common shareholders and income (loss) per common share data are provided in accordance with SFAS No. 123, Accounting for Stock-Based Compensation, as if the fair value method had been applied. The following table illustrates the effect on our net income (loss) attributable to common shareholders and income (loss) per common share if the Company had applied the fair value recognition provisions of SFAS No. 123 (in thousands, except for per share data):

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2003	**2002**	**2003**	**2002**
Income (loss) attributable to common shareholders:				
As reported	$ (7,594)	$ (32,595)	$ (9,957)	$ 57,306
Add: Stock-based employee compensation included in reported net income (loss) attributable to common shareholders	165	45	358	120

Deduct: Stock-based employee compensation expense determined under fair-value-based method for all awards	(3,835)	(6,347)	(12,867)	(20,580)
Pro forma	$ (11,264)	$ (38,897)	$ (22,466)	$ 36,846
Income (loss) per common share basic:				
As reported	$ (0.46)	$ (2.66)	$ (0.69)	$ 4.97
Pro forma	$ (0.69)	$ (3.18)	$ (1.55)	$ 3.19
Loss per common share diluted:				
As reported	$ (0.46)	$ (2.66)	$ (0.69)	$ (3.43)
Pro forma	$ (0.69)	$ (3.18)	$ (1.55)	$ (5.19)

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Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

Computation of Historical Net Income (Loss) Per Common Share

Basic income (loss) per common share is computed using the weighted average number of common shares outstanding during the period. Diluted income (loss) per common share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period, including incremental common shares issuable upon the exercise of stock options and warrants (using the treasury stock method) and the conversion of our 5 1/4% convertible subordinated debentures and our former Series A 6.00% convertible redeemable preferred stock (using the if-converted method). Common equivalent shares are excluded from the calculation if their effect is anti-dilutive.

During the three and nine months ended September 30, 2003, as well as the three months ended September 30, 2002, the dilutive loss per common share calculation was the same as the basic loss per common share calculation as all potentially dilutive securities were anti-dilutive.

The following tables set forth the computation of income (loss) per common share for the nine months ended September 30, 2002 (in thousands, except per share data):

	Net Income (Loss)	Shares	Per Share Amount
Net loss	$ (39,874)		
Less: Preferred stock dividends and accretion	(3,861)		
Plus: Repurchase of convertible redeemable preferred stock	101,041		
Basic Income Per Common Share			
Income attributable to common shareholders	57,306	11,539	$ 4.97
Effect of Dilutive Securities			
Convertible redeemable preferred stock	(97,180)	87	
Diluted Income Per Common Share			
Loss attributable to common shareholders	$ (39,874)	11,626	$ (3.43)

Potentially dilutive common shares of 4,896,887 and 2,465,631 were excluded from the computation of diluted loss per common share because their effect was anti-dilutive for the three and nine months ending September 30, 2003 and the three and nine months September 30, 2002, respectively. In addition, 247,939 common shares that were previously held in escrow in connection with the Atlas Commerce, Inc. (Atlas Commerce) transaction are only included in the loss per common share calculation subsequent to their release date of March 31, 2003.

Unaudited Pro Forma Balance Sheet

The unaudited pro forma balance sheet as of September 30, 2003 reflects the following three subsequent events (see Note 7):

In October 2003, Verticalnet signed Waiver Letter Agreements with certain warrantholders who had acquired warrants in conjunction with the August 12, 2003 private placement (see Note 2). The Waiver Letter Agreements resulted in a modification to provide for a cashless exercise in the event of a Non-Registration Event, as defined, and the elimination of a net cash settlement (i.e., put) provision in the warrant. In addition, certain penalty provisions were modified to provide that the warrantholders would receive no liquidated damages in the event of a Non-Registration Event. The put provision in the original warrant resulted in the instrument being accounted for as a liability. Upon the elimination of this provision, the fair value of these warrants was reclassified from other current liabilities to equity.

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Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

The effects on the balance sheet accounts were as follows (in thousands):

	Debit	Credit
Other current liabilities	$ 149	
Additional paid-in capital		$ 149

On October 9, 2003, we completed a $1.8 million private placement of our common stock. The Company issued 1,800,000 shares of common stock along with warrants to purchase 720,000 shares of common stock at $1.35 per share.

The effects on the balance sheet accounts were as follows (in thousands):

	Debit	Credit
Cash and cash equivalents	$ 1,612	
Accounts payable and accrued expenses		$ 25
Common stock		18
Additional paid-in capital		1,569

On October 22, 2003, we reached an agreement with Silicon Valley Bank in connection with a letter of credit provided by Silicon Valley Bank for a lease of office space in San Francisco. As part of the settlement, the Company has agreed to pay Silicon Valley Bank $480,000 and Silicon Valley Bank has agreed to dismiss the lawsuit. See Note 6 to these consolidated financial statements.

The effects on the balance sheet accounts were as follows (in thousands):

	Debit	Credit
Accounts payable and accrued expenses	$ 480	
Cash		$ 480

Adoption of New Pronouncements

In April 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections. SFAS No. 4, Reporting Gains and Losses from Extinguishment of Debt, required that gains and losses from extinguishments of debt be included in the determination of net income and be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. Although SFAS No. 145 became effective January 1, 2003, the Company elected to early adopt the provisions of SFAS No. 145 in 2002. During the third quarter of 2002, in connection with the settlement of obligations involving British Telecommunications Plc. (BT), the Company recognized a $4.8 million gain representing the difference between the fair value of the consideration issued in the settlement transaction and the carrying value of the amounts due BT. As a result of the early adoption of SFAS No. 145, the Company evaluated the classification of this gain in accordance with the provisions of APB Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, and determined that the gain did not meet the criteria for classification as an extraordinary item.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 addresses the financial accounting and reporting of expenses related to restructurings initiated after 2002, and applies to costs associated with an exit activity (including a restructuring) or with a disposal of long-lived assets. Those activities can include eliminating or reducing product lines, terminating employees and contracts, and relocating facilities or personnel. Under SFAS No. 146, a company will record a liability for a cost associated with an exit or disposal activity when the liability is incurred and can be measured at fair value. The provisions of SFAS No. 146 are effective prospectively for exit or disposal activities initiated after December 31, 2002.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, which amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for interim periods ending after December 15, 2002, which the Company has applied in these consolidated financial statements.

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Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except for certain items and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have an impact on our consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of SFAS No. 150 are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, Elements of Financial Statements. The remaining provisions of SFAS No. 150 are consistent with the FASB s proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares, depending on the nature of the relationship established between the holder and the issuer. While the FASB still plans to revise that definition through an amendment to Concepts Statement 6, it has decided to defer issuing that amendment until it has concluded its deliberations on the next phase of this project. That next phase will deal with certain compound financial instruments including puttable shares, convertible bonds, and dual-indexed financial instruments. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have an impact on the Company s financial position, results of operations, or cash flows.

(2) Liquidity

We believe that our current level of liquid assets and the expected cash flows from contractual revenue arrangements will be sufficient to finance our capital requirements and anticipated operating losses for at least the next twelve months. However, to the extent that the current level of liquid assets or future revenues proves to be insufficient, we may need to further reduce our operating costs or obtain additional debt or equity financing. Additionally, we may, if the capital markets present attractive opportunities, raise cash through the sale of debt or equity. We can provide no assurance that we will be successful in obtaining any required or desired financing either on acceptable terms or at all.

In July 2003, we completed the repurchase of $6.4 million of our 5¼% convertible subordinated debentures due September 2004 for total consideration of $5.8 million in cash, stock, and warrants. This consideration included $1.3 million in cash, common stock with a fair market value of $4.4 million and change of control warrants valued at $0.1 million. Additionally, we made a payment for accrued but unpaid interest of approximately $21,000, also in cash. In connection with the transaction, we wrote-off, against additional paid-in capital, approximately $55,000 in deferred debt offering costs attributable to the portion of debt repurchased. The Company recorded a charge to operations of $5.7 million representing the inducement for conversion of the convertible debentures, in accordance with SFAS No. 84, Induced Conversions of Convertible Debt. This charge is included in interest and other expenses, net in the consolidated statements of operations for the three and nine months ended September 30, 2003.

In August 2003, we completed a $1.1 million private placement of our common stock. The Company issued 1,140,000 shares of common stock along with warrants to purchase 456,000 shares of common stock at $1.20 per share, which were valued at $0.5 million. The Company received approximately $0.9 million in net proceeds from this transaction. As the warrants originally included a requirement for net cash settlement if the

Company was unable to register the shares to be issued upon exercise of the warrants, these warrants were required to be recorded as a liability until such time as the registration requirements expired. In August and September, Verticalnet signed Waiver Letter Agreements with certain warrantholders, which resulted in the warrants being modified to provide for a cashless exercise in the event of a Non-Registration Event, as defined, and the elimination of the net cash settlement provision. In addition, certain penalty provisions were modified to provide that the warrantholders would receive no liquidated damages in the event of a Non-Registration Event. Upon the elimination of the net cash settlement provision, the fair value of the warrants ($197,000) was reclassified from other current liabilities to additional paid-in capital. Subsequent to September 30, 2003, additional warrantholders also signed such Waiver Letter Agreements. See Notes 1 and 7 to these consolidated financial statements regarding this subsequent event.

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Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

On October 9, 2003, we completed a $1.8 million private placement of our common stock. The Company issued 1,800,000 shares of common stock along with warrants to purchase 720,000 shares of common stock at $1.35 per share. The Company received approximately $1.6 million in net proceeds from this transaction. See note 7 to these consolidated financial statements regarding this subsequent event.

We may attempt to settle the Company s remaining $728,000 of convertible debentures. If successful, our financial resources will be reduced.

(3) Discontinued Operations

SMB

On June 28, 2002, we completed the sale of the SMB unit to Vert Markets, Inc., an affiliate of Corry Publishing, Inc. The SMB unit generated revenue from e-enablement and e-commerce, as well as advertising and services. As consideration for the transaction, we received cash of $2.35 million. In addition, we may receive up to an additional $6.5 million based on a four-year performance-based earn-out provision. We recorded a loss on disposal of approximately $165,000 in the six months ended June 30, 2002 for the sale of the SMB unit.

The results of the SMB unit have been shown as a discontinued operation and prior periods have been restated. Revenues and losses from this discontinued operation are as follows:

	Nine Months Ended September 30, 2002
E-commerce, advertising, software, maintenance, and other revenues	$ 18,982
Income from discontinued operations	8,508
Loss on disposal of discontinued operations	(165)

(4) Restructuring Charges and Asset Write-down

During 2003, we continued to make payments under previous restructuring charges incurred in connection with strategic and organizational initiatives designed to realign business operations, eliminate acquisition related redundancies, and reduce costs. The aggregate remaining restructuring accrual at September 30, 2003 of $498,000, included in accrued expenses on the consolidated balance sheet, is expected to be adequate to cover the actual amount to be paid. Differences, if any, between the estimated amount accrued and the actual amount paid will be reflected in operating expenses in future periods. The Company expects to complete all payments relating to this restructuring accrual by the first

quarter of 2004.

The following table provides a summary by category and a rollforward of the changes in the restructuring accrual for the nine months ended September 30, 2003 (in thousands):

	Accrual at December 31, 2002	Cash payments	Adjustments	Accrual at September 30, 2003
Lease termination costs	$ 3,484	$ (2,504)	$ (482)	$ 498
Employee severance and related benefits	50	(40)	(10)	
Other exit costs		(3)	3	
	$ 3,534	$ (2,547)	$ (489)	$ 498

On October 22, 2003, we reached an agreement with Silicon Valley Bank in connection with a letter of credit they had provided pertaining to a lease of office space in San Francisco. As a result, the restructuring accrual has been adjusted to reflect the agreed upon settlement. See Note 6 to these consolidated financial statements.

Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

(5) Commitments and Contingencies

SEC Comment Letter

In connection with our acquisition of Atlas Commerce, Inc., we filed a registration statement on Form S-3 with the SEC registering the resale of shares of our common stock issued in the acquisition. In connection with a routine review and comment letter process related to this filing, we have received comments from the SEC. As part of the ongoing comment and response process, the SEC reviewed our Form 10-K for the period ended December 31, 2002 and Form 10-Q for the period ended June 30, 2003 and has provided comments generally related to augmenting our disclosure in certain areas. We believe the ultimate resolution of such comments would not change our accumulated deficit at September 30, 2003 as presented in our consolidated financial statements. However, we intend to amend our Form 10-K for the period ended December 31, 2002 and our Form 10-Q for the period ended June 30, 2003, to comply with the SEC s request for amended disclosure for certain items. On October 8, 2003, we withdrew the registration statement registering the resale of shares of our common stock issued in the Atlas Commerce acquisition. On November 4, 2003 we filed a response with the SEC regarding the remaining open comments. We believe we have addressed the SEC s comments in this Form 10-Q.

(6) Other Litigation

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 in an action captioned CJA Acquisition, Inc. v. Verticalnet, et al., C.A. No. 01-CV-5241 (the CJA Action). Also named as defendants were four underwriters involved in the issuance and initial public offering of our common stock in February 1999 Lehman Brothers Inc., Hambrecht & Quist LLC, Volpe Brown Whelan & Company LLC, and WIT Capital Corporation. The complaint in the CJA Action alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Section 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated there under, based on, among other things, claims that the four underwriters awarded material portions of the initial shares to certain favored customers in exchange for excessive commissions. The plaintiff also asserts that the underwriters 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 the Company 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 CJA Action was filed, several copycat complaints were filed in U.S. Federal Court for the Southern District of New York. Those complaints, whose allegations mirror those found in the CJA Action, include Ezra Charitable Trust v. Verticalnet, et al., C.A. No. 01-CV-5350; Kofsky v. Verticalnet, et al., C.A. No. 01-CV-5628; Reeberg v. Verticalnet, C.A. No. 01-CV-5730; Lee v. Verticalnet, et al., C.A. No. 01-CV-7385; Hoang v. Verticalnet, et al., C.A. No. 01-CV-6864; Morris v. Verticalnet, et al., C.A. No. 01-CV-9459, and Murphy v. Verticalnet, et al., C.A. No. 01-CV-8084. None of the complaints state the amount of any damages being sought, but do ask the court to award rescissory damages. All of the foregoing suits were amended and consolidated into a single complaint that was filed with the U.S. Federal Court on April 19, 2002. This amended complaint contains additional factual

Verticalnet Inc.

Notes to Consolidated Financial Statements (Unaudited)

allegations concerning the events discussed in the original complaints, and asserts that, in addition to Sections 11 and 15 of the Securities Act, the Company and our officers and directors also violated Sections 10(b), 20(a), and Rule 10b-5 of the Exchange Act in connection with the IPO. In addition to this amended and consolidated complaint, the plaintiffs in this lawsuit and in the hundreds of other similar suits filed against other companies in connection with IPOs that occurred in the late 1990s have filed master allegations that primarily focus on the conduct of the underwriters of the IPOs, including our IPO. On October 9, 2002, the U.S. Federal Court for the Southern District of New York 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. On or about June 5, 2003, Verticalnet s counsel, with the approval of the Company s directors, executed a Memorandum of Understanding on behalf of Verticalnet with respect to a proposed settlement of the plaintiff s claims against Verticalnet. This proposed resolution of the litigation has been publicly announced (although not yet formally accepted by the plaintiffs) and widely reported in the press. The proposed settlement, if approved by the District Court, would result in, among other things, the dismissal of all claims against Verticalnet, its officers and directors. It is expected that the proposed resolution will be reviewed by the District Court in late 2003 or early 2004. Under the present terms of the proposed settlement described above, Verticalnet would also assign its claims against the underwriters to the plaintiffs in the consolidated actions.

On May 15, 2003, Silicon Valley Bank commenced a lawsuit against certain of the Company s subsidiaries in the U.S. District Court for the Eastern District of Pennsylvania, captioned Silicon Valley Bank v. Tradeum, Inc. and Verticalnet Solutions, LLC, C.A. No. 03-2949, in connection with a letter of credit provided by Silicon Valley Bank for a lease of office space in San Francisco. In October 2003, the Company executed a settlement agreement with Silicon Valley Bank, pursuant to which the Company paid Silicon Valley Bank $480,000 and Silicon Valley Bank released the Company and its subsidiaries from further claims. As a result of the settlement the lawsuit was dismissed.

In July 2000, we entered into an Opportunity Grant Program Contract with the Commonwealth of Pennsylvania Department of Community and Economic Development (PaDCED) whereby we received a grant in the amount of $1.0 million from the Commonwealth. The grant was conditioned upon, among other things, the creation of 1,000 full time jobs and that we would operate in the Horsham facility for at least five years. In July 2000, Atlas Commerce entered into an Opportunity Grant Program Contract with the PaDCED whereby Atlas Commerce received a grant in the amount of $400,000 from the Commonwealth, which amount was increased to $600,000 in June 2001. The grant was conditioned upon, among other things, the creation of 250 full time jobs and that Atlas Commerce would operate in the Malvern facility for at least five years. Both contracts contain a provision that requires repayment of the grant amount in the event the conditions are not met.

In November 2002, the PaDCED requested that we repay the entire grant amount of $1.0 million for the July 2000 grant to Verticalnet. The Company responded to the PaDCED that it believes it had substantially complied with the conditions. In September 2003, the PaDCED filed a Complaint-Civil Action in the Montgomery County Court of Common Pleas, although the Complaint has not yet been served upon us. The Complaint seeks to recover the total amount of the grant to Verticalnet. Although we would prefer to amicably resolve the matter, we will vigorously defend any action to recover the grant amount.

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

(7) Subsequent Events

In October 2003, Verticalnet signed Waiver Letter Agreements with certain warrantholders who had acquired warrants in conjunction with the August 12, 2003 private placement (see Note 2). The Waiver Letter Agreements resulted in a modification to provide for a cashless exercise in the event of a Non-Registration Event, as defined, and the elimination of a net cash settlement (i.e., put) provision in the warrant. In addition, certain penalty provisions were modified to provide that the warrantholders would receive no liquidated damages in the event of a Non-Registration Event. The put provision in the original warrants resulted in the instrument being accounted for as a liability. Upon the elimination of this provision, the fair value of these warrants was reclassified from other current liabilities to equity.

On October 9, 2003, we completed a $1.8 million private placement of our common stock. The Company issued 1,800,000 shares of common stock along with warrants to purchase 720,000 shares of common stock at $1.35 per share. Shareholders equity will increase by approximately $1.6 million as a result of the private placement.

On October 22, 2003, we reached an agreement with Silicon Valley Bank in connection with a letter of credit provided by Silicon Valley Bank for a lease of office space in San Francisco. As part of the settlement, the Company paid Silicon Valley Bank $480,000 and Silicon Valley Bank agreed to release the Company from all other claims. See Note 6 to these consolidated financial statements.

Due to the significance of these three transactions on the Company s financial position, we have presented a pro forma balance sheet reflecting these transactions as if they had occurred on September 30, 2003.

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

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 which 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 SmallCap 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 the section of this report entitled Factors Affecting our Business Condition. 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.

Company Overview

We are a provider of Strategic Sourcing and Supply Management solutions that enable companies to identify, negotiate, realize, and sustain supply chain savings and supply base performance improvement. Led by our Spend Analysis solution that quickly provides companies with insight into enterprise-wide spending, Verticalnet s full suite of Supply Management solutions enables companies to achieve lower prices, improved contract compliance, better supplier service, and shorter sourcing cycles.

In June 2002, we completed the sale of certain assets of the Small/Medium Business (SMB) unit that operated and managed online marketplaces. The SMB unit was sold to Corry Publishing for $2.35 million in cash consideration, plus up to an additional $6.5 million as an earn-out over the four-year period after the closing date. Additionally, during the quarter ended June 30, 2002, other assets in the SMB unit were sold under a separate agreement. Together, the transactions substantially finalized the operations of the SMB unit as part of Verticalnet and helped complete our transformation from an online operator of online public vertical communities to an enterprise software company. The operating results of the SMB unit through June 28, 2002 have been reflected as a discontinued operation in our consolidated financial statements.

With our transformation to an enterprise software business model complete, management has taken the following significant actions since June 2002 to restructure our balance sheet and improve the financial viability of our business:

In June 2002, the Company completed the repurchase of all of its outstanding shares of Series A 6.00% convertible redeemable preferred stock due 2010, plus accrued dividends thereon, for a purchase price of $5.0 million, and cancelled a common stock purchase warrant, dated April 7, 2000. The effect of the transaction was a net increase to shareholders equity of $101.0 million.

In July 2002, we completed the repurchase of $13.85 million of our 5 1/4% convertible subordinated debentures due September 2004 for total consideration of $2.9 million. This consideration included 1,270,854 shares of common stock valued at $0.8 million and $2.1 million in cash consideration. Additionally, we made a payment for accrued but unpaid interest of $0.3 million, also in cash. In connection with the transaction, $0.2 million of deferred debt offering costs attributable to the portion of debt repurchased were written off against additional paid-in capital. The Company recorded a charge to operations of $2.9 million representing the inducement for conversion of the convertible debentures, in accordance with Statement of Financial Accounting Standards (SFAS) No. 84, Induced Conversions of Convertible Debt. The net effect on shareholders equity was an increase of $11.5 million. In December 2002, we completed the repurchase of $0.7 million of our 5 1/4% convertible subordinated debentures for total consideration of $0.1 million. We recognized a gain of $0.6 million in connection with the December repurchase. In July 2003, the Company completed the repurchase of $6.4 million of our 5 1/4% convertible subordinated debentures due September 2004 for total consideration of $5.8 million. This consideration included 2,694,100 shares of common stock, with a fair market value of $4.4 million, $1.3 million of cash, and change of control warrants to purchase 305,120 shares of common stock. The warrants are exercisable only upon a change of control, expire on September

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27, 2004 and were valued at $0.1 million. Additionally the Company made a payment for accrued but unpaid interest of $21,000 also in cash and approximately $55,000 of deferred offering costs attributable to the portion of debt repurchased was written off against additional paid-in capital. In connection with the repurchase, the Company recorded a charge to operations in the third quarter of 2003 of $5.7 million representing the inducement for conversion of the convertible debentures, in accordance with SFAS No. 84.

In September 2002, we completed the repurchase of the remaining 10% interest in Verticalnet Europe, B.V. that we did not own for consideration of $6.5 million in cash, of which $0.9 million pertained to accrued interest, and 1,000,000 shares of common stock valued at $1.2 million (200,000 shares were previously issued in 2002 as partial payments toward the obligation, along with an additional $3.0 million payment which included payment of accrued interest of $0.2 million). In connection with this settlement, the put and call agreement between Verticalnet and British Telecommunications Plc. (BT) was terminated. Separately, the Company and BT also agreed to terminate a Reseller Agreement between the parties, including a $1.5 million prepaid license obligation. As a result of this settlement, the Company recorded a $4.8 million gain representing the difference between the fair value of the consideration issued in the settlement transaction and the carrying value of the amounts due BT.

Also in September 2002, the Company and its wholly-owned subsidiary, VNI Holdings, Inc. (VNI) entered into an agreement with another investor in Converge, Inc. (Converge) to sell all of the Company s equity interests in, and notes receivable from, Converge for cash consideration of approximately $1.9 million. At the first closing on September 30, 2002, VNI transferred the notes receivable and a portion of the Converge equity to the buyer and received the entire $1.9 million cash consideration. Under the terms of the agreement, the Company was to transfer to the buyer all of the outstanding capital stock of VNI at a second closing. If the Company was not able to transfer the stock of VNI, the Company could have been required to refund $0.1 million to the buyer. The Company was relieved of this obligation as part of the sale of Converge s assets in the first quarter of 2003.

We completed a goodwill impairment test as of September 30, 2002, under SFAS No. 142, Goodwill and Other Intangible Assets. This test requires a comparison of the fair value of a reporting unit with its carrying amount, including goodwill. We did not consider the market capitalization of the Company, which consists of only one reporting unit, to be representative of its fair value due to the volatility of the market price. Therefore, we estimated the fair value of the business based upon the amounts we could reasonably expect to realize in the sale of the assets of the business. As a result of this test, the Company recorded an impairment charge to goodwill of $27.6 million. Of this amount, $21.6 million related to the December 2001 acquisition of Atlas Commerce, Inc. (Atlas Commerce) and $6.0 million related to the Company s acquisition of Isadra, Inc. (Isadra) in August 1999.

In November 2002, the Company entered into a second amendment to the amended and restated subscription license agreement with Converge. This amendment eliminated the obligation of the Company to provide future Verticalnet products to Converge at no cost for the term of the original subscription license agreement. As there remained no further obligation by Verticalnet under the license agreement with Converge, the remaining deferred license revenue balance of $19.6 million was recognized during the fourth quarter of 2002. Since all amounts due under the amended and restated subscription license agreement had been collected, the revenue recognized did not represent additional cash inflows to the Company. This amendment did not alter the maintenance and support agreement between the Company and Converge.

In January 2003, the Company amended the lease agreement with its primary landlord resulting in an annual savings of $2.7 million of operating expenses and reducing the Company s off balance sheet obligations by $16.4 million, which consisted of both future minimum lease payment and related operations expenses. The amended agreement terminated the Company s financial obligation for the lease of the 700 Dresher Road and 300 Chester Field Parkway locations. Additionally, the agreement provided for occupancy of the 400 Chester Field Parkway premises until May 31, 2003 with options to continue the lease on a quarterly basis. We have exercised the option to continue the lease for an additional 90 days, commencing September 1, 2003.

In August 2003, we completed a $1.1 million private placement of our common stock. The Company issued 1,140,000 shares of common stock along with warrants to purchase 456,000 shares of common stock at $1.20 per share, which were valued at approximately $0.5 million. The Company received approximately $0.9 million in net proceeds from this transaction.

In October 2003, we completed a $1.8 million private placement of our common stock. The Company issued 1,800,000 shares of common stock along with warrants to purchase 720,000 shares of common stock at $1.35 per share. The Company received approximately $1.6

million in net proceeds from this transaction. See note 7 to the consolidated financial statements included elsewhere in this report regarding this subsequent event.

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Results of Continuing Operations for the Three and Nine Months Ended September 30, 2003 and September 30, 2002

Revenues

Total revenues for the quarter ended September 30, 2003 were $1.8 million as compared to $6.6 million for the quarter ended September 30, 2002. For the nine month periods ended September 30, 2003 and 2002, total revenues were $7.5 million and $20.8 million, respectively.

Revenues in the ongoing business are comprised of software license revenues and service and maintenance revenues. For the three months ended September 30, 2003 and 2002, software license revenues were $0.1 and $4.4 million, respectively. For the nine months ended September 30, 2003, software license revenues were $0.3 million versus $15.3 million in the same period last year. The decline relates primarily to changes in our agreement with Converge and a more difficult macro economic market for software companies. There have been no new license agreements signed since March 2002. Revenues derived from the Converge arrangement represented approximately 4% and 66% of total revenues for the nine months ended September 30, 2003 and 2002, respectively.

Despite the reduction in revenues we expect to recognize from Converge in 2003, as compared to those we recognized in 2002, we do not believe such reduction will materially affect out future operating results, as we have obtained other sources of revenue, and have significantly reduced our overall cost structure.

Services and maintenance revenues were $1.8 million for the three months ended September 30, 2003 versus $2.2 million for the three months ended September 30, 2002, and increased year to date to $7.1 million compared to $5.5 million for the same period in 2002. The increase in service and maintenance revenues is due to selling additional services to our customers.

For the three and nine months ended September 30, 2003, 76% and 75% of total revenues were derived from the Company s two largest customers.

Cost of Revenues

Cost of revenues is comprised of the cost of software license and the cost of services and maintenance. The cost of software license itself is comprised of royalties and the cost of acquired technology, which is the non-cash amortization of currently used technologies acquired through acquisitions.

The cost of software license was $0.2 million for the three months ended September 30, 2003 and 2002. For the nine months ended September 30, 2003, the cost of software licenses decreased to $0.5 million compared to $0.9 million for the same period last year. The decrease for the nine months ended September 30, 2003 is due primarily to the decrease in the amortization of the technology acquired in the Isadra and Tradeum, Inc. (Tradeum) acquisitions, which had been fully amortized as of December 31, 2002. The cost of acquired technology for the three and nine months of 2003 relates primarily to the Atlas Commerce acquisition, which occurred in December 2001.

The cost of services and maintenance includes the cost of the Company s consultants who are primarily responsible for the software implementations and configurations. Also included is the cost of the Company s customer support function, which is provided to customers as part of the recurring maintenance fees. For the three months ended September 30, 2003 and 2002 these costs were $0.5 million and $1.3 million, respectively. During the nine months ended September 30, 2003 the costs decreased to $1.8 million from $4.2 million during the same period of 2002. The decrease is primarily due to reduced facilities and infrastructure costs and a significant reduction in headcount in the first nine months of 2002 as a result of the restructuring actions that occurred during 2002. For the nine months ended September 30, 2003, the combination of these items accounted for approximately $2.0 million of the decrease. The reduction of third-party consultants and a decrease in amortization expense contributed approximately $0.3 million and $0.1 million to the overall decrease, respectively.

Research and Development

Research and development costs consist primarily of salaries and fringe benefits costs of our development efforts related to our specific customers, product strategy, development, and testing employees. For the nine months ended September 30, 2003, research and development costs decreased $5.0 million to $2.9 million as compared to the same period in the prior year. Research and development costs decreased to $0.9 million from $1.5 million for the three months ended September 30, 2003 and 2002, respectively. The decrease was primarily due to headcount reductions associated with the restructuring actions that occurred during 2002. During the three and nine months ended September 30, 2003, reductions in salary and fringe benefits related costs accounted for approximately $0.4 million and $3.3 million of the decrease, respectively. Reduction in facilities and infrastructure costs attributable to the research and development group contributed approximately $0.1 million and $1.0 million to the overall decrease, respectively.

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Sales and Marketing

Sales and marketing expenses consist primarily of salaries and fringe benefits costs, as well as commissions, for sales and marketing employees. In addition, the travel costs associated with business development are included in sales and marketing expenses. The sales and marketing expenses for the nine months ended September 30, 2003 and 2002 were $1.8 million and $4.7 million, respectively. The sales and marketing expenses for the three months ended September 30, 2003 and 2002 were $0.6 million and $1.5 million, respectively. For the three and nine months ended September 30, 2003, the significant decrease in sales and marketing expenses is primarily related to headcount reductions, which resulted in salary and fringe benefits decreasing by $0.4 million and $1.5 million, respectively. For the three and nine months ended September 30, 2003, facilities and infrastructure costs attributable to the group decreased by $0.2 million and $0.4 million, respectively, while direct marketing expenses, such as advertising, public relations and trade shows, declined approximately $0.1 million and $0.7 million, respectively.

General and Administrative

General and administrative expenses consist primarily of salaries and related costs for our executive, administrative, finance, legal, and human resources personnel. General and administrative expenses decreased $3.4 million to $4.1 million for the nine months ended September 30, 2003 from $7.5 million for the nine months ended September 30, 2002. For the three months ended September 30, 2003, general and administrative expenses increased to $1.6 million from $1.3 million for the same period in 2002. For the nine months ended September 30, 2003 these expenses declined primarily as a result of the restructuring actions undertaken in 2002. For the nine months ended September 30, 2003, headcount related cost reductions accounted for $1.0 million, a decrease in depreciation expense accounted for $2.0 million of the decline and a decrease in other general and administrative expenses, such as rent, contributed $0.3 million. For the three months ended September 30, 2003 these expenses increased primarily due to the prior year s one-time settlement gains of $0.9 million relating to certain litigation and tax related issues.

Restructuring and Asset Impairment Charges (Reversals)

Restructuring and impairment charge (reversals) for the three and nine months ended September 30, 2003 reflect the net adjustment to the restructuring accrual. For the three and nine months ended September 30, 2002, the Company recognized approximately $28.9 million and $30.7 million in restructuring and impairment charges, respectively. The charges include a goodwill impairment of $27.5 million related to the goodwill recorded in the acquisition of Atlas Commerce and Isadra. The remaining charges include adjustments to the restructuring charge recognized in the fourth quarter of 2001. The $1.4 million and the $3.2 million adjustments for the quarter and nine months ended September 30, 2002, respectively, relate primarily to facility leases, and in the nine month period include $0.6 million related to severance costs incurred as a result of the Atlas Commerce acquisition and integration. During the three months ended September 30, 2003, the accrual for facility leases was adjusted by approximately $0.2 million to reflect the settlement with Silicon Valley Bank. See Notes 6 and 7 to the consolidated financial statements included elsewhere in this report regarding this event.

Amortization Expense

For the nine months ended September 30, 2002 amortization expense totaled $2.1 million, which primarily reflected the non-cash amortization of deferred costs related to warrants and Series A preferred stock issued to Microsoft. The Company did not incur any such amortization expense during the three months ended September 30, 2003 or 2002 or nine months ended September 30, 2003.

Interest and Other Expense, net

Interest and other expense, net was comprised of the following (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2003	**2002**	**2003**	**2002**
Gain (loss) on asset disposal	$	$ (25)		