VERTICALNET INC
Form 10-Q
May 15, 2007

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

FORM 10-Q

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

For the quarterly period ended March 31, 2007

OR

o **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)	**(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 þ No o

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 o Accelerated filer o Non-accelerated filer þ

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

The number of shares outstanding of the registrant s common stock as of May 11, 2007 was 12,409,228.

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FORM 10-Q
For the Quarterly Period Ended March 31, 2007
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Part I. Financial Information
Item 1. Condensed Consolidated Financial Statements

VERTICALNET, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	March 31, 2007 (unaudited)	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 1,586	$ 2,809
Accounts receivable, net	3,832	3,877
Prepaid expenses and other current assets	1,022	778
Total current assets	6,440	7,464
Property and equipment, net	830	920
Goodwill	9,706	9,709
Other intangible assets, net	1,821	2,184
Other assets	291	416
Total assets	$ 19,088	$ 20,693
Liabilities and Shareholders Equity		
Current liabilities:		
Current portion of long-term debt, convertible notes, and other non-current liabilities	$ 1,716	$ 2,170
Accounts payable and accrued expenses	5,954	5,698
Deferred revenues	3,830	3,756
Total current liabilities	11,500	11,624
Non-current portion of deferred revenues	1,034	857
Long-term debt and other non-current liabilities	5,284	5,270
Total liabilities	17,818	17,751
Commitments and contingencies (see Notes 2, 5, 6, and 7)		
Shareholders equity:		
Preferred stock $.01 par value, 10,000,000 shares authorized, none issued at March 31, 2007 and December 31, 2006		

Common stock $.01 par value, 21,428,571 shares authorized at March 31, 2007 and December 31, 2006, 10,745,462 shares issued at March 31, 2007 and 9,372,685 shares issued at December 31, 2006		107		94
Additional paid-in capital		1,231,322		1,230,501
Accumulated other comprehensive loss		(30)		(33)
Accumulated deficit		(1,229,324)		(1,226,815)
		2,075		3,747
Treasury stock at cost, 9,377 shares at March 31, 2007 and December 31, 2006		(805)		(805)
Total shareholders equity		1,270		2,942
Total liabilities and shareholders equity	$	19,088	$	20,693

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Revenues:		
Software and software related	$ 1,559	$ 1,541
Services	1,858	2,375
Total revenues	3,417	3,916
Cost of revenues:		
Cost of software and software related	357	598
Cost of services	1,107	1,652
Amortization of acquired technology and customer contracts	250	247
Total cost of revenues	1,714	2,497
Gross profit	1,703	1,419
Operating expenses:		
Research and development	983	1,475
Sales and marketing	1,340	1,935
General and administrative	1,391	1,650
Litigation and settlement costs		1,018
Restructuring charges		238
Amortization of other intangible assets	116	258
Total operating expenses	3,830	6,574
Operating loss	(2,127)	(5,155)
Interest and other expense, net	382	153
Net loss	$ (2,509)	$ (5,308)
Basic and diluted loss per common share	$ (0.24)	$ (0.74)
Basic and diluted weighted average common shares outstanding	10,312	7,167

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Operating activities:		
Net loss	$ (2,509)	$ (5,308)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	476	650
Stock-based compensation	79	480
Accretion of promissory notes and non-cash interest	244	427
Change in the fair value of derivative liabilities	(119)	(507)
Amortization of deferred financing costs	59	120
Other non-cash items		9
Change in assets and liabilities, net of effect of acquisition:		
Restricted cash		(211)
Accounts receivable	45	1,906
Prepaid expenses and other assets	220	205
Accounts payable and accrued expenses	416	888
Deferred revenues	251	8
Net cash used in operating activities	(838)	(1,333)
Investing activities:		
Capital expenditures	(19)	(45)
Acquisitions related payments		(57)
Restricted cash		155
Net cash provided by (used in) investing activities	(19)	53
Financing activities:		
Principal payments on long-term debt and obligations under capital leases	(370)	(135)
Proceeds from exercise of restricted stock and issuance of common stock	3	2
Net cash used in financing activities	(367)	(133)
Effect of exchange rate fluctuation on cash and cash equivalents	1	9
Net decrease in cash and cash equivalents	(1,223)	(1,404)
Cash and cash equivalents beginning of period	2,809	4,576
Cash and cash equivalents end of period	$ 1,586	$ 3,172
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 35	$ 115

Supplemental schedule of non-cash investing and financing activities:		
Conversion of and payments on senior convertible promissory notes and accrued interest into/with common stock	$ 752	$ 1,006
Financed insurance policies	397	494
Capital expenditures financed through capital lease arrangements		44

See accompanying notes to condensed consolidated financial statements.

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

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Treasury Stock	Total Shareholders Equity
Balance, December 31, 2006	9,373	$ 94	$ 1,230,501	$ (33)	$ (1,226,815)	$ (805)	$ 2,942
Exercise of stock options, non-vested stock, and restricted units	36		3				3
Conversion of and payments on senior convertible promissory notes and accrued interest into / with common stock (Note 5)	1,320	13	739				752
Issuance of non-vested stock	16						
Stock-based compensation expense			79				79
Net loss					(2,509)		(2,509)
Other comprehensive income				3			3
Balance, March 31, 2007 (unaudited)	10,745	$ 107	$ 1,231,322	$ (30)	$ (1,229,324)	$ (805)	$ 1,270

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 March 31,	
	2007	**2006**
Net loss	$ (2,509)	$ (5,308)
Foreign currency translation adjustment	3	38
Comprehensive loss	$ (2,506)	$ (5,270)

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 three months ended March 31, 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 Split

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 Reverse Split). Pursuant to the 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 Reverse Split. No fractional shares were issued in connection with the Reverse Split. Any fractional shares resulting from the Reverse Split were rounded up to the nearest whole shares and no cash payment was made in respect to such rounding.

All references relating to 2006 in the condensed consolidated financial statements and accompanying notes to shares and per shares amounts have been adjusted for this reverse split.

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.

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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 $131,000 and $228,000 at March 31, 2007 and December 31, 2006, respectively.

Restricted Cash

Restricted cash balances represent certificates of deposit held pursuant to a building lease agreement. At March 31, 2007 and December 31, 2006, we had approximately $156,000 of restricted cash classified as other non-current assets on the condensed consolidated balance sheet.

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 March 31, 2007 and April 30, 2007, the fair value of the Company (based on market capitalization) was greater than the carrying value of the Company s net assets. Accordingly, no impairment was indicated. As of March 31, 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.

Deferred Revenue

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 March 31, 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 March 31, 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 March 31, 2007 and December 31, 2006.

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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 months ended March 31, 2007, the Company recorded $138,000 in third party software reseller commissions, primarily as a result of our relationship with IBM in the United Kingdom and the sale of their software. The Company did not record any third-party software reseller commissions during the three months ended March 31, 2006.

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

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

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.

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

Services revenues

Consulting contracts with fixed-priced arrangements are recognized using the percentage-of-completion method. Percentage-of-completion accounting involves calculating the percentage of services provided during the period compared to the total estimated services to be provided over the duration of the contract. This method is followed where reasonably dependable estimates of the revenues and costs applicable to various elements of a contract can be made. Estimates of total contract revenues and costs are continuously monitored during the term of the contract, and recorded revenues and costs are subject to revision as the contract progresses. Such revisions may result in increases or decreases to revenues and results of operations and are reflected in the 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 three months ended March 31, 2007 and 2006, revenues and amounts due from our largest customers were as follows (in thousands):

	2007			2006		
Customer	**Accounts Receivable Balance (a)**	**Revenues**	**% of Total Revenues**	**Accounts Receivable Balance (a)**	**Revenues**	**% of Total Revenues**
A	$ 202	$ 170	5.0%	$ 624	$ 707	18.1%
B	110	118	3.5	683	599	15.3
C	199	424	12.4			
All others, net of allowance (b)	3,321	2,705	79.1	1,975	2,610	66.6
Total	$ 3,832	$ 3,417	100.0%	$ 3,282	$ 3,916	100.0%

(a) Represents both billed and unbilled amounts.

(b) Accounts receivable balance includes

unbilled amounts as March 31, 2007 and 2006 of $761,000 and $1.1 million, respectively.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123R, Share-Based Payment, using the modified prospective approach. SFAS No. 123R revised SFAS No. 123, Accounting for Stock-Based Compensation and superseded Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. During the three months ended March 31, 2007 and 2006, the Company recorded a stock-based compensation charge in accordance with SFAS No. 123R of $56,000 and $205,000, respectively. Additionally, during the three months ended March 31, 2007 and 2006, the Company recorded a compensation charge of $23,000 and $275,000, respectively, related to the amortization of restricted stock grants.

The fair-value of stock based compensation is determined using the Black-Scholes valuation model, which is the same model the Company used previously for valuing stock based compensation awards for footnote disclosure purposes. The fair-value of stock based compensation is recognized over the requisite service period.

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Foreign Currency Translation

We translate the assets and liabilities of international subsidiaries into U.S. dollars at the current rates of exchange in effect as of each balance sheet date. Revenues and expenses are translated using average rates in effect during the period. Gains and losses from translation adjustments are included in accumulated other comprehensive loss on the condensed consolidated balance sheet. Foreign currency transaction gains or losses are recognized in current operations and have not been significant to our operating results in any period. In addition, the effect of foreign currency rate changes on cash and cash equivalents has not been significant in any period.

Contingencies

The Company records accruals for contingencies arising from claims, assessments, litigation, fines, and penalties and other sources when it is probable that a liability has been incurred and the amount can be reasonably estimated. Legal costs expected to be incurred in connection with a loss contingency are accrued when probable and reasonably estimable.

Accounting for Derivatives

We account for derivatives in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, which provides accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Derivative instruments embedded in contracts, such as conversion and prepayment features are considered derivative instruments and are required by SFAS No. 133, to the extent not already a free standing contract, to be bifurcated from the debt instrument and accounted for separately. All derivatives, whether designated in hedging relationships or not, are recorded on the condensed consolidated balance sheet at fair value (See Note 5 for additional information regarding the Company s outstanding derivatives).

Computation of Historical Income (Loss) Per Common Share

Basic loss per common share is computed using the weighted average number of common shares outstanding during the period, exclusive of non-vested stock grants. Diluted 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), the conversion of our senior secured convertible promissory notes, and non-vested stock grants. Common equivalent shares are excluded from the calculation if their effect is anti-dilutive.

During the three months ended March 31, 2007 and 2006, the diluted loss per common share calculation was the same as the basic loss per common share calculation as all potentially dilutive securities were anti-dilutive.

As a result, potentially dilutive common shares of 2,583,738 and 3,869,399 as of March 31, 2007 and 2006, respectively, were excluded from the computation of diluted loss per common share because their effect was anti-dilutive.

Adoption of Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, which amends SFAS No. 133, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 155 provides guidance to simplify the accounting for certain hybrid instruments by permitting fair value remeasurement for any hybrid financial instrument that contains an embedded derivative, as well as, clarifies that beneficial interests in securitized financial assets are subject to SFAS No. 133. In addition, SFAS No. 155 eliminates a restriction on the passive derivative instruments that a qualifying special-purpose entity may hold under SFAS No. 140. SFAS No. 155 is effective for all financial instruments acquired, issued, or subject to a new basis occurring after the beginning of an entity s first fiscal year that begins after September 15, 2006. An entity may apply SFAS No. 155 on an instrument-by-instrument basis to instruments that it holds at the date of adoption. The adoption of this statement did not have a material effect on our financial condition or results of operations.

In June 2006, the FASB issued FASB Interpretation 48, Accounting for Uncertainty in Tax Positions, (FIN 48) to clarify the criteria for recognizing tax benefits under FASB Statement No. 109, Accounting for Income Taxes, and to require additional financial statement disclosure. FIN 48 requires that we recognize, in our condensed consolidated financial statements, the impact of a tax position if that position is more-likely-than-not to be sustained on audit, based

on the technical merits of the position. The provisions of FIN 48 are effective for us beginning January 1, 2007, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening accumulated deficit. The adoption of this statement did not have a material impact on our financial statements.

In June 2006, EITF issued EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation), to clarify diversity in practice on the presentation of different types of taxes in the financial statements. The Task Force concluded that, for taxes within the scope of the issue, a company may adopt a policy of presenting taxes either gross within revenue or net. That is, it may include charges to customers for taxes within revenues and the charge for the taxes from the taxing authority within cost of sales, or, alternatively, it may net the charge to the customer and the charge from the taxing authority. If taxes subject to EITF No. 06-3 are significant, a company is required to disclose its accounting policy for presenting taxes and the amounts of such taxes that are recognized on a gross basis. The guidance in this consensus is effective for the first interim reporting period beginning after December 15, 2006. The Company adopted EITF No. 06-3 on January 1, 2007 and presents taxes on a net basis within our condensed consolidated financial statements. The adoption of this statement did not have a material impact on our financial statements.

In September 2006, the FASB issued FASB No. 157, Fair Value Measurements. SFAS No. 157 is definitional and disclosure oriented and addresses how companies should approach measuring fair value when required by U.S. Generally Accepted Accounting Principles (GAAP); it does not create or modify any current GAAP requirements to apply fair value accounting. The standard provides a single definition for fair value that is to be applied consistently and also generally describes and prioritizes according to reliability the methods and inputs used in valuations. SFAS No. 157 prescribes various disclosures about financial statement categories and amounts which are measured at fair value, if such disclosures are not already specified elsewhere in GAAP. The new measurement and disclosure requirements of SFAS No. 157 are effective for the Company in the first quarter 2008, with early adoption permitted. The Company expects no significant impact from adopting the standard.

In December 2006, the FASB issued FASB Staff Position (FSP) EITF 00-19-2 Accounting for Registration Payment Arrangements (FSP EITF 00-19-2) which specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be separately recognized and measured in accordance with SFAS No. 5, Accounting for Contingencies. Adoption of FSP EITF 00-19-02 was required to be adopted by the Company on January 1, 2007. The adoption of this FSP did not have a material impact on our financial statements.

In February 2007, the FASB issued SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 expands opportunities to use fair value measurement in financial reporting and permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We have not decided if we will choose to measure any eligible financial assets and liabilities at fair value when we adopt SFAS 159 as of January 1, 2008.

(2) Liquidity

We believe that we will be able to finance our capital requirements and operations through, at least, May 31, 2008, assuming that (i) we are able to repay a portion of our senior secured convertible promissory notes in the aggregate principal amount of $6.6 million, as amended (the Convertible Notes), with our common stock as discussed below, (ii) the Convertible Notes and our senior subordinated discounted promissory (the Discount Note) are not declared in default within this timeframe, and (iii) our actual revenues and expenses are within our current projected estimates.

As of March 31, 2007, we had cash and cash equivalents of $1.6 million. Under the terms of the Convertible Notes, we are required to maintain a cash and cash equivalents balance of at least $1.5 million. As of March 31, 2007, the outstanding payments to be made under the Convertible Notes are $1.2 million, plus interest, and the amount of each remaining monthly principal payment under the Convertible Notes is $292,500 from April 2007 through July 2007.

As of March 31, 2007, the outstanding principal amount of $5.5 million was due on April 1, 2008 under our recently amended Discount Note and interest payments of $165,000 are payable under the Discount Note quarterly until the maturity date. On March 28, 2007, we amended the Discount Note such that the maturity date can be extended (at our sole discretion) from April 1, 2008 to September 30, 2008.

Given our cash level and debt repayment schedules, we are seeking to obtain additional debt or equity financing or seeking to restructure or refinance our existing indebtedness, subject to obtaining any required consent from our debt holders, which may result in the issuance of additional debt or equity securities that will further dilute our existing shareholders. In addition, we are exploring the licensing of certain non-strategic technology assets to enhance our

liquidity and further reduce our cost structure, as well as the sale of specific non-strategic technology assets redundant with our core technology products, subject to obtaining the consent of our debt holders to sell such assets. In the event that we are successful in the sale or licensing of these non-strategic assets, we may be required to use the proceeds to reduce the outstanding balance of the convertible notes or the discount note.

In May 2007, the Company entered in to an agreement with a third party that will allow them access to the source code and object code of a legacy software product. Under the agreement, we received $700,000 upon the execution of the agreement and will be paid $100,000 within sixty days and $200,000 within one year of the execution of the license agreement. The Company is in the process of evaluating the accounting for this transaction. This transaction will be recorded in the second quarter of 2007.

Under the terms of our Discount Note, we are prohibited from paying the monthly principal and interest payments under the Convertible Notes in cash to the extent we can make such payments in shares of our common stock in accordance with the terms of the Convertible Notes. In the past, we have typically made the monthly principal and interest payments under the Convertible Notes in shares of our common stock, or a combination of cash and shares of our common stock. Under the terms of the Convertible Notes, the number of shares we can use to pay principal and interest under the Convertible Notes is subject to limitations based on the trading volume of our common stock. Recently, the price and the trading volume of our common stock has declined, and as a result, we have not been able to make the entire principal and interest payments under the Convertible Notes in shares of common stock. If we cannot make principal and interest payments under the Convertible Notes with shares of common stock, we will have to use our available cash to make such payments and, as a result, may need to accelerate our alternatives set forth above (see Note 5 of the condensed consolidated financial statements).

On September 27, 2006, we received written notification, or the notice, from Nasdaq that for 30 consecutive trading days the bid price of our common stock had closed below the minimum $1.00 per share required for continued listing under Nasdaq Marketplace Rule 4310(c)(4), or the rule. We were provided an initial period of 180 calendar days, or until March 26, 2007, to regain compliance with the rule.

On March 27, 2007, we received written notification from Nasdaq that the staff had determined that (i) we did not meet the Nasdaq Capital Market initial listing criteria of having shareholders equity of at least $5 million as set forth in Marketplace Rule 4310(c),(ii) did not meet the minimum bid price requirement pursuant to the rule, and (iii) that our stock will be delisted on April 5, 2007 unless we file an appeal of the staff s determination. On April 2, 2007, we filed an appeal of the staff s determination to delist our securities to a Listing Qualifications Panel. We have received a hearing date of May 17, 2007. To the extent that we are delisted from Nasdaq, we believe that we will be able to list our shares on the OTC Bulletin Board. The listing of our shares on the OTC Bulletin Board will not preclude us from making future payments under the Convertible Notes in shares of our common stock.

If our common stock is delisted from The Nasdaq Capital Market for any reason for more than three business days, we are obligated to pay the holders of our Convertible Notes in cash an aggregate amount equal to 1.5% of the original principal amount of the Convertible Notes for the first calendar month and each additional calendar month after delisting until the Convertible Notes are no longer outstanding. Based on the original principal amount of the Convertible Notes, these monthly payments would be approximately $88,000.

There can be no assurance that our common stock will trade above $1.00 per share, that we will meet all of the listing criteria for The Nasdaq Capital Market, that we will prevail at the hearing before the Listing Qualifications Panel, or that our stock will remain listed.

There can be no assurance that we will be in compliance with the covenants under the Convertible Notes and the Discount Note, although, we were in compliance with the covenants under the Convertible Notes and the Discount Note as of March 31, 2007. The Convertible Notes and the Discount Note contain cross-default provisions, which means that a default under either instrument results in a default under the other instrument. If we are unable to comply with the covenants under the Convertible Notes or the Discount Note, the holders of the Convertible Notes and the Discount Note may declare us in default and may declare all amounts due under the notes.

(3) Detail of Certain Balance Sheet Accounts

Accounts receivable, net consists of the following balances (in thousands):

	March 31, 2007	December 31, 2006
Accounts Receivable, trade	$ 3,069	$ 2,889
Unbilled accounts receivable	852	1,077
Retainage	8	8
	3,929	3,974
Less: allowance for doubtful accounts	(97)	(97)

	$	3,832	$	3,877

Unbilled receivables represent revenue recognized for performance under customer contracts and agreements which have not been billed as of the period end including certain third-party software reseller commissions. Retainage represents amounts withheld under contractual provisions by customers until the specific projects are completed. All amounts are expected to be billed and collected within one year.

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Property and equipment, net consists of the following balances (in thousands):

	March 31, 2007	December 31, 2006
Software	$ 1,720	$ 1,720
Computer equipment	2,020	2,000
Office equipment and furniture	264	264
Leasehold improvements	890	890
	4,894	4,874
Less: accumulated depreciation and amortization	(4,064)	(3,954)
	$ 830	$ 920

From time to time, we enter into capital lease arrangements for property and equipment. As of March 31, 2007 and December 31, 2006, the gross amount included in computer equipment related to capital leases was $353,000. Accumulated amortization applicable to capital leases was $272,000 and $255,000 as of March 31, 2007 and December 31, 2006, respectively.

Depreciation and amortization related to property and equipment was $110,000 and $145,000 for the three months ended March 31, 2007 and 2006, respectively. Amortization applicable to property and equipment under capital leases of $17,000 and $28,000 for the three months ended March 31, 2007 and 2006, respectively, are included in such expense.

Accounts payable and accrued expenses consist of the following balances (in thousands):

	March 31, 2007	December 31, 2006
Accounts payable	$ 2,968	$ 2,908
Accrued taxes	719	788
Compensation and related costs	931	577
Commission due to sales chain partners	277	358
Professional fees	348	318
Derivative liabilities	110	229
Convertible and discount note interest	174	176
Financial printing	220	175
Other	207	169
	$ 5,954	$ 5,698

(4) Goodwill and Other Intangibles

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.

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As of March 31, 2007 and April 30, 2007, the fair value (based on market capitalization) of the Company was greater than the carrying value of the Company s net assets. Accordingly, no impairment was indicated. As of March 31, 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. Management believes that no impairment is necessary at March 31, 2007.

The following table reflects the components of amortizable intangible assets as of March 31, 2007 and December 31, 2006 (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net Book Value
March 31, 2007:			
Acquired technology	$ 3,733	3,569	$ 164
Customer contracts and relationships	6,964	5,384	1,580
Non-compete agreements	251	174	77
Trademarks	11	11	
	$ 10,959	$ 9,138	$ 1,821
December 31, 2006:			
Acquired technology	$ 3,733	$ 3,431	$ 302
Customer contracts and relationships	6,958	5,162	1,796
Non-compete agreements	251	165	86
Trademarks	11	11	
	$ 10,953	$ 8,769	$ 2,184

During the three months ended March 31, 2007 and 2006, we recognized $366,000 and $505,000, respectively, in intangible asset amortization expense.

(5) Long-term Debt, Convertible Notes, and Other Non-Current Liabilities

Long-term debt and convertible notes consist of the following (in thousands):

	March 31, 2007	December 31, 2006
Capital leases	$ 96	$ 111
Senior secured convertible promissory notes	1,106	1,894
Senior subordinated discount notes	5,147	5,069
Other long-term liabilities	651	366
	7,000	7,440
Less: current portion of long-term debt, convertible notes, and other non-current liabilities	(1,716)	(2,170)

Long-term debt, convertible notes, and other non-current liabilities	$	5,284	$	5,270

Senior Secured Convertible Promissory Notes

On August 16, 2005, Verticalnet and certain investors (the Convertible Note Holders) entered into a Note and Warrant Purchase Agreement, as amended, pursuant to which: (i) the Company issued and sold to the Convertible Note Holders certain Convertible Notes; and (ii) the Company issued Warrants, dated as of August 16, 2005 (each, a Warrant), to the Convertible Note Holders, to purchase shares of the Company s common stock at an exercise price of $5.39 per share, as adjusted for the Company s June 12, 2006 one-for-seven reverse stock split.

On May 15, 2006, the Company issued and sold to an investor (the Discount Note Holder) a Discount Note in the principal amount of $5.3 million. Pursuant to the Discount Note, if the Company was unable to obtain the consent of the holders of the Senior Notes Holders to permit the Company to grant the Discount Note Holder a subordinated lien and security interest in all of the Company s assets and the assets of the Company s subsidiaries (the Security Interest), the holder of the Discount Note could have declared the Discount Note due at any time after January 31, 2007. If, however, the Company obtained the consent of the Convertible Note Holders to grant the Security Interest on or before January 31, 2007, the scheduled maturity date of the Discount Note was November 18, 2007.
On December 19, 2006, the Company entered into a Consent, Waiver and Amendment No. 1 to Warrant (the Consent Agreement) with the remaining Convertible Note Holders. Pursuant to the Consent Agreement, the Company reduced the exercise price of each Warrant held by the remaining Convertible Note Holders from $5.39 per share to $0.88 per share, which was equal to the $0.80 closing price of the Company s common stock on The Nasdaq Capital Market on December 19, 2006, plus 10% (the Warrant Repricing). In consideration for the Warrant Repricing, each of the remaining Convertible Note Holders granted their consent to permit the Company to grant the Security Interest to the Discount Note Holder. As a result, the Discount Note Holder no longer has the right under the Discount Note to declare the Discount Note due prior to its November 18, 2007 scheduled maturity date, unless an event of default occurs or the Company consummates a fundamental transaction, which is defined to include a sale of the Company. The Company recorded additional interest expense of $122,000 in 2006 due to the modification of the warrants.
On December 19, 2006, the Company and its domestic subsidiaries entered into a Security Agreement with the Discount Note Holder (the Security Agreement) whereby the Company and its domestic subsidiaries granted the Discount Note Holder a security interest in all of the Company s and its domestic subsidiaries assets to secure the Company s obligations under the Discount Note. By entering into the Security Agreement, the Company satisfied its obligation under the Discount Note to obtain the consent of the Convertible Note Holders to grant the Security Interest. As a result, the Discount Note Holder no longer has the right under the Discount Note to declare the Discount Note due prior to its November 18, 2007 scheduled maturity date, unless an event of default occurs or the Company consummates a fundamental transaction, which is defined to include a sale of the Company.
On December 19, 2006, the Company, the Convertible Note Holders and the Discount Note Holder entered into a Subordination and Intercreditor Agreement (the Intercreditor Agreement). The Intercreditor Agreement provides, among other things: (i) for the subordination of the Discount Note to the Convertible Notes; (ii) that the Company may make payments of interest to the Discount Note Holder when due pursuant to the Discount Note, except in the event of a default under the Convertible Notes; and (iii) for certain limitations on the Discount Note Holder s rights to accelerate payment of amounts due under the Discount Note or to take any legal action in relation thereto for a period of 180 days if the Convertible Note Holders have given notice of an event of default.
Also, on December 19, 2006, all of the domestic subsidiaries of the Company executed a Guaranty and Suretyship Agreement in favor of the Discount Note Holder (the Guaranty Agreement), whereby, among other things, all of the domestic subsidiaries of the Company guaranteed the Company s obligations under the Discount Note.
On December 20, 2006, the Company and the Discount Note Holder entered into an Amendment Number 1 to Senior Subordinated Discount Note, whereby the Company and the Discount Note Holder agreed to extend the maturity date of the Discount Note from November 18, 2007 to April 1, 2008 and also agreed to increase the principal amount of the Discount Note from $5.3 million to $5.5 million. Interest on the outstanding principal amount of the Discount Note continues to accrue at 12% per annum and is payable quarterly in arrears on the first day of January, April, July and October of each year until the April 1, 2008 maturity date. All other terms of the Discount Note also remained unchanged. See discussion below on Amendment Number 2 to Discount Note.
The Convertible Notes mature on July 2, 2007 (the Maturity Date) and accrue interest at 9% per annum from the issue date. Interest is payable monthly, in arrears, beginning December 2005 until the earlier of the Maturity Date or the date of conversion (the Conversion Date). Monthly principal payments of $330,000 commenced in December 2005 and are payable thereafter on the first business day of each month through July 2007 or the Conversion Date, whichever is sooner. As a result of several conversions during 2005 and 2006, the monthly principal payment has been reduced to approximately $318,000. At the Company s discretion, the Company may pay the monthly principal and interest payments in cash, common stock, or a combination of cash and common stock, subject to certain

limitations set forth in the Convertible Notes, including the maximum amount of shares issued in a month cannot exceed 20% of the total dollar volume of the shares trading activity, as defined. The conversion price used for payments of principal and interest in shares of common stock will be equal to the Conversion Price if the average price of the Company s stock is at least 115% of the Conversion Price. If the average price of the Company s stock is not at least 115% of the Conversion Price, the conversion price used for payments of principal and interest in shares of common stock will be equal to 85% of the average of the five lowest daily volume weighted average prices of the Company s common stock for the ten trading days before the date the Company elects to pay in shares of common stock. Upon the occurrence of certain events as set forth in the Convertible Notes, the Convertible Note Holders may require the Company to prepay the Convertible Notes at 110% of the remaining principal amount of the Convertible Notes or redeem the Convertible Notes and under certain events, the related warrants at the then fair value determined by the related agreement.

On September 15, 2005, we filed a registration statement (the 2005 Registration Statement) with the SEC that registered for resale the maximum number of shares of common stock we could issue, prior to obtaining the approval of our shareholders, for the payment of principal and interest on the Convertible Notes or upon conversion of the Convertible Notes. The 2005 Registration Statement also registered for resale the shares of common stock issuable upon exercise of the warrants. The 2005 Registration Statement was declared effective by the SEC on October 7, 2005. At our 2006 Annual Meeting of Shareholders held on May 19, 2006, our shareholders approved a proposal allowing us to issue an unlimited number of shares of common stock pursuant to the Convertible Notes. As a result, on July 14, 2006, we filed another registration statement (the New Registration Statement) registering for resale our estimate of the number of shares of common stock issuable as payment for the remaining principal and interest payments on the Convertible Notes or upon conversion of the Convertible Notes. On September 20, 2006, the New Registration Statement was declared effective by the SEC.

In February 2007, we filed a registration statement registering 2,500,000 shares of common stock for resale (the 2007 Registration Statement), which was our estimate of the number of shares of common stock issuable as payment for the remaining principal and interest payments on the Convertible Notes or upon conversion of the Convertible Notes. The 2007 Registration Statement was declared effective in February 2007.

The Company can cause a mandatory conversion of the Convertible Notes into shares of common stock if after six months following the effective date of the 2005 Registration Statement the price of the Company s common stock exceeds 200% of the Conversion Price for a period of 20 consecutive days and certain other requirements are met. The agreements relating to the Convertible Notes contain several non-financial covenants and the Company agreed not to purchase, redeem, or pay dividends or distributions on common stock or equivalents except under certain non-officer incentive agreements, and to reserve a number of authorized but
unissued shares of common stock equal to 120% of the aggregate number of shares to effect the conversion of the Convertible Notes, including accrued interest, and exercise of the warrants. Events of default in the agreements related to the Convertible Notes include, among others, suspension from listing on an applicable trading market, the registration statement referred to above fail to remain effective, and default on other Company indebtedness. Upon an event of default, the Convertible Note Holders can declare all amounts under the Convertible Notes due and payable. The Company has also agreed that if the Convertible Note Holders are unable to use the registration statement referred to above because, among other reasons, it has lapsed or is suspended, as defined in the related agreement, then the Company will pay the Convertible Note Holders an amount equal to one and one half percent (1.5%) of the original principal amount of the Convertible Notes, in cash, for every thirty day period that such registration statements cannot be used.

The Company also agreed that if its shares of common stock are delisted from The Nasdaq Capital Market for any reason for more than three business days, it will pay the Convertible Note Holders in cash an amount equal to one and one half percent (1.5%) of the original principal amount of the Convertible Notes, in cash, for the first calendar month and each additional calendar month after delisting until the Convertible Notes are no longer outstanding. This amount is approximately $88,000 per month.

The Company has agreed with the Convertible Note Holders (i) that it will maintain at least $1.5 million in its bank accounts while the Convertible Notes are outstanding and (ii) that it will be restricted from issuing certain types of debt and equity instruments while the Convertible Notes are outstanding.

The conversion and prepayment feature are considered a derivative instrument and are required to the extent not already a free standing contract, to be bifurcated from the debt instrument and accounted for separately. In addition, to the extent the related debt instrument is outstanding, the warrant is accounted for as a liability due to the existence of certain provisions in the instrument. As a result, the Company recorded a total aggregate derivative liability of $2.4 million as of August 16, 2005. The derivative liabilities consist of the conversion and prepayment feature, and the warrants which were both valued at $1.2 million. Changes in the fair value of the derivative liabilities are recorded in the consolidated statement of operations. As of March 31, 2007, the fair value of the derivative liabilities for the conversion and prepayment feature and the warrants was $70,000 and $40,000, respectively. As of December 31, 2006, the derivative liabilities had a fair value of $119,000 and $110,000, for the conversion and prepayment feature and the warrants, respectively. The aggregate change in fair value of these derivatives decreased and accordingly, the

Company recognized a benefit of $119,000 and $507,000 during the three month ended March 31, 2007 and 2006, respectively, which is included in interest and other expense, net in the accompanying condensed consolidated statements of operations.

The debt discount of $2.4 million is being accreted over the life of the Convertible Notes using the effective interest rate method and is being recorded as additional interest expense in the statement of operations. The effective interest rate used to accrete the debt discount is 56.3%. The Company recorded additional interest expense for the three months ended March 31, 2007 and 2006 of $153,000 and $427,000, respectively, related to this accretion. The unamortized debt discount at March 31, 2007 and December 31, 2006 was approximately $64,000 and $217,000, respectively. The Company incurred $684,000 of costs related to completing the private placement, which is included in other assets on the condensed consolidated balance sheet. Included in the costs are $35,000 related to the issuance of 20,205 warrants to the placement agent. The deferred financing costs are being amortized using the effective interest method over the life of the Convertible Notes. The net balance of the deferred financing costs as of March 31, 2007 and December 31, 2006 was approximately $24,000 and $79,000, respectively. For the three months ended March 31, 2007 and 2006, the Company recorded $55,000 and $120,000, respectively, of interest expense related to the amortization of the deferred financing costs. At March 31, 2007 and December 31, 2006, $9,000 and $16,000, respectively, of accrued interest related to the Convertible Notes was included in accounts payable and accrued expenses in the condensed consolidated balance sheet.

Based upon the terms of the Convertible Notes, the Company, at its discretion, may pay the monthly principal and interest payments in cash, common stock, or a combination of cash and common stock. The Company issued 1,320,132 and 277,874 shares of common stock during the three months ended March 31, 2007 and 2006, respectively, for the principal and interest payments. In April and May 2007, the Company made these payments with a combination of cash and its common stock and as a result, the Company has issued an additional 649,422 and 1,014,344 shares of common stock on April 2, 2007 and May 1, 2007, respectively. As of May 10, 2007, we had approximately 500,000 shares of common stock remaining available for issuance under the 2007 Registration Statement.

As of March 31, 2007, we are in compliance with the terms of the Convertible Notes.

Senior Subordinated Discount Note

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

The transaction resulted in net proceeds to the Company of approximately $3.7 million, after deducting the offering costs and fees. The Company is using these proceeds for working capital and general corporate purposes, subject to certain exceptions and limitations set forth in the Purchase Agreement.

The debt discount of $1.5 million is being amortized over the period ending on the earliest date the May Investor can call the Discount Note (which is April 1, 2008) using the effective interest rate method and is being recorded as additional interest expense in the statement of operations. The effective interest rate used to amortize the debt discount is 19.1%. The Company recorded additional interest expense for the three months ended March 31, 2007 of $78,000, related to this amortization. The unamortized debt discount at March 31, 2007 and December 31, 2006 was approximately $353,000 and $431,000, respectively. The Company incurred $324,000 of costs related to completing the private placement, which is included in other assets on the condensed consolidated balance sheet. The deferred financing costs are being amortized using the effective interest method over the same period as the debt discount. The net balance of the deferred financing costs as of March 31, 2007 and December 31, 2006 was approximately $50,000 and $55,000, respectively. The Company recorded $5,000 of interest expense related to the amortization of the deferred financing costs for the three months ended March 31, 2007. At March 31, 2007 and December 31, 2006, $165,000 and $160,000, respectively, of accrued interest related to the Discount Note was included in accounts payable and accrued expenses in the condensed consolidated balance sheet.

Pursuant to the Purchase Agreement, the Company agreed to use commercially reasonable efforts to obtain the consent of the holders of the Convertible Notes, to permit the Company to grant a subordinated lien and security interest in all of the Company s and its subsidiaries assets to the May Investor (the Consent).

The Company issued the Discount Note on May 18, 2006. Interest on the principal amount of the Discount Note accrues at 6.00% per annum payable quarterly in arrears, beginning July 2006 until the maturity date. The principal amount of the Discount Note will become due on the earlier of: (i) 18 months from the date of issuance; (ii) January 31, 2007, if the Company is unable to obtain the Consent; or (iii) the date on which the Company consummates a fundamental transaction, which is defined to include a transaction involving the sale of substantially all of its assets or any merger, consolidation, or similar transaction involving the transfer of greater than 50% of the Company s outstanding voting securities, any reclassification or change in the outstanding shares of the Company s common stock, other than a change of par value or as a result of a subdivision or combination or the Reverse Stock Split, or any event or transaction or series of such that results in the Company s Board of Directors ceasing to constitute a majority of the Company s Board. The Company may prepay the Discount Note at any time. However, if the Company was not able to obtain the Consent by June 18, 2006, the interest rate would increase to 12% per annum (the Rate Increase). Although the Company was unable to obtain the Consent by June 18, 2006, the May Investor granted the Company a conditional waiver (the Conditional Waiver) to the Rate Increase if prior to July 18, 2006, the Company was able to enter into an agreement with a third party, satisfactory to the May Investor, with respect to certain potential liabilities. Because the Company was not able to enter into such agreement by July 18, 2006,

pursuant to the Discount Note and the Conditional Waiver, the interest rate increased from 6% per annum to 12% per annum retroactively effective to June 18, 2006. The May Investor was previously able to declare the Discount Note due at any time after January 31, 2007, unless the Company obtains the Consent prior to that date. On December 19, 2006, the Company obtained the Consent. As a result, the Discount Note Holder no longer has the right under the Discount Note to declare the Discount Note due prior to its November 18, 2007 scheduled maturity date, unless an event of default occurs or the Company consummates a fundamental transaction, which is defined to include a sale of the Company.

Furthermore, the Discount Note provides that upon the occurrence of certain events of default, including among others the failure to make a timely payment on the Discount Note or any other indebtedness in excess of $100,000, suffering an event of default under other indebtedness, bankruptcy, an uncovered final judgment being rendered against the Company exceeding $100,000, a going concern opinion being issued by the Company s independent registered public accounting firm, or the failure to maintain the listing of the Company s stock on a satisfactory exchange or market including the OTC Bulletin Board, the interest rate will increase to 14.00% per annum. In addition, if an event of default occurs due to bankruptcy, the Discount Note and accrued interest would automatically become due and payable. Upon all other events of default, the May Investor can declare the Discount Note and accrued interest automatically due and payable.

The terms of the Discount Note restricts the Company s ability to sell its assets without the written consent of the May Investor, incur indebtedness, make cash payments on existing indebtedness, pay dividends, and redeem outstanding shares.

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

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

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

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

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

Discount Note becomes due and payable in full if the Company consummates a fundamental transaction, which is defined to include a sale of the Company.

As of March 31, 2007, we are in compliance with the terms of the Discount Note.

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(6) Commitments and Contingencies

Future minimum lease payments remaining under our capital and operating leases for fiscal years ending December 31 (in thousands):

	Lease Obligations		
	Operating	Capital	Total
2007 (a)	$ 582	$ 66	$ 648
2008	564	38	602
2009	373	1	374
2010	365		365
	1,884	105	1,989
Less interest		(9)	(9)
Total	$ 1,884	$ 96	$ 1,980

(a) Reflects amounts payable over the last nine months of 2007.

These future minimum lease payments include all facility leases for which we are contractually committed to make payments as of March 31, 2007.

The Company licenses software to its customers under written agreements. Each agreement contains the relevant terms of the contractual arrangement with the customers, and generally includes provisions for indemnifying the customers against losses, expenses, and liabilities from damages that may be awarded against the customer in the event the software is found to infringe upon certain intellectual property rights of a third party. The agreement generally limits the scope of and remedies for such indemnification obligations in a variety of industry-standard respects. The Company has not identified any losses that are probable under these provisions and, accordingly, no liability related to these indemnification provisions has been recorded.

The Company currently has employment agreements with certain senior executives that automatically renew each year unless either party gives at least thirty-days to one-year advance notice of non-renewal. These agreements provide for minimum salaries of $697,000 for the remainder of 2007. The terms of these agreements include severance and health insurance coverage, ranging from three months to one year, as well as pro rated portions of target bonuses, up to an aggregate of approximately $904,000.

(7) 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 (the District Court). Also named as defendants were four underwriters involved in the issuance and initial public offering (IPO) of our common stock in February 1999. The complaint alleges violations of federal securities law based on, among other things, claims that the underwriters (i) awarded material portions of the initial shares to certain favored customers in exchange for excessive commissions and (ii) engaged in a practice known as laddering, whereby the clients or customers agreed that in exchange for IPO shares they would purchase additional shares at progressively higher prices after the IPO. With respect to Verticalnet, the complaint alleges that Verticalnet and its officers and directors failed to disclose in the prospectus and the registration statement the existence of these purported excessive commissions and laddering agreements. After the initial complaint was filed, several copycat complaints with nearly identical allegations were filed by other plaintiffs in the District Court. All of the suits were consolidated into a single amended complaint containing additional factual

allegations concerning the events set forth in the original complaints filed with the District Court in April 2002. In October 2002, the District Court entered an order dismissing, without prejudice, the claims against the individual Verticalnet officers and directors who had been named as defendants in the various complaints. In February 2003, the District Court entered an order denying a motion made by the defendants to dismiss the actions in their entirety, but granting the motion as to certain of the claims against some defendants. However, the District Court did not dismiss any claims against Verticalnet. In June 2003, Verticalnet s counsel, with the approval of Verticalnet s directors, executed a memorandum of understanding on behalf of Verticalnet with respect to a proposed settlement of the plaintiffs claims against Verticalnet. The proposed settlement, if finally approved by the District Court, would result in, among other things, the dismissal of all claims against Verticalnet and its officers and directors. Under the present terms of the proposed settlement, Verticalnet would also assign its claims against the underwriters to the plaintiffs in the consolidated actions. In February 2005, the District Court preliminarily approved the proposed settlement. In April 2006, the District Court held a final fairness hearing on the proposed settlement but reserved its final approval. On December 5, 2006, the Second Circuit Court of Appeals vacated the District Court s certification of the class action and remanded the case to the District Court for further proceedings. It is uncertain what effect the ruling by the Second Circuit Court of Appeals will have upon the proposed settlement or on the underlying litigation. The Company believes that the outcome of this uncertainty will not have a material impact on our financial statements.

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On September 30, 2004, the Company was served with a complaint (the Complaint) filed against the Company and several of its former officers and directors in the U.S. District Court for the Eastern District of Pennsylvania in an action captioned Jodek Charitable Trust, R.A., Individually and as Assignee of Zvi Schreiber, LLC et al. (Jodek) v. Vertical Net Inc., et al., C.A. No. 04-4455 (Jodek Case). The Complaint alleged that, with regards to the issuance of the Company s stock to the plaintiff s predecessors in interest in connection with the Company s acquisition of Tradeum, Inc. in March 2000, the plaintiff was damaged by the defendants delays in registering stock, updating the registration of stock, releasing stock from lock-ups and releasing stock from escrows. On May 5, 2006, the Company was informed that its insurer was largely denying the Company s claim for coverage under the Company s directors and officers insurance policy (the D&O Policy). On August 11, 2006, the Company and Jodek entered into a Settlement Agreement (the Settlement Agreement), that provided for the settlement of the Jodek Case. Pursuant to the Settlement Agreement: (i) the settlement amount was fixed at $5,563,000; (ii) the Company agreed to pay the balance of its $500,000 retention obligation under the D&O Policy (less than $100,000) to the plaintiff (which amount has been paid); (iii) the Company agreed to prosecute an action, at the plaintiff s expense, against the Company s insurer to require the insurer to pay the balance of the settlement amount for the benefit of plaintiff; and (iv) the plaintiff agreed to release the Company of all claims. Pursuant to the Settlement Agreement, the Company will only be required to pay the balance of the settlement amount ($5,563,000) if any of the Company s claim is collected from the insurer to the extent of the amount collected; therefore, this amount is not recorded as a liability in the accompanying condensed consolidated balance sheet. On August 22, 2006, the U.S. District Court for the Eastern District of Pennsylvania entered an order approving the Settlement Agreement and entering it as an order of the Court. On September 22, 2006, in accordance with the Settlement Agreement, the Company instituted an action in the U.S. District Court for the Eastern District of Pennsylvania captioned Verticalnet, Inc. v. U.S. Specialty Insurance Company at Civil Action No. 06-4245 (the Second Jodek Case). Pursuant to the Settlement Agreement, the attorney representing the Company in the Second Jodek Case was selected by and is being paid for solely by Jodek.

On May 9, 2006, CombineNet, Inc. (CombineNet) and Verticalnet entered into a Settlement Agreement and Release (the CombineNet Settlement Agreement) that resolved certain litigation commenced by CombineNet. The CombineNet Settlement Agreement provided, among other things, that (i) the Company pay CombineNet (a) $125,000 upon execution of the agreement; (b) $125,000 on July 31, 2006; and (c) beginning October 31, 2006, $50,000 per quarter for eight consecutive quarters; provided that this obligation will continue for so long as Verticalnet decides to continue offering certain optimization products; (ii) CombineNet granted Verticalnet a limited license to use the CombineNet s technology through July 2006 in order to complete existing certain contracts; (iii) Verticalnet would permit an expert to review Verticalnet s Advanced Sourcing RFX to determine whether certain elements of the RFX used or were derived from CombineNet s technology; (iv) Verticalnet would permit the expert to review certain future Verticalnet optimization products to determine whether the new products used or were derived from CombineNet s technology; and (v) that Verticalnet would pay the expert s fees, both for an original review and for the future reviews set forth in sections (iii) and (iv) above. On June 16, 2006, the expert rendered his final report, and found that neither Verticalnet s Advanced Sourcing RFX nor its new optimization products were derived from CombineNet s CEDL technology. During the three months ended March 31, 2006, the Company recorded $722,000 in litigation and settlement costs for the CombineNet Settlement Agreement and related costs. As of March 31, 2007, the Company has paid $350,000 of the total settlement obligation, and has a remaining obligation of $300,000.

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

(8) Capital Stock

At March 31, 2007 and December 31, 2006, our amended and restated Articles of Incorporation provide us the authority to issue 21,428,571 shares of common stock and 10,000,000 shares of blank check preferred stock.

Stock Option Fair Value Information

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model. Expected volatility is based on the historical volatility of the price of the Company s stock. The expected life of options represents the period of time that options are expected to be outstanding. Starting in 2006, upon the adoption

of SFAS No. 123R, the Company began using the simplified method as prescribed in the SEC s Staff Accounting Bulletin No. 107, Share-Based Payments, to recalculate expected life. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

On January 30, 2007, the Company granted 16,477 shares in restricted stock awards to employees. The restricted stock grant vests on the one year anniversary from the date of grant.

During the three months ended March 31, 2007, the Company did not grant any stock options.

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Stock-based Compensation Expense

Total stock-based compensation relating to stock option and restricted stock was recorded for the three months ended March 31, 2007 and 2006, respectively, to various operating expense categories as follows:

	Three Months Ended March 31,	
	2007	**2006**
Cost of revenues	$ 2	$ 114
Research and development	19	70
Sales and marketing	30	100
General and administrative	28	196
	$ 79	$ 480

The Company received $3,000 and $2,000 in cash for the exercise of restricted units during the three months ended March 31, 2007 and 2006, respectively. There were no exercises of stock options during the three months ended March 31, 2007 and 2006.

(9) Restructuring

During the three months ended March 31, 2007, there were no restructuring charges recorded.

During the three months ended March 31, 2006, we incurred additional net restructuring charges of $238,000 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 March 31, 2006 was $261,000. The Company completed all payments relating to this restructuring accrual by January 2007.

(10) Segment Information

The Company follows SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, which establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is regularly evaluated by the chief operating decision maker (CODM) in deciding how to allocate resources and in assessing performance.

The Company has one operating segment. The Company markets its products in the United States of America and in foreign countries through its direct sales force and indirect sales channels. The CODM evaluates resource allocation decisions and the performance of the Company based upon consolidated revenues and expense financial information. The CODM does not receive financial information about revenue and expense allocations on a disaggregated basis.

Information regarding revenues for the three months ended March 31, 2007 and 2006 and long-lived assets (excluding goodwill and intangibles) in geographic areas as of March 31, 2007 and December 31, 2006 is as follows (in thousands):

	Three months ended March 31,	
	2007	**2006**
Revenues:		
United States	$ 2,655	$ 3,481
International	762	435
Total revenues	$ 3,417	$ 3,916

	March 31, 2007	**December 31, 2006**
Long-lived Assets:		
United States	$ 1,092	$ 1,300
International	29	36

	$	1,121	$	1,336

Revenues are allocated to countries based on the location of the Company s subsidiaries providing the product or services. The Company s international revenues were derived primarily from sales in Europe.

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(11) Interest and Other Expense (Income), Net

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

	Three months ended March 31,	
	2007	2006
Interest expense, net	$ 494	$ 640
Change in fair value of derivative liabilities	(119)	(507)
Transaction loss (gain)	6	21
Other expenses (income), net	1	(1)
	$ 382	$ 153

As a result of certain features contained in our Convertible Notes and related warrants, we were required under U.S. generally accepted accounting principles to record derivative liabilities, which have an aggregate fair value of $110,000 and $229,000 as of March 31, 2007 and December 31, 2006, respectively, and are recorded as part of accrued expenses on the accompanying condensed consolidated balance sheet. Each quarter, we are required to revalue the derivative liabilities and the change from the prior period will be recorded as a non-cash charge or benefit in the condensed consolidated statement of operations. During the three months ended March 31, 2007 and 2006, we recorded a non-cash benefit of $119,000 and $507,000, respectively. Changes in the fair value of the derivative liabilities are primarily measured using the Black-Scholes valuation model and are recorded as a change in fair value of derivative liabilities in the condensed consolidated statement of operations. The fair value of the derivative liabilities are directly affected by the change in the market value of our stock.

At the time of the issuance of the Convertible Notes, we recorded a debt discount of $2.4 million related to the derivative liabilities. This amount is being amortized over the life of the Convertible Notes and recorded as additional interest expense. During the three months ended March 31, 2007 and 2006, we recorded $153,000 and $427,000, respectively, as interest expense related to this amortization.

At the time of the issuance of the Discount Note, we recorded a debt discount of $1.3 million. This amount is being amortized over the life of the Discount Note and recorded as additional interest expense. During the three months ended March 31, 2007, we recorded $78,000 as interest expense related to this amortization.

During the three months ended March 31, 2007, the Company recorded $59,000 of interest expense related to the amortization of deferred financing costs related to the Convertible Notes and the Discount Note. During the three months ended March 31, 2006, the Company recorded $120,000 of interest expense related to the amortization of deferred financing costs related to the Convertible Notes.

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 and may not be realized because they are based upon current expectations that involve risks and uncertainties. Actual results and the timing of certain events may differ materially from those currently expected as a result of these risks and uncertainties. Factors that may cause or contribute to a difference between the expected or desired results and actual results include, but are not limited to, the availability of and terms of equity and debt financing to fund our business; our reliance on the development of our enterprise software business; our ability to continue to remain listed on the Nasdaq Capital Market; competition in our target markets; economic conditions in general and in our specific target markets; our ability to use and protect our intellectual property; and our ability to attract and retain qualified personnel, as well as the risks discussed in Part II , Item 1A of this report entitled Risk Factors. Given these uncertainties, investors are cautioned not to place undue reliance on our forward-looking statements. We disclaim any obligation to update these factors or to announce publicly the results of any revisions to any of the forward-looking statements contained in this report to reflect future events or developments.

Company Overview

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 provide our clients with the visibility, insight and control required to identify, realize, and sustain value from supply management initiatives.

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

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

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

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and consolidated results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles in the United States. The preparation of our condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates based upon historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates.

We believe that our critical accounting policies affect our more significant estimates and judgments used in the preparation of our consolidated financial statements. Our Annual Report on Form 10-K for the year ended December 31, 2006 contains a discussion of these critical accounting policies. There have been no significant changes in our critical accounting policies since December 31, 2006. See also Note 2 to our unaudited condensed consolidated financial statements for the three month period ending March 31, 2007 as set forth herein.

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RESULTS OF CONTINUING OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006

The following table sets forth statement of operations data expressed as a percentage of total revenues for the periods indicated (some items may not add due to rounding):

	Three months ended March 31,	
	2007	**2006**
Revenues:		
Software and software related	45.6%	39.4%
Services	54.4%	60.6%
Total revenues	100.0%	100.0%
Cost of revenues:		
Cost of software and software related	10.4%	15.3%
Cost of services	32.4%	42.2%
Amortization of acquired technology and customer contracts	7.3%	6.3%
Total cost of revenues	50.2%	63.8%
Gross profit	49.8%	36.2%
Operating expenses:		
Research and development	28.8%	37.7%
Sales and marketing	39.2%	49.4%
General and administrative	40.7%	42.1%
Litigation and settlement costs		26.0%
Restructuring charges		6.1%
Amortization of other intangible assets	3.4%	6.6%
Total operating expenses	112.1%	167.9%
Operating loss	(62.2%)	(131.7%)
Interest and other expense (income), net	11.2%	3.9%
Net loss	(73.4%)	(135.6%)

EMPLOYEE HEADCOUNT BY CLASSIFICATION

	March 31,					
	2007			2006		
	Employees	Dedicated Offshore Consultants	Total	Employees	Dedicated Offshore Consultants	Total
Cost of revenues	34	7	41	49	7	56
Research and development	20	18	38	28	29	57
Sales and marketing	24		24	31		31
General and administrative	15	1	16	23		23
Total	93	26	119	131	36	167

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Revenues

(in thousands)	Three months ended March 31, 2007	2006	Difference $	%
Software and software related	$ 1,559	$ 1,541	$ 18	1.2%
Services	1,858	2,375	(517)	(21.8%)
Total revenues	$ 3,417	$ 3,916	$ (499)	(12.7%)

Revenue Concentration

As of and for the three months ended March 31, 2007 and 2006, revenues and amounts due from our largest customers were as follows (in thousands):

	2007			2006		
Customer	**Accounts Receivable Balance (a)**	**Revenues**	**% of Total Revenues**	**Accounts Receivable Balance (a)**	**Revenues**	**% of Total Revenues**
A	$ 202	$ 170	5.0%	$ 624	$ 707	18.1%
B	110	118	3.5	683	599	15.3
C	199	424	12.4			
All others, net of allowance (b)	3,321	2,705	79.1	1,975	2,610	66.6
Total	$ 3,832	$ 3,417	100.0%	$ 3,282	$ 3,916	100.0%

(a) Represents both billed and unbilled amounts.

(b) Account receivable balance includes unbilled amounts as March 31, 2007 and 2006 of $761,000 and $1.1 million, respectively.

Software and software related revenues are comprised of software licenses, third party software reseller commissions, hosting, and maintenance revenues. Services revenues represent revenue derived from consulting services.

Due to the different accounting treatment of our revenue streams under applicable accounting guidance, each type of revenue has a different impact on our condensed consolidated financial statements. For our on-demand hosted term-based licensed solutions, the prices are generally fixed for a specific period of time, and revenue is recognized ratably over the term. Therefore, a hosted term-based license will result in significantly lower current-period revenue

than an equal-sized perpetual license, but with higher revenue recognized in future periods. Similarly, maintenance fees are generally fixed for a specific period of time, and revenue is recognized ratably over the maintenance term. Maintenance contracts are typically entered into when new software licenses are purchased, at a specified percentage of the software license fee. In addition, most of our customers renew their maintenance contracts annually to continue receiving product updates and product support. Service revenues are driven by a contract or statement of work, in which the fees may be fixed for specific services to be provided over time or billed on a time and materials basis. Like subscription and maintenance fees, service fees revenue is recognized over the course of the fixed time or project period. As a result, cash flows from these licenses and or services will precede revenue recognition and are included in deferred revenue until they are recognized. To the extent that revenue preceeds cash flows or contractual billing terms, the amounts are included in unbilled accounts receivable.

As presented in the table above, the decrease in total revenues for the three months ended March 31, 2007 compared to the same period in 2006 was primarily due to the decrease in revenues generated from our two largest customers in 2006, which represented $1.0 million of the decrease. This decrease was offset by a continuing increase in revenues from our core offerings. Since 2002, Customer B has been one of our largest customers, however, due to where we are in the lifecycle of the relationship, the customer s need for our services is decreasing and we expect the revenue we will be generating from them will continue to decrease. With regard to Customer A, we have experienced a decrease in revenue levels in 2007 and we expect the decrease to continue. Historically, revenues generated from Customer A have varied significantly by quarter. Customer C represents a large service engagement associated with a perpetual license that the Company entered into in the third quarter of 2006. We expect to recognize revenues from this engagement through the third quarter of 2007.

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 months ended March 31, 2007, the Company recorded $138,000 in third party software reseller commissions (included in Customer C above), primarily as a result of our relationship with IBM in the United Kingdom and the sale of their software. The Company did not record any third-party software reseller commissions during the three months ended March 31, 2006.

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The Company continues to sign additional software and software related agreements. During the three months ended March 31, 2007, the Company entered into 6 new software and software related agreements with customers for a total value of $1.4 million compared to 8 new software and software related agreements for a total value of $1.3 million during the same period in 2006. However, as discussed above, under applicable accounting guidance we recognize the software revenues ratably over the term of the contract and, therefore, it is not reflected in its entirety in revenue during the three months ended March 31, 2007.

Cost of Revenues

	Three months ended March 31,		Difference	
(in thousands)	**2007**	**2006**	**$**	**%**
Cost of software and software related	$ 357	$ 598	$ (241)	(40.3%)
Cost of services	1,107	1,652	(545)	(33.0%)
Amortization of acquired technology and customer contracts	250	247	3	1.2%
Total cost of revenues	$ 1,714	$ 2,497	$ (783)	(31.4%)

As a result of our continuing cost saving efforts, we have been able to remove significant costs, specifically headcount related costs from our cost structure. During the remainder of 2007, we will continue to investigate opportunities to remove costs from our ongoing operations. We expect that our cost of revenues and operating costs will be at lower levels going forward compared to where they were previously.

Cost of Software and Software Related

The cost of software and software related is comprised primarily of headcount related costs, including the cost of the Company s customer support function, which is provided to customers as part of recurring maintenance fees, and third-party provided hosting services, as well as related infrastructure costs. Also included is the cost of royalties on technology contained in our products that is licensed from third parties.

Software and software related costs decreased by approximately $241,000 during the three months ended March 31, 2007 as compared to the same period in 2006. The decrease was primarily due to the reduction in the hosting costs, headcount related costs, off-shore resources, and stock based compensation of $113,000, $81,000, $34,000, and $14,000, respectively. These reductions are the result of the Company s efforts to remove costs from its ongoing operations and were achieved as a result of the Company s shift from onshore to offshore resources and by the Company switching to a different third-party hosting provider. These decreases were offset by increases in other software and software related costs of $1,000 as compared to the same period in 2006.

Cost of Services

Cost of services includes the cost of Company and third-party consultants who are primarily responsible for the software implementations and configurations, as well as providing other supply chain consulting services, and related infrastructure costs.

The decrease in service related costs during the three months ended March 31, 2007 was attributed to a reduction in headcount related costs, travel and entertainment costs, stock based compensation, and infrastructure costs of $339,000, $150,000, $98,000, and $43,000, respectively, as compared to the same period in 2006. These decreases were offset by increases third-party consulting and other service costs of $67,000 and $18,000, respectively, as compared to the same period in 2006.

Amortization of Acquired Technology and Customer Contracts

Amortization of acquired technology and customer contracts increased slightly for the three months ended March 31, 2007 as compared to the same period in 2006.

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Operating Expenses

	Three months ended March 31,		Difference	
(in thousands)	2007	2006	$	%
Research and development	$ 983	$ 1,475	$ (492)	(33.4%)
Sales and marketing	1,340	1,935	(595)	(30.7%)
General and administrative	1,391	1,650	(259)	(15.7%)
Litigation and settlement costs		1,018	(1,018)	(100.0%)
Restructuring charges		238	(238)	(100.0%)
Amortization of other intangible assets	116	258	(142)	(55.0%)
Total operating expenses	$ 3,830	$ 6,574	$ (2,744)	(41.7%)

Operating expenses, including cost of revenues, decreased to $5.5 million in the three months ended March 31, 2007 compared to $9.1 million in the three months ended March 31, 2006. The decrease in operating expenses is primarily attributable to an overall decline in operating costs due to the cost cutting measures initiated in 2005 and 2006.

Research and Development

Research and development costs consist primarily of headcount related costs of the Company s product strategy, development, and testing employees and offshore development contractors, as well as related infrastructure costs. During the three months ended March 31, 2007, the decrease in research and development costs were primarily the result of the reduction in historical headcount related costs, off-shore resources, stock based compensation, and third-party consulting costs (other than off-shore development) of $270,000, $97,000, $51,000, and $41,000, respectively. These costs were further reduced by a decrease in software license costs, and other related costs of $18,000 and $15,000, respectively. The Company has taken many steps to lower its overall cost structure, including the reduction of personnel. We have seen the impact of these cost reductions and we expect to continue to see their impact going forward.

As of March 31, 2007, the Company had a total of 38 people dedicated to development, which includes 18 dedicated offshore developers, compared to a total development headcount of 57, including 29 dedicated offshore developers as of March 31, 2006.

Sales and Marketing

Sales and marketing expenses consist primarily of headcount related costs, as well as incentive compensation for sales and marketing employees, related travel and infrastructure expenses, and third-party marketing costs.

There was a decrease in sales and marketing expenses for the three months ended March 31, 2007 as compared to the same period in 2006. Accounting for the decrease were decreases in historical headcount related costs, marketing expenses, such as advertising, public relations, and trade show costs, travel and entertainment costs, stock based compensation, infrastructure and other sales and marketing costs of $261,000, $154,000, $74,000, $70,000, $12,000 and $24,000, respectively. We have seen the impact of our cost reductions on sales and marketing expenses and we expect to continue to see their impact going forward.

General and Administrative

General and administrative expenses consist primarily of headcount related costs for our executive, administrative, finance, legal, and human resources personnel, as well as related infrastructure costs. In addition, general and administrative expenses include directors and officers insurance, and audit, legal, and other professional fees.

The decrease in general and administrative expenses for the three months ended March 31, 2007 was primarily a result of stock based compensation, insurance costs, historical headcount costs, tax expense, travel and entertainment, and other general and administrative costs of $168,000, $53,000, $46,000, $38,000, $17,000 and $29,000, respectively, as compared to the same period in 2006. These costs were offset by an increase in infrastructure costs and professional fees of $61,000 and $31,000, as compared to the same period in 2006. These decreases are a result of the Company s continuing commitment to control its costs.

Litigation and Settlement Costs

During the three months ended March 31, 2007, there were no litigation and settlement costs recorded.

During the three months ended March 31, 2006, the Company recorded $722,000 in expenses for a settlement relating to a suit filed by a former partner, and now a competitor, charging that Tigris, a company Verticalnet acquired in 2004, had appropriated certain trade secrets from the former partner in a period prior to Verticalnet s acquisition and that Verticalnet was improperly continuing to use these trade secrets. In addition, the Company incurred litigation related expenses of $296,000 relating to the Jodek Case (see Note 7 to the condensed consolidated financial statements).

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Restructuring Charges

During the three months ended March 31, 2007, there were no restructuring charges recorded.

During the three months ended March 31, 2006, we recorded $238,000 in restructuring charges in connection with the Company s strategic and organizational initiatives designed to realign business operations, eliminate acquisition related redundancies, and reduce costs.

Amortization of Other Intangible Assets

The decrease in amortization of other intangible assets during the three ended March 31, 2007 as compared to the same periods in 2006 was a result of the completion of amortization of certain other intangible assets acquired from the Tigris and B2eMarkets acquisitions, which occurred in January 2004 and July 2004, respectively, offset by the addition of the amortization of other intangible assets acquired from the Digital Union acquisition which occurred in July 2005.

Interest and Other Expense (Income), Net

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

	Three months ended March 31,	
	2007	**2006**
Interest expense, net	$ 494	$ 640
Change in fair value of derivative liabilities	(119)	(507)
Transaction loss (gain)	6	21
Other expenses (income), net	1	(1)
	$ 382	$ 153

As a result of certain features contained in our Convertible Notes and related warrants, we were required under U.S. generally accepted accounting principles to record derivative liabilities, which have an aggregate fair value of $110,000 and $229,000 as of March 31, 2007 and December 31, 2006, respectively, and are recorded as part of accrued expenses on the condensed consolidated balance sheet. Each quarter, we are required to revalue the derivative liabilities and the change from the prior period will be recorded as a non-cash charge or benefit in the condensed consolidated statement of operations. During the three months ended March 31, 2007 and 2006, we recorded a non-cash benefit of $119,000 and $507,000, respectively. Changes in the fair value of the derivative liabilities are primarily measured using the Black-Scholes valuation model and are recorded as a change in fair value of derivative liabilities in the condensed consolidated statement of operations. The fair value of the derivative liabilities are directly affected by the change in the market value of our stock.

At the time of the issuance of the Convertible Notes, we recorded a debt discount of $2.4 million related to the derivative liabilities. This amount will be amortized over the life of the notes and recorded as additional interest expense. During the three months ended March 31, 2007 and 2006, we recorded $153,000 and $427,000, respectively, as interest expense related to this amortization.

At the time of the issuance of the Discount Note, we recorded a debt discount of $1.3 million. This amount is being amortized over the life of the note and recorded as additional interest expense. During the three months ended March 31, 2007, we recorded $78,000 as interest expense related to this amortization.

During the three months ended March 31, 2007, the Company recorded $59,000 of interest expense related to the amortization of deferred financing costs related to the Convertible Notes and the Discount Note. During the three months ended March 31, 2006, the Company recorded $120,000 of interest expense related to the amortization of deferred financing costs related to the Convertible Notes.

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LIQUIDITY AND CAPITAL RESOURCES

The following table highlights key financial measurements of the Company:

(in thousands)	March 31, 2007	December 31, 2006
Cash and cash equivalents	$ 1,586	$ 2,809
Accounts receivable, net	$ 3,832	$ 3,877
Working capital (deficit)	$ (5,060)	$ (4,160)
Current ratio	0.56	0.64
Deferred revenues	$ 4,864	$ 4,613
Total debt and other non-current liabilities, including current portion and derivative liabilities	$ 7,110	$ 7,669

	Three Months Ended March 31,	
	2007	2006
Cash flow activities:		
Net cash used in operating activities	$ (838)	$ (1,333)
Net cash provided by (used in) investing activities	(19)	53
Net cash used in financing activities	(367)	(133)

Historically, the Company has funded itself primarily through the sale of equity and debt instruments, as well as revenue from operations.

Operating activities

During the three months ended March 31, 2007, net cash used in operating activities was approximately $838,000 and was primarily a result of the net loss from operations of $2.5 million, offset by a $739,000 in other non-cash charges, an increase of $416,000 in accounts payable and accrued expenses, an increase in deferred revenues of $251,000, an increase of $220,000 in prepaid expenses and other assets, and an decrease of $45,000 in accounts receivable.

Investing activities

During the three months ended March 31, 2007, net cash used in investing activities was $19,000 solely due to capital expenditures.

Financing activities

We believe that we will be able to finance our capital requirements and operations through, at least, May 31, 2008, assuming that (i) we are able to repay a portion of the Convertible Notes with our common stock as discussed below, (ii) the Convertible Notes and Discount Note are not declared in default within this timeframe, and (iii) our actual revenues and expenses are within our current projected estimates.

As of March 31, 2007, we had cash and cash equivalents of $1.6 million. Under the terms of the Convertible Notes, we are required to maintain a cash and cash equivalents balance of at least $1.5 million. As of March 31, 2007, the outstanding payments to be made under the Convertible Notes are $1.2 million, plus interest, and the amount of each remaining monthly principal payment under the Convertible Notes is $292,500 from April 2007 through July 2007.

As of March 31, 2007, the outstanding principal amount of $5.5 million was due on April 1, 2008 under our recently amended Discount Note and interest payments of $165,000 are payable under the Discount Note quarterly until the maturity date. On March 28, 2007, we amended the Discount Note such that the maturity date can be extended (at our sole discretion) from April 1, 2008 to September 30, 2008.

Given our cash level and debt repayment schedules, we are seeking to obtain additional debt or equity financing or seeking to restructure or refinance our existing indebtedness, subject to obtaining any required consent from our debt holders, which may result in the issuance of additional debt or equity securities that will further dilute our existing shareholders. In addition, we are exploring the licensing of certain non-strategic technology assets to enhance our liquidity and further reduce our cost structure, as well as the sale of specific non-strategic technology assets redundant

with our core technology products, subject to obtaining the consent of our debt holders to sell such assets. In the event that we are successful in the sale or licensing of these non-strategic assets, we may be required to use the proceeds to reduce the outstanding balance of the convertible notes or the discount note.

In May 2007, the Company entered in to an agreement with a third party that will allow them access to the source code and object code of a legacy software product. Under the agreement, we received $700,000 upon the execution of the agreement and will be paid $100,000 within sixty days and $200,000 within one year of the execution of the license agreement. The Company is in the process of evaluating the accounting for this transaction. This transaction will be recorded in the second quarter of 2007.

Under the terms of our Discount Note, we are prohibited from paying the monthly principal and interest payments under the Convertible Notes in cash to the extent we can make such payments in shares of our common stock in accordance with the terms of the Convertible Notes. In the past, we have typically made the monthly principal and interest payments under the Convertible Notes in shares of our common stock, or a combination of cash and shares of our common stock. Under the terms of the Convertible Notes, the number of shares we can use to pay principal and interest under the Convertible Notes is subject to limitations based on the trading volume of our common stock. Recently, the price and the trading volume of our common stock has declined, and as a result, we have not been able to make the entire principal and interest payments under the Convertible Notes in shares of common stock. If we cannot make principal and interest payments under the Convertible Notes with shares of common stock, we will have to use our available cash to make such payments and, as a result, may need to accelerate our alternatives set forth above (see Note 5 of the condensed consolidated financial statements).

On September 27, 2006, we received written notification, or the notice, from Nasdaq that for 30 consecutive trading days the bid price of our common stock had closed below the minimum $1.00 per share required for continued listing under Nasdaq Marketplace Rule 4310(c)(4), or the rule. We were provided an initial period of 180 calendar days, or until March 26, 2007, to regain compliance with the rule.

On March 27, 2007, we received written notification from Nasdaq that the staff had determined that (i) we did not meet the Nasdaq Capital Market initial listing criteria of having shareholders equity of at least $5 million as set forth in Marketplace Rule 4310(c),(ii) did not meet the minimum bid price requirement pursuant to the rule, and (iii) that our stock will be delisted on April 5, 2007 unless we file an appeal of the staff s determination. On April 2, 2007, we filed an appeal of the staff s determination to delist our securities to a Listing Qualifications Panel. We have received a hearing date of May 17, 2007. To the extent that we are delisted from Nasdaq, we believe that we will be able to list our shares on the OTC Bulletin Board. The listing of our shares on the OTC Bulletin Board will not preclude us from making future payments under the Convertible Notes in shares of our common stock.

If our common stock is delisted from The Nasdaq Capital Market for any reason for more than three business days, we are obligated to pay the holders of our Convertible Notes in cash an aggregate amount equal to 1.5% of the original principal amount of the Convertible Notes for the first calendar month and each additional calendar month after delisting until the Convertible Notes are no longer outstanding. Based on the original principal amount of the Convertible Notes, these monthly payments would be approximately $88,000.

There can be no assurance that our common stock will trade above $1.00 per share, that we will meet all of the listing criteria for The Nasdaq Capital Market, that we will prevail at the hearing before the Listing Qualifications Panel, or that our stock will remain listed.

There can be no assurance that we will be in compliance with the covenants under the Convertible Notes and the Discount Note, although, we were in compliance with the covenants under the Convertible Notes and the Discount Note as of March 31, 2007. The Convertible Notes and the Discount Note contain cross-default provisions, which means that a default under either instrument results in a default under the other instrument. If we are unable to comply with the covenants under the Convertible Notes or the Discount Note, the holders of the Convertible Notes and the Discount Note may declare us in default and may declare all amounts due under the notes.

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Contractual Commitments

The following table outlines future contractual commitments (see Note 2, 5, 6, and 7 to the condensed consolidated financial statements):

Expected Cash Payment by Period
(in thousands)

	2007(a)	2008	2009	2010	2011	Thereafter	Total
Senior secured convertible promissory notes (b)	$ 1,192	$	$	$	$	$	$ 1,192
Senior subordinated discount notes (c)	495	5,830					6,325
Operating leases	582	564	373	365			1,884
Capital leases (d)	66	38	1				105
Liability settlement (e)	150	150					300
Tenant improvement loan (f)	8	7					15
Insurance financing (g)	368						368
Employment agreements (h)	697						697
Other obligations (i)	152	12					164
Total	$ 3,710	$ 6,601	$ 374	$ 365	$	$	$ 11,050

(a) Reflects amounts payable over the last nine months of 2007.

(b) Senior secured convertible promissory notes include future interest obligations.

(c) Senior subordinated discount note include future interest obligations.

(d) Capital lease balances include future interest obligations.

(e) Liability settlement balances include future interest

obligations.

(f) Tenant improvement loan balances include future interest obligations.

(g) Relates to insurance policy financing in 2007.

(h) Represents minimum salaries due to certain executives based on existing employment agreements. In addition, these agreements provide for additional payments upon employee separation of approximately $904,000.

(i) Relates to third-party hosting facilities and minimum offshore development resources commitments.

Off-Balance Sheet Arrangements

We do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as special purpose entities (SPEs) or variable interest entities (VIEs), which would have been established for the purpose of facilitating off-balance sheet arrangements or other limited purposes. As of March 31, 2007 and December 31, 2006, we were not involved with any unconsolidated SPEs or VIEs.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Risk

We develop products primarily in the United States of America and India and market our products primarily in the United States of America and Europe. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Since the majority of our non-U.S. sales are priced in currencies other than the U.S. dollar, a strengthening of the dollar versus the Euro or the British Pound may reduce the level of reported revenues. If any of the events described above were to occur, our net sales could be seriously impacted, since a growing portion of our net sales are derived from international operations. For the three months ended March 31, 2007 and 2006, approximately 22%, and 11%, respectively, of our total revenues were derived from sales in currencies other than the U.S. dollar. Our U.S. dollar earnings and net cash flows from international operations may also be adversely affected by changes in foreign currency exchange rates.

Interest Rate Risk

Other than the Convertible Notes and the Discount Note, our exposure to market risk related changes in interest rates relates primarily to our cash and cash equivalents. We have invested in instruments that meet high quality credit standards, as specified in our investment policy. The policy also limits the amount of credit exposure we may have to any one issue, issuer, or type of investment. Due to the nature and size of our investment portfolio, we believe that a sudden change in interest rates would not have a material effect on the value of the portfolio since in most cases the average yield on our investments is approximately 5.2% at March 31, 2007. The impact on our future interest income and future changes in investment yields will depend largely on the gross amount of our investment portfolio.

Derivatives

On August 16, 2005, the Company issued the Convertible Notes to the Convertible Note Holders (see Note 5 to the condensed consolidated financial statements). The Convertible Notes are convertible into shares of Verticalnet s common stock, at the option of the convertible note holders, at a fixed conversion price of $4.90 per share (the Conversion Price), subject to adjustment upon certain conditions, including certain issuances of stock at a price below $4.90 per share, stock dividends or splits, and distributions of equity, debt, or assets. As of March 31, 2007, 240,566 shares would be issuable if the convertible note holders elected to convert the remaining principal amount of the Convertible Notes and accrued interest. The Company also issued to the convertible note holders warrants to purchase an aggregate of 674,143 shares of Verticalnet common stock at an exercise price of $0.88 per share. The warrants are exercisable after six months from the closing date of the Convertible Notes for a period of five years from the closing date. The term of the warrants can be extended by the convertible note holders for the number of days that the shares underlying the warrants are not saleable as a result of the suspension of trading of the Company s common stock on an applicable trading market and if the convertible note holders are not permitted to use the prospectus included in the registration statement for the resale of the shares.

The Convertible Notes mature on July 2, 2007 (the Maturity Date) and accrue interest at 9% per annum from the issue date. Interest is payable monthly, in arrears, beginning December 2005 until the earlier of the Maturity Date or the date of conversion (the Conversion Date). Monthly principal payments of $330,000 commenced in December 2005 and are payable thereafter on the first business day of each month through July 2007 or the Conversion Date, whichever is sooner. As a result of several conversions during 2005 and 2006, the monthly principal payment has been reduced to approximately $318,000. At the Company s discretion, the Company may pay the monthly principal and interest payments in cash, common stock, or a combination of cash and common stock, subject to certain limitations set forth in the Convertible Notes, including the maximum amount of shares issued in a month cannot exceed 20% of the total dollar volume of the shares trading activity, as defined. The conversion price used for payments of principal and interest in shares of common stock will be equal to the Conversion Price if the average price of the Company s stock is at least 115% of the Conversion Price. If the average price of the Company s stock is not at least 115% of the Conversion Price, the conversion price used for payments of principal and interest in shares of common stock will be equal to 85% of the average of the five lowest daily volume weighted average prices of the Company s common stock for the ten trading days before the date the Company elects to pay in shares of common stock. Upon the occurrence of certain events as set forth in the Convertible Notes, the convertible note holders may require the Company to prepay the Convertible Notes at 110% of the remaining principal amount of the Convertible

Notes or redeem the Convertible Notes and under certain events, the related warrants at the then fair value determined by the related agreement. The interest rate on the Convertible Notes is 9.0% per annum and, accordingly, is not affected by changes in interest rates. However, if interest rates decline, the interest paid by the Company could be at above-market rates.

The Company has also agreed that if the convertible note holders are unable to use the registration statement registering for resale the shares of common stock issuable as payment for the principal and interest payment under the Convertible Notes or upon conversion of the Convertible Notes, because, among other reasons, it has lapsed or is suspended, as defined in the related agreement, then the Company will pay the convertible note holders an amount equal to one and one half percent (1.5%) of the original principal amount of the Convertible Notes, in cash, for every thirty day period that such registration statement cannot be used.

In accordance with SFAS No. 133, and related amendments and guidance, the conversion and prepayment feature are considered a derivative instrument and are required to the extent not already a free standing contract, to be bifurcated from the debt instrument and accounted for separately. In addition, to the extent the related debt instrument is outstanding, the warrant is accounted for as a liability due to the existence of certain provisions in the instrument. As a result, the Company recorded a total aggregate derivative liability of $2.4 million as of August 16, 2005. The derivative liabilities consist of the conversion and prepayment feature, and the warrants which were both valued at $1.2 million. Changes in the fair value of the derivative liabilities are primarily measured using the Black-Scholes valuation model and are recorded in the consolidated statement of operations. The fair value of the derivatives is directly affected by the change in the market value of the Company s common stock. As of March 31, 2007, the fair value of the derivative liabilities for the conversion and prepayment feature and the warrants was $70,000 and $40,000, respectively. As of December 31, 2006, the fair value of the derivative liabilities for the conversion and prepayment feature and the warrants was $119,000 and $110,000, respectively.

Based upon the terms of the Convertible Notes, the Company, at its discretion, may pay the monthly principal and interest payments in cash, common stock, or a combination of cash and common stock. The Company issued 1,320,132 and 277,874 shares of common stock during the three months ended March 31, 2007 and 2006 for the principal and interest payments, respectively.

In April and May 2007, the Company made these payments with a combination of cash and its common stock and as a result, the Company has issued an additional 649,422 and 1,014,344 shares of common stock on April 2, 2007 and May 1, 2007, respectively.

Item 4. Controls and Procedures

(a) ***Evaluation of disclosure controls and procedures.*** Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Accounting Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2007. Based on that evaluation, the Chief Executive Officer and Chief Accounting Officer concluded that our disclosure controls and procedures as of March 31, 2007 have been designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Accounting Officer, as appropriate, to allow timely decisions regarding disclosure. We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

(b) ***Changes in internal controls.*** No change in our internal control over financial reporting occurred during our most recent fiscal quarter that has affected, or is reasonably likely to affect, our internal control over financial reporting.

Part II. Other Information

Except as listed below, other items in Part II are omitted because the items are inapplicable or require no response.

Item 1. Legal Proceedings

There are no material changes from the legal proceedings as previously disclosed in our Form 10-K for the year ended December 31, 2006 in Part II, Item 1 of Form 10-K.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Items 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006 and the additional factors set forth below, all of which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K and below are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

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

As of March 31, 2007, we had cash and cash equivalents of $1.6 million. Under the terms of our Convertible Notes, we are required to maintain a cash balance of at least $1.5 million. As of March 31, 2007, the outstanding payments to be made under the Convertible Notes are $1.2 million, plus interest, and the amount of each remaining monthly principal payments under the Convertible Notes is $292,500 from April 2007 through July 2007.

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

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

In May 2007, the Company entered in to an agreement with a third party that will allow them access to the source code and object code of a legacy software product. Under the agreement, we received $700,000 upon the execution of the agreement and will be paid $100,000 within sixty days and $200,000 within one year of the execution of the license agreement. The Company is in the process of evaluating the accounting for this transaction. This transaction will be recorded in the second quarter of 2007.

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

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

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

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

In February 2007, our registration statement registering 2,500,000 shares of common stock for resale was declared effective, which was our estimate of the number of shares of common stock issuable as payment for the remaining principal and interest payments on the Convertible Notes or upon conversion of the Convertible Notes. We may also be required to make monthly principal and interest payments on the Convertible Notes in cash instead of shares of common stock if this registration statement later ceases to remain effective or if the number of shares of common stock registered there under is not sufficient to make such payments. As of May 10, 2007, we had approximately 500,000 shares of common stock remaining available for issuance under the registration statement that was declared effective in February 2007 for payments on the convertible notes.

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

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

- increasing our vulnerability to general adverse economic and industry conditions;

- limiting our ability to obtain additional financing;

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

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

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

Our Convertible Notes and Discount Note allow the holders thereof to require us to prepay the notes upon the occurrence of various events of default, such as the failure to list our shares on the OTC Bulletin Board or another acceptable exchange if we are delisted from The Nasdaq Capital Market or our receiving a qualification from our auditors as to our ability to continue as a going concern. The Convertible Notes and the Discount Note contain cross-default provisions, which means that a default under either instrument results in a default under the other instrument. If we are unable to comply with the covenants under the Convertible Notes or the Discount Note, the holders of the Convertible Notes and the Discount Note may declare us in default and may declare all amounts due under the notes, including any accrued interest and penalties. There can be no assurance that we will be in compliance with the covenants under the Convertible Notes and the Discount Note, although, we were in compliance with the covenants under the Convertible Notes and the Discount Note as of March 31, 2007.

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

We generate a significant portion of our revenues and accounts receivable from certain customers.
For the three months ended March 31, 2007, our three largest customer accounted for $712,000 of 20.9% of our total revenues. During the same period in 2006, these same customers accounted for $1.3 million or 33.4% of our total revenues.
As of March 31, 2007, these three customers accounted for $511,000 or 13.3% of our accounts receivable balance, of which $249,000 has been collected as of May 1, 2007. Although we have had a successful collection history with these customers, and do not foresee any collection issues, there can be no assurance that we will be able to collect outstanding balances and future invoices from them.
We may be unable to maintain our listing on The Nasdaq Capital Market, which could cause our stock price to fall and decrease the liquidity of our common stock.
Our common stock is currently listed on The Nasdaq Capital Market, or Nasdaq. Continued listing on Nasdaq requires us to meet certain qualitative standards, including maintaining a certain number of independent Board members and independent audit committee members, and certain quantitative standards, including that we maintain at least $2.5 million in shareholders equity and that the closing price of our common stock not be less than $1.00 per share for 30 consecutive trading days.
On September 27, 2006, we received written notification, or the notice, from Nasdaq that for 30 consecutive trading days the bid price of our common stock had closed below the minimum $1.00 per share required for continued listing under Nasdaq Marketplace Rule 4310(c)(4), or the rule. We were provided an initial period of 180 calendar days, or until March 26, 2007, to regain compliance with the rule. The notice states the Nasdaq staff, or the staff, will provide written notification that the we have achieved compliance with the rule if at any time before March 26, 2007, the bid price of our common stock closes at $1.00 per share or more for a minimum of 10 consecutive business days, although the notice also states that the staff has the discretion to require compliance for a period in excess of 10 consecutive business days, but generally no more than 20 consecutive business days, under certain circumstances.
On March 27, 2007, we received written notification, or the second notice, from Nasdaq that the staff had determined that we did not regain compliance with the rule and that we were not eligible for an additional 180 day compliance period because we did not meet the Nasdaq Capital Market initial listing criteria set forth in Marketplace Rule 4310(c). Specifically, we did not meet The Nasdaq Capital Market initial listing criteria of (i) having shareholders equity of at least $5 million, having a market value of listed securities of at least $50 million or having net income from continuing operations of $750,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years, and (ii) having a market value of listed securities of at least $5 million. The second notice stated that as a result our stock will be delisted on April 5, 2007, unless we requested an appeal of the staff s determination to a Nasdaq Listing Qualifications Panel by April 3, 2007. On April 2, 2007, we requested an appeal of the staff s determination to delist our securities to a Nasdaq Listing Qualifications Panel. We have received a hearing date of May 17, 2007.
There can be no assurance that the Nasdaq Listing Qualifications Panel will grant our request for continued listing.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable.
(b) Not applicable.
(c) Not applicable.

Item 3. Defaults Upon Senior Securities

(a) None.
(b) None.

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

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Number	Description
31.1	Chief Executive Officer s Rule 13a-14(a)/15d-14(a) Certification.*
31.2	Chief Accounting Officer s Rule 13a-14(a)/15d-14(a) Certification.*
32.1	Chief Executive Officer s Certification Pursuant to 18 U.S.C. Section 1350.
32.2	Chief Accounting Officer s Certification Pursuant to 18 U.S.C. Section 1350.

* Filed herewith.

Furnished herewith.

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SIGNATURES

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

VERTICALNET, INC.

By:	/s/ NATHANAEL V. LENTZ
Name:	**Nathanael V. Lentz** **President and Chief Executive Officer**
Date: May 15, 2007	
By:	/s/ JONATHAN T. COHEN
Name:	**Jonathan T. Cohen** **Vice President and** **Chief Accounting Officer** **(principal financial and accounting officer)**
Date: May 15, 2007	

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