

## VERTICALNET (NASDAQ: VERT)

Initiating Coverage: ACCUMULATE

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## KEY CONSIDERATIONS

- VerticalNet Inc.(the company) maintains a solid position as the leading provider of a conglomerate of vertical trade communities.
- While the company currently generates substantially all of its revenue from the Internet advertising including the development of "storefronts"(Web pages that focus on advertisers' products and provide a link to the advertisers' web sites), electronic commerce will make up a substantial portion of future revenues.
- Content distribution alliances with Excite, Altavista and e-commerce alliances with Junglee Corp. and Onsale Inc. are the part of company's overall strategy to increase the number of users to visit vertical trade communities and develop e-commerce activity.
- The company's aggressive acquisition policy has increased the revenue base and has resulted in quick expansion.
- Presently, high growth of revenue achieved due to increase in advertisers is offset by increase in sales and marketing costs. Because of aggressive expansion plans the company may incur significant operating losses for next few years.

Recent Price (8/25/99)	\$35.80
52WK High	\$74.50
52WK Low	\$17.38
P/E	N/A
P/Book (MRQ)	22.58
P/Sales	76.93
Market Capitalization	\$1213 million
Shares Outstanding	33.90 million
Float	7.00 million
Daily Volume (3-month Average)	0.82 million

## EPS

1997	-0.95
1998	-2.64
1Q1999	-0.276
2Q1999	-0.20
Trailing 12 months	-2.125
1999E	-0.84
2000E	-0.93

## COMPANY PROFILE

VerticalNet Inc. was formed in 1995 and is the Internet's leading owner and operator of industry specific web sites designed as online business-to-business communities, known as vertical trade communities. These vertical trade communities act as comprehensive sources of information, interaction and electronic commerce - the buying and selling of goods over the Internet. Each of the communities, individually branded by industry, focuses on one business sector at a time and caters to individuals with similar professional interests. These vertical trade communities offer product information, directories, requests for proposals, classifieds, discussion forums, job listings, electronic commerce opportunities, online professional education courses, and industry news. VerticalNet currently operates 46 vertical trade communities in ten industrial sectors. The company has its headquarters in Horsham, Pennsylvania. VerticalNet Inc.'s Web site can be reached at [www.verticalnet.com](http://www.verticalnet.com).

## ONE YEAR PRICE AND VOLUME GRAPH



Courtesy of Big Charts

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## THE ONLINE BUSINESS TO BUSINESS MARKET

The Internet has emerged as a mass communication and commerce medium enabling millions of people worldwide to share information, create community among individuals with similar interests and conduct business electronically. Internet users are likely to grow to 320 million in 2002 from 100 million in 1998. The vertical trade communities take advantage of Internet's ability to allow users around the world to contact each other online, allowing buyers to research source, contact and purchase from suppliers. Along with the impressive growth of the Internet, business-to-business usage is also growing rapidly. Businesses are increasingly leveraging the Internet's ability to reach customers globally, deliver personalized content and open new distribution centers.

Internet advertising and electronic commerce are projected to experience significant growth in the future.

- Business-to-Business share of e-commerce should increase from 53% in 1997 to over 75% by 2002 according to Forrester Research.
- Internet advertising is projected to grow to 7.7 billion in 2002 from 1.9 billion in 1998 according to Jupiter communications.
- Business-to-business Internet advertising is projected to grow to 2.6 billion in 2002 from 290 million in 1998.
- Business-to-business e-commerce is projected to grow to 52.6 billion in 2002 from 8.7 billion in 1998 and
- Online business auctions are projected to grow from 8.7 billion in 1998 up to 52.6 billion in 2002 according to Forrester Research.

Traditional media for business-to-business includes trade magazines, trade shows, buyers' guide, direct mail catalogue and such other forms. But due to their limitations such as limited circulation of trade magazines, expensive and infrequent trade shows, and cumbersome search through buyers' guide and variety of such other reasons electronic commerce is gaining fast popularity. The Internet, through vertical trade communities, provides a new and more efficient medium to meet specific needs of business and professionals.

## BUSINESS MODEL

The company aims to move traditional "off-line" services to the Internet. The vertical trade communities target separate industrial sectors to provide businesses and professionals with high quality content, community and commerce that include the following:

- Comprehensive content, services and features: The editors of vertical trade communities provide valuable information on products, technology, industry regulations, news and management. They archive historical content, enabling users to research through large databases of information. They also operate requests for proposals and related posting and response areas.
- Active community participation: The communities provide features such as Ask the expert, discussion forums, chat rooms, bulletin boards and career centers, all of which foster active participation among the users.
- Targeted cost-effective medium for business-to-business advertising: The narrow focus of communities may permit the company to command premium advertising rates.
- High quality sales leads: The communities generate high quality sales leads that are timely and effective and contain detailed buyer information. Robust sales leads left by buyers allow sellers to respond more effectively.
- Connects buyers and sellers globally: Vertical trade communities provide an online market place that allows buyers and sellers worldwide to exchange information, source products and execute online transactions.

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The following is an overview of the trade communities of the company:

**Advanced Technologies**

- Aerospace Online, Computer OEM Online, Embedded Technology.com , Medical Design Online, Plant Automation.com, Test and Measurement.com

**Communications**

- Digital Broadcasting.com, Fiber Optics Online, Photonics Online, Premises Networks, RF Globalnet, Wireless Design Online

**Environmental**

- Pollution Online, Power Online, Public Works.com, Pulp and Paper Online, Safety Online, Solid Waste Online, Water Online

**Food & Packaging**

- Bakery Online, Beverage Online, Dairy Network, Food Online, Food Ingredients Online, Meat and Poultry Online, Packaging Network

**Food Service/Hospitality**

- Food Service Central

**Healthcare Industries**

- E-Dental.com, Hospital Network, Nurses.com

**Manufacturing Technologies**

- Machine Tools Online, Tooling Online, Metrology World Online (Coming Soon)

**Process**

- Adhesives and Sealants.com, Chemical Online, Hydrocarbon Online, Oil and Gas Online, Paint and Coatings Online, Pharmaceutical Online, Semiconductor Online

**Service**

- HR Hub, Property and Casualty.com

**Science**

- Bioresearch Online, Drug Discovery Online, Laboratory Network

The acquisition of labX.com, the Internet's e-commerce leader in scientific laboratory equipment, on July 30,1999 will make the company's science industries sector expand its base. The recent acquisition on August 11, 1999 of e-commerce technical leader CertiSource Inc., a leading online reseller of professional training products, classes and services, will enable the company to create a new vertical community for human resource professionals.

**Features of Vertical trade communities:**

- Marketplace: Shopping resource containing books, software and video products.
- Online buyers' guide and search engine: Comprehensive buyers' guide fully searchable by product name and supplier. In response to a keyword search, companies serving the industry are listed with storefront, advertisers presented first. Links to company storefronts allow users to research advertisers about pricing, delivery and product specifications.
- News and analysis: Includes feature articles and product case studies, daily updates and press releases and news stories targeted to each respective industry.
- Product Center: Comprehensive resource for industry professionals with information of latest products in industry. Site editors act as third parties with objective analysis of products and their uses.
- Community: Site and interactive features, real time discussion forums for industry professionals, bulletins boards, trade show information and other useful industry events.
- Resources: "Freeware" and demo software download library and industry association guides.
- Career center: Resume posting for job seekers, help wanted listings and career support material.
- Requests for proposals, quotations and bids: Internationally posted projects open to bid.

We expect the company to expand its electronic commerce to include selling goods and services promoted on its advertisers' storefronts and from its own virtual store.

Thus, the company currently generates substantially all of its revenue from Internet advertising including the development of storefronts. The time of storefront advertising is generally one year and that of banner

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advertising is three months. The company also generates its revenue from career services, auctions, education and electronic commerce, specifically the sale of books and third party software. The company offers sale of books, software and goods offered by third party web sites. It offers auction sites with goods posted by inventory liquidators. The company should significantly improve its revenue generation capacity by selling goods from its own storefronts and from advertisers storefronts.

**Features of advertisers' storefronts:**

- Corporate profile provides advertiser's background and overview of its products and services.
- Contact us: Further information can be requested via e-mail. These requests are regarded as sales leads by advertisers.
- Career center: Advertisers list open job opportunities.
- Purchase online of advertisers goods.
- Associated articles: Feature articles, case studies and other informational material about the advertiser.
- New product releases.
- For more: Provides gateway into advertisers' web site.

These features, along with wide coverage in each industrial sector and continuous desire to grow by adding more communities and operate efficiently places the company in a leading position in a marketplace self-created and self-visualized. This broad base naturally reduces the business risk associated with concentration of business in one industrial sector.

## **BUSINESS STRATEGY**

- **Exploiting First Mover Status.** The company has achieved the status of First Mover by visualizing and creating a conglomerate of vertical trade communities. Not only this, it has its sense of urgency to exploit the status of First Mover. The long established media companies that serve industrial markets with news and information, trade shows and marketing environment have been slow to adopt to the Internet. At the same time the Internet is open to new relationships, where old media brands have limited advantage. VerticalNet has clearly seized this opportunity to acquire new media leadership. It has redefined how businesses transact and interact with each other using e-commerce. The Company is pursuing a long-term growth strategy and sacrificing profitability in the short term for the sake of dominance in the long-term by aggressively expanding its presence in the rapidly growing Internet.
- **Customer Focus.** By providing businesses and professionals with high quality contents, active community participation, targeted cost-effective medium for business-to-business advertising, generating high quality sales leads and a global online marketplace, the company has successfully created a premier marketplace for electronic commerce.
- **Brand Name.** The company still needs to still focus on brand name because it is relatively new. In order to be successful it needs to establish and strengthen its brand awareness as well as those of each individual vertical trade community. If this is not done timely then it could adversely affect the business in the near future as the competition increases.
- **Alliances and Acquisitions.** As we discuss later in this report, the company is planning to grow from the current network of 46 vertical trade communities to a network with more than 100 communities by the end of 2000. The new communities and the contents and services of all the communities will be enriched and expanded through strategic alliances with and acquisitions of existing companies.

## **TECHNOLOGY**

The company has developed and implemented a variety of technologies for its site management, search, customer interaction and transaction processing systems. Applications have been developed that allow advertisers to track the success rate of advertising campaigns. An application using the Microsoft Site Server

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Suite of development tools allows the clients to sell products over the Internet. The company has developed its own site management tools to facilitate the continuous maintenance and updating of vertical trade communities.

- **Scalability:** The scalable structure of the hardware and software is designed to allow rapid deployment of multiple trade communities while maintaining desired user performance standards. The system's template technology and generic database allow for addition, modification or replacement of web site based applications in a cost-efficient and expeditious manner.
- **Security.** A major reason for the average consumer's reticence to purchase on the Internet is security. VerticalNet uses the Checkpoint's Firewall-1 software to protect its web servers. It uses Netscape software as its Web server. Exodus and Icon provide monitoring and support 24 hours a day, seven days a week supplementing systems administrators. The production machines are located at Exodus Communications Inc. and Icon CMT Corp. which provide data center hosting facilities and redundant high-speed hosting facilities.
- **Systems Integration.** Agreement with webMethods, the leading provider XML-based solutions for business-to-business e-commerce and integration, enables VerticalNet to use its XML based products to provide buyers and sellers with bi-directional integration between ERP systems, databases, legacy applications and the web. This facilitates end-to-end integration within vertical trading networks. Customers can automate business transactions such as procurement of online catalogs, order fulfillment and processing with less business latency than traditional methods used to manage supply chain relationships.

Several other agreements are entered to maintain technology leadership that presents the visitors with an experience of convenience, value and easy to use.

## STRENGTH OF MANAGEMENT AND STAFF

- **High Quality Staff:** The company is able to generate heavy traffic because of its good editors. The editorial product draws people in again and again. The company has successfully positioned itself as a timely destination for viewing specific industry information and live forums. To achieve this, it has hired people from the print world and trade magazines such as Chemical Equipment, Laser Focus World, Medical Design News and Water World. The key to VerticalNet success is its ability to retain highly qualified editorial, technical and sales personnel.
- **Management:** VerticalNet has assembled a management team with complementary skills and experience in Internet services, editorial technology and business development. With a clear mission to be the online community and e-commerce leader for global vertical industries the company has successfully demonstrated a well managed high growth rate. We expect the company to demonstrate similar growth in future also.

## INDUSTRY AND COMPETITION

Professors M. Sawhney and S. Kaplan [Business 2.0, Sept. 1999] state that the B-to-B e-commerce hubs (i.e. communities) are very different from the business-to-consumer e-commerce businesses. The most important and perhaps the least understood difference between consumer commerce ventures and B-to-B hubs are the *returns to scale*. Consumer hubs, even as expansive as Buy.com's, are one-way networks that deal directly with buyers and create benefits mostly to sellers. B-to-B commerce hubs tend to be two-way networks that mediate between buyers and sellers, and create benefits for both sides. Lots of benefits: The value created by consumer hubs tend to increase *linearly* with the number of buyers; the value created by B-to-B hubs increases as the *square* of the number of participants.

Furthermore, domain of expertise is important. Setting up shop as an online retailer does not require deep knowledge of specific categories. For instance, the founders of Amazon.com had no previous experience and quite easily migrated across retail categories. In contrast, the founders of vertical hubs such as SciQuest and PlasticNet.com had extensive industry experience and relationships with key buyers and suppliers.

In addition, B-to-B buyers and sellers don't simply see banner advertisement and sign up with vertical hubs like SciQuest.com or PlasticsNet.com. Customer acquisition requires sales calls, and the process of signing up buyers and sellers is time-consuming and expensive. Customer switching costs and customer retention rates are therefore correspondingly higher for vertical hubs, once they embed themselves into the business processes of buyers and sellers. For them, competition is a lot further away than a mouse click.

There are several vertical hubs (communities) that serve one particular market or industry focus. They provide deep domain-specific content and domain-specific relationships. Examples: Altra Energy (energy), Band-X (telecommunications), Cattle Offerings Worldwide (beef and dairy), SciQuest.com (life sciences), e-Steel (steel), Floraplex (florists), IMX Exchange (mortgages), PaperExchange (paper), PlasticNet.com (plastics), and Ultrarise (secondary mortgage exchange). Vertical hubs typically start out by automating and hosting the procurement process, and then supplement their offerings with industry-specific content. The likely success of a vertical hub increases with:

- Greater fragmentation among buyers and sellers.
- Greater inefficiency in the existing supply chain.
- Creating critical mass of key suppliers and buyers.
- Domain knowledge and industry relationships.
- Creating master catalogs and sophisticated searching.
- Adjacent verticals for leveraging existing supplier or buyer base.

Therefore, the primary challenge for vertical hubs is the difficulty of diversifying and extending their business into other vertical markets, because their expertise and relationships are fairly domain-specific. We believe, however, that if VerticalNet is successful in using its brand and First Mover advantages to expand through acquisitions of and alliances with specialized vertical hubs, it has the potential to become a very strong leader in the sector of diverse vertical communities. VerticalNet has tremendous growth opportunities due to its First Mover advantage in this sector that is characterized with high returns to scale and high customer switching and retention costs, as discussed above. This should off balance the challenge it faces in expanding to other vertical markets and in increasing its e-commerce.

VerticalNet is well positioned in the sense that it has established itself as a First Mover in the industrial market to provide with online news and information, trade shows and marketing environments which was, till now served by traditional media companies such as McGraw Hill and Reed Elsevier and directory registry companies such as Thomas register. It is the only conglomerate of online business-to-business communities/hubs. As the Company expands its product lines, it faces competition from specialized hubs, traditional trade publishers, directory registry companies, Internet search engine companies, trade associations and electronic commerce technology suppliers. The following are some other notable present and potential players:

<b>Table 1</b>		<b>COMPETITORS</b>		
		<b>8/19/99</b>		
<b>Advertisement</b>	<b>E-Services</b>	<b>Traditional</b>	<b>Information</b>	<b>Auction Services</b>
Double Click	Earthweb	McGraw Hills	Careerbulider	EBay
CMGI	E*Trade Group	Reed Elsevier	Onhealth Network	Onsale
Infospace	News Edge	Thomas Register	Mapquest	Ubid
MediaMetrix	Dr.Koop		SportslineUSA	Yahoo! Auctions

Although VerticalNet still maintains a dominant position there are possibilities that increasing competition and a volatile and revolutionary Internet industry could change the Company's leading position. However, the company's aggressive strategy of growth and diversification of revenues will certainly help it to maintain its lead in the industry.

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## ANALYSIS OF RISK FACTORS

- Current revenues are mainly derived from advertising on vertical trade communities. Competition for advertising is immense. Factors such as advertiser's acceptance of the Internet as a legitimate medium for advertisement, demographic features attractive to advertisers on vertical trade communities with large customer base, expansion of sales force may affect advertisement revenues. In the future advertising rates may be based on the parameters such as number of sales inquiries generated or visitors send from the company's web sites to advertisers web sites instead of present factors such as the maturity of a particular vertical trade community, the number of storefronts and the length of advertising contract. All these factors could materially affect the company's revenue.
- In the future the revenue base should be broadened and we believe that in the long term, revenues from electronic commerce should grow. Presently, the company is generating only 5% of the total revenue from e-commerce. The company needs to generate more revenues from e-commerce and business services in the future. But due to factors such as buyers' unwillingness to shift from traditional vendors to online vendors, adverse publicity and consumer concern about the security of electronic commerce, etc. may cause a slow adoption of the Internet for electronic commerce. This may greatly reduce the revenue growth of the company.
- One potential threat is from enterprise resource planning companies such as SAP and Peoplesoft (PSFT) which provide software solutions enabling business to bypass VerticalNet's services. Another pitfall may be that once a relationship between businesses is cemented (even ones started on a Verticalnet's site), the need for the middleman may go away if the companies decide to execute future deals directly.
- Although presently the company has no chief competitor and there are no companies with a larger portfolio than VerticalNet, several companies offer competitive trade communities. In the future, the competition is likely to be intense as barriers to entry are minimal and the competitors can develop Internet product or services that are better than VerticalNet. If the competition is from the companies having better brand recognition than VerticalNet, such as Yahoo, Amazon.com, then the revenues may be significantly affected.

## RECENT AGREEMENTS AND ACQUISITIONS

**Excite agreement:** A three year renewal sponsorship agreement with Excite, a leading Internet navigational service provider, to build and operate an industrial channel on Excite service for all the trade communities. These channels are highlighted summaries of much of the content and features of the home page of vertical trade communities and provide a preview of the services and content on each vertical trade community. For an annual fee of \$1.3 million in 1999, \$2.3 million in 2000 and \$2 million in 2001 Excite will deliver minimum performance level of exposures in each year.

**Alta Vista agreement:** A one year renewable agreement with Alta Vista, a leading search engine company, to develop co-branded web sites, the revenue to be shared between both. For a fee of \$1 million it has guaranteed a minimum level of visits to VerticalNet's web sites.

**Motorola agreement;** The company is to provide Motorola with intranet-based educational services to Motorola's engineers. The contract requires Motorola to purchase predefined minimum education services.

**First USA's Corporate Purchasing Services Business Group:** A multi-year and multi-million dollar deal with First USA bank will make the company the exclusive provider of card based corporate purchasing services across all VerticalNet communities. Future e-commerce purchasing opportunities within VerticalNet storefronts are also planned. This agreement is likely to consolidate the company's position in e-commerce.

**Agreement with Order Trust:** VerticalNet has selected Order Trust, a provider of integrated order management services for e-commerce to deliver back-end order management services for its e-commerce marketplace. This will enable VerticalNet to focus on growing its online communities, expanding its products and

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services and driving traffic to its marketplace, while Order Trust will handle the operational complexity in routing orders to third party recipients.

**Agreement with Aeneid:** Aeneid Corporation, an Internet Information Exchange company, agreed to jointly develop Aeneid Eocenters to be deployed across VerticalNet online communities, enhancing the value to information providers who conduct commerce on VerticalNet sites, and rapidly expanding the adoption of Aeneid Eocenters in vertical portal markets. Aeneid develops and manages the Aeneid Eocenter service which enables vertical portals to become professional destination sites by building traffic, improving site loyalty and increasing revenues through new commerce opportunities. Aeneid Eocenters, built on mature content and aggregation and commerce technology, are complete Internet research environments for vertical portals that want to become the preferred destinations for business professionals.

**Agreement with Powerize.com:** Powerize.com, a leading Internet aggregator and distributor of business and financial information, and VerticalNet agreed to promote access to the formers' large aggregation of premium and financial content within the latter's communities. Powerize.com was provided exclusive sponsorship of the Business Information category in the Business Services Center on all of the VerticalNet trading community web sites. The company expects to enhance its ability to bring global business-to-business buyers and suppliers together through the comprehensive business and financial content that Powerize.com provides.

**Agreement with Metropolis Transactive Holdings:** The first International agreement with this South African company will extend VerticalNet's global reach in the emerging business-to-business e-commerce by allowing Metropolis to use its platform to develop industrial communities throughout Africa. Under the terms of the multi-million dollar agreement, which will initially span three years, Metropolis will create vertical trade communities in Africa and offer "storefronts" to African-based companies within these communities. Both companies will have links connecting their communities to foster information exchange and e-commerce. VerticalNet will be compensated through up-front set-up fees paid by Metropolis as well as through shared e-commerce and advertising revenue streams.

**Agreement with webMethods:** Agreement with webMethods, the leading provider of XML-based solutions for business-to-business e-commerce and integration, will enable VerticalNet to use its XML based products to provide buyers and sellers with bi-directional integration between ERP systems, databases, legacy applications and the web. It will facilitate end-to-end integration within vertical trading networks. Customers could then automate business transactions such as procurement of online catalogs, order fulfillment and processing, with less business latency than traditional methods used to manage supply chain relationships.

**Agreement with Universal Process Equipment:** This agreement was reached to create an online marketplace for the sale of high-end process equipment and plants. VerticalNet will market a wide range of used and surplus high-end processing equipment supplied by UPE and its 13 group companies, as well as to employ advanced auction, e-commerce and customer service technologies to facilitate sales.



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All these marketing, distribution and technological alliances, along with other agreements such as with Visio, Deja News, AichE, Yahoo, Lycos, MetaCrawler and several other such agreements are likely to give a boost to revenue earning capacity of the company in near future.

With recent acquisitions of companies such as R F Globalnet, Boulder Interactive Technology Services Company(BITC), Informatrix Worldwide Inc. Coastal Video Communications' web site called Safety Online, Isadara, Oillink web site, ElectricNet web site, Techspex Inc. LabX, Certisource Inc. the company has demonstrated its aggressive expansion strategy of acquiring running businesses. This has widened its operational horizons as well. All these alliances and acquisitions place the company in a unique dominating position where it may be hard for the competitors to develop such broad base as VerticalNet. We expect to see more alliances and acquisitions from the company for a few more years as it plans to have more than 100 vertical trade communities by the end of 2000 from the present network of 46 as on August 19,1999.

## EXPLANATION OF FINANCIALS

**Revenues.** The company derives its revenue mainly from Internet advertising including development of storefronts. The advertising contracts do not extend beyond a year. The company increased its number of storefronts from 833 as of June 30,1998, up to 2094 as of June 30,1999 and the number of vertical trade communities from 17 as of June 30,1998, up to 43 as of June 30,1999. As a result revenues grew from \$965,000 for six months ended June 30,1998 up to \$5.5 million for the six months ended June 30,1999. During the last quarter the company continued to diversify its revenue streams, which originate from sponsorships, e-commerce, career services, auctions and applications. During the last quarter, storefront revenues accounted for 40% as compared to 50% in the previous quarter. Sponsorship revenues represented 55% of total revenue compared to 47% in the previous quarter. The company witnessed an increase in traffic in e-commerce activity with unique visits reaching 4.0 million in the quarter ended June 30, 1999, up 38% from 2.9 million in the previous quarter. Approximately 40 % of the visitors are international. It is a welcome sign of revenues coming from different sources. As the company plans to add more communities we expect the revenues to maintain high growth rate. We expect increases in revenue from e-commerce and auction activities also.

**Profitability:** The company is concentrating heavily on growth and as a result one should not expect short term profitability. Profit should not be, right now, considered to be a major factor. Due to its expansionist strategy the company has to forego short term profits for attaining long term success.

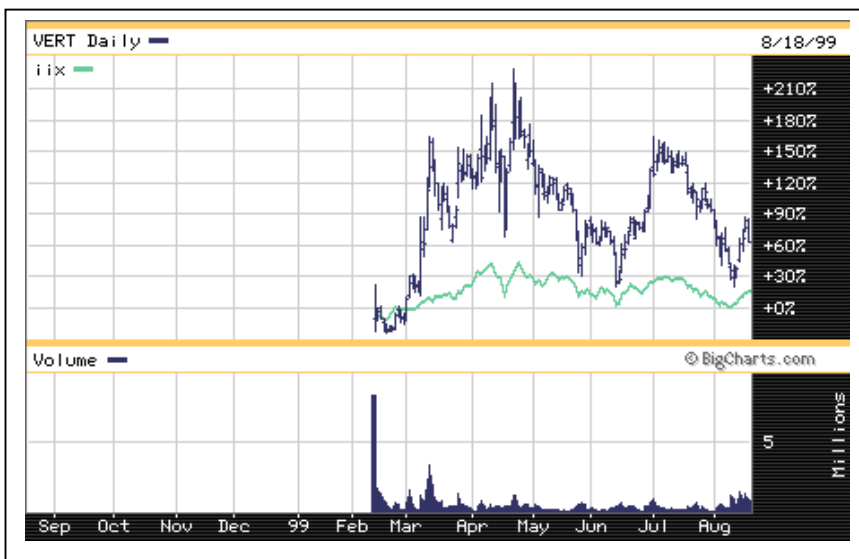
**Operating Expenses.** Operating expenses represent a large portion of VerticalNet's cash outflows as the company spends heavily on acquiring equipment and personnel to maintain, operate and upgrade the increased number of trade communities. Their increase can also be attributed to the enhancement of features, content and services of vertical trade communities. Sales and marketing expenses are likely to increase due to increase in the number of sales personnel, commissions and promotion of vertical trade communities. We believe that these expenses will increase significantly as the company pursues an aggressive growth strategy.

**Cash Flows.** The cash flows from operational activities of VerticalNet has remained negative and we expect that it will be negative in the future because of the increase in operational expenses associated with adding new communities and new storefronts. But as soon as the growth rate is stabilized we can expect positive cash flows. The company had negative cash flow of \$ 3.3 million for the six months ended June 30,1998, which has decreased up to negative \$10.6 million for six months ended June 30,1999. This gap is covered by cash and highly liquid, high-quality debt instruments, which are readily available for operating purposes. On February 17,1999, the company received a net \$58.3 million from IPO of 4,025,000 common stock. As of June 30, 1999 the company had cash and cash equivalents and investments in marketable debt securities totaling \$47.1 million compared to \$5.7 million on Dec 31,1998. We expect that the company will maintain sufficient cash on hand to fund its future acquisitions and meet the operational expenses.

**Interest:** Interest income, net of interest expense increased from \$ (61,643) for six months ended June 1998 to \$86,2379 for six months ended June 1999. It was mainly due to higher investment balance resulting from Initial Public Offering of the company's stock. Currently, the company has the majority of its cash balance in debt instruments of US government and its agencies and high quality corporate issuers.

## Valuation

**Internet Sector.** The Internet sector has been highly volatile relative to the rest of the stock market. The recent movements in the industry can be traced to the high expectations by investors of the future prospects of the Internet and news releases relating to mergers within the industry. A comparison to the Amex Internet Index shows that the stock of VerticalNet has outperformed it. But it also exhibits tremendous volatility. The initial volatility can be attributed to the IPO in February of this year. The rest can be traced to fluctuations in the quarterly results and investors unwillingness to delay earnings for brand and infrastructure development in the Internet Sector.



**Revenue Growth.** Although the revenues have demonstrated heavy fluctuations, they have increased by at least 50% over several quarters.

The revenue has grown from \$96,500 for first six months ended June 30, 1998, up to \$ 5.50 million for six months ended June 30, 1999. We expect a modest revenue growth rate of about 232% for this year and 75% for the next year. This growth is reasonable as the company plans to increase its vertical trade communities up to 50 by the end of this year and to more than 100 by the end of year 2000. Some of the increase in revenue will come from the additional vertical communities, storefronts and electronic activities including auction sales.

**Price-to-Sales.** As the leading provider of vertical trade communities, VerticalNet has commanded a higher price to sales ratio of 76.93 than the Technology Sector having a ratio of 22.66 and the Computer Services Industry having a ratio of 11.73. Since most of the emerging Internet companies have yet to turn a profit, this is an essential ratio for determining a company's relative value within the industry. As VerticalNet has no close and identical competitors, a comparison does not hold much ground. Nevertheless, the following table shows a comparison with other Internet Services providing companies to get some idea of company's valuation. Although it is hard to tell how much higher, we believe that VerticalNet observes a P/S ratio higher than those of many other Internet companies due to its First Mover advantage and for the being only broadly diversified business-to-business community.

	\$ Price	Market Cap in Millions	Trailing 12 Month Sales in Millions	P/S	Gross Margin % (TTM)	Other Particulars*
VerticalNet	35.80	1238.2	16.10	76.93	34.72	46 communities
UBib	17.63	161.22	130.02	1.24	8.41	377000 users
Xoom.com	38.25	613.38	22.34	27.46	55.10	6.9 million users
Ebay	98.00	12604.76	128.98	97.73	80.72	3.8 million users
Healtheon	34.63	2457.58	90.39	27.19	0.94	180000 cosumers
Doubleclick	82.38	3260.4	119.74	27.23	38.15	8.2 billion. Ad. Impressions/month

\*As published in Business 2.0 August 1999.

**Gross Margins.** Until now the gross margins of the company were negative but for the last two quarters the company has exhibited positive signs. It can be mainly attributed to the fact that the increase in revenue was more than the increase in editorial expenses. We believe that this trend will continue in the future as the

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operations have started to be streamlined. Moreover, the company will continue to generate more revenues from electronic commerce and auctions and increase in traffic. While the Technology Sector has a gross margin ratio of 42.47% and the Computer Services Industry has 53.05%, it can be safely concluded that the company's gross margin should remain below 50% as its e-commerce (a low margin business) should increase while its advertising revenue (a high margin business) should decrease as percentages of total revenues.

**Other Important ratios:** The Price to Book Value (most recent quarter) of the company is 22.58 while that of the Technology sector is 18.34 and that of the Computer Services Industry is 13.79, which reflects higher growth potential expected by VerticalNet's shareholders than average. While the Revenue Per Employee of the company, the Technology sector and the Computer Services Industry are \$34,800, \$323,633 and \$420,181 respectively, we believe that the company has significant potential to grow in the future.

**Customer Base.** The company plans to increase the number of trade communities to at least 50 by the end of 1999 and to more than 100 by the end of 2000. The company has witnessed heavy traffic growth in the second quarter ending June 1999 with visitors reaching 4 million, up 38% from 2.9 million in the first quarter. Approximately 40% of the visitors are international, many from emerging countries. As VerticalNet continues to diversify its revenue streams, which originate from storefronts sponsorships, e-commerce and co-marketing partnerships including banners buttons, newsletters, career services, auctions and applications we expect that the customers base will grow significantly in the near future also.

### **Investment Opinion**

Having acquired the status of First Mover to serve information to the industrial markets, the company is moving confidently towards acquiring new media leadership in this segment. We believe that in the near future the company will be able to realize this goal. It has a clear vision of expansion through alliances and acquisitions. This should help it to expand the number of visitors and create an opportunity for advertisers and, thus, grow the market for e-commerce and other transaction revenue. We also believe that the company will continue exhibit a high growth rate as in the past. We believe that VerticalNet's growing recognition of brand name along with customer focus strategy will help the company to acquire new media leadership. As we believe the company's stock to be a long-term play, we give VerticalNet an accumulate recommendation.

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**VerticalNet.****Income Statement****(in thousands, expect per share data)**

ending December 31.	July95 to FY95	FY96	FY97	FY98	FY99E	FY00E
Sales	16	285	792	3135	10422	18238
Cost of Sales	24	214	1056	3238	5482	9593
<b>Gross Profit</b>	<b>(8)</b>	<b>71</b>	<b>(264)</b>	<b>(103)</b>	<b>4940</b>	<b>8645</b>
Product Development	22	214	711	1405	5382	7064
Sales & Marketing	147	268	2301	7895	19257	25275
General & Admn.	33	292	1388	3823	6925	7790
Amortization of Goodwill				283	1222	1344
Operating Expense	202	774	4400	13406	32786	41473
Operating Income(loss)	(210)	(703)	(4664)	(13509)	(27846)	(32828)
Net Interest	(1)	(6)	(115)	(85)	2293	1834
Net Income(loss)	(211)	(709)	(4779)	(13594)	(25553)	(30994)
Shares Outstanding	2193358	5167296	5053730	5141100	30350757	33385833
<b>Diluted EPS</b>	<b>(0.10)</b>	<b>(0.14)</b>	<b>(0.95)</b>	<b>(2.64)</b>	<b>(0.84)</b>	<b>(0.93)</b>

**Margin Analysis**

(% of sales)

Gross Margin	-50%	25%	-33%	-3%	47%	47%
Product Development	138%	75%	90%	45%	52%	39%
Sales & Marketing	919%	94%	291%	252%	185%	139%
General & Admn.	206%	102%	175%	122%	66%	43%
Amortization of Goodwill	0%	0%	0%	9%	12%	7%

**Growth (%)**

Total Revenue		791%	178%	296%	232%	75%
Cost of Revenue		346%	393%	207%	69%	75%
Gross Profit		-544%	-472%	-61%	-4896%	75%
Operating Expense		92%	468%	205%	145%	26%
Operating Income		67%	563%	190%	106%	18%
Net Income		68%	574%	184%	88%	21%