UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2005

OR

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

For the transition period from ______ to ______

Commission File Number 000-25269

VERTICALNET, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania	**23-2815834**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
400 CHESTER FIELD PARKWAY	
MALVERN, PENNSYLVANIA	**19355**
(Address of principal executive offices)	**(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 x No ¨

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

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

The number of shares outstanding of the registrant s common stock as of August 10, 2005 was 47,444,193 (includes 702,927 shares subject to an escrow agreement in connection with an acquisition)**.**

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VERTICALNET, INC.

FORM 10-Q

For the Quarterly Period Ended June 30, 2005

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

VERTICALNET, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	June 30, 2005	December 31, 2004
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 3,919	$ 9,370
Accounts receivable, net	4,361	5,902
Investment	242	
Prepaid expenses and other current assets	1,784	802
Total current assets	10,306	16,074
Property and equipment, net	1,257	1,173
Investment		606
Goodwill	16,376	16,364
Other intangible assets, net	4,487	5,603
Other assets	362	525
Total assets	$ 32,788	$ 40,345
Liabilities and Shareholders Equity		
Current liabilities:		
Current portion of long-term debt	$ 588	$ 71
Accounts payable and accrued expenses	3,933	4,993
Deferred revenues	3,103	3,147
Total current liabilities	7,624	8,211
Non-current portion of deferred revenues	22	204
Long-term debt	115	42
Total liabilities	7,761	8,457
Commitments and contingencies (see Notes 2, 7, and 8)		
Shareholders equity:		
Preferred stock $.01 par value, 10,000,000 shares authorized, none issued at June 30, 2005 and December 31, 2004		

Common stock $.01 par value, 100,000,000 shares authorized, 43,051,139 shares issued at June 30, 2005 and 42,702,941 shares issued at December 31, 2004	431	427
Additional paid-in capital	1,222,316	1,222,210
Deferred compensation	(752)	(1,067)
Accumulated other comprehensive loss	(387)	(254)
Accumulated deficit	(1,195,776)	(1,188,623)
	25,832	32,693
Treasury stock at cost, 65,636 shares at June 30, 2005 and December 31, 2004	(805)	(805)
Total shareholders equity	25,027	31,888
Total liabilities and shareholders equity	$ 32,788	$ 40,345

See accompanying notes to consolidated financial statements.

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VERTICALNET, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(in thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Revenues:				
Software and software related	$ 1,597	$ 563	$ 3,112	$ 1,112
Services	3,447	5,972	7,208	9,959
Total revenues	5,044	6,535	10,320	11,071
Cost of revenues:				
Cost of software and software related	756	273	1,455	529
Cost of services	1,794	2,412	3,741	3,952
Amortization of acquired technology and customer contracts	240	325	479	650
Total cost of revenues	2,790	3,010	5,675	5,131
Gross profit	2,254	3,525	4,645	5,940
Operating expenses:				
Research and development	1,737	1,248	3,448	2,445
Sales and marketing	2,009	1,459	3,862	2,525
General and administrative	1,312	1,341	2,824	2,836
Restructuring charges	324		324	
Stock-based compensation (a)	197	450	417	920
Amortization of other intangible assets	301	246	625	377
Total operating expenses	5,880	4,744	11,500	9,103
Operating loss	(3,626)	(1,219)	(6,855)	(3,163)
Interest and other expense, net	338	33	298	318
Net loss	$ (3,964)	$ (1,252)	$ (7,153)	$ (3,481)
Basic and diluted loss per common share	$ (0.09)	$ (0.05)	$ (0.17)	$ (0.14)
Weighted average common shares outstanding:				
Basic and diluted	42,163	25,598	42,070	24,500

(a) For the three and six months ended June 30, 2005 and 2004, stock-based compensation expense, net of the effects of cancellations, is attributable to various expense categories as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Cost of revenues	$ 31	$ 133	$ 43	$ 333
Research and development	4	115	18	185
Sales and marketing	73	57	164	127
General and administrative	89	145	192	275
Total	$ 197	$ 450	$ 417	$ 920

See accompanying notes to consolidated financial statements.

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VERTICALNET, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Six months ended June 30,	
	2005	**2004**
Operating activities:		
Net loss	$ (7,153)	$ (3,481)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,402	1,211
Realized loss on investment		35
Write-down related to cost method investment	364	
Stock-based compensation, net of cancellations	417	920
Other non-cash items		282
Change in assets and liabilities, net of effect of acquisition:		
Accounts receivable	1,541	(614)
Prepaid expenses and other assets	(3)	480
Accounts payable and accrued expenses	(910)	441
Deferred revenues	(226)	111
Net cash used in operating activities	(4,568)	(615)
Investing activities:		
Capital expenditures	(242)	(57)
Acquisitions, net of cash acquired	(150)	(3,826)
Proceeds from sale of short-term investments		2
Proceeds from sale of cost, equity method, and available-for-sale investments		2,980
Purchase of cost, equity method, and available-for-sale investments		(3,000)
Restricted cash		(311)
Net cash used in investing activities	(392)	(4,212)
Financing activities:		
Principal payments on long-term debt and obligations under capital leases	(366)	(349)
Proceeds from exercise of stock options and warrants	8	712
Proceeds from issuance of common stock and warrants, net		7,023
Net cash provided by (used in) financing activities	(358)	7,386
Effect of exchange rate fluctuation on cash and cash equivalents	(133)	(1)
Net increase (decrease) in cash and cash equivalents	(5,451)	2,558
Cash and cash equivalents - beginning of period	9,370	4,408
Cash and cash equivalents - end of period	$ 3,919	$ 6,966
Supplemental disclosure of cash flow information:		

Cash paid during the period for interest	$	16	$	36
Supplemental schedule of non-cash investing and financing activities:				
Financed insurance policies	$	816	$	748
Capital expenditures financed through capital lease arrangements		141		
Issuance of common stock as consideration for the Tigris acquisition				5,740
Assumption of stock option plan as consideration for the Tigris acquisition				2,212

See accompanying notes to consolidated financial statements.

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VERTICALNET, INC.

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

(in thousands)

	Common Stock							
	Shares	**Amount**	**Additional Paid-in Capital**	**Deferred Compensation**	**Accumulated Other Comprehensive Loss**	**Accumulated Deficit**	**Treasury Stock**	**Total Shareholders Equity**
Balance, January 1, 2005	42,703	$ 427	$ 1,222,210	$ (1,067)	$ (254)	$ (1,188,623)	$ (805)	$ 31,888
Exercise of stock options	271	3	5					8
Deferred stock-based compensation	77	1	101	(102)				
Amortization of deferred stock-based compensation				417				417
Net loss						(7,153)		(7,153)
Other comprehensive loss					(133)			(133)
Balance, June 30, 2005 (unaudited)	43,051	$ 431	$ 1,222,316	$ (752)	$ (387)	$ (1,195,776)	$ (805)	$ 25,027

See accompanying notes to consolidated financial statements.

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VERTICALNET, INC.

CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE LOSS (UNAUDITED)

(in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2005	**2004**	**2005**	**2004**
Net loss	$ (3,964)	$ (1,252)	$ (7,153)	$ (3,481)
Foreign currency translation adjustment	(40)	(1)	(133)	(1)
Reclassification adjustment for realized loss included in net loss		15		15
Comprehensive loss	$ (4,004)	$ (1,238)	$ (7,286)	$ (3,467)

See accompanying notes to consolidated financial statements.

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VERTICALNET, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Description of 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 Supply Management solutions to Global 2000 companies. We provide a full scope of Supply Management software, services, and domain expertise in areas that include: Program Management, Spend Analysis, eSourcing, Advanced Sourcing, Contract Management, and Supplier Performance Management. Our solutions help our customers save money on the goods and services they buy.

Historically, we derived our revenue primarily from the licensing of our software, as well as implementation and development services. As a result of the January 2004 acquisition of Tigris Corp (Tigris), we also generate revenues from spend analysis and other supply chain consulting services and as a result of the July 2004 acquisition of B2eMarkets, Inc. (B2eMarkets), we have seen an increase in the amount of our revenues coming from the licensing of our products and maintenance. In July 2005, we acquired Digital Union Limited (Digital Union), and we expect to see a continued increase in the proportion of our revenues from software and software related revenues.

Basis of Presentation

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

The accompanying unaudited consolidated financial statements of the Company reflect all adjustments (all of which are normal and recurring in nature) that, in the opinion of management, are necessary for a fair presentation of the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2005. Certain information and note disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted under the Securities and Exchange Commission s (SEC) rules and regulations. These unaudited consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto, together with management s discussion and analysis of financial condition and results of operations, presented in the Company s Annual Report on Form 10-K for the year ended December 31, 2004 filed on March 31, 2005 with the Securities and Exchange Commission**.**

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.

Restricted Cash

Restricted cash represents certificates of deposit held pursuant to building lease agreements and other financing arrangements. At June 30, 2005 we had approximately $155,000 of restricted cash classified as other current assets and $156,000 of restricted cash classified as non-current other assets on the consolidated balance sheet. At December 31, 2004, we had approximately $311,000 of restricted cash classified as non-current other assets on the consolidated balance sheet.

Intangible Assets and Other Long-Lived Assets

In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible 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. In addition, SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

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In accordance with SFAS No. 144, 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.

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, 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. The revenue associated with those services is recognized under services revenues as described below.

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

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

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.

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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. 00-03, Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity s Hardware. Revenues related to such arrangements are recognized on a monthly basis over the term of the contract. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

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

Services revenues

Consulting contracts with fixed-priced arrangements are recognized using the percentage-of-completion method. Percentage-of-completion accounting involves calculating the percentage of services provided during the period compared to the total estimated services to be provided over the duration of the contract. This method is followed where reasonably dependable estimates of the revenues and costs applicable to various elements of a contract can be made. Estimates of total contract revenues and costs are continuously monitored during the term of the contract, and recorded revenues and costs are subject to revision as the contract progresses. Such revisions may result in increases or decreases to revenues and results of operations and are reflected in the consolidated financial statements in the period in which they are first identified.

Consulting services with fees based on time and materials or cost-plus are recognized in accordance with SAB No. 104 as the services are performed (as measured by time incurred) and amounts earned. We consider amounts 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, 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 six months ended June 30, 2005 and 2004 revenues and amounts due from our largest customers were as follows (in thousands):

	2005			2004		
Customer	**Accounts Receivable Balance (a)**	**Revenues**	**% of Total Revenues**	**Accounts Receivable Balance (a)**	**Revenues**	**% of Total Revenues**
A	$ 1,253	$ 2,704	26.2%	$ 1,479	$ 2,601	23.5%
B	397	1,805	17.5%	2,304	4,420	39.9%
Total	$ 1,650	$ 4,509	43.7%	$ 3,783	$ 7,021	63.4%

(a) Represents both billed and unbilled amounts

Revenues from the same customers for the three months ended June 30, 2005 and 2004 were as follow (in thousands):

	2005		2004	
Customer	**Revenues**	**% of Total Revenues**	**Revenues**	**% of Total Revenues**
A	$ 1,511	30.0%	$ 1,660	25.4%
B	839	16.6%	2,454	37.6%
Total	$ 2,350	46.6%	$ 4,114	63.0%

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.

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Cost of Services

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

Research and Development

Research and development costs consist primarily of salaries and benefits, consulting, and other related expenses, which are expensed as incurred.

Sales and Marketing

Sales and marketing expenses consist primarily of headcount related costs, including incentive compensation for sales and marketing employees and related travel and infrastructure expenses, as well as third-party marketing costs such as advertising costs. We expense advertising costs as incurred and report such costs as a component of sales and marketing expense.

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 equipment leasing and infrastructure costs, insurance, and professional fees.

Stock Options

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

	Three months ended June 30,		**Six months ended June 30,**	
	2005	**2004**	**2005**	**2004**

Net loss:				
As reported	$ (3,964)	$ (1,252)	$ (7,153)	$ (3,481)
Add: Stock-based employee compensation included in reported net loss	197	450	417	920
Deduct: Stock-based employee compensation expense determined under fair-value-based method for all awards	(715)	(517)	(1,572)	(1,100)
Pro forma	$ (4,482)	$ (1,319)	$ (8,308)	$ (3,661)
Loss per common share basic and diluted:				
As reported	$ (0.09)	$ (0.05)	$ (0.17)	$ (0.14)
Pro forma	$ (0.11)	$ (0.05)	$ (0.20)	$ (0.15)

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. Foreign currency translation adjustments are included in accumulated other comprehensive loss on the 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.

Comprehensive Loss

We report comprehensive loss in accordance with the provisions of SFAS No. 130, Reporting Comprehensive Income, which establishes standards for reporting comprehensive loss and its components in financial statements. Comprehensive loss, as defined, includes all changes in equity during a period from non-owner sources.

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Computation of Historical 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 unvested restricted 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 former 5 ¼% convertible subordinated debentures (using the if-converted method) and unvested restricted stock grants. Common equivalent shares are excluded from the calculation if their effect is anti-dilutive.

During the three and six months ended June 30, 2005 and 2004, 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, outstanding options of 13,937,673 and 9,542,534 as of June 30, 2005 and 2004, respectively, were excluded from the computation of diluted loss per common share. In addition, 355,209 common shares previously held in escrow in connection with the acquisition of Tigris were only included in the loss per share calculation subsequent to their release date of April 30, 2004.

As a result of the B2eMarkets acquisition, there were 752,454 shares of common stock that were held in escrow. Of those held in escrow, 49,527 shares were owed to the prior owners of Adaptivetrade, Inc., a company that was acquired by B2eMarkets in February 2004. These shares were only included in the loss per share calculation subsequent to their release date of February 27, 2005. The remaining 702,927 shares were placed in escrow upon the conversion of a note given as consideration for the acquisition into common stock and are scheduled to be released from escrow during the third quarter of 2005.

Adoption of New Pronouncement

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R (revised 2004), Share-Based Payment. SFAS No. 123R is a revision of SFAS No. 123 and supersedes APB Opinion No. 25 and its related implementation guidance. SFAS No. 123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of those equity instruments. SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. With limited exceptions, the amount of compensation costs will be measured based on the grant date fair value of the equity or liability instrument issued. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. Beginning with the first quarter of 2006, we will recognize compensation expense in accordance with SFAS No. 123R. The adoption of this standard for the expensing of stock options is expected to reduce pretax earnings in future years. The impact of adoption of SFAS No. 123R cannot be predicted at this time because it will depend on the level of share-based payments granted in the future and the model we choose to use. However, had we adopted SFAS No. 123R in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described above in Stock Options.

(2) Liquidity

We believe that our current level of liquid assets will be sufficient to finance our capital requirements and anticipated operating losses through at least August 31, 2006. However, to the extent that the current levels of liquid assets prove to be insufficient, we may need to further reduce our operating costs or obtain additional debt or equity financing. Additionally, we may, if the capital markets present attractive opportunities, raise cash through the sale of debt or equity. We can provide no assurance that we will be successful in obtaining any required or desired financing either on acceptable terms or at all.

(3) Acquisitions

Digital Union Limited

On July 22, 2005, Verticalnet acquired Digital Union, a privately-held provider of on-demand sourcing and procurement solutions based in Guildford, Surrey, United Kingdom. Digital Union s results will be included in the Company s results effective from the acquisition date (see Note 11 to these consolidated financial statements).

B2e Markets, Inc.

On July 19, 2004, a wholly-owned direct subsidiary of Verticalnet merged with B2eMarkets, a privately-held provider of Strategic Sourcing software solutions. B2eMarkets results have been included in the Company s results since July 20, 2004.

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The aggregate purchase price of the B2eMarkets acquisition was $12.9 million, including transaction costs of approximately $2.4 million, which primarily consisted of fees paid for investment banking, legal, and professional services. The consideration included the issuance of 5,100,000 shares of common stock (31,215 were held in escrow until February 2005), valued on the date of closing at approximately $6.6 million, and a promissory note in the principal amount of $5.9 million, which was valued at $3.9 million on the date of closing. The note plus interest was converted into 3,029,162 shares of Verticalnet common stock, after the conversion of the note was approved by Verticalnet s shareholders at the November 2004 annual shareholders meeting, of which 18,312 shares were held in escrow until February 2005 and 702,927 shares are being held in escrow until the third quarter of 2005. The promissory note had an effective interest rate of 16.6% annum. The interest expense was recorded as a non-cash item in our consolidated statement of cash flows since the accrued interest was not paid in cash when the note was converted.

In accordance with SFAS No. 141, Business Combinations, the Company allocated the purchase price to the tangible and intangible assets acquired and the liabilities assumed, based on their estimated fair values. The excess of the purchase price over the fair values was recorded as goodwill. The fair value assigned to intangible assets acquired was based on a valuation performed by an independent third-party valuation firm. The total purchase price was allocated as follows (in thousands):

Current assets	$ 1,759
Property and equipment	280
Other assets	19
Goodwill	11,499
Intangible assets	3,780
Total assets acquired	17,337
Current liabilities	(4,429)
Total purchase price	$ 12,908

Tigris

On January 30, 2004, a wholly-owned direct subsidiary of Verticalnet merged with and into Tigris, a privately-held strategic sourcing and supply chain consulting firm based in New York City. Tigris results have been included in the Company s results since January 31, 2004.

The aggregate purchase price of the Tigris acquisition was approximately $12.1 million, including transaction costs of approximately $300,000, which primarily consisted of fees paid for professional services. The consideration included $3.5 million in cash, 1,870,450 shares of our common stock valued on the date of closing at approximately $5.7 million (355,029 shares were held in escrow until they were released to Tigris shareholder on April 30, 2004), issuance of employee options to purchase 751,670 shares of our common stock valued as of the date of acquisition at $2.2 million and assumed debt of approximately $346,000.

In accordance with SFAS No. 141, the Company allocated the purchase price to the tangible and intangible assets acquired and the liabilities assumed, based on their estimated fair values. The excess of the purchase price over the fair values was recorded as goodwill. The fair value assigned to intangible assets acquired was based on a valuation performed by an independent third-party valuation firm. The total purchase price was allocated as follows (in thousands):

Current assets	$ 3,375
Property and equipment	1,048
Goodwill	4,865
Intangible assets	3,570
Total assets acquired	12,858
Current liabilities, less assumed debt	(764)
Total purchase price	$ 12,094

Unaudited Pro Forma Information

The unaudited financial information in the table below summarizes the combined results of operations of Verticalnet, Tigris, and B2eMarkets, on a pro forma basis, as though the companies had been combined as of the beginning of each period presented. The pro forma information does not include the recent acquisition of Digital Union, as the historical financial statements and intangible valuations are not yet available. This pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved had the acquisitions taken place at the beginning of

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each period presented. The unaudited pro forma information for the three and six months ended June 30, 2004 combines the historical results for Verticalnet and B2eMarkets for the three and six months ended June 30, 2004 and the historical results for Tigris for the period January 1 through January 30, 2004. The following pro forma information is in thousands, except per share amounts.

	Three months ended June 30, 2004	Six months ended June 30, 2004
Revenue	$ 8,206	$ 15,936
Net loss	$ (3,451)	$ (7,119)
Loss per share	$ (0.11)	$ (0.24)
Weighted average shares outstanding		
Basic and diluted	30,667	29,880

(4) Investment

In a prior year, we had invested in equity instruments of a privately held company for business and strategic purposes. The investment was included in other investments as of December 31, 2004 and was accounted for under the cost method as our ownership interest was less than 20% and we did not have the ability to exercise significant influence over operations. In August 2005, we sold this investment and received proceeds of $242,000. As of June 30, 2005, we have recorded a $364,000 write-down on the investment to reflect the difference between the offer price and the then carrying value of this investment. In addition, the investment has been classified in current assets, reflecting its pending sale.

(5) Detail of Certain Balance Sheet Accounts

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

	June 30, 2005	December 31, 2004
Accounts receivable, trade	$ 3,960	$ 5,590
Unbilled accounts receivable	354	274
Retainage	81	72
	4,395	5,936
Less: allowance for doubtful accounts	(34)	(34)
	$ 4,361	$ 5,902

Unbilled receivables represent revenue recognized for performances under customer contracts and arrangements which have not been billed as of the period end. All amounts are expected to be billed and collected within one year.

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

	June 30, 2005	December 31, 2004
Software	$ 1,608	$ 1,607
Computer equipment	1,735	1,355
Office equipment and furniture	134	132
Leasehold improvements	919	919
	4,396	4,013
Less: accumulated depreciation and amortization	(3,139)	(2,840)
Property and equipment, net	$ 1,257	$ 1,173

Depreciation and amortization related to property and equipment was $298,000 and $185,000 for the six months ended June 30, 2005 and 2004, respectively. Amortization applicable to property and equipment under capital leases was $39,000 and $32,000 for the six months ended June 30, 2005 and 2004, respectively, and is included in such expense.

Depreciation and amortization related to property and equipment was $156,000 and $92,000 for the three months ended June 30, 2005 and 2004, respectively. Amortization applicable to property and equipment under capital leases was $25,000 and $18,000 for the three months ended June 30, 2005 and 2004, respectively, and is included in such expense.

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

	June 30, 2005	December 31, 2004
Accounts payable	$ 1,590	$ 1,245
Compensation and related costs	611	1,142
Taxes and interest payable	558	584
Legal and settlement liabilities	200	594
Acquisition related costs	155	552
Restructuring costs	147	
Other	672	876
	$ 3,933	$ 4,993

(6) Goodwill and Other Intangibles

Our goodwill balance consists of $4.9 million from the Tigris acquisition, which occurred in January 2004 and $11.4 million from the B2eMarkets acquisition, which occurred in July 2004.

The following table reflects the components of amortizable intangible assets as of June 30, 2005 and December 31, 2004 (in thousands).

	Gross Carrying Amount	Accumulated Amortization
June 30, 2005:		
Acquired technology	$ 3,575	$ 2,449
Customer contracts and relationships	6,223	3,007
Non-compete agreements	240	95
	$ 10,038	$ 5,551
December 31, 2004:		
Acquired technology	$ 3,575	$ 2,173
Customer contracts and relationships	6,235	2,219
Non-compete agreements	240	55
	$ 10,050	$ 4,447

(7) Commitments and Contingencies

The following table outlines future minimum lease payments under our capital and operating leases for fiscal years ending December 31 (in thousands):

	Lease Obligations		
	Operating	Capital (b)	Total
2005 (a)	$ 1,161	$ 46	$ 1,207
2006	998	76	1,074
2007	706	51	757
2008	492	13	505
2009	374		374
Therafter	355		355
Total	$ 4,086	$ 186	$ 4,272

(a) Reflects amounts payable over the last six months of 2005

(b) Capital lease balances exclude future interest obligations.

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These future minimum lease payments include all facility leases for which we are contractually committed to make payments as of June 30, 2005.

During 2003, we amended our lease with our primary landlord. The amended agreement provided for occupancy of our main facility in Malvern, Pennsylvania until May 2003, with options to continue the lease on a quarterly basis. We have exercised options to continue the lease up to at least August 2005. In July 2005, the Company entered into a longer term lease arrangement with the current landlord for new space. The term of the new lease is for five years commencing upon the date that the new space becomes available, which is anticipated to be October 1, 2005. The future minimum lease payments for this new lease have been included in the table above.

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.

In July 2000, Verticalnet entered into an Opportunity Grant Program Contract with the Commonwealth of Pennsylvania, Department of Community and Economic Development (the PaDCED) whereby Verticalnet received a grant in the amount of $1.0 million from the PaDCED. The grant was conditioned upon, among other things, the creation of 1,000 full time jobs and that Verticalnet would operate in its former facility in Horsham, PA for at least five years. In July 2000, Atlas Commerce, Inc. (Atlas Commerce) entered into an Opportunity Grant Program Contract with the PaDCED whereby Atlas Commerce received a grant in the amount of $400,000 from the Commonwealth, which amount was increased to $600,000 in June 2001. The grant was conditioned upon, among other things, the creation of 250 full time jobs and that Atlas Commerce would operate in its Malvern facility for at least five years. Both

contracts contained a provision that required repayment of the grant amount in the event the conditions were not met. In December 2001, Verticalnet acquired Atlas Commerce via a merger. In September 2003, the PaDCED filed a Complaint-Civil Action in the Montgomery County Court of Common Pleas seeking to recover the total amount of the grant to Verticalnet. On January 27, 2005, Verticalnet and Atlas Commerce entered into a Settlement and Release Agreement (the Settlement Agreement) with the PaDCED, resolving (i) the above civil action between the PaDCED and Verticalnet, and (ii) the PaDCED s claims against Atlas Commerce. Pursuant to the Settlement Agreement, Verticalnet agreed to pay the PaDCED an aggregate of $400,000, payable in four equal quarterly installments in full and complete satisfaction of the PaDCED s claims against Verticalnet and Atlas Commerce. The first payment of $100,000 was made on January 27, 2005, the second payment of $100,000 was made on April 1, 2005, the third payment was made on July 1, 2005 and the final payment of $100,000 is due on October 1, 2005.

The Company currently has employment agreements with certain senior executives that provide for a minimum level of salaries in 2005, and automatically renew each year unless either party gives at least one-year advance notice of non-renewal. 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.

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(8) 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 and scheduled a final fairness hearing on the settlement for January 2006.

On September 30, 2004, the Company was served with a 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. v. Vertical Net Inc., et al., C.A. No. 04-4455. The complaint alleges that, with regards to the issuance of the Company s stock to the plaintiffs in connection with the Company s acquisition of Tradeum, Inc. in March 2000, the plaintiffs were damaged by the defendants delays in registering stock, updating the registration of stock, releasing stock from lock-ups and releasing stock from escrows. The plaintiffs claim they sustained damages in excess of $65.0 million as a result of the decrease in the stock price during the alleged delays. The Company disputes the allegations raised in the complaint and intends to vigorously defend itself. The Company and the other defendants have filed a motion to dismiss the complaint, but as of August 15, 2005, the Court had not yet ruled on the motion.

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.

(9) Capital Stock

In January 2004, we completed a $7.7 million private placement of our common stock. The Company issued 3,798,592 shares of common stock along with warrants to purchase 949,649 shares of common stock at an exercise price of $3.72 per share. The Company received approximately $7.0 million in net proceeds from this transaction.

(10) Restructuring Charges

During the three months ended June 30, 2005, we recorded restructuring charges in connection with strategic and organizational initiatives designed to realign business operations, eliminate acquisition related redundancies, and reduce costs. The Company expects to pay these employee severance and related benefits restructuring accruals over the remainder of 2005.

The following tables provide a summary by category and a roll-forward of the changes in the restructuring accrual for the six months ended June 30, 2005 (in thousands):

	Accrual at January 1, 2005	Accrual	Cash payments	Accrual at June 30, 2005
Employee severance and related benefits	$	$ 324	$ (177)	$ 147

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(11) Subsequent Events

On July 22, 2005, Verticalnet acquired Digital Union, a privately-held provider of on-demand sourcing and procurement solutions based in Guildford, Surrey, United Kingdom. The aggregate purchase price of the Digital Union acquisition was $3.4 million, including transaction costs of approximately $450,000, which primarily consisted of fees paid for professional services. The consideration included the issuance of 4,458,690 shares of common stock, valued on the date of closing at approximately $3.0 million. The value of the Verticalnet stock issued to the Digital Union shareholders was based upon the average closing price of the Company s common stock over a three day period that included the two days prior and the day the merger agreement was signed, which was $0.67 per share. In addition, the terms of the acquisition also include a provision that enables Digital Union s shareholders to receive up to an additional 3,500,000 Verticalnet shares based upon the achievement of revenue milestones within the first year after the closing of the transaction.

The Company has engaged a third party valuation firm to value the intangibles acquired in the Digital Union acquisition. That firm has not yet completed its valuation work. In addition, the historical financial statements of Digital Union are not yet available. Therefore, we have not provided any information concerning the purchase price allocation or pro forma results of operations.

The shares of common stock issued in the Digital Union transaction have not been registered under the Securities Act of 1933 and may not be subsequently offered or sold by the Digital Union shareholders absent registration or an applicable exemption from the registration requirements. Verticalnet has agreed to file a registration statement covering the resale of the securities issued in this transaction.

On August 16, 2005, the Company issued senior secured convertible promissory notes (the Notes) in the principal amount of $6.6 million to various independent institutional investors (the Investors). The Notes are convertible into shares of Verticalnet s common stock, at the option of the Investors, at a fixed conversion price of $0.70 per share (the Conversion Price), subject to adjustment upon certain conditions, including if the Company issues stock at a price below $0.70 per share. The Company also issued to the Investors warrants to purchase an aggregate of 4,719,000 shares of Verticalnet common stock at an exercise price of $0.77 per share, subject to adjustment upon certain conditions, including if the Company issues stock at a price below $0.77 per share. The warrants are exercisable after six months from the closing date of the Notes for a period of five years from the closing date. The term of the warrants can be extended by the Investors 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, the failure of the registration statement covering the resale of the shares to be declared effective within a certain time period after closing and if the Investors are not permitted to use the prospectus included in the registration statement for the resale of the shares. The Company also issued the placement agent for the transaction a warrant to purchase 141,429 shares of common stock having the same terms and conditions as the warrants issued to the Investors.

The 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 will commence 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. 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 Notes. The conversion price used for payments of principal and interest in shares of common stock will be $0.70 per share if the price of the Company s stock exceeds certain trading price thresholds, or 85% of the five day volume weighted average price of the Company s stock if the trading price thresholds are not exceeded. Upon the occurrence of certain events as set forth in the Notes, the Investors may require the Company to prepay the Notes at 110% of the remaining principal amount of the Notes.

The Company has agreed that it will file a registration statement on Form S-3 (the Registration Statement) within 30 days after the closing to enable the resale of the common stock underlying the Notes and Warrants. The Company has also agreed that if the Investors are unable to use the Registration Statement because, among other reasons, the Registration Statement has not been timely filed or the Registration Statement has not been declared effective by the effectiveness date, as defined in the related agreement, then the Company will pay the Investors an amount equal to one and one half percent (1.5%) of the original principal amount of the Notes, in cash, for every thirty day period that the Registration Statement cannot be used.

The Company has agreed with the Investors (i) that it will maintain at least $1.5 million in its bank accounts while the Notes are outstanding; (ii) that it will not undertake a subsequent financing for a period of sixty days after the Registration Statement is declared effective; (iii) that at the Company s next annual meeting of its shareholders, the Company will solicit the approval of the Company s shareholders to approve the issuance of shares of common stock upon conversion of the Notes in excess of 19.99% of the number of shares outstanding immediately prior to the closing date; (iv) that they will have rights of first refusal on future financings within fourteen months after the effective date of the Registration Statement; and (v) that it will be restricted from issuing certain types of debt and equity instruments while the Notes are outstanding.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

Our forward-looking statements are not meant to predict future events or circumstances 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 SmallCap Market; competition in our target markets; economic conditions in general and in our specific target markets; our ability to use and protect our intellectual property; and our ability to attract and retain qualified personnel, as well as the risks discussed in the section of this report entitled Factors Affecting Our Business Condition. Given these uncertainties, investors are cautioned not to place undue reliance on our forward-looking statements. We disclaim any obligation to update these factors or to announce publicly the results of any revisions to any of the forward-looking statements contained in this report to reflect future events or developments.

Company Overview

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

Verticalnet s software customers license our software via a perpetual license or 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 and application service provider (ASP) hosting, Verticalnet offers the majority of its software products in an On-Demand delivery model. On-Demand delivery enables our customers to pay a single annual fee that includes software license, maintenance, application hosting, customer/community support, and training. 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 Advanced 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.

Historically, we derived our revenue primarily from the licensing of our software, as well as implementation and development services. As a result of the January 2004 acquisition of Tigris Corp (Tigris), we also generate revenues from spend analysis and other supply chain consulting services and as a result of the July 2004 acquisition of B2eMarkets, Inc. (B2eMarkets), we have seen an increase in the amount of our revenue coming from the licensing of our products and maintenance. In July 2005, we acquired Digital Union Limited (Digital Union), and we expect to see a continued increase in the proportion of our revenues from software and software related revenues.

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Recent Developments

Financing

On August 16, 2005, the Company issued senior secured convertible promissory notes (the Notes) in the principal amount of $6.6 million to various independent institutional investors (the Investors). The Notes are convertible into shares of Verticalnet s common stock, at the option of the Investors, at a fixed conversion price of $0.70 per share (the Conversion Price), subject to adjustment upon certain conditions, including if the Company issues stock at a price below $0.70 per share. The Company also issued to the Investors warrants to purchase an aggregate of 4,719,000 shares of Verticalnet common stock at an exercise price of $0.77 per share, subject to adjustment upon certain conditions, including if the Company issues stock at a price below $0.77 per share. The warrants are exercisable after six months from the closing date of the Notes for a period of five years from the closing date. The term of the warrants can be extended by the Investors 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, the failure of the registration statement covering the resale of the shares to be declared effective within a certain time period after closing and if the Investors are not permitted to use the prospectus included in the registration statement for the resale of the shares. The Company also issued the placement agent for the transaction a warrant to purchase 141,429 shares of common stock having the same terms and conditions as the warrants issued to the Investors.

The 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 will commence 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. 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 Notes. The conversion price used for payments of principal and interest in shares of common stock will be $0.70 per share if the price of the Company s stock exceeds certain trading price thresholds, or 85% of the five day volume weighted average price of the Company s stock if the trading price thresholds are not exceeded. Upon the occurrence of certain events as set forth in the Notes, the Investors may require the Company to prepay the Notes at 110% of the remaining principal amount of the Notes. The Company has agreed that it will maintain at least $1.5 million in its bank accounts while the Notes are outstanding. The Company has also agreed to file a registration statement covering the resale of the shares of common stock underlying the Notes and Warrants issued in this transaction. (See Note 11 to the consolidated financial statements).

Digital Union Limited Acquisition

On July 22, 2005, Verticalnet acquired Digital Union, a privately-held provider of on-demand sourcing and procurement solutions based in Guildford, Surrey, United Kingdom. The aggregate purchase price of the Digital Union acquisition was $3.4 million, including transaction costs of approximately $450,000, which primarily consisted of fees paid for professional services. The consideration included the issuance of 4,458,690 shares of common stock, valued on the date of closing at approximately $3.0 million. The value of the Verticalnet stock issued to the Digital Union shareholders was based upon the average closing price of the Company s common stock over a three day period that included the two days prior and the day the merger agreement was signed, which was $0.67 per share. In addition, the terms of the acquisition also include a provision that enables Digital Union s shareholders to receive up to an additional 3,500,000 Verticalnet shares based upon the achievement of revenue milestones within the first year after the closing of the transaction.

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RESULTS OF CONTINUING OPERATIONS FOR THE THREE AND SIX MONTHS ENDED

JUNE 30, 2005 AND 2004

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

	Three months ended June 30,		Six months ended June 30,	
	2005	**2004**	**2005**	**2004**
Revenues:				
Software and software related	31.7%	8.6%	30.2%	10.0%
Services	68.3%	91.4%	69.8%	90.0%
Total revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues:				
Cost of software and software related	15.0%	4.2%	14.1%	4.8%
Cost of services	35.6%	36.9%	36.3%	35.7%
Amortization of acquired technology and customer contracts	4.8%	5.0%	4.6%	5.9%
Total cost of revenues	55.3%	46.1%	55.0%	46.3%
Gross profit	44.7%	53.9%	45.0%	53.7%
Operating expenses:				
Research and development	34.4%	19.1%	33.4%	22.1%
Sales and marketing	39.8%	22.3%	37.4%	22.8%
General and administrative	26.0%	20.5%	27.4%	25.6%
Restructuring charges	6.4%		3.1%	
Stock-based compensation	3.9%	6.9%	4.0%	8.3%
Amortization of other intangible assets	6.0%	3.8%	6.1%	3.4%