

VERTICALNET INC
Form 10-Q
November 19, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

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

For the quarterly period ended September 30, 2007

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
(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

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

The number of shares outstanding of the registrant's common stock as of November 12, 2007 was 1,610,845.

VERTICALNET, INC.
FORM 10-Q
For the Quarterly Period Ended September 30, 2007
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VERTICALNET, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	September 30, 2007 (unaudited)	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 642	\$ 2,809
Accounts receivable, net	3,476	3,877
Prepaid expenses and other current assets	1,148	778
Total current assets	5,266	7,464
Property and equipment, net	348	920
Goodwill	9,765	9,709
Other intangible assets, net	1,308	2,184
Other assets	127	416
Total assets	\$ 16,814	\$ 20,693
Liabilities and Shareholders Equity		
Current liabilities:		
Current portion of long-term debt, convertible notes, and other non-current liabilities	\$ 5,623	\$ 2,170
Accounts payable and accrued expenses	5,701	5,698
Deferred revenues	3,391	3,756
Total current liabilities	14,715	11,624
Non-current portion of deferred revenues	1,489	857
Long-term debt and other non-current liabilities	25	5,270
Total liabilities	16,229	17,751
Series B Convertible Preferred Stock	147	
Commitments and contingencies (see Notes 2, 5, 6, 7 and 8)		
Shareholders equity:		

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Preferred stock \$.01 par value, 35,000,000 shares authorized, 8,700,000 shares issued at September 30, 2007 and 10,000,000 shares authorized and none issued at December 31, 2006		
Common stock \$.01 par value, 15,000,000 shares authorized, 1,613,549 shares issued at September 30, 2007 and 2,678,571 shares authorized, 1,171,586 shares issued at December 31, 2006	129	94
Additional paid-in capital	1,234,903	1,230,501
Accumulated other comprehensive (loss) income	32	(33)
Accumulated deficit	(1,233,821)	(1,226,815)
	1,243	3,747
Treasury stock at cost, 1,173 shares at September 30, 2007 and December 31, 2006	(805)	(805)
Total shareholders equity	438	2,942
Total liabilities and shareholders equity	\$ 16,814	\$ 20,693

See accompanying notes to condensed consolidated financial statements.

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VERTICALNET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
(in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Revenues:				
Software and software related	\$ 1,671	\$ 2,343	\$ 4,890	\$ 5,774
Services	1,367	1,830	4,981	6,500
Total revenues	3,038	4,173	9,871	12,274
Cost of revenues:				
Cost of software and software related	345	529	1,053	1,702
Cost of services	904	1,047	3,178	4,131
Amortization of acquired technology and customer contracts	117	272	617	768
Total cost of revenues	1,366	1,848	4,848	6,601
Gross profit	1,672	2,325	5,023	5,673
Operating expenses:				
Research and development	824	1,201	2,811	4,074
Sales and marketing	1,172	1,630	3,804	5,464
General and administrative	1,276	1,547	3,645	4,885
Litigation and settlement costs		6		1,032
Restructuring charges (reversals)		(21)		195
Impairment charge for goodwill				9,877
Amortization of other intangible assets	86	201	288	660
Total operating expenses	3,358	4,564	10,548	26,187
Operating loss	(1,686)	(2,239)	(5,525)	(20,514)
Interest and other expense (income), net	(297)	1,145	1,234	1,489
Net loss before preferred stock dividends	(1,389)	(3,384)	(6,759)	(22,003)
Preferred stock deemed dividends	210		247	
Net loss applicable to common shareholders	\$ (1,599)	\$ (3,384)	\$ (7,006)	\$ (22,003)
Basic and diluted loss per common share	\$ (.99)	\$ (3.36)	\$ (4.76)	\$ (23.11)
Basic and diluted weighted average common shares outstanding (Note 1)	1,616	1,008	1,473	952

See accompanying notes to condensed consolidated financial statements.

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VERTICALNET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(in thousands)

	Nine Months Ended	
	September 30,	
	2007	2006
Operating activities:		
Net loss	\$ (7,006)	\$ (22,003)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,204	1,839
Stock-based compensation	144	1,414
Impairment of goodwill		9,877
Accretion of promissory notes and non-cash interest	639	1,820
Change in the fair value of derivative liabilities	438	(1,265)
Loss on asset disposal	316	
Amortization of deferred financing costs	103	467
Preferred stock deemed dividends	247	
Other non-cash items	1	9
Change in assets and liabilities, net:		
Accounts receivable	401	331
Prepaid expenses and other assets	288	345
Accounts payable and accrued expenses	178	1,479
Deferred revenues	267	1,212
Net cash used in operating activities	(2,780)	(4,475)
Investing activities:		
Capital expenditures	(39)	(77)
Acquisitions related payments		(57)
Restricted cash	155	155
Net cash provided by investing activities	116	21
Financing activities:		
Principal payments on long-term debt and obligations under capital leases	(1,437)	(1,364)
Proceeds from issuance of senior subordinated discount note, net		3,677
Proceeds from issuance of preferred stock, net	1,954	
Proceeds from exercise of restricted stock and issuance of common stock	3	11
Net cash provided by financing activities	520	2,324
Effect of exchange rate fluctuation on cash and cash equivalents	(23)	21
Net decrease in cash and cash equivalents	(2,167)	(2,109)
Cash and cash equivalents beginning of period	2,809	4,576
Cash and cash equivalents end of period	\$ 642	\$ 2,467

Supplemental disclosure of cash flow information:

Cash paid during the period for interest	\$	561	\$	260
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Supplemental schedule of non-cash investing and financing activities:

Conversion of and payments on senior convertible promissory notes and accrued interest into/common stock	\$	1,523	\$	2,394
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Financed insurance policies		570		663
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Capital expenditures financed through capital lease arrangements				42
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See accompanying notes to condensed consolidated financial statements.

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VERTICALNET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (UNAUDITED)
(in thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)		Accumulated Deficit	Treasury Stock	Total Shareholders Equity
	Shares	Amount						
Balance, January 1, 2007 (Note 1)	1,172	\$ 94	\$ 1,230,501	\$ (33)	\$ (1,226,815)	\$ (805)	\$ 2,942	
Exercise of stock options, non-vested stock, and restricted units	5		3				3	
Preferred stock deemed dividends			247				247	
Reclass of net Warrant liabilities			2,520				2,520	
Conversion of and payments on senior convertible promissory notes and accrued interest into / with common stock (Note 5)	436	35	1,488				1,523	
Issuance of non-vested stock	1							
Stock-based compensation expense			144				144	
Net loss					(7,006)		(7,006)	
Other comprehensive income				65			65	
Balance, September 30, 2007 (unaudited)	1,614	\$ 129	\$ 1,234,903	\$ 32	\$ (1,233,821)	\$ (805)	\$ 438	

See accompanying notes to condensed consolidated financial statements.

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VERTICALNET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)
(in thousands)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Net loss to common shareholders	\$ (1,599)	\$ (3,384)	\$ (7,006)	\$ (22,003)
Foreign currency translation adjustment	20	73	65	276
Comprehensive loss	\$ (1,579)	\$ (3,311)	\$ (6,941)	\$ (21,727)

See accompanying notes to condensed consolidated financial statements.

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VERTICALNET, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

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 generate savings on the goods and services they buy.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements are presented pursuant to the rules and regulations of the United States Securities and Exchange Commission in accordance with the disclosure requirements for the quarterly report on Form 10-Q. In the opinion of the management of the Company, the unaudited condensed financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary to fairly state the results for the interim periods presented. Operating results for the nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes of the Company included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Our condensed consolidated financial statements include the accounts of our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern and accordingly the financial statements do not include any adjustments (see Note 2).

Reverse Stock Splits

All references relating to 2007 and 2006 in the condensed consolidated financial statements and accompanying notes to shares and per shares amounts have been adjusted for the reverse splits discussed below.

2007 Reverse Split

At the Company's 2007 Annual Meeting of Shareholders held on August 15, 2007, the Company's shareholders approved an amendment to the Company's Amended and Restated Articles of Incorporation to effect a reverse stock split of the Company's outstanding common stock at an exchange ratio of not less than one-for-five and not more than one-for-ten, and authorized the Company's Board of Directors to implement a reverse stock split within this range at any time prior to the 2008 Annual Meeting of Shareholders.

On August 16, 2007, the Company effected a one-for-eight reverse split of its outstanding shares of common stock, par value \$0.01 per share (the 2007 Reverse Split). Pursuant to the 2007 Reverse Split, each holder of eight shares of the Company's common stock became the holder of one share of the Company's common stock. All outstanding options, warrants, convertible notes or other rights convertible into or exercisable for shares of common stock other than the Series B Preferred stock, were adjusted in accordance with their terms and pursuant to the ratio of the 2007 Reverse Split. No fractional shares were issued in connection with the 2007 Reverse Split. Any fractional shares resulting from the 2007 Reverse Split were rounded up to the nearest whole shares and no cash payment was made in respect to such rounding.

On August 15, 2007, the Company filed an Amendment to its Amended and Restated Articles of Incorporation (the 2007 Amendment) with the Secretary of State of the Commonwealth of Pennsylvania to effect: (i) the Reverse Stock Split; (ii) an increase in the number of authorized shares of Common Stock to 120,000,000 shares; and (iii) an increase in the number of authorized shares of Preferred Stock to 35,000,000 shares.

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At the Company's 2006 Annual Meeting of Shareholders held on May 19, 2006, the Company's shareholders approved an amendment to the Company's Amended and Restated Articles of Incorporation to effect a reverse stock split of the Company's outstanding common stock at an exchange ratio of not less than one-for-three and not more than one-for-seven, and authorized the Company's Board of Directors to implement a reverse stock split within this range at any time prior to the 2007 Annual Meeting of Shareholders.

On June 12, 2006, the Company effected a one-for-seven reverse split of its outstanding shares of common stock, par value \$0.01 per share (the 2006 Reverse Split). Pursuant to the 2006 Reverse Split, each holder of seven shares of the Company's common stock became the holder of one share of the Company's common stock. All outstanding options, warrants, convertible notes or other rights convertible into or exercisable for shares of common stock, were adjusted in accordance with their terms and pursuant to the ratio of the 2006 Reverse Split. No fractional shares were issued in connection with the 2006 Reverse Split. Any fractional shares resulting from the 2006 Reverse Split were rounded up to the nearest whole shares and no cash payment was made in respect to such rounding.

On June 8, 2006, the Company filed an Amendment to its Amended and Restated Articles of Incorporation (the Amendment) with the Secretary of State of the Commonwealth of Pennsylvania to effect: (i) the Reverse Split; and (ii) an increase in the number of authorized shares of common stock to 21,428,571 shares.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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.

Cash and Cash Equivalents

Cash and cash equivalents include cash, money market investments, and other highly-liquid investments with purchased maturities of three months or less. Cash equivalents were approximately \$37,000 and \$228,000 at September 30, 2007 and December 31, 2006, respectively.

Restricted Cash

Restricted cash balances represent certificates of deposit held pursuant to a building lease agreement. At December 31, 2006, we had approximately \$155,000 of restricted cash classified as other non-current assets on the condensed consolidated balance sheet. In August 2007, the Company entered into a cancellation agreement with the landlord of our New York City office space. The certificates of deposit was held pursuant to the New York City office space lease agreement. As a result of the cancellation agreement, the landlord retained \$125,000 of the restricted cash and the balance was returned to the Company (see Note 12).

Intangible Assets and Other Long-Lived Assets

Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead are tested for impairment annually or more frequently if certain indicators arise. Intangible assets with estimable useful lives are amortized over their respective useful lives to their estimated residual values, and reviewed for impairment.

In June 2006, based on our then current market capitalization, as well as other business indicators, we concluded that our goodwill balance was impaired and recorded an impairment charge of \$9.9 million.

We perform the annual goodwill impairment test in the fourth quarter of each fiscal year. 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 November 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 exceeded the carrying value of the Company's net assets and, therefore, no impairment charge was deemed necessary. As of September 30, 2007 and October 31, 2007, the fair value of the Company (based on market capitalization as well as the transaction described in Note 13) was greater than the carrying value of the Company's net assets. Accordingly, no impairment was indicated. As of September 30, 2007, and through the date of the filing of this Form 10-Q, the

Company's market value has continued to decline. 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.

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 carrying 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.

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Deferred revenue includes amounts invoiced to or received from customers for whom revenue has not been recognized, which in most cases relates to maintenance, hosting, or license fees that are deferred until they can be recognized.

Financial Instruments

We have determined the estimated fair value of our financial instruments using available market information and valuation methodologies. As of September 30, 2007 and December 31, 2006, our financial instruments included cash equivalents, accounts receivable, accounts payable, capital leases, derivative and other liabilities, convertible notes and a discount note. Considerable judgment is required to develop the estimates of fair value; thus, the estimates are not necessarily indicative of the amounts that could be realized in a current market exchange. However, we believe the carrying values of these assets and liabilities, with the exception of the capital leases, derivative and other liabilities, and the discount note are a reasonable estimate of their fair market values at September 30, 2007 and December 31, 2006 due to the short maturities of such items. The Company believes that the fair values of the capital leases, discount note, and other liabilities are not materially different from the carrying values. The derivative liabilities are recorded at fair value on the condensed consolidated balance sheet as of September 30, 2007 and December 31, 2006.

Concentration of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash and cash equivalents in bank deposits accounts and trade receivables. Cash and cash equivalents are held with high quality financial institutions. We periodically perform credit evaluations of our customers and maintain reserves for potential losses, if necessary. We do not anticipate losses from these receivables in excess of the provided allowances. See Revenue Recognition below for additional information on credit and revenue concentrations.

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, from third-party software reseller commissions, 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 cancel have expired.

We recognize revenue related to 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 outside of our normal payment terms 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 the three and nine months ended September 30, 2007, the Company recorded \$151,000 and \$356,000, respectively, in third party software reseller commissions. During the three and nine months ended September 30, 2006, the Company recorded \$68,000 and \$302,000 in third party software reseller commissions. These third party software reseller commissions were primarily a result of our relationship with IBM in the United Kingdom and the sale of their software.

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.

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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.

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 proportional performance method of accounting. Proportional performance 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 condensed 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.

As of and for the nine months ended September 30, 2007 and 2006, revenues and amounts due from our largest customers were as follows (in thousands):

Customer	2007		2006	
	Accounts Receivable Bala	% of Total	Accounts Receivable	% of Total