

THEGLOBE COM INC  
Form 10-K  
March 30, 2007

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

**FORM 10-K**

(Mark One)

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the fiscal year ended December 31, 2006**

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 NO. 0-25053

**THEGLOBE.COM, INC.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

STATE OF DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	14-1782422 (I.R.S. EMPLOYER IDENTIFICATION NO.)
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110 EAST BROWARD BOULEVARD, SUITE 1400, FORT LAUDERDALE, FL. 33301  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

Registrant's telephone number, including area code (954) 769 - 5900

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$.001 per share

Preferred Stock Purchase Rights

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  
 Yes  No

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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: x Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Sec.229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

Aggregate market value of the voting Common Stock held by non-affiliates of the registrant as of the close of business on March 19, 2007: \$4,227,395.\*

\*Includes voting stock held by third parties, which may be deemed to be beneficially owned by affiliates, but for which such affiliates have disclaimed beneficial ownership.

The number of shares outstanding of the Registrant's Common Stock, \$.001 par value (the "Common Stock") as of March 19, 2007 was 172,484,838.

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**theglobe.com, inc.**

**FORM 10-K**

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## FORWARD LOOKING STATEMENTS

This Form 10-K contains forward-looking statements within the meaning of the federal securities laws that relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology, such as "may," "will," "should," "could," "expect," "plan," "anticipate," "believe," "estimate," "project," "predict," "intend," "potential" or "continue" or the negative of such terms or other comparable terminology, although not all forward-looking statements contain such terms. In addition, these forward-looking statements include, but are not limited to, statements regarding:

- implementing our business plans;
- marketing and commercialization of our products and services;
- plans for future products and services and for enhancements of existing products and services;
- our ability to implement cost-reduction programs;
- potential governmental regulation and taxation;
- the outcome of pending litigation;
- our intellectual property;
- our estimates of future revenue and profitability;
- our estimates or expectations of continued losses;
- our expectations regarding future expenses, including cost of revenue, product development, sales and marketing, and general and administrative expenses;
- difficulty or inability to raise additional financing, if needed, on terms acceptable to us;
- our estimates regarding our capital requirements and our needs for additional financing;
- attracting and retaining customers and employees;
- rapid technological changes in our industry and relevant markets;
- sources of revenue and anticipated revenue;
- plans to shutdown certain businesses;
- our ability to sell and/or recover certain business assets;
- competition in our market; and
- our ability to continue to operate as a going concern.

These statements are only predictions. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are not required to and do not intend to update any of the forward-looking statements after the date of this Form 10-K or to conform these statements to actual results. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this Form 10-K might not occur. Actual results, levels of activity, performance, achievements and events may vary significantly from those implied by the forward-looking statements. A description of risks that could cause our results to vary appears under "Risk Factors" and elsewhere in this Form 10-K.

In this Form 10-K, we refer to information regarding our potential markets and other industry data. We believe that we have obtained this information from reliable sources that customarily are relied upon by companies in our industry, but we have not independently verified any of this information.

## PART I

### ITEM 1. BUSINESS

#### DESCRIPTION OF BUSINESS

During 2006 theglobe.com, inc. (the "Company" or "theglobe") managed three primary lines of business, as follows:

· Computer games businesses — Our print publication business comprised of Computer Games magazine and MMOGames magazine (renamed from Massive Magazine in the first quarter of 2007); our online website business, comprised of the CGOnline website ([www.cgonline.com](http://www.cgonline.com)), the MMOGames magazine website ([www.mmogamesmag.com](http://www.mmogamesmag.com)) and the Game Swap Zone website ([www.gameswapzone.com](http://www.gameswapzone.com)); and our e-commerce games distribution company, Chips & Bits, Inc. ([www.chipsbits.com](http://www.chipsbits.com)). Our Now Playing magazine publication and the accompanying website were sold in January 2006 for approximately \$130 thousand in cash;

· Voice over Internet Protocol ("VoIP") telephony services business — Consisting of tglo.com, inc. (formerly known as voiceglo Holdings, Inc.). The term "VoIP" refers to a category of hardware and software that enables people to use the Internet to make phone calls; and

· Internet services business — Consisting of Tralliance Corporation ("Tralliance") which is the registry for the ".travel" top-level Internet domain.

In March 2007, management made the decision to shutdown the operations of both its computer games and VoIP telephony services lines of business and to focus 100% of its resources and efforts to further develop its Internet services business. See Note 19, "Subsequent Events," of the Notes to Consolidated Financial Statements and the "Liquidity and Capital Resources" section of the Management's Discussion and Analysis of Financial Condition and Results of Operations included within this Form 10-K for a more complete discussion.

On October 31, 2005, the Company completed the sale of all of the business and substantially all of the net assets of SendTec, Inc. ("SendTec"), our direct response marketing services and technology company, for approximately \$39.9 million in cash. Results of operations for SendTec have been reported separately as "Discontinued Operations" in the accompanying consolidated statement of operations for the years ended December 31, 2005 and 2004.

During 2006, 2005 and 2004, the Company's computer games business segment provided approximately 59%, 81% and 89%, respectively, of our consolidated net revenue from continuing operations. Tralliance which comprises our Internet services business segment contributed approximately 40% of our consolidated net revenue during 2006, up from approximately 8% in the prior year as Tralliance did not begin generating revenue until the fourth quarter of 2005. Our VoIP products and services have not produced any significant revenue. All revenue derived from the business segments which comprised our operations during 2006 was considered to be attributable to the United States because it was impracticable to determine the country of origin.

#### HISTORICAL OVERVIEW

theglobe was incorporated on May 1, 1995 (inception) and commenced operations on that date. Originally, theglobe.com was an online community with registered members and users in the United States and abroad. That product gave users the freedom to personalize their online experiences by publishing their own content and by

interacting with others having similar interests. However, due to the deterioration of the online advertising market, the Company was forced to restructure and ceased the operations of its online community on August 15, 2001. The Company then sold most of its remaining online and offline properties. The Company continued to operate its Computer Games print magazine and the associated CGOnline website, as well as the e-commerce games distribution business of Chips & Bits. On June 1, 2002, Chairman Michael S. Egan and Director Edward A. Cespedes became Chief Executive Officer and President of the Company, respectively.

On November 14, 2002, the Company acquired certain Voice over Internet Protocol ("VoIP") assets. In exchange for the assets, the Company issued warrants to acquire 1,750,000 shares of its Common Stock and an additional 425,000 warrants as part of an earn-out structure upon the attainment of certain performance targets. The earn-out performance targets were not achieved and the 425,000 earn-out warrants expired on December 31, 2003.

On February 25, 2003, theglobe entered into a Loan and Purchase Option Agreement, as amended, with Tralliance, an Internet related business venture, pursuant to which it agreed to fund, in the form of a loan, at the discretion of the Company, Tralliance's operating expenses and obtained the option to acquire all of the outstanding capital stock of Tralliance in exchange for, when and if exercised, \$40,000 in cash and the issuance of an aggregate of 2,000,000 unregistered restricted shares of theglobe's Common Stock. On May 5, 2005, Tralliance and the Internet Corporation for Assigned Names and Numbers ("ICANN") entered into an agreement designating Tralliance as the registry for the ".travel" top-level domain. On May 9, 2005, the Company exercised its option to acquire all of the outstanding capital stock of Tralliance. The purchase price consisted of the issuance of 2,000,000 shares of theglobe's Common Stock, warrants to acquire 475,000 shares of theglobe's Common Stock and \$40,000 in cash. The warrants are exercisable for a period of five years at an exercise price of \$0.11 per share. The Common Stock issued as a result of the acquisition of Tralliance is entitled to certain "piggy-back" registration rights.

On May 28, 2003, the Company acquired Direct Partner Telecom, Inc. ("DPT"), a company engaged in VoIP telephony services in exchange for 1,375,000 shares of the Company's Common Stock and the issuance of warrants to acquire 500,000 shares of the Company's Common Stock. DPT was a specialized international communications carrier providing VoIP communications services to emerging countries. The DPT network had provided "next generation" packet-based telephony and value added data services to carriers and businesses in the United States and internationally. The Company acquired all of the physical assets and intellectual property of DPT and originally planned to continue to operate the company as a subsidiary and engage in the provision of VoIP services to other telephony businesses on a wholesale transactional basis. In the first quarter of 2004, the Company decided to suspend DPT's wholesale business and dedicate the DPT physical and intellectual assets to its retail VoIP business. As a result, the Company wrote-off the goodwill associated with the purchase of DPT as of December 31, 2003, and has since employed DPT's physical assets in the build out of its VoIP network.

On September 1, 2004, the Company closed upon an Agreement and Plan of Merger dated August 31, 2004, pursuant to which the Company acquired all of the issued and outstanding shares of capital stock of SendTec, Inc., ("SendTec"), a direct response marketing services and technology company. Pursuant to the terms of the Merger, in consideration for the acquisition of SendTec, theglobe paid consideration consisting of: (i) \$6,000,000 in cash, excluding transaction costs, (ii) the issuance of an aggregate of 17,500,024 shares of theglobe's Common Stock, (iii) the issuance of an aggregate of 175,000 shares of Series H Automatically Converting Preferred Stock (which was converted into 17,500,500 shares of theglobe's Common Stock on December 1, 2004, the effective date of the amendment to the Company's certificate of incorporation increasing its authorized shares of Common Stock from 200,000,000 shares to 500,000,000 shares), and (iv) the issuance of a subordinated promissory note in the amount of \$1 million. The Company also issued an aggregate of 3,974,165 replacement options to acquire theglobe's Common Stock for each of the issued and outstanding options to acquire SendTec shares held by the former employees of SendTec.

On August 10, 2005, the Company entered into an Asset Purchase Agreement with RelationServe Media, Inc. ("RelationServe") whereby the Company agreed to sell all of the business and substantially all of the net assets of the SendTec marketing services subsidiary to RelationServe for \$37.5 million in cash, subject to certain net working capital adjustments. On August 23, 2005, the Company entered into Amendment No. 1 to the Asset Purchase Agreement with RelationServe (the "1<sup>st</sup> Amendment" and together with the original Asset Purchase Agreement, the "Purchase Agreement"). On October 31, 2005, the Company completed the asset sale. Including preliminary adjustments to the purchase price related to estimated excess working capital of SendTec as of the date of sale, the Company received an aggregate of approximately \$39.9 million in cash pursuant to the Purchase Agreement.

Additionally, as contemplated by the Purchase Agreement, immediately following the asset sale, the Company completed the redemption of approximately 28.9 million shares of theglobe's Common Stock owned by six members of the former management of SendTec for approximately \$11.6 million in cash pursuant to a Redemption Agreement dated August 23, 2005. Pursuant to a separate Termination Agreement, the Company also terminated and canceled approximately 1.3 million stock options and the contingent interest in approximately 2.1 million earn-out warrants held by the six members of the former management in exchange for approximately \$400 thousand in cash. The Company also terminated stock options of certain other non-management employees of SendTec and entered into bonus arrangements with a number of other non-management SendTec employees for amounts totaling approximately \$600 thousand.

## OUR LINES OF BUSINESS

### OUR INTERNET SERVICES BUSINESS

Tralliance was incorporated in 2002 to develop products and services to enhance online commerce between consumers and the travel and tourism industries, including administration of the “.travel” top-level domain. In February 2003, theglobe entered into a Loan and Purchase Option Agreement, as amended, with Tralliance in which theglobe agreed to fund, in the form of a loan, at the discretion of theglobe, Tralliance’s operating expenses and obtained the option to acquire all of the outstanding capital stock of Tralliance. On May 5, 2005, the Internet Corporation for Assigned Names and Numbers (“ICANN”) and Tralliance entered into a contract whereby Tralliance was designated as the exclusive registry for the “.travel” top-level domain for an initial period of ten years. Renewal of the ICANN contract beyond the initial ten year term is conditioned upon the negotiation of renewal terms reasonably acceptable to ICANN. Additionally, we have agreed to engage in good faith negotiations at regular intervals throughout the term of our contract (at least once every three years) regarding possible changes to the provisions of the contract, including changes in the fees and payments that we are required to make to ICANN. In the event that we materially and fundamentally breach the contract and fail to cure such breach within thirty days of notice, ICANN has the right to immediately terminate our contract. Effective May 9, 2005, theglobe exercised its option to purchase Tralliance.

The establishment of the “.travel” top-level domain enables businesses, organizations, governmental agencies and other enterprises that operate within the travel and tourism industry to establish a unique Internet domain name from which to communicate and conduct commerce. An Internet domain name is made up of a top-level domain and a second-level domain. For example, in the domain name “companyX.travel”, “companyX” is the second-level domain and “.travel” is the top-level domain. As the registry for the “.travel” top-level domain, Tralliance is responsible for maintaining the master database of all second-level “.travel” domain names and their corresponding Internet Protocol (“IP”) addresses.

To facilitate the “.travel” domain name registration process, Tralliance has entered into contracts with a number of registrars. These registrars act as intermediaries between Tralliance and customers (referred to as registrants) seeking to register “.travel” domain names. The registrars handle the billing and collection of registration fees, customer service and technical management of the registration database. Registrants can register “.travel” domain names for terms of one year (minimum) up to 10 years (maximum). The registrars retain a portion of the registration fee collected by them as their compensation and remit the remainder, presently \$80 per domain name per year, of the registration fee to Tralliance.

In order to register a “.travel” domain name, a registrant must first be verified as being eligible (“authenticated”) by virtue of being a valid participant in the travel industry. Additionally, eligibility data is required to be updated and reviewed annually, subsequent to initial registration. Once authenticated, a registrant is only permitted to register “.travel” domain names that are associated with the registrant’s business or organization. Tralliance has entered into contracts with a number of travel associations or other independent organizations (“authentication providers”) whereby, in consideration for the payment of fixed and/or variable fees, all required authentication procedures are performed by such authentication providers. Tralliance has also outsourced various other registry operations, database maintenance and policy formulation functions to certain other independent businesses or organizations in consideration for the payment of certain fixed and/or variable fees.

In launching the “.travel” top-level domain registry, Tralliance adopted a phased approach consisting of three distinct stages. During the third quarter of 2005, Tralliance implemented phase one, which consisted of a pre-authentication of a limited group of potential registrants. During the fourth quarter of 2005, Tralliance implemented phase two, which involved the registration of the limited group of registrants who had been pre-authenticated. It was during this limited registration phase that Tralliance initially began collecting registration fees from its “.travel” registrars. Finally, in January 2006, Tralliance commenced the final phase of its launch, which culminated in live “.travel” registry operations.

As of March 20, 2007 the total number of “.travel” domain names registered approximated 26,400.

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On August 15, 2006, the Company introduced its online search engine dedicated to the travel industry, [www.search.travel](http://www.search.travel). The search engine was developed by Tralliance to benefit both consumers at large and “.travel” domain name registrants, as the search engine delivers qualified search results from the entire World Wide Web, giving priority to destinations and businesses that are authenticated “.travel” registrants. During August 2006, the Company launched a national television campaign to promote the new search engine and website. The Company has begun marketing the [www.search.travel](http://www.search.travel) website to potential advertisers interested in targeting the travel consumer and plans to seek additional net revenue through the sale of advertising sponsorships. As of March 19, 2007, advertising net revenue attributable to the [www.search.travel](http://www.search.travel) website has not been significant.

### **OUR COMPUTER GAMES BUSINESS**

In February 2000, the Company entered the computer games business by acquiring Computer Games Magazine, a print publication for personal computer (“PC”) gamers; CGOnline, the online counterpart to Computer Games magazine; and Chips & Bits, an e-commerce games distribution business.

Historically, content of Computer Games Magazine and CGOnline focused primarily on the PC games market niche, which has experienced declining sales during recent years. Additionally, the overall games distribution marketplace has become increasingly competitive during recent years due to the increased selection and number of video games offered by mass merchants, regional chains, video game and PC software specialty stores, toy retail chains, consumer electronic stores and online retailers. Due in large part to the above factors, the total net revenue derived from the Company’s computer games business decreased significantly during the past several years (from \$7.2 million in 2002 to \$2.0 million in 2006).

During 2004, the Company developed and began to implement plans to expand its business beyond games and into other areas of the entertainment industry. In Spring 2004, a new magazine, Now Playing began to be delivered within Computer Games Magazine and in March 2005, Now Playing began to be distributed as a separate publication. Now Playing covered movies, DVD’s, television, music, games, comics and anime, and was designed to fulfill the wider pop culture interests of readers and to attract a more diverse group of advertisers: autos, television, telecommunications and film to name a few. During 2005, the Now Playing online website ([www.nowplaying.com](http://www.nowplaying.com)), the online counterpart for Now Playing magazine, was implemented and costs were also incurred to develop a new corporate website ([www.theglobe.com](http://www.theglobe.com)), also targeted at the broader entertainment marketplace.

In August 2005, based upon a re-evaluation of the capital requirements and risks/rewards related to completing the transition to a broader-based entertainment business, the Company decided to abort its diversification efforts and refocus its strategy back to operating and improving its traditional games-based businesses. During the remainder of 2005, the Company implemented a number of revenue enhancement programs, including establishing a used game auction website ([www.gameswapzone.com](http://www.gameswapzone.com)), introducing a digital version of its Computer Games Magazine, and entering into several marketing partnership affiliate programs. Additionally, during the latter part of 2005, the Company completed the implementation of a number of cost-reduction programs related to facility consolidations, headcount reductions, and decreases in magazine publishing and sales costs. In January 2006, the Company completed the sale of all assets related to Now Playing Magazine and the Now Playing Online website for approximately \$130,000.

The premiere issue of a new quarterly print publication, Massive Magazine (renamed MMOGames Magazine in 2007), was released in September 2006. The new magazine was dedicated solely to “massively multiplayer online” games (“MMO” games) and included features on the culture of MMO games, focusing on players, guilds and communities. The editorial staff of Computer Games Magazine produced the content for the new magazine. The new magazine was also accompanied by a complementary website ( [www.mmogamesmag.com](http://www.mmogamesmag.com)).



In March 2007, management and the Board of Directors of the Company made the decision to cease all activities related to its Computer Games businesses, including discontinuing the operations of its magazine publications, games distribution business and related websites. The Company's decision to shutdown its Computer Games businesses was based primarily on the historical losses sustained by these businesses during the recent past and management's expectations of continued future losses. The Company is currently in the process of implementing a business shutdown plan, which includes the termination of employee and vendor relationships and the collection and payment of outstanding accounts receivables and payables. We are also attempting to sell certain of the businesses' component assets; however, we do not expect the proceeds from such sales to be significant. (See Note 19, "Subsequent Events," in the Notes to Consolidated Financial Statements).

Our games businesses derived substantially all of their revenue from sales of magazines via subscriptions and newsstands, sale of advertising, primarily in our magazines but to a lesser extent on our websites, and to the sales of video and computer games products. Curtis Circulation Company, which handled the newsstand distribution of our games businesses magazine publications, accounted for approximately 12% of the total net revenue of our games business segment during 2006. During each of the years ended December 31, 2005 and 2004, no single customer accounted for more than 10% of the total net revenue of our computer games business segment.

### **OUR VOIP TELEPHONY BUSINESS**

On November 14, 2002, we entered the VoIP business by acquiring certain software assets from Brian Fowler. On May 28, 2003, the Company acquired DPT, a company engaged in VoIP wholesale telephony services. At the time we acquired DPT, it was a specialized international communications carrier providing wholesale VoIP communications services to emerging countries. In the first quarter of 2004, we decided to suspend DPT's wholesale business and dedicate the DPT physical and intellectual assets to our retail VoIP business.

During the third quarter of 2003, the Company launched its first suite of consumer and business level VoIP services. The Company launched its browser-based VoIP product during the first quarter of 2004. These services allowed customers to communicate using VoIP technology for dramatically reduced pricing compared to traditional telephony networks. The services also offered traditional telephony features such as voicemail, caller ID, call forwarding, and call waiting for no additional cost to the customer, as well as incremental services that were not then supported by the public switched telephone network ("PSTN") like the ability to use numbers remotely and voicemail to email services. In the fourth quarter of 2004, the Company announced an "instant messenger" or "IM" related application which enabled users to chat via voice or text across multiple platforms using their preferred instant messenger service. During the second quarter of 2005, the Company released a number of new VoIP products and features which allowed users to communicate via mobile phones, traditional land line phones and/or computers. From the initial launch of its VoIP services in 2003 through 2005, the Company continued to expand its VoIP network, which was comprised of switching hardware and software, servers, billing and inventory systems, and telecommunication carrier contractual relationships. Throughout this period, the capacity of our VoIP network greatly exceeded usage.

The Company's retail VoIP service plans had included both "peer-to-peer" plans, for which subscribers were able to place calls free of charge over the Internet to other subscribers' Internet connections, and "paid" plans which involved interconnection with the PSTN and for which subscribers were charged certain fixed and/or variable service charges.

During 2003 through 2005, the Company attempted to market and distribute its VoIP retail products through various direct and indirect sales channels including Internet advertising, structured customer referral programs, network marketing, television infomercials and partnerships with third party national retailers. None of the marketing and sales programs implemented during these years were successful in generating a significant number of "paid" plan customers or revenue. The Company's marketing efforts during this period of time achieved only limited success in developing a "peer-to-peer" subscriber base of free service plan users.

During 2006, the Company re-focused its efforts on VoIP product development. During the first quarter of 2006, the Company developed a plan to reconfigure, phase out and eliminate certain components of its existing VoIP network. During the second quarter of 2006, the Company discontinued offering service to its small existing “paid” plan customer base and completed the implementation of its plan to significantly reduce the excess capacity and operating costs of its VoIP network. During November 2006, the Company entered into a license agreement with Speecho, LLC, which granted a license to use the Company’s chat, VoIP and video communications technology for a monthly license fee of \$10,000 per month with an initial term of ten years. The Company’s Chairman, the Company’s President and the Company’s Vice President of Finance, as well as certain other current and former employees of the Company, are members of a company that owns 50% of the membership interests in Speecho, LLC.

In March 2007, management and the Board of Directors of the Company decided to discontinue the operating, research and development activities of its VoIP telephony services business and terminate all of the remaining employees of the business. At this time, the Company intends to only incur those costs required to maintain the service obligations of the license agreement with Speecho, LLC. The Company has no plans to actively market the further licensing of its chat, VoIP and video communications technology. The Company's decision to discontinue the operations of its VoIP telephony services business was based primarily on the historical losses sustained by the business during the past several years, management's expectations of continued losses for the foreseeable future and estimates of the amount of capital required to attempt to successfully monetize its business. (See Note 19, "Subsequent Events," in the Notes to the Consolidated Financial Statements).

## COMPETITION

### Internet Services Business

We face competition from a number of businesses and organizations that have longer operating histories, greater name recognition and more advanced and complete technical systems. Additionally, many of our competitors are larger enterprises that have greater financial, technical and marketing resources than we have.

While we do not face direct competition for the registry of ".travel" domain names because of the exclusive nature of our ICANN contract, we compete with other companies that maintain the registries for different domain names, including Verisign, Inc., which manages the ".com" and ".net" registries; Afiliis Limited, which manages the ".info" registry; and a number of country-specific domain name registries (such as ".uk" for domain names in the United Kingdom).

Our [www.search.travel](http://www.search.travel) search engine competes for advertising dollars with large Internet portal and search engine sites, such as Google, America Online, MSN and Yahoo!, that offer listings or other advertising opportunities for travel companies. These companies have significantly greater financial, technical, marketing and other resources and larger client bases. In addition, we also compete with traditional media companies, such as newspaper and magazine publishers, that provide online advertising opportunities on their websites.

In developing and distributing future products and services for the Internet-based services markets and in seeking the renewal of our existing contract or obtaining new ICANN contracts, we expect to face intense competition from multiple competitors.

## INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS

We regard substantial elements of our websites and underlying technology as proprietary. In addition, we have developed in our VoIP business certain technologies which we believe are proprietary. We attempt to protect these assets by relying on intellectual property laws. We also generally enter into confidentiality agreements with our employees and consultants and in connection with our license agreements with third parties. We also seek to control access to and distribution of our technology, documentation and other proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our proprietary information without authorization or to develop similar technology independently. We pursue the registration of our trademarks in the United States and internationally. We have been awarded a patent for our VoIP technology related to the origination and termination of telephone calls between subscriber terminals connected to a public packet network.

Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which our services are made available through the Internet. Policing unauthorized use of our proprietary information is difficult. Existing or future trademarks or service marks applied for or registered by other parties and which are similar to ours may prevent us from expanding the use of our trademarks and service marks into other areas.

Enforcing our patent rights could result in costly litigation. Our patent applications could be rejected or any patents granted could be invalidated in litigation. Additionally, our competitors or others could be awarded patents on technologies and business processes that could require us to significantly alter our technology, change our business processes or pay substantial license and royalty fees. In the fourth quarter of 2005, we were sued by Sprint Communications Company, L.P. (“Sprint”) for alleged unauthorized use of “inventions” described and claimed in seven patents held by Sprint. In August 2006, we entered into a settlement agreement with Sprint which resolved the pending patent infringement lawsuit. As part of the settlement, we agreed to enter into a non-exclusive license under certain of Sprint’s patents. (See “Risk Factors-We Rely on Intellectual Property and Proprietary Rights.”).

## GOVERNMENT REGULATION AND LEGAL UNCERTAINTIES

### In General

We are subject to laws and regulations that are applicable to various Internet activities. There are an increasing number of federal, state, local and foreign laws and regulations pertaining to the Internet. In addition, a number of federal, state, local and foreign legislative and regulatory proposals are under consideration. Laws and regulations have been and will likely continue to be adopted with respect to the Internet relating to, among other things, liability for information retrieved from or transmitted over the Internet, online content regulation, user privacy, data protection, pricing, content, copyrights, distribution, email solicitation, "spam", electronic contracts and other communications, consumer protection, the provision of online payment services, broadband residential Internet access, and the characteristics and quality of products and services. On June 1, 2006, we were sued by MySpace, Inc. ("MySpace") for alleged violations of the CAN-SPAM Act, the Lanham Act and the California Business & Professions Code § 17529.5 (the "California Act"), as well as trademark infringement, false advertising, breach of contract, breach of the covenant of good faith and fair dealing, and unfair competition. On February 28, 2007, the United States District Court for the Central District of California entered an order granting in part MySpace's motion for summary judgment, finding that we were liable for violation of the CAN-SPAM Act and the California Business & Professions Code, and for breach of contract. On March 15, 2007, the Company entered into a Settlement Agreement with MySpace whereby, among other things, the Company agreed to pay MySpace approximately \$2.6 million on or before April 5, 2007 in exchange for a mutual release of all claims against one another, including any claims against the Company's directors and officers. (See "Risk Factors-We Rely on Intellectual Property and Proprietary Rights." and "Item 3. Legal Proceedings").

Changes in tax laws relating to electronic commerce could materially affect our business, prospects and financial condition. One or more states or foreign countries may seek to impose sales or other tax collection obligations on out-of-jurisdiction companies that engage in electronic commerce. A successful assertion by one or more states or foreign countries that we should collect sales or other taxes on services could result in substantial tax liabilities for past sales, decrease our ability to compete with other entities involved in the industries in which we participate, and otherwise harm our business.

Currently, decisions of the U.S. Supreme Court restrict the imposition of obligations to collect state and local sales and use taxes with respect to electronic commerce. However, a number of states, as well as the U.S. Congress, have been considering various initiatives that could limit or supersede the Supreme Court's position regarding sales and use taxes on electronic commerce. If any of these initiatives addressed the Supreme Court's constitutional concerns and resulted in a reversal of its current position, we could be required to collect sales and use taxes. The imposition by state and local governments of various taxes upon electronic commerce could create administrative burdens for us and could adversely affect our business operations, and ultimately our financial condition, operating results and future prospects.

Regardless of the type of state tax imposed, the threshold issue involving state taxation of any transaction is always whether sufficient nexus, or contact, exists between the taxing entity and the taxpayer or the transaction to which the tax is being applied. The concept of nexus is constantly changing and no bright line exists that would sufficiently alert a business as to whether it is subject to tax in a specific jurisdiction. All states which have attempted to tax Internet access or online services have done so by asserting that the sale of such information services, data processing services or other type of transaction is subject to tax in that particular state.

A handful of states impose taxes on computer services, data processing services, information services and other similar types of services. Some of these states have asserted that Internet access and/or online information services are subject to these taxes.

Moreover, the applicability to the Internet of existing laws governing issues such as intellectual property ownership and infringement, copyright, trademark, trade secret, obscenity, libel, employment and personal privacy is uncertain and developing. It is not clear how existing laws governing issues such as property ownership, sales and other taxes, libel, and personal privacy apply to the Internet and electronic commerce. Any new legislation or regulation, or the application or interpretation of existing laws or regulations, may decrease the growth in the use of the Internet, may impose additional burdens on electronic commerce or may alter how we do business.

### **Certain Other Regulation Affecting the Internet Generally**

New laws and regulations affecting the Internet generally may increase our costs of compliance and doing business, decrease the growth in Internet use, decrease the demand for our services or otherwise have a material adverse effect on our business.

Today, there are still relatively few laws specifically directed towards online services. However, due to the increasing popularity and use of the Internet and online services, many laws and regulations relating to the Internet are being debated at all levels of governments around the world and it is possible that such laws and regulations will be adopted. It is not clear how existing laws governing issues such as property ownership, copyrights and other intellectual property issues, taxation, libel and defamation, obscenity, and personal privacy apply to online businesses. The vast majority of these laws were adopted prior to the advent of the Internet and related technologies and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. In the United States, Congress has recently adopted legislation that regulates certain aspects of the Internet, including online content, user privacy and taxation. In addition, Congress and other federal entities are considering other legislative and regulatory proposals that would further regulate the Internet. Congress has, for example, considered legislation on a wide range of issues including Internet spamming, database privacy, gambling, pornography and child protection, Internet fraud, privacy and digital signatures. For example, Congress recently passed and the President signed into law several proposals that have been made at the U.S. state and local level that would impose additional taxes on the sale of goods and services through the Internet. These proposals, if adopted, could substantially impair the growth of e-commerce, and could diminish our opportunity to derive financial benefit from our activities. For example, in December 2004, the U.S. federal government enacted the Internet Tax Nondiscrimination Act (the "ITNA"). While the ITNA generally extends through November 2007 the moratorium on taxes on Internet access and multiple and discriminatory taxes on electronic commerce, it does not affect the imposition of tax on a charge for voice or similar service utilizing Internet Protocol or any successor protocol. In addition, the ITNA does not prohibit federal, state, or local authorities from collecting taxes on our income or from collecting taxes that are due under existing tax rules.

Various states have adopted and are considering Internet-related legislation. Increased U.S. regulation of the Internet, including Internet tracking technologies, may slow its growth, particularly if other governments follow suit, which may negatively impact the cost of doing business over the Internet and materially adversely affect our business, financial condition, results of operations and future prospects. The Company has no way of knowing whether legislation will pass or what form it might take. Domain names have been the subject of significant trademark litigation in the United States and internationally. The current system for registering, allocating and managing domain names has been the subject of litigation and may be altered in the future. The regulation of domain names in the United States and in foreign countries may change. Regulatory bodies are anticipated to establish additional top-level domains and may appoint additional domain name registrars or modify the requirements for holding domain names, any or all of which may dilute the strength of our names. We may not acquire or maintain our domain names in all of the countries in which our websites may be accessed, or for any or all of the top-level domain names that may be introduced.

### **International Regulation of Internet Services**

Internationally, the European Union has enacted several directives relating to the Internet. The European Union has, for example, adopted a directive that imposes restrictions on the collection and use of personal data. Under the directive, citizens of the European Union are guaranteed rights to access their data, rights to know where the data originated, rights to have inaccurate data rectified, rights to recourse in the event of unlawful processing and rights to withhold permission to use their data for direct marketing. The directive could, among other things, affect U.S. companies that collect or transmit information over the Internet from individuals in European Union member states, and will impose restrictions that are more stringent than current Internet privacy standards in the U.S. In particular, companies with offices located in European Union countries will not be allowed to send personal information to countries that do not maintain adequate standards of privacy. Compliance with these laws is both necessary and difficult. Failure to comply could subject us to lawsuits, fines, criminal penalties, statutory damages, adverse publicity, and other losses that could harm our business. Changes to existing laws or the passage of new laws intended to address these privacy and data protection and retention issues could directly affect the way we do business or could create uncertainty on the Internet. This could reduce demand for our services, increase the cost of doing business as a result of litigation costs or increased service or delivery costs, or otherwise harm our business.

Other laws that reference the Internet, such as the European Union's Directive on Distance Selling and Electronic Commerce has begun to be interpreted by the courts and implemented by the European Union member states, but their applicability and scope remain somewhat uncertain. Regulatory agencies or courts may claim or hold that we or our users are either subject to licensure or prohibited from conducting our business in their jurisdiction, either with respect to our services in general, or with respect to certain categories or items of our services. As we expand our international activities, we become obligated to comply with the laws of the countries in which we operate. Laws regulating Internet companies outside of the U.S. may be less favorable than those in the U.S., giving greater rights to consumers, content owners, and users. Compliance may be more costly or may require us to change our business practices or restrict our service offerings relative to those in the U.S. Our failure to comply with foreign laws could subject us to penalties ranging from criminal prosecution to bans on our services.

## **EMPLOYEES**

As of March 19, 2007, we had approximately 37 active full-time employees. Our future success depends, in part, on our ability to continue to attract, retain and motivate highly qualified technical and management personnel. Competition for these persons is intense. From time to time, we also employ independent contractors to support our network operations, research and development, marketing, sales and support and administrative organizations. Our employees are not represented by any collective bargaining unit and we have never experienced a work stoppage. We believe that our relations with our employees are good.

## **ITEM 1A. RISK FACTORS**

In addition to the other information in this report, the following factors should be carefully considered in evaluating our business and prospects.

### **RISKS RELATING TO OUR BUSINESS GENERALLY**

#### **WE MAY NOT BE ABLE TO CONTINUE AS A GOING CONCERN.**

We have received a report from our independent accountants, relating to our December 31, 2006 audited financial statements containing an explanatory paragraph stating that our recurring losses from operations and our accumulated deficit raise substantial doubt about our ability to continue as a going concern. For the reasons described below, Company management does not believe that cash on hand and cash flow generated internally by the Company will be adequate to fund the operation of its businesses beyond a short period of time. These reasons raise significant doubt about the Company's ability to continue as a going concern.

As more fully discussed in Note 14, "Litigation," of the Notes to Consolidated Financial Statements, on March 15, 2007, the Company entered into a Settlement Agreement with MySpace, Inc. ("MySpace"), related to a lawsuit which was filed by MySpace on June 1, 2006 in the United States District Court for the Central District of California (the "Court"). The lawsuit alleged, among other things, that the Company sent unsolicited and unauthorized commercial email messages to MySpace members in violation of certain federal and state laws and the Company's contract with MySpace. On February 28, 2007, the Court entered an order (the "Order") finding the Company liable for violating certain federal and state laws and for breaching its contract with MySpace. The Order was not a final judgment nor did it make a determination as to the actual amount of damages to be awarded. However, based upon preliminary estimates, the Company believes that total awarded damages could range from approximately \$45.5 million to \$125.5 million, excluding "per incident" damages assessed under California law. Pursuant to the Settlement Agreement, the Company agreed to pay MySpace approximately \$2.6 million on or before April 5, 2007 in exchange for a mutual release of all claims against one another, including any claims against the Company's directors and officers. As part of the settlement, Michael Egan, the Company's CEO, who is also an affiliate, agreed to enter into an agreement with MySpace on or before April 5<sup>th</sup> pursuant to which he would, among other things, provide a letter of credit, cash or

other equivalent security (collectively, the “Security”) in form and substance satisfactory to MySpace. Such Security is to expire and be released on the 100<sup>th</sup> day following the Company’s payment of the foregoing \$2.6 million so long as no bankruptcy petition, assignment for the benefit of creditors or like liquidation, reorganization or insolvency proceeding is instituted or filed related to the Company during such 100-day period.

The Company does not currently have the resources to both pay the \$2.6 million settlement amount and to fund operations beyond April 2007. The Company intends to seek to raise capital or otherwise borrow funds with which to pay such amount and otherwise to fund operations. Although there is no commitment to do so, any such funds would most likely come primarily from Mr. Egan or affiliates of Mr. Egan or the Company, as the Company currently has no access to credit facilities with traditional third party lenders and has historically relied on borrowings from related parties to meet short-term liquidity needs. Any such capital raised would not be registered under the Securities Act of 1933 and would not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. There can be no assurance that the Company will be successful in raising such capital or borrowing such funds and any capital raised will likely result in very substantial dilution of the number of shares outstanding or which could be outstanding upon the exercise or conversion of any derivative securities issued by the Company as part of such capital raise. The failure to pay the \$2.6 million to MySpace and/or the failure to satisfactorily provide the Security would result in a resumption of the litigation with MySpace and, in all likelihood, would have a material adverse effect on the Company, including the potential bankruptcy and cessation of business of the Company.

The Company continues to incur consolidated net losses and management believes that the Company will continue to be unprofitable in the foreseeable future. As of February 28, 2007, the Company had a net working capital deficit of approximately \$7.3 million, inclusive of a cash and cash equivalents balance of approximately \$4.0 million. Such working capital deficit includes a settlement liability of approximately \$2.6 million owed to MySpace and an aggregate of \$3.4 million in secured convertible demand notes (the "Convertible Notes") and accrued interest of approximately \$611 thousand due to entities controlled by the Company's Chairman and Chief Executive Officer. Inasmuch as substantially all of the assets of the Company and its subsidiaries secure the Convertible Notes, in connection with any resulting proceeding to collect the indebtedness related to the Convertible Notes, the noteholders could seize and sell the assets of the Company and its subsidiaries, any or all of which would have a material adverse effect on the financial condition and future operations of the Company, including the potential bankruptcy or cessation of business of the Company.

It is our preference to avoid filing for protection under the U.S. Bankruptcy Code. However, in order to avoid such filing and continue as a going concern, we believe that, in addition to settling the MySpace litigation as discussed above, we must (i) quickly raise a sufficient amount of capital; (ii) successfully implement a business plan focused primarily on expanding our Tralliance Internet services revenue base, and reducing Tralliance and corporate overhead expenses; and (iii) successfully eliminate future losses incurred by our VoIP telephony services and computer games business segments by effectuating our planned shutdown and/or selling certain component assets of these businesses. There can be no assurance that the Company will be able to successfully complete any or all of the above actions which we believe are required in order to continue as a going concern.

#### **WE HAVE A HISTORY OF OPERATING LOSSES AND EXPECT TO CONTINUE TO INCUR LOSSES.**

Since our inception, we have incurred net losses each year and we expect that we will continue to incur net losses for the foreseeable future. We had losses from continuing operations, net of applicable income tax benefits, of approximately \$17.0 million, \$13.3 million and \$24.9 million for the years ended December 31, 2006, 2005 and 2004, respectively. The principal causes of our losses are likely to continue to be:

- costs resulting from the operation of our business;

- failure to generate sufficient revenue; and
- selling, general and administrative expenses.

Although we have restructured our businesses, we still expect to continue to incur losses as we attempt to improve the performance and operating results of our Internet services business and while we attempt to sell components of our recently discontinued computer games and VoIP telephony services businesses.

**WE ARE A PARTY TO LITIGATION MATTERS AND OTHER CLAIMS THAT MAY SUBJECT US TO SIGNIFICANT LIABILITY AND BE TIME CONSUMING AND EXPENSIVE.**

We are currently a party to litigation and other claims and/or disputes arising in the ordinary course of business. At this time, other than the \$2.6 million settlement amount owed to MySpace, we cannot reasonably estimate the range of any loss or damages resulting from any of the pending lawsuits or claims due to uncertainty regarding the ultimate outcome. The defense of any litigation or the process required to resolve outstanding claims and/or disputes may be expensive and divert management's attention from day-to-day operations. An adverse outcome in any of these matters could materially and adversely affect our results of operations and financial position and may utilize a significant portion of our cash resources. See Note 14, "Litigation," in the Notes to Consolidated Financial Statements for further details regarding outstanding lawsuits.

**OUR NET OPERATING LOSS CARRYFORWARDS MAY BE SUBSTANTIALLY LIMITED.**

As of December 31, 2006, we had net operating loss carryforwards which may be potentially available for U.S. tax purposes of approximately \$162 million. These carryforwards expire through 2026. The Tax Reform Act of 1986 imposes substantial restrictions on the utilization of net operating losses and tax credits in the event of an "ownership change" of a corporation. Due to various significant changes in our ownership interests, as defined in the Internal Revenue Code of 1986, as amended, we have substantially limited the availability of our net operating loss carryforwards. There can be no assurance that we will be able to utilize any net operating loss carryforwards in the future.

**WE DEPEND ON THE CONTINUED GROWTH IN THE USE AND COMMERCIAL VIABILITY OF THE INTERNET.**

Our Internet services business is substantially dependent upon the continued growth in the general use of the Internet. Internet and electronic commerce growth may be inhibited for a number of reasons, including:

- inadequate network infrastructure;
- security and authentication concerns;
- inadequate quality and availability of cost-effective, high-speed service;
- general economic and business downturns; and
- catastrophic events, including war and terrorism.

As web usage grows, the Internet infrastructure may not be able to support the demands placed on it by this growth or its performance and reliability may decline. Websites have experienced interruptions in their service as a result of outages and other delays occurring throughout the Internet network infrastructure. If these outages or delays

frequently occur in the future, web usage, as well as usage of our services, could grow more slowly or decline. Also, the Internet's commercial viability may be significantly hampered due to:

- delays in the development or adoption of new operating and technical standards and performance improvements required to handle increased levels of activity;

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- increased government regulation;
- potential governmental taxation of such services; and
- insufficient availability of telecommunications services which could result in slower response times and adversely affect usage of the Internet.

**WE MAY FACE INCREASED GOVERNMENT REGULATION, TAXATION AND LEGAL UNCERTAINTIES IN OUR INDUSTRY, BOTH DOMESTICALLY AND INTERNATIONALLY, WHICH COULD NEGATIVELY IMPACT OUR FINANCIAL CONDITION AND/OR OUR RESULTS OF OPERATIONS.**

There are an increasing number of federal, state, local and foreign laws and regulations pertaining to the Internet. In addition, a number of federal, state, local and foreign legislative and regulatory proposals are under consideration. Laws and regulations have been and will likely continue to be adopted with respect to the Internet relating to, among other things, liability for information retrieved from or transmitted over the Internet, online content regulation, user privacy, data protection, pricing, content, copyrights, distribution, electronic contracts and other communications, consumer protection, the provision of online payment services, broadband residential Internet access and the characteristics and quality of products and services.

Changes in tax laws relating to electronic commerce could materially affect our business, prospects and financial condition. One or more states or foreign countries may seek to impose sales or other tax collection obligations on out-of-jurisdiction companies that engage in electronic commerce. A successful assertion by one or more states or foreign countries that we should collect sales or other taxes on services could result in substantial tax liabilities for past sales, decrease our ability to compete with other entities involved in the industries in which we participate, and otherwise harm our business.

Moreover, the applicability to the Internet of existing laws governing issues such as intellectual property ownership and infringement, copyright, trademark, trade secret, obscenity, libel, employment and personal privacy is uncertain and developing. It is not clear how existing laws governing issues such as property ownership, sales and other taxes, libel, and personal privacy apply to the Internet and electronic commerce. Any new legislation or regulation, or the application or interpretation of existing laws or regulations, may decrease the growth in the use of the Internet, may impose additional burdens on electronic commerce or may alter how we do business. This could decrease the demand for our existing or proposed services, increase our cost of doing business, increase the costs of products sold through the Internet or otherwise have a material adverse effect on our business, plans, prospects, results of operations and financial condition.

**WE RELY ON INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS.**

We regard substantial elements of our websites and underlying technology, as well as certain VoIP technology assets, as proprietary and attempt to protect them by relying on intellectual property laws and restrictions on disclosure. We also generally enter into confidentiality agreements with our employees and consultants. In connection with our license agreements with third parties, we generally seek to control access to and distribution of our technology and other proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our proprietary information without authorization or to develop similar technology independently. Thus, we cannot assure you that the steps taken by us will prevent misappropriation or infringement of our proprietary information, which could have an adverse effect on our business. In addition, our competitors may independently develop similar technology, duplicate our products, or design around our intellectual property rights.



We pursue the registration of our trademarks in the United States and, in some cases, internationally. We have been awarded patent protection for certain VoIP assets which we acquired or which we have developed. However, effective intellectual property protection may not be available in every country in which our services are distributed or made available through the Internet. Policing unauthorized use of our proprietary information is difficult. Legal standards relating to the validity, enforceability and scope of protection of proprietary rights in Internet related businesses are also uncertain and still evolving. We cannot assure you about the future viability or value of any of our proprietary rights.

Litigation may be necessary in the future to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. However, we may not have sufficient funds or personnel to adequately litigate or otherwise protect our rights. Furthermore, we cannot assure you that our business activities and product offerings will not infringe upon the proprietary rights of others, or that other parties will not assert infringement claims against us, including claims related to providing hyperlinks to websites operated by third parties, sending unsolicited email messages or providing advertising on a keyword basis that links a specific search term entered by a user to the appearance of a particular advertisement. Moreover, from time to time, third parties have asserted and may in the future assert claims of alleged infringement by us of their intellectual property rights. In the fourth quarter of 2005, we were sued by Sprint Communications Company, L.P. (“Sprint”) for alleged unauthorized use of “inventions” described and claimed in seven patents held by Sprint. In August 2006, we entered into a settlement agreement with Sprint which resolved the pending patent infringement lawsuit. As part of the settlement, we agreed to enter into a non-exclusive license under certain of Sprint’s patents. Additionally, on February 28, 2007, the United States District Court for the Central District of California entered an order, related to the lawsuit filed against theglobe by MySpace, Inc. (“MySpace”), granting in part MySpace’s motion for summary judgment, finding that we were liable for violation of the CAN-SPAM Act and the California Business & Professions Code, and for breach of contract. On March 15, 2007, the Company entered into a Settlement Agreement with MySpace whereby, among other things, the Company agreed to pay MySpace approximately \$2.6 million on or before April 5, 2007 in exchange for a mutual release of all claims against one another, including any claims against the Company’s directors and officers. See Note 14, “Litigation,” in the Notes to Consolidated Financial Statements for further details regarding the litigation mentioned above. Any litigation claims or counterclaims could impair our business because they could:

- be time-consuming;
- result in significant costs;
- subject us to significant liability for damages;
- result in invalidation of our proprietary rights;
- divert management's attention;
- cause product release delays; or
- require us to redesign our products or require us to enter into royalty or licensing agreements that may not be available on terms acceptable to us, or at all.

We license from third parties various technologies incorporated into our products, networks and sites. We cannot assure you that these third-party technology licenses will continue to be available to us on commercially reasonable terms. Additionally, we cannot assure you that the third parties from which we license our technology will be able to defend our proprietary rights successfully against claims of infringement. As a result, our inability to obtain any of these technology licenses could result in delays or reductions in the introduction of new products and services or could adversely affect the performance of our existing products and services until equivalent technology can be identified,

licensed and integrated.

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The regulation of domain names in the United States and in foreign countries may change. Regulatory bodies could establish and have established additional top-level domains, could appoint additional domain name registries or could modify the requirements for holding domain names, any or all of which may dilute the strength of our names or our “.travel” domain registry business. We may not acquire or maintain our domain names in all of the countries in which our websites may be accessed, or for any or all of the top-level domain names that may be introduced. The relationship between regulations governing domain names and laws protecting proprietary rights is unclear. Therefore, we may not be able to prevent third parties from acquiring domain names that infringe or otherwise decrease the value of our trademarks and other proprietary rights.

**WE MAY BE UNSUCCESSFUL IN ESTABLISHING AND MAINTAINING BRAND AWARENESS; BRAND IDENTITY IS CRITICAL TO OUR COMPANY.**

Our success in the markets in which we operate will depend on our ability to create and maintain brand awareness for our product offerings. This has in some cases required, and may continue to require, a significant amount of capital to allow us to market our products and establish brand recognition and customer loyalty. Many of our competitors are larger than us and have substantially greater financial resources.

If we fail to promote and maintain our various brands or our business' brand values are diluted, our business, operating results, and financial condition could be materially adversely affected. The importance of brand recognition will continue to increase because low barriers of entry to the industries in which we operate may result in an increased number of direct competitors. To promote our brands, we may be required to continue to increase our financial commitment to creating and maintaining brand awareness. We may not generate a corresponding increase in revenue to justify these costs.

**OUR QUARTERLY OPERATING RESULTS FLUCTUATE.**

Due to our significant change in operations, including the entry into new lines of business and disposition of other lines of business, our historical quarterly operating results are not necessarily reflective of future results. The factors that will cause our quarterly operating results to fluctuate in the future include:

- the outcome and costs related to defending and settling outstanding litigation, claims and disputes;
- sales of our recently discontinued businesses or assets;
- changes in the number of sales or technical employees;
- the level of traffic on our websites;
- the overall demand for Internet travel services and Internet advertising;
- the addition or loss of “.travel” domain name registrants, advertising clients of our [www.search.travel](http://www.search.travel) website and electronic commerce partners on our website;
- overall usage and acceptance of the Internet;
- seasonal trends in advertising and electronic commerce sales in our business;
- costs relating to the implementation or cessation of marketing plans for our business;

- other costs relating to the maintenance of our operations;
- the restructuring of our business;

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- failure to generate significant revenues and profit margins from new and/or existing products and services; and
- competition from others providing services similar to ours.

**OUR LIMITED OPERATING HISTORY MAKES FINANCIAL FORECASTING DIFFICULT. OUR INEXPERIENCE IN THE INTERNET SERVICES BUSINESS WILL MAKE FINANCIAL FORECASTING EVEN MORE DIFFICULT.**

We have a limited operating history for you to use in evaluating our prospects and us, particularly as it pertains to our Internet services business. Our prospects should be considered in light of the risks encountered by companies operating in new and rapidly evolving markets like ours. We may not successfully address these risks. For example, we may not be able to:

- maintain or increase levels of user traffic on our [www.search.travel](http://www.search.travel) website;
- generate and maintain adequate levels of “.travel” domain name registrations;
- generate and maintain adequate [www.search.travel](http://www.search.travel) advertising revenue;
- adapt to meet changes in our markets and competitive developments; and
- identify, attract, retain and motivate qualified personnel.

**OUR MANAGEMENT TEAM IS INEXPERIENCED IN THE MANAGEMENT OF A LARGE OPERATING COMPANY.**

Only our Chairman has had experience managing a large operating company. Accordingly, we cannot assure you that:

- our key employees will be able to work together effectively as a team;
- we will be able to retain the remaining members of our management team;
- we will be able to hire, train and manage our employee base;
- our systems, procedures or controls will be adequate to support our operations; and
- our management will be able to achieve the rapid execution necessary to fully exploit the market opportunity for our products and services.

**WE DEPEND ON HIGHLY QUALIFIED TECHNICAL AND MANAGERIAL PERSONNEL**

Our future success also depends on our continuing ability to attract, retain and motivate highly qualified technical expertise and managerial personnel necessary to operate our businesses. We may need to give retention bonuses and stock incentives to certain employees to keep them, which can be costly to us. The loss of the services of members of our management team or other key personnel could harm our business. Our future success depends to a significant extent on the continued service of key management, client service, product development, sales and technical personnel. We do not maintain key person life insurance on any of our executive officers and do not intend to purchase any in the future. Although we generally enter into non-competition agreements with our key employees, our business could be harmed if one or more of our officers or key employees decided to join a competitor or otherwise

compete with us.

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We may be unable to attract, assimilate or retain highly qualified technical and managerial personnel in the future. Our deteriorating financial performance creates uncertainty that may result in departures of key employees and our inability to attract suitable replacements and/or additional managerial personnel in the future. Wages for managerial and technical employees are increasing and are expected to continue to increase in the future. We have from time to time in the past experienced, and could continue to experience in the future if we need to hire any additional personnel, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. If we were unable to attract and retain the technical and managerial personnel necessary to support and grow our businesses, our businesses would likely be materially and adversely affected.

**OUR OFFICERS, INCLUDING OUR CHAIRMAN AND CHIEF EXECUTIVE OFFICER AND PRESIDENT HAVE OTHER INTERESTS AND TIME COMMITMENTS; WE HAVE CONFLICTS OF INTEREST WITH SOME OF OUR DIRECTORS; ALL OF OUR DIRECTORS ARE EMPLOYEES OR STOCKHOLDERS OF THE COMPANY OR AFFILIATES OF OUR LARGEST STOCKHOLDER.**

Because our Chairman and Chief Executive Officer, Mr. Michael Egan, is an officer or director of other companies, we have to compete for his time. Mr. Egan became our Chief Executive Officer effective June 1, 2002. Mr. Egan is also the controlling investor of Dancing Bear Investments, Inc. and E&C Capital Partners LLLP, which are our largest stockholders. Mr. Egan has not committed to devote any specific percentage of his business time with us. Accordingly, we compete with Dancing Bear Investments, Inc., E&C Capital Partners LLLP, Blue Wall, LLC, Speecho, LLC and Mr. Egan's other related entities for his time.

Our President, Treasurer and Chief Financial Officer and Director, Mr. Edward A. Cespedes, is also an officer or director of other companies. Accordingly, we must compete for his time. Mr. Cespedes is an officer or director of various privately held entities and is also affiliated with Dancing Bear Investments, Inc.

Our Vice President of Finance and Director, Ms. Robin Lebowitz is also affiliated with Dancing Bear Investments, Inc. She is also an officer or director of other companies or entities controlled by Mr. Egan and Mr. Cespedes.

Due to the relationships with his related entities, Mr. Egan will have an inherent conflict of interest in making any decision related to transactions between the related entities and us, including investment in our securities. Furthermore, the Company's Board of Directors presently is comprised entirely of individuals which are employees of theglobe, and therefore are not "independent." We intend to review related party transactions in the future on a case-by-case basis.

**WE RELY ON THIRD PARTY OUTSOURCED HOSTING FACILITIES OVER WHICH WE HAVE LIMITED CONTROL.**

Our principal servers are located in areas throughout the eastern region of the United States primarily at third party outsourced hosting facilities. Our operations depend on the ability to protect our systems against damage from unexpected events, including fire, power loss, water damage, telecommunications failures and vandalism. Any disruption in our Internet access could have a material adverse effect on us. In addition, computer viruses, electronic break-ins or other similar disruptive problems could also materially adversely affect our businesses. Our reputation and/or the brands of our business could be materially and adversely affected by any problems experienced by our websites, databases or our supporting information technology networks. We may not have insurance to adequately compensate us for any losses that may occur due to any failures or interruptions in our systems. We do not presently have any secondary off-site systems or a formal disaster recovery plan.

**HACKERS MAY ATTEMPT TO PENETRATE OUR SECURITY SYSTEM; ONLINE SECURITY BREACHES COULD HARM OUR BUSINESS.**

Consumer and supplier confidence in our businesses depends on maintaining relevant security features. Substantial or ongoing security breaches on our systems or other Internet-based systems could significantly harm our business. We incur substantial expenses protecting against and remedying security breaches. Security breaches also could damage our reputation and expose us to a risk of loss or litigation. Experienced programmers or "hackers" have successfully penetrated our systems and we expect that these attempts will continue to occur from time to time. Because a hacker who is able to penetrate our network security could misappropriate proprietary or confidential information or cause interruptions in our products and services, we may have to expend significant capital and resources to protect against or to alleviate problems caused by these hackers. Additionally, we may not have a timely remedy against a hacker who is able to penetrate our network security. Such security breaches could materially adversely affect our company. In addition, the transmission of computer viruses resulting from hackers or otherwise could expose us to significant liability. Our insurance may not be adequate to reimburse us for losses caused by security breaches. We also face risks associated with security breaches affecting third parties with whom we have relationships.

**WE MAY BE EXPOSED TO LIABILITY FOR INFORMATION RETRIEVED FROM OR TRANSMITTED OVER THE INTERNET.**

Users may access content on our websites or the websites of our distribution partners or other third parties through website links or other means, and they may download content and subsequently transmit this content to others over the Internet. This could result in claims against us based on a variety of theories, including defamation, obscenity, negligence, copyright infringement, trademark infringement or the wrongful actions of third parties. Other theories may be brought based on the nature, publication and distribution of our content or based on errors or false or misleading information provided on our websites. Claims have been brought against online services in the past and we have received inquiries from third parties regarding these matters. Such claims could be material in the future.

**WE MAY BE EXPOSED TO LIABILITY FOR PRODUCTS OR SERVICES SOLD OVER THE INTERNET, INCLUDING PRODUCTS AND SERVICES SOLD BY OTHERS.**

We enter into agreements with commerce partners and sponsors under which, in some cases, we are entitled to receive a share of revenue from the purchase of goods and services through direct links from our sites. We cannot assure you that any indemnification that may be provided to us in some of these agreements with these parties will be adequate. Even if these claims do not result in our liability, we could incur significant costs in investigating and defending against these claims. The imposition of potential liability for information carried on or disseminated through our systems could require us to implement measures to reduce our exposure to liability. Those measures may require the expenditure of substantial resources and limit the attractiveness of our services. Additionally, our insurance policies may not cover all potential liabilities to which we are exposed.

**WE MAY NOT BE ABLE TO IMPLEMENT SECTION 404 OF THE SARBANES-OXLEY ACT ON A TIMELY BASIS.**

The Securities and Exchange Commission (the "SEC"), as directed by Section 404 of The Sarbanes-Oxley Act, adopted rules generally requiring each public company to include a report of management on the company's internal controls over financial reporting in its annual report on Form 10-K that contains an assessment by management of the effectiveness of the company's internal controls over financial reporting. In addition, the company's independent registered public accounting firm must attest to and report on management's assessment of the effectiveness of the company's internal controls over financial reporting. This requirement will first apply to our annual report on Form 10-K for the fiscal year ending December 31, 2007.

We have not yet developed a Section 404 implementation plan. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement.

We expect that we will need to hire and/or engage additional personnel and incur incremental costs in order to complete the work required by Section 404. There can be no assurance that we will be able to complete a Section 404 plan on a timely basis. The Company's liquidity position will also impact our ability to adequately fund our Section 404 efforts.

Even if we timely complete a Section 404 plan, we may not be able to conclude that our internal controls over financial reporting are effective, or in the event that we conclude that our internal controls are effective, our independent accountants may disagree with our assessment and may issue a report that is qualified. This could subject the Company to regulatory scrutiny and a loss of public confidence in our internal controls. In addition, any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm the Company's operating results or cause the Company to fail to meet its reporting obligations.



## **RISKS RELATING TO OUR INTERNET SERVICES BUSINESS**

### **OUR CONTRACT TO SERVE AS THE REGISTRY FOR THE “.TRAVEL” TOP-LEVEL DOMAIN MAY BE TERMINATED EARLY, WHICH WOULD LIKELY DO IRREPARABLE HARM TO OUR DEVELOPING INTERNET SERVICES BUSINESS.**

Our contract with the Internet Corporation for Assigned Names and Numbers (“ICANN”) to serve as the registry for the “.travel” top-level Internet domain is for an initial term of ten years. Additionally, we have agreed to engage in good faith negotiations at regular intervals throughout the term of our contract (at least once every three years) regarding possible changes to the provisions of the contract, including changes in the fees and payments that we are required to make to ICANN. In the event that we materially and fundamentally breach the contract and fail to cure such breach within thirty days of notice, ICANN has the right to immediately terminate our contract.

Should our “.travel” registry contract be terminated early by ICANN, we would likely permanently shutdown our Internet services business. Further, we could be held liable to pay additional fees or financial damages to ICANN or certain of our related subcontractors and, in certain limited circumstances, to pay punitive, exemplary or other damages to ICANN. Any such developments could have a material adverse effect on our financial condition and results of operations.

### **OUR BUSINESS COULD BE MATERIALLY HARMED IF IN THE FUTURE THE ADMINISTRATION AND OPERATION OF THE INTERNET NO LONGER RELIES UPON THE EXISTING DOMAIN NAME SYSTEM.**

The domain name registration industry continues to develop and adapt to changing technology. This development may include changes in the administration or operation of the Internet, including the creation and institution of alternate systems for directing Internet traffic without the use of the existing domain name system. The widespread acceptance of any alternative systems could eliminate the need to register a domain name to establish an online presence and could materially adversely affect our business, financial condition and results of operations.

### **WE OUTSOURCE CERTAIN OPERATIONS WHICH EXPOSES US TO RISKS RELATED TO OUR THIRD PARTY VENDORS.**

We do not develop and maintain all of the products and services that we offer. We offer most of our services to our customers through various third party service providers engaged to perform these services on our behalf and also outsource most of our operations to third parties. Accordingly, we are dependent, in part, on the services of third party service providers, which may raise concerns by our customers regarding our ability to control the services we offer them if certain elements are managed by another company. In the event that these service providers fail to maintain adequate levels of support, do not provide high quality service, discontinue their lines of business, cease or reduce operations or terminate their contracts with us, our business, operations and customer relations may be impacted negatively and we may be required to pursue replacement third party relationships, which we may not be able to obtain on as favorable terms or at all. If a problem should arise with a provider, transitioning services and data from one provider to another can often be a complicated and time consuming process and we cannot assure that if we need to switch from a provider we would be able to do so without significant disruptions, or at all. If we were unable to complete a transition to a new provider on a timely basis, or at all, we could be forced to either temporarily or permanently discontinue certain services which may disrupt services to our customers. Any failure to provide services would have a negative impact on our revenue, profitability and financial condition and could materially harm our Internet services business.

**REGULATORY AND STATUTORY CHANGES COULD HARM OUR INTERNET SERVICES BUSINESS.**

We cannot predict with any certainty the effect that new governmental or regulatory policies, including changes in consumer privacy policies or industry reaction to those policies, will have on our domain name registry business. Additionally, ICANN's limited resources may seriously affect its ability to carry out its mandate or could force ICANN to impose additional fees on registries. Changes in governmental or regulatory statutes or policies could cause decreases in future revenue and increases in future costs which could have a material adverse effect on the development of our domain name registry business.

**OUR INTERNET SERVICES BUSINESS IS DEPENDENT ON THE TRAVEL INDUSTRY. OUR BUSINESS MAY AFFECTED BY EVENTS WHICH AFFECT THE TRAVEL INDUSTRY IN GENERAL.**

Revenue and cash flows of our Internet services business principally result from the registrations of domain names in the ".travel" top level domain. The ability to register such domain names are only available to businesses which are involved in the travel industry. Events such as terrorist attacks, military actions and natural disasters have had a significant adverse affect on the travel industry in the past. In addition, recessions or other economic pressures, such as the level of employment in the U.S or abroad have also had negative impacts on the travel industry. The overall demand for advertising, as well as the level of consumer travel may also be linked to such events or economic conditions. If such events result in a negative impact on the travel industry, such impact could have a material adverse effect on our business, results of operations and financial condition.

**WE MAY NOT BE ABLE TO ATTRACT ADVERTISERS OR INTERNET USERS TO OUR SEARCH.TRAVEL WEBSITE.**

Our [www.search.travel](http://www.search.travel) search engine competes for advertising dollars with large Internet portal and search engine sites, such as Google, America Online, MSN and Yahoo!, that offer listings or other advertising opportunities for travel companies. These companies have significantly greater financial, technical, marketing and other resources and larger client bases. In addition, we also compete with traditional media companies, such as newspaper and magazine publishers, that provide online advertising opportunities on their websites. We expect to face additional competition as other companies enter the online advertising market. If we do not attract a sufficient number of Internet users and advertisers to our search engine website, our present business model may not be successful and our business could be adversely affected.

**RISKS RELATING TO OUR RECENTLY DISCONTINUED OPERATIONS**

**WE MAY NOT BE ABLE TO RECOVER THE FULL CARRYING VALUE OF THE ASSETS OF OUR RECENTLY DISCONTINUED BUSINESSES.**

In connection with our recent decision to discontinue the operations of our computer games and VoIP telephony services businesses, we are currently in the process of evaluating the recoverability of the carrying value of the remaining assets of these businesses. At the present time, management is not aware of any issues that would negatively impact the recoverability of these assets. However, there can be no assurance that future events will not occur, particularly with respect to the collection of approximately \$500 thousand in accounts receivable of our computer games businesses, which will adversely impact the recoverability of these discontinued business assets. Any such adverse future events could negatively impact the Company's already weakened liquidity and financial condition.

**WE MAY INCUR EXCESSIVE SHUTDOWN COSTS.**

In connection with our recent decision to discontinue the operations of our computer games and VoIP telephony services businesses, we are in the process of evaluating the amount of costs expected to be incurred in shutting down

these businesses. The amount of these shutdown costs, including employee termination benefits and vendor contract termination costs, are not yet certain, however, at the present time, we believe that total shutdown costs for both businesses combined will range from between \$20 thousand to \$835 thousand. Although we will attempt to negotiate vendor settlements near the lower end of this range, there can be no assurance that we will be successful. Additionally, liabilities presently unknown to us could be identified in the future. Either or both of these adverse outcomes could negatively impact the Company's already weakened liquidity and financial condition.

## **RISKS RELATING TO OUR COMMON STOCK**

### **THE VOLUME OF SHARES AVAILABLE FOR FUTURE SALE IN THE OPEN MARKET COULD DRIVE DOWN THE PRICE OF OUR STOCK OR KEEP OUR STOCK PRICE FROM IMPROVING, EVEN IF OUR FINANCIAL PERFORMANCE IMPROVES.**

As of March 19, 2007, we had issued and outstanding approximately 172.5 million shares, of which approximately 84.8 million shares were freely tradable over the public markets. There is limited trading volume in our shares and we are now traded only in the over-the-counter market. Most of our outstanding restricted shares of Common Stock were issued more than one year ago and are therefore eligible to be resold over the public markets pursuant to Rule 144 promulgated under the Securities Act of 1933, as amended.

Sales of significant amounts of Common Stock in the public market in the future, the perception that sales will occur or the registration of additional shares pursuant to existing contractual obligations could materially and adversely drive down the price of our stock. In addition, such factors could adversely affect the ability of the market price of the Common Stock to increase even if our business prospects were to improve. Substantially all of our stockholders holding restricted securities, including shares issuable upon the exercise of warrants or the conversion of convertible notes to acquire our Common Stock (which are convertible into 68 million shares), have registration rights under various conditions and are or will become available for resale in the future.

In addition, as of December 31, 2006, there were outstanding options to purchase approximately 20.1 million shares of our Common Stock, which become eligible for sale in the public market from time to time depending on vesting and the expiration of lock-up agreements. The shares issuable upon exercise of these options are registered under the Securities Act and consequently, subject to certain volume restrictions as to shares issuable to executive officers, will be freely tradable.

Also as of March 19, 2007, we had issued and outstanding warrants to acquire approximately 16.9 million shares of our Common Stock. Many of the outstanding instruments representing the warrants contain anti-dilution provisions pursuant to which the exercise prices and number of shares issuable upon exercise may be adjusted.

### **OUR CHAIRMAN MAY CONTROL US.**

Michael S. Egan, our Chairman and Chief Executive Officer, beneficially owns or controls, directly or indirectly, approximately 150 million shares of our Common Stock as of March 19, 2007, which in the aggregate represents approximately 58% of the outstanding shares of our Common Stock (treating as outstanding for this purpose the shares of Common Stock issuable upon exercise and/or conversion of the options, convertible promissory notes and warrants owned by Mr. Egan or his affiliates). Accordingly, Mr. Egan will be able to exercise significant influence over, if not control, any stockholder vote.

### **DELISTING OF OUR COMMON STOCK MAKES IT MORE DIFFICULT FOR INVESTORS TO SELL SHARES. THIS MAY POTENTIALLY LEAD TO FUTURE MARKET DECLINES.**

The shares of our Common Stock were delisted from the NASDAQ national market in April 2001 and are now traded in the over-the-counter market on what is commonly referred to as the electronic bulletin board or "OTCBB." As a result, an investor may find it more difficult to dispose of or obtain accurate quotations as to the market value of the securities. The delisting has made trading our shares more difficult for investors, potentially leading to further declines in share price and making it less likely our stock price will increase. It has also made it more difficult for us to raise additional capital. We may also incur additional costs under state blue-sky laws if we sell equity due to our delisting.



**OUR COMMON STOCK MAY BECOME SUBJECT TO CERTAIN "PENNY STOCK" RULES WHICH MAY MAKE IT A LESS ATTRACTIVE INVESTMENT.**

Since the trading price of our Common Stock is less than \$5.00 per share, trading in our Common Stock would be subject to the requirements of Rule 15c-9 of the Exchange Act if our net tangible assets were to fall below \$2.0 million. Under Rule 15c-9, brokers who recommend penny stocks to persons who are not established customers and accredited investors, as defined in the Exchange Act, must satisfy special sales practice requirements, including requirements that they make an individualized written suitability determination for the purchaser; and receive the purchaser's written consent prior to the transaction. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 also requires additional disclosures in connection with any trades involving a penny stock, including the delivery, prior to any penny stock transaction, of a disclosure schedule explaining the penny stock market and the risks associated with that market. Such requirements may severely limit the market liquidity of our Common Stock and the ability of purchasers of our equity securities to sell their securities in the secondary market. For all of these reasons, an investment in our equity securities may not be attractive to our potential investors.

**ANTI-TAKEOVER PROVISIONS AFFECTING US COULD PREVENT OR DELAY A CHANGE OF CONTROL.**

Provisions of our charter, by-laws and stockholder rights plan and provisions of applicable Delaware law may:

- have the effect of delaying, deferring or preventing a change in control of our Company;
- discourage bids of our Common Stock at a premium over the market price; or
- adversely affect the market price of, and the voting and other rights of the holders of, our Common Stock.

Certain Delaware laws could have the effect of delaying, deterring or preventing a change in control of our Company. One of these laws prohibits us from engaging in a business combination with any interested stockholder for a period of three years from the date the person became an interested stockholder, unless various conditions are met. In addition, provisions of our charter and by-laws, and the significant amount of Common Stock held by our current executive officers, directors and affiliates, could together have the effect of discouraging potential takeover attempts or making it more difficult for stockholders to change management. In addition, the employment contracts of our Chairman and CEO, President and Vice President of Finance provide for substantial lump sum payments ranging from 2 (for the Vice President) to 10 times (for each of the Chairman and President) of their respective average combined salaries and bonuses (together with the continuation of various benefits for extended periods) in the event of their termination without cause or a termination by the executive for "good reason," which is conclusively presumed in the event of a "change-in-control" (as such terms are defined in such agreements).

**OUR STOCK PRICE IS VOLATILE AND MAY DECLINE.**

The trading price of our Common Stock has been volatile and may continue to be volatile in response to various factors, including:

- the performance and public acceptance of our product lines;
- quarterly variations in our operating results;
- competitive announcements;

- sales of any of our recently discontinued businesses and/or components of their assets;
- the operating and stock price performance of other companies that investors may deem comparable to us; and

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· news relating to trends in our markets.

The market price of our Common Stock could also decline as a result of unforeseen factors. The stock market has experienced significant price and volume fluctuations, and the market prices of technology companies, particularly Internet related companies, have been highly volatile. Our stock is also more volatile due to the limited trading volume and the high number of shares eligible for trading in the market.

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

#### **ITEM 2. PROPERTIES**

Our corporate headquarters is located in Fort Lauderdale, Florida, where we sublease approximately 15,000 square feet of office space from a company which is controlled by our Chairman. We lease approximately 2,200 square feet of office space in Vermont in connection with the operations of our computer games division and also lease approximately 5,000 square feet of warehouse space in Pompano Beach, Florida. Additionally, we currently utilize space in secure telecommunications data centers located in several states which is used to house certain Internet routing and computer equipment.

#### **ITEM 3. LEGAL PROCEEDINGS**

On June 1, 2006, MySpace, Inc. ("MySpace"), a Delaware corporation, filed a lawsuit in the United States District Court for the Central District of California against theglobe.com, inc. (the "Company"). We were served with the lawsuit on June 6, 2006. MySpace alleged that the Company sent at least 100,000 unsolicited and unauthorized commercial email messages to MySpace members using MySpace user accounts improperly established by the Company, that the user accounts were used in a false and misleading fashion and that the Company's alleged activities constituted violations of the CAN-SPAM Act, the Lanham Act and California Business & Professions Code § 17529.5 (the "California Act"), as well as trademark infringement, false advertising, breach of contract, breach of the covenant of good faith and fair dealing, and unfair competition. MySpace seeks monetary penalties, damages and injunctive relief for these alleged violations. It asserts entitlement to recover "a minimum of" \$62.3 million of damages, in addition to three times the amount of MySpace's actual damages and/or disgorgement of the Company's purported profits from alleged violations of the Lanham Act, punitive damages and attorneys' fees. Subsequent discovery in the case disclosed that the total number of unsolicited messages was approximately 400,000.

On February 28, 2007, the Court entered an order (the "Order") granting in part MySpace's motion for summary judgment, finding that the Company was liable for violation of the CAN-SPAM Act and the California Business & Professions Code, and for breach of contract (as embodied in MySpace's "Terms of Service" contract). The Order also upheld as valid that portion of MySpace's Terms of Service contract which provides for liquidated damages of \$50 per email message sent after March 17, 2006 in violation of such Terms. The Company estimates that approximately 110,000 of the emails in question were sent after such date, which could result in damages of approximately \$5.5 million. In addition, the CAN-SPAM Act provides for statutory damages of between \$100 and \$300 per email sent in violation of the statute. Total damages under CAN-SPAM could therefore range between about \$40 million to about \$120 million. In addition, under the California Act, statutory damages of \$1,000,000 "per incident" could be assessed.

On March 15, 2007, the Company entered into a Settlement Agreement with MySpace whereby it agreed to pay MySpace approximately \$2.6 million on or before April 5, 2007 in exchange for a mutual release of all claims against one another, including any claims against the Company's directors and officers. As part of the settlement, Michael Egan, the Company's CEO, who is also an affiliate of the Company, agreed to enter into an agreement with MySpace on or before April 5<sup>th</sup> pursuant to which he would, among other things, provide a letter of credit, cash or other

equivalent security (collectively, "Security") in form and substance satisfactory to MySpace. Such Security is to expire and be released on the 100<sup>th</sup> day following the Company's payment of the foregoing \$2.6 million so long as no bankruptcy petition, assignment for the benefit of creditors or like liquidation, reorganization or insolvency proceeding is instituted or filed related to the Company during such 100-day period.

The Company does not currently have the resources to both pay the \$2.6 million settlement amount and to fund operations beyond April 2007. The Company intends to seek to raise capital or otherwise borrow funds with which to pay such amount and otherwise to fund operations. Although there is no commitment to do so, any such funds would most likely come primarily from Mr. Egan or affiliates of Mr. Egan or the Company. Any such capital raised would not be registered under the Securities Act of 1933 and would not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. There can be no assurance that the Company will be successful in raising such capital or borrowing such funds and any capital raised will likely result in very substantial dilution of the number of shares outstanding or which could be outstanding upon the exercise or conversion of any derivative securities issued by the Company as part of such capital raise. The failure to pay the \$2.6 million to MySpace and/or the failure to satisfactorily provide the Security would result in a resumption of the litigation with MySpace and, in all likelihood, would have a material adverse effect on the Company, including the potential bankruptcy and cessation of business of the Company.

On and after August 3, 2001 and as of the date of this filing, the Company is aware that six putative shareholder class action lawsuits were filed against the Company, certain of its current and former officers and directors (the "Individual Defendants"), and several investment banks that were the underwriters of the Company's initial public offering. The lawsuits were filed in the United States District Court for the Southern District of New York.

The lawsuits purport to be class actions filed on behalf of purchasers of the stock of the Company during the period from November 12, 1998 through December 6, 2000. Plaintiffs allege that the underwriter defendants agreed to allocate stock in the Company's initial public offering to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases of stock in the aftermarket at pre-determined prices. Plaintiffs allege that the Prospectus for the Company's initial public offering was false and misleading and in violation of the securities laws because it did not disclose these arrangements. On December 5, 2001, an amended complaint was filed in one of the actions, alleging the same conduct described above in connection with the Company's November 23, 1998 initial public offering and its May 19, 1999 secondary offering. A Consolidated Amended Complaint, which is now the operative complaint, was filed in the Southern District of New York on April 19, 2002. The action seeks damages in an unspecified amount. On February 19, 2003, a motion to dismiss all claims against the Company was denied by the Court. On October 13, 2004, the Court certified a class in six of the approximately 300 other nearly identical actions (the "focus cases") and noted that the decision is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Underwriter Defendants appealed the decision and the Second Circuit vacated the district court's decision granting class certification in those six cases on December 5, 2006. Plaintiffs have not yet moved to certify a class in theglobe.com case.

The Company has approved a settlement agreement and related agreements which set forth the terms of a settlement between the Company, the Individual Defendants, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. It is unclear what impact the Second Circuit's decision vacating class certification in the six focus cases will have on the settlement, which has not yet been finally approved by the Court. On December 14, 2006, Judge Scheindlin held a hearing. Plaintiffs informed the Court that they planned to file a petition for rehearing and rehearing *en banc*. The Court stayed all proceedings, including a decision on final approval of the settlement and any amendments of the complaints, pending the Second Circuit's decision on Plaintiffs' petition for rehearing. Plaintiffs filed the petition for rehearing and rehearing *en banc* on January 5, 2007.

Among other provisions, if it is ultimately approved by the Court, the settlement provides for a release of the Company and the Individual Defendants for the conduct alleged in the action to be wrongful. The Company would agree to undertake certain responsibilities, including agreeing to assign away, not assert, or release certain potential claims the Company may have against its underwriters. The settlement agreement also provides a guaranteed recovery of \$1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter defendants settle all of the cases for at least \$1 billion, no payment will be required under the issuers' settlement agreement. To the extent that the underwriter defendants settle for less than \$1 billion, the issuers are

required to make up the difference. On April 20, 2006, JPMorgan Chase and the Plaintiffs reached a preliminary agreement to settle for \$425 million. The JPMorgan Chase preliminary agreement has not yet been approved by the Court. In an amendment to the issuers' settlement agreement, the issuers' insurers agreed that the JPMorgan preliminary agreement, if approved, would offset the insurers' obligation to cover the remainder of Plaintiffs' guaranteed \$1 billion recovery by 50% of the value of the JP Morgan settlement, or \$212.5 million. Therefore, if the JP Morgan preliminary agreement to settle is finalized, and then preliminarily and finally approved by the Court, then the maximum amount that the issuers' insurers will be potentially liable for is \$787.5 million. It is unclear what impact the Second Circuit's decision vacating class certification in the focus cases will have on the JP Morgan preliminary agreement.

It is anticipated that any potential financial obligation of the Company to plaintiffs pursuant to the terms of the issuers' settlement agreement and related agreements will be covered by existing insurance. The Company currently is not aware of any material limitations on the expected recovery of any potential financial obligation to plaintiffs from its insurance carriers. Its carriers are solvent, and the company is not aware of any uncertainties as to the legal sufficiency of an insurance claim with respect to any recovery by plaintiffs. Therefore, we do not expect that the settlement will involve any payment by the Company. If material limitations on the expected recovery of any potential financial obligation to the plaintiffs from the Company's insurance carriers should arise, the Company's maximum financial obligation to plaintiffs pursuant to the settlement agreement would be less than \$3.4 million. However, if the JPMorgan Chase preliminary agreement is finalized, then preliminarily and finally approved, the Company's maximum financial obligation would be less than \$2.7 million.

There is no assurance that the court will grant final approval to the issuers' settlement. If the settlement agreement is not approved and the Company is found liable, we are unable to estimate or predict the potential damages that might be awarded, whether such damages would be greater than the Company's insurance coverage, and whether such damages would have a material impact on our results of operations or financial condition in any future period.

The Company is currently a party to certain other claims and disputes arising in the ordinary course of business. The Company currently believes that the ultimate outcome of these other matters, individually and in the aggregate, will not have a material adverse affect on the Company's financial position, results of operations or cash flows. However, because of the nature and inherent uncertainties of legal proceedings, should the outcome of these matters be unfavorable, the Company's business, financial condition, results of operations and cash flows could be materially and adversely affected.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

## PART II

#### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

##### MARKET INFORMATION

The shares of our Common Stock trade in the over-the-counter market on what is commonly referred to as the electronic bulletin board, under the symbol "TGLO.OB". The following table sets forth the range of high and low bid prices of our Common Stock for the periods indicated as reported by the over-the-counter market (the electronic bulletin board). The quotations below reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions:

	2006		2005		2004	
	High	Low	High	Low	High	Low
Fourth Quarter	\$ 0.09	\$ 0.05	\$ 0.49	\$ 0.24	\$ 0.56	\$ 0.36
Third Quarter	\$ 0.27	\$ 0.08	\$ 0.45	\$ 0.10	\$ 0.65	\$ 0.24
Second Quarter	\$ 0.31	\$ 0.09	\$ 0.16	\$ 0.08	\$ 0.96	\$ 0.28
First Quarter	\$ 0.44	\$ 0.30	\$ 0.43	\$ 0.12	\$ 1.42	\$ 0.83

The market price of our Common Stock is highly volatile and fluctuates in response to a wide variety of factors. (See "Risk Factors-Our Stock Price is Volatile and May Decline.")



**HOLDERS OF COMMON STOCK**

We had approximately 657 holders of record of Common Stock as of March 19, 2007. This does not reflect persons or entities that hold Common Stock in nominee or "street" name through various brokerage firms.

**DIVIDENDS**

We have not paid any cash dividends on our Common Stock since our inception and do not intend to pay dividends in the foreseeable future. Our board of directors will determine if we pay any future dividends.

**SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS AS OF DECEMBER 31, 2006**

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity Compensation plans approved by security holders	11,271,620	\$ 0.56	647,600
Equity Compensation plans not approved by security holders	8,871,000	\$ 0.11	2,194,141
<b>Total</b>	<b>20,142,620</b>	<b>\$ 0.36</b>	<b>2,841,741</b>

Equity compensation plans not approved by security holders consist of the following:

- 1,750,000 shares of Common Stock of theglobe.com, inc., issued to Edward A. Cespedes pursuant to the Non-Qualified Stock Option Agreement dated August 12, 2002 at an exercise price of \$0.02 per share. These stock options vested immediately and have a life of ten years from date of grant.
- 2,500,000 shares of Common Stock of theglobe.com, inc., issued to Michael S. Egan pursuant to the Non-Qualified Stock Option Agreement dated August 12, 2002 at an exercise price of \$0.02 per share. These stock options vested immediately and have a life of ten years from date of grant.
- 500,000 shares of Common Stock of theglobe.com, inc., issued to Robin S. Lebowitz pursuant to the Non-Qualified Stock Option Agreement dated August 12, 2002 at an exercise price of \$0.02 per share. These stock options vested immediately and have a life of ten years from date of grant.
- The Company's 2003 Amended and Restated Non-Qualified Stock Option Plan (the "2003 Plan"). The purpose of the 2003 Plan is to strengthen theglobe.com, inc. by providing an incentive to certain employees and consultants (or in certain circumstances, individuals who are the principals of certain consultants) of the Company or any subsidiary of the Company, with a view toward encouraging them to

devote their abilities and industry to the success of the Company's business enterprise. The 2003 Plan is administered by a Committee appointed by the Board to administer the Plan, which has the power to determine those eligible individuals to whom options shall be granted under the 2003 Plan and the number of such options to be granted and to prescribe the terms and conditions (which need not be identical) of each such option, including the exercise price per share subject to each option and vesting schedule of options granted thereunder, and make any amendment or modification to any agreement consistent with the terms of the 2003 Plan. The maximum number of shares that may be made the subject of options granted under the 2003 Plan is 1,000,000 and no option may have a term in excess of ten years. Options to acquire an aggregate of 41,000 shares of Common Stock have been issued to various independent sales agents at a weighted average exercise price of \$1.54. These stock options vested immediately and have a life of ten years from date of grant. Options to acquire an aggregate of 65,000 shares of Common Stock have been issued to various employees and independent contractors at a weighted average exercise price of \$1.00. These stock options vested immediately and have a life of ten years from date of grant. Options to acquire an aggregate of 110,000 shares of Common Stock have been issued to two independent contractors at a weighted average exercise price of \$1.22. These stock options vested immediately and have a life of five years from date of grant.

- The Company's 2004 Stock Incentive Plan (the "2004 Plan"). The purpose of the 2004 Plan is to enhance the profitability and value of the Company for the benefit of its stockholders by enabling the Company to offer eligible employees, consultants and non-employee directors stock-based and other incentives, thereby creating a means to raise the level of equity ownership by such individuals in order to attract, retain and reward such individuals and strengthen the mutuality of interests between such individuals and the Company's stockholders. The 2004 Plan is administered by a Committee appointed by the Board to administer the Plan, which has the power to determine those eligible individuals to whom stock options, stock appreciation rights, restricted stock awards, performance awards, or other stock-based awards shall be granted under the 2004 Plan and the number of such options, rights or awards to be granted and to prescribe the terms and conditions (which need not be identical) of each such option, right or award, including the exercise price per share subject to each option and vesting schedule of options granted thereunder, and make any amendment or modification to any agreement consistent with the terms of the 2004 Plan. The maximum number of shares that may be made the subject of options, rights or awards granted under the 2004 Plan is 7,500,000 and no option may have a term in excess of ten years. In October of 2004, options to acquire 250,000 shares of Common Stock were issued to an employee at an exercise price of \$0.52, of which 62,500 of these stock options vested immediately and the balance vests ratably on a quarterly basis over three years. These options have a life of ten years from date of grant. In June of 2006, options to acquire 1,000,000 shares of Common Stock were issued to two employees at an exercise price of \$0.10, of which 25% of these options vested immediately and the balance vests ratably on a quarterly basis over three years. These options have a life of ten years from date of grant. In August of 2006, options to acquire 2,655,000 shares of Common Stock were issued to 28 employees at an exercise price of \$0.14, of which 25% of these options vested immediately and the balance vests ratably on a quarterly basis over three years. These options have a life of ten years from date of grant.

**PERFORMANCE GRAPH**

The following graph compares the cumulative total return on theglobe's common stock during the last five fiscal years with the NASDAQ Stock Market Index (U.S. Companies) and the AMEX Interactive Week Internet Index during the same period. The graph shows the value, at the end of each of the last five fiscal years, of \$100 invested in theglobe common stock or the indices on December 31, 2001, and assumes the reinvestment of all dividends. Historical stock price performance is not necessarily indicative of future stock price performance.

	At December 31					
	2001	2002	2003	2004	2005	2006
theglobe	\$ 100	\$ 200	\$ 4,433	\$ 1,400	\$ 1,300	\$ 200
NASDAQ	\$ 100	\$ 69	\$ 104	\$ 113	\$ 115	\$ 127
AMEX Internet	\$ 100	\$ 57	\$ 98	\$ 119	\$ 120	\$ 137

The shares of our common stock were delisted from the NASDAQ national market in April 2001 and now trade in the over-the-counter market on what is commonly referred to as the electronic bulletin board or "OTCBB", under the symbol "TGLO.OB".

**RECENT SALES OF UNREGISTERED SECURITIES**

None.

**ITEM 6. SELECTED FINANCIAL DATA****SELECTED CONSOLIDATED FINANCIAL DATA OF THEGLOBE.COM, INC. (1)**

The selected consolidated balance sheet data as of December 31, 2006 and 2005 and the selected consolidated operating data for the years ended December 31, 2006, 2005 and 2004 have been derived from our audited consolidated financial statements included elsewhere herein. The selected consolidated balance sheet data as of December 31, 2004, 2003 and 2002 and the selected consolidated operating data for the years ended December 31, 2003 and 2002 have been derived from our audited consolidated financial statements not included herein. The nature of our business has changed significantly from 2002 to 2006. As a result, our historical results are not necessarily comparable. Additionally, our historical results are not necessarily indicative of results for any future period. You should read these selected consolidated financial data, together with the accompanying notes, in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of this 10-K and our consolidated financial statements and the related notes.

	Year Ended December 31,				
	2006	2005(2)	2004	2003	2002
	(In thousands, except per share data)				
<u>Operating Data:</u>					
Continuing Operations:					
Net revenue	\$ 3,482	\$ 2,395	\$ 3,499	\$ 5,284	\$ 7,245
Operating expenses	20,470	24,940	27,921	14,097	10,186
Loss from continuing operations	(16,974)	(13,348)	(24,876)	(11,034)	(2,615)
Discontinued operations, net of tax	—	1,838	603	—	—
Net loss	(16,974)	(11,510)	(24,273)	(11,034)	(2,615)
Net loss applicable to common stockholders	(16,974)	(11,510)	(24,273)	(19,154)	(2,615)
Basic and diluted net loss per common share:					
Loss from continuing operations	\$ (0.10)	\$ (0.07)	\$ (0.19)	\$ (0.49)	\$ (0.09)
Net loss	(0.10)	(0.06)	(0.19)	(0.49)	(0.09)
<u>Balance Sheet Data (at end of period):</u>					
Total assets	\$ 7,405	\$ 21,411	\$ 34,017	\$ 7,172	\$ 3,047
Long-term debt	—	—	27	1,793	88

(1) Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications had no effect on the net losses as previously reported by the Company. Significant events affecting our historical performance in 2004 through 2006 are described in Management's Discussion and Analysis of Financial Condition and Results of Operations.

(2) 2005 consolidated financial data include transactions related to (i) the sale of the business and substantially all of the net assets of SendTec, Inc. to RelationServe Media, Inc. on October 31, 2005 (the "SendTec Asset Sale") and the resultant gain on sale of approximately \$1.7 million, and (ii) the repurchase of Common Stock and termination of stock options and warrants in accordance with certain SendTec Asset Sale ancillary agreements, including the Redemption Agreement and the Termination Agreement.

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **BASIS OF PRESENTATION OF CONSOLIDATED FINANCIAL STATEMENTS; GOING CONCERN**

Certain matters discussed below under "Liquidity and Capital Resources" raise substantial doubt about our ability to continue as a going concern. In addition, we have received a report from our independent accountants, relating to our December 31, 2006 audited financial statements containing an explanatory paragraph stating that our recurring losses from operations and our accumulated deficit raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Accordingly, our consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should we be unable to continue as a going concern.

### **OVERVIEW**

During 2006 theglobe.com, inc. (the "Company" or "theglobe") managed three primary lines of business, as follows:

- Computer games businesses — Our print publication business comprised of Computer Games magazine and MMOGames magazine (renamed from Massive Magazine in the first quarter of 2007); our online website business, comprised of the CGOnline website ([www.cgonline.com](http://www.cgonline.com)), the MMOGames magazine website ([www.mmogamesmag.com](http://www.mmogamesmag.com)) and the Game Swap Zone website ([www.gameswapzone.com](http://www.gameswapzone.com)); and our e-commerce games distribution company, Chips & Bits, Inc. ([www.chipsbits.com](http://www.chipsbits.com)). Our Now Playing magazine publication and the accompanying website were sold in January 2006;
- Voice over Internet Protocol ("VoIP") telephony services business — Consisting of tglo.com, inc. (formerly known as voiceglo Holdings, Inc.). The term "VoIP" refers to a category of hardware and software that enables people to use the Internet to make phone calls; and
- Internet services business - Consisting of Tralliance Corporation which is the registry for the ".travel" top-level Internet domain.

In March 2007, management and the Board of Directors made the decision to shutdown the operations of both its Computer Games and VoIP telephony services lines of business and to focus 100% of its resources and efforts to further develop its Internet services business. See the "Liquidity and Capital Resources" section of this Management's Discussion and Analysis of Financial Condition and Results of Operations for a more complete discussion.

On October 31, 2005, we completed the sale of the business and substantially all of the net assets of SendTec, Inc. ("SendTec"), a direct response marketing services and technology company, for approximately \$39.9 million in cash. We acquired SendTec effective September 1, 2004. Results of operations for SendTec have been reported separately as "Discontinued Operations" in the accompanying consolidated statements of operations for the years ended December 31, 2005 and 2004.

### **RESULTS OF OPERATIONS**

The nature of our business has significantly changed from 2004 to 2006. As a result of our decision to enter into the VoIP business, we have incurred substantial expenditures without corresponding revenue as we attempted to develop our VoIP product line and as we put into place the infrastructure for our VoIP products. In addition, we entered into two new business lines, marketing services and Internet services, as a result of our acquisitions of SendTec on

September 1, 2004 and Tralliance on May 9, 2005, respectively. In addition, we sold the business and substantially all of the net assets of SendTec effective October 31, 2005, and as a result have reported SendTec's results of operations as "Discontinued Operations" for the years ended December 31, 2005 and 2004. The results of operations of Tralliance are included in the Company's consolidated operating results only from its date of acquisition. Consequently, and primarily as a result of these factors, the results of operations for each of the years ended December 31, 2006, 2005 and 2004 are not necessarily comparable.

**YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005**

NET REVENUE. Net revenue totaled \$3.5 million for the year ended December 31, 2006 as compared to \$2.4 million for the year ended December 31, 2005. The \$1.1 million increase in consolidated net revenue was principally the result of the additional revenue generated by our Internet services business segment.

**NET REVENUE BY BUSINESS SEGMENT:**

Years ended:	2006	2005
Computer games	\$ 2,038,649	\$ 1,948,716
Internet services	1,408,737	197,873
VoIP telephony services	34,638	248,789
	\$ 3,482,024	\$ 2,395,378

Increases of \$72 thousand in net revenue derived from print advertisements in our magazine publications and \$97 thousand in sales of our magazines as compared to the year ended December 31, 2005, were partially offset by a \$79 thousand decrease in sales of products by our e-commerce games distribution company.

Advertising revenue from the sale of print advertisements in our magazine publications totaled approximately \$1.4 million in each of the years ended December 31, 2006 and 2005, while net revenue attributable to the sale of our magazine publications totaled \$417 thousand in 2006 compared to \$320 thousand in 2005. Approximately 87% and 95% of the net revenue generated by our publishing operations, or \$1.6 million, in each of 2006 and 2005, respectively, was attributable to our magazine publication which is focused on PC gaming. Over the last several years, the market for PC games has deteriorated, while the console games market has experienced growth. This shift in the gaming market negatively impacted the print advertising sales and circulation of our magazine focused on PC gaming. In order to attempt to capture market share of the current gaming audience, we introduced a new quarterly magazine publication in September 2006 which focuses on “massively multiplayer online” (“MMO”) games, which contributed approximately \$247 thousand in net revenue during 2006. During January 2006, we completed the sale of our Now Playing magazine which had contributed approximately \$78 thousand in net revenue during 2005.

Sales of products by our e-commerce games distribution business totaled approximately \$186 thousand, or 5% of consolidated net revenue, for the year ended December 31, 2006. This represented a decline from the \$265 thousand, or 11% of consolidated net revenue, reported for the year ended December 31, 2005. Our e-commerce games distribution business continued to operate in a highly competitive environment, experiencing competitive pressure from other Internet commerce websites such as Amazon.com. In addition, an increasing number of major retailers have increased the selection of video, console and PC games offered by both their traditional “bricks and mortar” locations and their online commerce sites resulting in increased competition.

Our Internet services business, Tralliance, contributed \$1.4 million in net revenue for the year ended December 31, 2006 as compared to \$198 thousand for the prior year. Tralliance, which was acquired in May 2005, began collecting fees for Internet domain name registrations in October 2005. Thus, the results of operations for 2006 include a full year of revenue recognition related to the operations of Tralliance versus three months of revenue recognition during 2005. Net revenue attributable to such domain name registrations is recognized as revenue on a straight-line basis over the term of the registrations.

Net revenue generated by our VoIP telephony services division totaled \$35 thousand in 2006 as compared to \$249 thousand in 2005. During the second quarter of 2006, the Company discontinued offering service to its small VoIP “paid” plan customer base and completed the implementation of a plan to significantly reduce the excess capacity and operating costs of its VoIP network.



**OPERATING EXPENSES BY BUSINESS SEGMENT:**

2006	Cost of Revenue	Sales and Marketing	Product Development	General and Administrative	Depreciation and Amortization	Total
Computer games	\$ 1,173,118	\$ 578,368	\$ 498,434	\$ 483,940	\$ 28,286	\$ 2,762,146
Internet services	454,563	3,109,533	—	1,768,065	232,575	5,564,736
VoIP telephony services	2,532,994	300,150	880,711	4,910,733	785,379	9,409,967
Corporate expenses	—	—	—	2,703,783	29,616	2,733,399
	\$ 4,160,675	\$ 3,988,051	\$ 1,379,145	\$ 9,866,521	\$ 1,075,856	\$ 20,470,248

2005	Cost of Revenue	Sales and Marketing	Product Development	General and Administrative	Depreciation and Amortization	Total
Computer games	\$ 2,049,896	\$ 537,005	\$ 697,803	\$ 780,258	\$ 30,845	\$ 4,095,807
Internet services	86,486	488,275	—	831,269	87,112	1,493,142
VoIP telephony services	6,288,577	1,692,420	693,056	3,611,686	1,109,743	13,395,482
Corporate expenses	—	—	—	5,918,956	36,598	5,955,554
	\$ 8,424,959	\$ 2,717,700	\$ 1,390,859	\$ 11,142,169	\$ 1,264,298	\$ 24,939,985

**COST OF REVENUE.** Cost of revenue totaled \$4.2 million for the year ended December 31, 2006 as compared to \$8.4 million for the year ended December 31, 2005. The \$4.2 million decrease in consolidated cost of revenue was principally attributable to the decline in cost of revenue of the VoIP telephony services segment.

Cost of revenue related to our computer games business segment consists primarily of printing, delivery and other fulfillment costs of our games magazines and the cost of merchandise sold and shipping fees in connection with our e-commerce games distribution business. Cost of revenue of our computer games segment totaled \$1.2 million for the year ended December 31, 2006, a decrease of \$877 thousand, or 43%, from the prior year. The decline in cost of revenue as compared to 2005 was principally the result of lower printing, paper and freight costs incurred in the production of our magazine publications. We reduced the total number of copies printed for each issue of our magazines and also published one less issue of our monthly gaming publication in 2006 as compared to 2005. In addition, the cost of revenue associated with our e-commerce games distribution business also declined as compared to 2005 primarily due to a lower volume of games sold.

Cost of revenue of our Internet services division consists primarily of fees paid to third party service providers which furnish outsourced services, including verification of registration eligibility, maintenance of the “.travel” directory of consumer-oriented registrant travel data, as well as other services. Fees for some of these services vary based on transaction levels or transaction types. Fees incurred for outsourced services are generally deferred and amortized to cost of revenue over the term of the related domain name registration. The results of operations for 2006 include a full year of cost of revenue related to the operations of Tralliance versus three months of costs during 2005, the principal factor contributing to the \$368 thousand increase in cost of revenue as compared to the prior year. Cost of revenue as a percent of net revenue was approximately 32% for 2006 as compared to 44% for 2005. This was due in part to Tralliance performing more verifications of registration eligibility in-house during the last half of 2006.

Cost of revenue of our VoIP telephony services business segment is principally comprised of network data center, carrier transport and circuit interconnection costs, as well as personnel and consulting costs incurred in support of our Internet telecommunications network. During 2006, we placed significant emphasis on the reduction of excess

capacity of our VoIP network, which included the renegotiation, non-renewal and/or termination of certain network agreements, as well as network personnel cost reductions. These efforts, as well as steps taken during the latter half of 2005 to reduce network support costs resulted in the \$3.8 million decrease in cost of revenue of our VoIP telephony services business segment as compared to 2005. Network data center and carrier costs decreased \$2.4 million, or 58%, and direct costs of employees supporting our Internet telecommunications network declined \$588 thousand, or 58%, in comparison to the year ended December 31, 2005. Additionally, costs related to the purchase of network software declined \$379 thousand as compared to 2005. The Company discontinued the capitalization of software development costs in its VoIP telephony business and began charging such costs to operations as incurred.

**SALES AND MARKETING.** Sales and marketing expenses consist primarily of salaries and related expenses of sales and marketing personnel, commissions, advertising and marketing costs, public relations expenses and promotional activities. Sales and marketing expenses totaled \$4.0 million for the year ended December 31, 2006, an increase of \$1.3 million from the \$2.7 million reported for 2005.

On November 22, 2006, the Company entered into certain marketing services agreements with two entities and issued 10,000,000 warrants to the controlling shareholder of the entities as consideration. The fair value attributable to the warrants of \$515 thousand, as calculated using the Black Scholes model, was charged to sales and marketing expenses of Tralliance as the two entities will be focusing their marketing efforts on our Internet services business. Excluding the charge related to the warrants, sales and marketing expenses of Tralliance totaled \$2.6 million for the year ended December 31, 2006, or an increase of \$2.1 million from the prior year. During August 2006, Tralliance introduced its web portal and search engine, [www.search.travel](http://www.search.travel), through the use of a targeted television and Internet advertising campaign. As a result, total 2006 advertising costs of Tralliance increased \$619 thousand from 2005 to a total of \$678 thousand. In addition, during the third quarter of 2006, Tralliance engaged several outside parties to promote its registry operations and the [www.search.travel](http://www.search.travel) website internationally, which resulted in the recognition of \$442 thousand of consulting fees and related costs. The Company also reassigned personnel from its VoIP telephony services division during 2006 to perform marketing functions for Tralliance which resulted in a \$508 thousand increase in sales and marketing personnel costs of Tralliance as compared to 2005. The remaining \$538 thousand increase in Tralliance's sales and marketing expenses as compared to the year ended December 31, 2005, consisted primarily of higher public relations, trade show and promotional costs.

Sales and marketing expenses of our VoIP telephony services business segment totaled \$300 thousand for the year ended December 31, 2006, a decrease of \$1.4 million, or 82%, from the prior year. During 2005, the Company re-evaluated its existing VoIP telephony services business plan and began the process of terminating and/or modifying certain of its then existing product offerings and marketing programs. During 2006, the Company refocused its efforts on the further expansion of its "peer-to-peer", or free service plan, customer base. As a result, the VoIP telephony services business segment significantly reduced its sales and marketing spending. Additionally, as discussed in the paragraph above, the Company reassigned certain personnel from its VoIP telephony services division during 2006 to perform marketing and administrative functions for Tralliance.

**PRODUCT DEVELOPMENT.** Product development expenses include salaries and related personnel costs; expenses incurred in connection with website development, testing and upgrades; editorial and content costs; and costs incurred in the development of our VoIP telephony products. Product development expenses totaled \$1.4 million in each of the years ended December 31, 2006 and 2005. A \$199 thousand decrease in product development costs incurred by our computer games businesses as compared to 2005, resulting principally from lower website development costs, was almost entirely offset by a \$188 thousand increase in product development expenses incurred by our VoIP telephony services division, due primarily to higher personnel costs.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses consist primarily of salaries and other personnel costs related to management, finance and accounting functions, facilities, outside legal and professional fees, information-technology consulting, directors and officers insurance, bad debt expenses and general corporate overhead costs. As discussed in Note 14, "Litigation," in the Notes to Consolidated Financial Statements, on March 15, 2007, the Company and Michael Egan entered into a Settlement Agreement with MySpace, Inc. (the "Settlement Agreement"). The Settlement Agreement required, among other things, the Company to pay to MySpace approximately \$2.6 million in cash on or before April 5, 2007. Excluding the \$2.6 million settlement, as well as an increase of \$680 thousand in attorneys' fees incurred by the VoIP telephony services division as compared to 2005, consolidated general and administrative expenses declined \$4.5 million as compared to the prior year. This decrease was principally due to \$3.0 million lower bonus awards to executive officers. In addition, excluding the legal costs mentioned previously, general and administrative expenses of our VoIP telephony services division decreased \$1.9 million, or 63%, as compared to the prior year primarily due to lower employee bonuses and information

technology consulting costs. General and administrative expenses of our Internet services business increased \$937 thousand as compared to 2005 primarily due to increases in personnel costs of \$340 thousand and travel and entertainment costs of \$356 thousand. During 2006, we reassigned employees from the VoIP telephony services division in order to accommodate the increase in authentication and registration activity experienced by Tralliance. In order to increase awareness of the “.travel” top-level domain, we have increased our participation in travel industry meetings and conferences, both nationally and internationally, since the October 2005 launch of our “.travel” domain registry operations which was the principal factor contributing to the increase in travel and entertainment costs.

As discussed in Note 1, "Organization and Summary of Significant Accounting Policies," and Note 11, "Stock Option Plans," of the Notes to Consolidated Financial Statements, we adopted Statement of Financial Accounting Standards No. 123R ("SFAS No. 123R") effective January 1, 2006 using the modified prospective application method. SFAS No. 123R generally requires all companies to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees and to recognize the related cost in its financial statements. As a result, general and administrative expenses of the corporate division included approximately \$436 thousand of additional stock compensation expense recognized in accordance with the requirements of SFAS No. 123R. Prior to January 1, 2006, we accounted for employee stock options pursuant to Accounting Principles Board Opinion No. 25 and financial results in the accompanying consolidated financial statements for prior periods have not been restated to give effect to the provisions of SFAS No. 123R. At December 31, 2006, there was approximately \$542 thousand of unrecognized compensation expense related to unvested stock options, excluding the 550,000 options which vest on the achievement of certain performance targets, which is expected to be recognized over a weighted-average period of 1.5 years.

**DEPRECIATION AND AMORTIZATION.** Depreciation and amortization expense totaled \$1.1 million for the year ended December 31, 2006 as compared to \$1.3 million for the prior year. The \$324 thousand decrease in depreciation and amortization expense incurred by our VoIP telephony services division as compared to 2005 was partially offset by an increase of \$145 thousand in depreciation and intangible asset amortization expenses incurred by our Internet services business.

**INTEREST INCOME (EXPENSE), NET.** Interest income, net of interest expense, totaled \$120 thousand for the year ended December 31, 2006. During the year ended December 31, 2005, we reported a total of \$4.1 million of net interest expense. A total of \$4.0 million of non-cash interest expense was recorded during 2005 related to the beneficial conversion features of the \$4.0 million of secured demand convertible promissory notes issued by the Company during 2005.

**OTHER INCOME (EXPENSE), NET.** Other income, net, of \$19 thousand reported for 2006 included a \$130 thousand net gain on the sale of our Now Playing Magazine publication and associated website and a \$130 thousand net loss on the sale of certain VoIP property and equipment. Other expense, net, of \$274 thousand reported for 2005 included \$280 thousand of reserves provided against amounts loaned by the Company to Tralliance prior to its acquisition in May 2005.

**INCOME TAXES.** The income tax provision of \$124 thousand recognized for continuing operations for the year ended December 31, 2006, resulted from additional state income taxes due upon the finalization of the Company's 2005 consolidated tax returns. An income tax benefit of \$13.6 million was recognized for continuing operations for the year ended December 31, 2005, as we were able to utilize our 2005 losses incurred by continuing operations, as well as losses from prior years, to partially offset the 2005 income and gain on sale of our discontinued operations. As of December 31, 2006, the Company had net operating loss carryforwards available for U.S. tax purposes of approximately \$162 million. These carryforwards expire through 2026. The Tax Reform Act of 1986 imposes substantial restrictions on the utilization of net operating losses and tax credits in the event of an "ownership change" of a corporation. Due to various significant changes in our ownership interests, as defined in the Internal Revenue Code of 1986, as amended, we have substantially limited the availability of our net operating loss carryforwards. There can be no assurance that we will be able to utilize any net operating loss carryforwards in the future.

**DISCONTINUED OPERATIONS**

As mentioned previously, the Company sold the business and substantially all of the net assets of SendTec, its marketing services business, effective October 31, 2005. SendTec was originally acquired by the Company on September 1, 2004. Accordingly, the results of SendTec have been reported as discontinued operations for the year ended December 31, 2005.

Income from the activities of discontinued operations, net of income taxes, totaled approximately \$69 thousand for the year ended December 31, 2005. The gain on the sale of SendTec included in the Company's results of operations for 2005, totaled approximately \$1.8 million, net of an income tax provision of approximately \$13.2 million. Reference should be made to Note 3, "Discontinued Operations - SendTec, Inc.", of the Notes to Consolidated Financial Statements for details regarding the sale.

**YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004****CONTINUING OPERATIONS**

**NET REVENUE.** Net revenue totaled \$2.4 million for the year ended December 31, 2005 as compared to \$3.5 million for the year ended December 31, 2004. The \$1.1 million decrease in consolidated net revenue was principally the result of the \$1.2 million decline in the net revenue of our computer games business segment.

**NET REVENUE BY BUSINESS SEGMENT:**

Years ended:	2005	2004
Computer games	\$ 1,948,716	\$ 3,107,637
Internet services	197,873	—
VoIP telephony services	248,789	391,154
	\$ 2,395,378	\$ 3,498,791

Decreases of \$637 thousand in print advertisements in our magazine publications, \$441 thousand in sales of games products by our e-commerce games distribution company and \$81 thousand in sales of our magazines, accounted for the decline in net revenue experienced by our computer games segment as compared to 2004.

Advertising revenue from the sale of print advertisements in our magazine publications totaled \$1.4 million and \$2.0 million for the years ended December 31, 2005 and 2004, respectively, or approximately 57% of each year's consolidated net revenue. Net revenue attributable to the sale of our magazine publications totaled \$320 thousand in 2005 compared to \$401 thousand in 2004. Our PC gaming focused magazine publication accounted for approximately 95% of the net revenue derived from our publishing business in 2005. As stated in the comparison of the year ended December 31, 2006 compared to the year ended December 31, 2005, over the last several years, the market for PC games has deteriorated, while the console games market has experienced growth. This shift in the gaming market negatively impacted our print advertising sales and the circulation of our PC gaming magazine.

Sales of products by our e-commerce games distribution business totaled approximately \$265 thousand, or 11% of consolidated net revenue, for the year ended December 31, 2005. This represented a decline from the \$706 thousand, or 20% of consolidated net revenue, reported for the year ended December 31, 2004.

Our Internet services business, Tralliance, contributed \$198 thousand in net revenue for the year ended December 31, 2005. Tralliance, which was acquired in May 2005, began collecting fees for Internet domain name registrations in October 2005. Net revenue attributable to such domain name registrations is recognized as revenue on a straight-line

basis over the term of the registrations.

Net revenue generated by our VoIP telephony services division totaled \$249 thousand in 2005 as compared to \$391 thousand in 2004. During 2004 and 2005, we continued to experience difficulties in creating customer awareness and gaining customer acceptance of our paid VoIP telephony products. As a result, we revised our VoIP product offerings and shifted our focus on the development of new products and features. In addition, as a result of the liquidity issues experienced by the Company during 2005, VoIP marketing and advertising programs were curtailed.

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**OPERATING EXPENSES BY BUSINESS SEGMENT:**

2005	Cost of Revenue	Sales and Marketing	Product Development	General and Administrative	Depreciation and Amortization	Total
Computer games	\$ 2,049,896	\$ 537,005	\$ 697,803	\$ 780,258	\$ 30,845	\$ 4,095,807
Internet services	86,486	488,275	—	831,269	87,112	1,493,142
VoIP telephony services	6,288,577	1,692,420	693,056	3,611,686	1,109,743	13,395,482
Corporate expenses	—	—	—	5,918,956	36,598	5,955,554
	\$ 8,424,959	\$ 2,717,700	\$ 1,390,859	\$ 11,142,169	\$ 1,264,298	\$ 24,939,985

2004	Cost of Revenue	Sales and Marketing	Product Development	General and Administrative	Depreciation and Amortization	Total
Computer games	\$ 2,114,716	\$ 377,531	\$ 475,785	\$ 571,285	\$ 10,606	\$ 3,549,923
VoIP telephony services	6,940,023	6,720,531	578,101	3,266,366	1,355,532	18,860,553
Corporate expenses	—	—	—	3,409,123	32,138	3,441,261
	\$ 9,054,739	\$ 7,098,062	\$ 1,053,886	\$ 7,246,774	\$ 1,398,276	\$ 25,851,737
VoIP telephony services:						
Impairment charge						1,661,975
Loss on settlement of contractual obligation						406,750
						\$ 27,920,462

**COST OF REVENUE.** Cost of revenue totaled \$8.4 million for the year ended December 31, 2005 as compared to \$9.1 million for the year ended December 31, 2004. The \$630 thousand decrease in consolidated cost of revenue was principally attributable to the decline in cost of revenue of the VoIP telephony services segment.

Cost of revenue of our computer games segment totaled \$2.0 million for the year ended December 31, 2005, a decrease of \$65 thousand from the year ended December 31, 2004. A decline of \$268 thousand in cost of revenue associated with our e-commerce games distribution business resulting primarily from a lower volume of games sold as compared to 2004 was partially offset by a \$203 thousand increase in cost of revenue attributable to our magazine publishing business. We began distribution of a new publication, Now Playing magazine, in March 2005 which was the principal factor contributing to the increase in cost of revenue compared to 2004. We sold Now Playing magazine and the accompanying website in January 2006 for \$130 thousand in cash.

During the years ended December 31, 2005 and 2004, VoIP telephony services cost of revenue included charges of approximately \$71 thousand and \$1.5 million, respectively, related to write-downs of telephony equipment inventory. Excluding the impact of such charges on both 2005 and 2004, cost of revenue of our VoIP telephony services division increased \$754 thousand as compared to 2004. Throughout 2004, the Company increased its VoIP network capacity by entering into agreements with numerous carriers for leased equipment and services and with third parties for a number of leased data center facilities. The Company also expanded its internal network support function by hiring additional technical personnel. Due to the ramp-up of network costs during 2004, the Company incurred higher network operating and support costs during 2005 compared to 2004. In addition, the Company discontinued the capitalization of software development costs in its VoIP telephony business and began charging such costs to expense as incurred as a result of the review of long-lived assets for impairment performed in connection with the preparation

of its 2004 year-end consolidated financial statements. Cost of revenue for the year ended December 31, 2005 included approximately \$420 thousand in expenses related to such software costs.

**SALES AND MARKETING.** Sales and marketing expenses totaled \$2.7 million for the year ended December 31, 2005, a decrease of \$4.4 million from the \$7.1 million reported for 2004. The VoIP telephony services business incurred significant costs during 2004 for Internet and television advertising campaigns, as well as commissions expenses related to its VoIP products. During the first quarter of 2005, the Company re-evaluated its existing VoIP telephony services business plan and began the process of terminating and/or modifying certain of its existing product offerings and marketing programs. The Company also began to develop and test certain new VoIP products and features. As a result, the VoIP telephony services business segment essentially curtailed its sales and marketing efforts in 2005, which resulted in a year over year decline of \$5.0 million in this expense category as compared to 2004. Partially offsetting this decline were the sales and marketing expenses incurred by Tralliance since date of acquisition of \$488 thousand and an increase of \$159 thousand in sales and marketing expenses of our computer games segment.

**PRODUCT DEVELOPMENT.** Product development expenses totaled \$1.4 million for the year ended December 31, 2005 as compared to \$1.1 million for the year ended December 31, 2004. The increase in product development expenses as compared to 2004 was primarily due to increases in website development costs incurred by our computer games businesses and personnel costs related to the continued development of our retail VoIP telephony products.

**GENERAL AND ADMINISTRATIVE EXPENSES.** General and administrative expenses of \$11.1 million for the year ended December 31, 2005 increased \$3.9 million from the \$7.2 million reported for 2004. The primary factors contributing to the increase in consolidated general and administrative expenses as compared to 2004 were \$3.0 million in higher bonuses awarded to executive officers and the inclusion of approximately \$831 thousand in general and administrative expenses incurred by our Internet services business in 2005. Tralliance, which comprises our Internet services segment, was acquired in May 2005 and the results of its operations have been included in our results only since its date of acquisition.

**DEPRECIATION AND AMORTIZATION.** Depreciation and amortization expense totaled \$1.3 million for the year ended December 31, 2005 as compared to \$1.4 million for the year ended December 31, 2004. Depreciation and amortization expense incurred by our VoIP telephony services division declined approximately \$246 thousand in comparison to 2004 primarily as a result of the write-off of certain long-lived assets as of December 31, 2004.

**INTEREST EXPENSE, NET.** Interest expense, net of interest income, totaled \$4.1 million for the year ended December 31, 2005 as compared to \$666 thousand in 2004. A total of \$4.0 million of non-cash interest expense was recorded during 2005 related to the beneficial conversion features of the \$4.0 million of secured demand convertible promissory notes issued by the Company during 2005. During 2004, approximately \$687 thousand of non-cash interest expense was recorded related to the beneficial conversion feature of the \$2.0 million demand convertible promissory note acquired by our Chairman and Chief Executive Officer and his spouse in February 2004.

**OTHER EXPENSE, NET.** Other expense, net, included reserves against the amounts loaned by the Company to Tralliance prior to its acquisition, totaling approximately \$280 thousand and \$507 thousand in 2005 and 2004, respectively. Partially offsetting the 2004 expense, was a favorable settlement of a vendor claim previously disputed by the computer games business segment of approximately \$350 thousand.

**INCOME TAXES.** An income tax benefit of \$13.6 million was recognized for continuing operations for the year ended December 31, 2005, as we were able to utilize our 2005 losses incurred by continuing operations, as well as losses from prior years, to partially offset the 2005 income and gain on sale of our discontinued operations. During the year ended December 31, 2004, an income tax benefit of approximately \$371 thousand was recognized for continuing operations which served to offset the income tax provision recorded for discontinued operations.

## **DISCONTINUED OPERATIONS**

As mentioned previously, the Company sold the business and substantially all of the net assets of SendTec, its marketing services business, effective October 31, 2005. SendTec was originally acquired by the Company on September 1, 2004. Accordingly, the results of SendTec have been reported as discontinued operations in the accompanying consolidated statements of operations for the years ended December 31, 2005 and 2004.

Income from the activities of discontinued operations, net of income taxes, totaled approximately \$69 thousand for the year ended December 31, 2005 compared to \$602 thousand for the year ended December 31, 2004. The gain on the sale of SendTec included in the Company's results of operations for 2005, totaled approximately \$1.8 million, net of an income tax provision of approximately \$13.2 million. Reference should be made to Note 3, "Discontinued Operations - SendTec, Inc.", of the Notes to Consolidated Financial Statements for details regarding the sale.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **FUTURE AND CRITICAL NEED FOR CAPITAL**

For the reasons described below, Company management does not believe that cash on hand and cash flow generated internally by the Company will be adequate to fund the operation of its businesses beyond a short period of time. Additionally, we have received a report from our independent accountants, relating to our December 31, 2006 audited financial statements, containing an explanatory paragraph stating that our recurring losses from operations and our accumulated deficit raise substantial doubts about our ability to continue as a going concern.

On June 1, 2006, MySpace, Inc. ("MySpace"), a Delaware corporation, filed a lawsuit in the United States District Court for the Central District of California against theglobe.com, inc. (the "Company"). We were served with the lawsuit on June 6, 2006. MySpace alleged that the Company sent at least 100,000 unsolicited and unauthorized commercial email messages to MySpace members using MySpace user accounts improperly established by the Company, that the user accounts were used in a false and misleading fashion and that the Company's alleged activities constituted violations of the CAN-SPAM Act, the Lanham Act and California Business & Professions Code § 17529.5 (the "California Act"), as well as trademark infringement, false advertising, breach of contract, breach of the covenant of good faith and fair dealing, and unfair competition. MySpace seeks monetary penalties, damages and injunctive relief for these alleged violations. It asserts entitlement to recover "a minimum of" \$62.3 million of damages, in addition to three times the amount of MySpace's actual damages and/or disgorgement of the Company's purported profits from alleged violations of the Lanham Act, punitive damages and attorneys' fees. Subsequent discovery in the case disclosed that the total number of unsolicited messages was approximately 400,000.

On February 28, 2007, the Court entered an order (the "Order") granting in part MySpace's motion for summary judgment, finding that the Company was liable for violation of the CAN-SPAM Act and the California Business & Professions Code, and for breach of contract (as embodied in MySpace's "Terms of Service" contract). The Order also upheld as valid that portion of MySpace's Terms of Service contract which provides for liquidated damages of \$50 per email message sent after March 17, 2006 in violation of such Terms. The Company estimates that approximately 110,000 of the emails in question were sent after such date, which could result in damages of approximately \$5.5 million. In addition, the CAN-SPAM Act provides for statutory damages of between \$100 and \$300 per email sent in violation of the statute. Total damages under CAN-SPAM could therefore range between about \$40 million to about \$120 million. In addition, under the California Act, statutory damages of \$1 million "per incident" could be assessed.

On March 15, 2007, the Company entered into a Settlement Agreement with MySpace whereby it agreed to pay MySpace approximately \$2.6 million on or before April 5, 2007 in exchange for a mutual release of all claims against one another, including any claims against the Company's directors and officers. As part of the settlement, Michael Egan, the Company's CEO, who is also an affiliate of the Company, agreed to enter into an agreement with MySpace on or before April 5<sup>th</sup> pursuant to which he would, among other things, provide a letter of credit, cash or other equivalent security (collectively, "Security") in form and substance satisfactory to MySpace. Such Security is to expire and be released on the 100<sup>th</sup> day following the Company's payment of the foregoing \$2.6 million so long as no bankruptcy petition, assignment for the benefit of creditors or like liquidation, reorganization or insolvency proceeding is instituted or filed related to the Company during such 100-day period.



The Company does not currently have the resources to both pay the \$2.6 million settlement amount and to fund operations beyond April 2007. The Company intends to seek to raise capital or otherwise borrow funds with which to pay such amount and otherwise to fund operations. Although there is no commitment to do so, any such funds would most likely come primarily from Mr. Egan or affiliates of Mr. Egan or the Company, as the Company currently has no access to credit facilities with traditional third party lenders and has historically relied on borrowings from related parties to meet short-term liquidity needs. Any such capital raised would not be registered under the Securities Act of 1933 and would not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. There can be no assurance that the Company will be successful in raising such capital or borrowing such funds and any capital raised will likely result in very substantial dilution of the number of shares outstanding or which could be outstanding upon the exercise or conversion of any derivative securities issued by the Company as part of such capital raise. The failure to pay the \$2.6 million to MySpace and/or the failure to satisfactorily provide the Security would result in a resumption of the litigation with MySpace and, in all likelihood, would have a material adverse effect on the Company, including the potential bankruptcy and cessation of business of the Company.

The Company continues to incur consolidated net losses and management believes that the Company will continue to be unprofitable in the foreseeable future. As of February 28, 2007, the Company had a net working capital deficit of approximately \$7.3 million, inclusive of a cash and cash equivalents balance of approximately \$4.0 million. Such working capital deficit includes a settlement liability of approximately \$2.6 million owed to MySpace and an aggregate of \$3.4 million in secured convertible demand notes (the "Convertible Notes") and approximately \$611 thousand of accrued interest due to entities controlled by the Company's Chairman and Chief Executive Officer. Inasmuch as substantially all of the assets of the Company and its subsidiaries secure the Convertible Notes, in connection with any resulting proceeding to collect the indebtedness related to the Convertible Notes, the noteholders could seize and sell the assets of the Company and its subsidiaries, any or all of which would have a material adverse effect on the financial condition and future operations of the Company, including the potential bankruptcy or cessation of business of the Company.

It is our preference to avoid filing for protection under the U.S. Bankruptcy Code. However, in order to avoid such filing and continue as a going concern, we believe that, in addition to settling the MySpace litigation as discussed above, we must (i) quickly raise a sufficient amount of capital; (ii) successfully implement a business plan focused primarily on expanding our Tralliance Internet services revenue base, and reducing Tralliance and corporate overhead expenses; and (iii) successfully eliminate future losses incurred by our VoIP telephony services and computer games business segments by effectuating our planned shutdown and/or selling certain component assets of these businesses. There can be no assurance that the Company will be able to successfully complete any or all of the above actions which we believe are required in order to continue as a going concern.

Tralliance, the Company's Internet services business, began collecting fees related to its ".travel" registry business in October 2005. In August 2006, we introduced our online search engine dedicated to the travel industry, [www.search.travel](http://www.search.travel), and launched a national television campaign to promote the new search engine and website. During the third quarter of 2006, we also expanded Tralliance's domestic and international sales and marketing infrastructure, principally by entering into a number of arrangements with third party consultants and travel-related organizations. At this time, our primary objective is to quickly and substantially increase Tralliance's revenue levels. In this regard, we are focused on accelerating the rate of new ".travel" domain name registrations, both in the U.S. and in international markets, in order to generate current revenue and to also provide a base for future registration renewal revenue. Additionally, we are focused on generating sponsorship and search advertising revenue streams from our newly established [www.search.travel](http://www.search.travel) search engine and website. In addition to the factors set forth in the preceding paragraph, management presently believes that its success in quickly and substantially increasing Tralliance's revenue levels will be a critical factor in the Company's ability to continue as a going concern.

In March 2007 management and the Board of Directors of the Company made the decision to cease all activities related to its Computer Games businesses, including discontinuing the operations of its magazine publications, e-commerce games distribution business and related websites. The Company's decision to shutdown its Computer Games businesses was based primarily on the historical losses sustained by these businesses during the recent past and management's expectations of continued future losses. The Company is currently in the process of implementing a business shutdown plan, which includes the termination of employee and vendor relationships and the collection and payment of outstanding accounts receivables and payables. We are also attempting to sell certain of the businesses' component assets; however, we do not expect the proceeds from such sales to be significant. As of December 31, 2006, the carrying amount of the major classes of the Computer Games business segment's assets and liabilities consisted of current assets of \$600 thousand, fixed assets of \$39 thousand and current liabilities of \$321 thousand.

In addition, in March 2007, management and the Board of Directors of the Company decided to discontinue the operating, research and development activities of its VoIP telephony services business and terminate all of the remaining employees of the business. At this time, the Company intends to only incur those costs required to maintain the service obligations of the license agreement with Speecho, LLC. The Company has no plans to actively market the further licensing of its chat, VoIP and video communications technology. The Company's decision to discontinue the operations of its VoIP telephony services business was based primarily on the historical losses sustained by the business during the past several years, management's expectations of continued losses for the foreseeable future and estimates of the amount of capital required to attempt to successfully monetize its business. The Company is currently in the process of implementing a business shutdown plan, which includes the termination of its existing carrier and vendor relationships, as well as the payment and/or settlement of outstanding payables. We are also attempting to sell certain of the businesses' component assets; however, we do not expect the proceeds from such sales to be significant. As of December 31, 2006, the carrying amount of the major classes of the VoIP telephony services business segment's assets and liabilities consisted of current assets of \$139 thousand, fixed assets of \$182 thousand and current liabilities of approximately \$2.3 million.

We are in the process of evaluating the recoverability of our existing computer games and VoIP telephony services businesses' assets, and at this time, we do not anticipate significant future impairment or other charges in this regard. Any such charges, if and when determined to be required, will be recorded when identified. We are also in the process of evaluating the amount of costs expected to be incurred in shutting down our computer games and VoIP telephony services businesses. The amount of these shutdown costs, including costs related to employee termination benefits and vendor contract termination costs are not yet certain, however, at the present time, we believe that total cash expenditures for shutdown costs will range between \$20 thousand and \$135 thousand for our computer games business and between zero and \$700 thousand for our VoIP telephony services business. We currently expect the shutdown of our computer games and VoIP telephony services businesses to be substantially completed by the end of the second quarter of 2007.

The shares of our Common Stock were delisted from the NASDAQ national market in April 2001 and are now traded in the over-the-counter market on what is commonly referred to as the electronic bulletin board or OTCBB. Since the trading price of our Common Stock is less than \$5.00 per share, trading in our Common Stock may also become subject to the requirements of Rule 15c-9 of the Exchange Act if our net tangible assets should fall below \$2.0 million. Under Rule 15c-9, brokers who recommend penny stocks to persons who are not established customers and accredited investors, as defined in the Exchange Act, must satisfy special sales practice requirements, including requirements that they make an individualized written suitability determination for the purchaser; and receive the purchaser's written consent prior to the transaction. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 also requires additional disclosures in connection with any trades involving a penny stock, including the delivery, prior to any penny stock transaction, of a disclosure schedule explaining the penny stock market and the risks associated with that market. Such requirements may severely limit the market liquidity of our Common Stock and the ability of purchasers of our equity securities to sell their securities in the secondary market. We may also incur additional costs under state blue sky laws if we sell equity due to our delisting.

## **CASH FLOW ITEMS**

### **YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005**

As of December 31, 2006, we had approximately \$5.3 million in cash and cash equivalents as compared to \$16.5 million, excluding \$1.0 million of funds held in escrow, as of December 31, 2005. Net cash and cash equivalents used in operating activities of continuing operations were \$12.4 million and \$17.6 million, for the years ended December 31, 2006 and 2005, respectively. The period-to-period decrease in net cash and cash equivalents used in operating activities of continuing operations resulted primarily from the impact of lower losses from continuing operations before income taxes in 2006 compared to 2005, partially offset by lower non-cash expenses and lower favorable

working capital changes in 2006 compared to 2005. The operating activities of discontinued operations provided approximately \$3.0 million of net cash and cash equivalents during 2005.

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Net cash and cash equivalents of \$1.2 million were provided by investing activities during the year ended December 31, 2006. As a result of the October 2005 sale of the SendTec business, we were required to place \$1.0 million of cash in an escrow account to secure our indemnification obligations. In March 2006, pursuant to the related escrow agreement, \$750 thousand of the escrow funds were released to the Company, with the remaining \$250 thousand released in December 2006. The remaining \$32 thousand in escrow funds released during 2006 represented funds which had been held in escrow in connection with sweepstakes promotions conducted by the VoIP telephony services division. In addition, during 2006, we received proceeds of \$138 thousand from the sale of certain VoIP property and equipment and \$130 thousand from the sale of our Now Playing magazine publication and website. During 2005, our continuing operations used a total of \$1.4 million in investing activities, including the \$1.0 million in funds placed in escrow as a result of the SendTec sale mentioned above, \$296 thousand for capital expenditures and \$280 thousand of loans to Tralliance prior to its acquisition by the Company.

Cash proceeds related to the October 31, 2005 sale of our SendTec marketing services business, net of related transaction costs and cash held by SendTec of approximately \$2.4 million which was included in the sale, totaled approximately \$34.8 million. Immediately following the sale of the SendTec business on October 31, 2005, we completed the redemption of approximately 28.9 million shares of our Common Stock owned by six members of management of SendTec for approximately \$11.6 million in cash pursuant to a Redemption Agreement dated August 23, 2005. Approximately \$7.6 million of the redemption payment was allocated to the SendTec sale transaction and recorded as a reduction of the gain on the sale, with the remaining \$4.0 million of the redemption payment attributed to the "fair value" of the shares of theglobe's Common Stock redeemed and recorded as treasury shares. The "fair value" of the shares for financial accounting purposes was calculated based on the closing price of the Company's Common Stock as reflected on the OTCBB on August 10, 2005, the date the principal terms of the Redemption Agreement were announced publicly. The closing of the redemption occurred on October 31, 2005.

Cash and cash equivalents used in financing activities totaled \$12 thousand and \$1.2 million for the years ended December 31, 2006 and 2005, respectively. During 2005, we received proceeds of \$4.0 million from the issuance of Convertible Notes and we also paid \$1.4 million of outstanding debt balances. As mentioned above, approximately \$4.0 million of the total \$11.6 million cash paid for the redemption of the 28.9 million shares of our Common Stock from the former management of SendTec was attributed to the "fair value" of the Common Stock issued for financial accounting purposes.

#### **YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004**

As of December 31, 2005, we had approximately \$16.5 million in cash and cash equivalents as compared to \$6.7 million as of December 31, 2004. These balances do not include cash held in escrow accounts totaling approximately \$1.0 million and \$93 thousand as of December 31, 2005 and 2004, respectively. Net cash and cash equivalents used in operating activities of continuing operations were \$17.6 million and \$19.6 million, for the years ended December 31, 2005 and 2004, respectively. The period-to-period decrease in net cash and cash equivalents used in operating activities of continuing operations resulted primarily from decreased net losses attributable to continuing operations in combination with the impact of higher non-cash interest expense and favorable working capital changes in 2005 compared to 2004, partially offset by the \$13.6 million deferred tax benefit recorded for continuing operations for 2005.

Net cash and cash equivalents provided by operating activities of discontinued operations totaled approximately \$3.0 million in 2005, an increase of \$1.1 million from the \$1.9 million reported for 2004.

Net cash and cash equivalents of \$1.4 million were used in investing activities of continuing operations during the year ended December 31, 2005 as compared to \$3.1 million in 2004. Net funds placed in escrow accounts totaled \$938 thousand in 2005 and \$93 thousand in 2004. As a result of the October 2005 sale of the SendTec business, we were required to place \$1.0 million of cash in an escrow account to secure our indemnification obligations. We

incurred costs totaling \$296 thousand and \$2.6 million for capital expenditures during 2005 and 2004, respectively. Capital expenditures in 2004 related primarily to the development of our VoIP telephony network and VoIP customer billing system. We also loaned approximately \$280 thousand and \$467 thousand to Tralliance prior to its acquisition by the Company during the years ended December 31, 2005 and 2004, respectively.

Cash proceeds related to the October 31, 2005 sale of our SendTec marketing services business, net of related transaction costs and cash held by SendTec of approximately \$2.4 million which was included in the sale, totaled approximately \$34.8 million. Immediately following the sale of the SendTec business on October 31, 2005, we completed the redemption of approximately 28.9 million shares of our Common Stock owned by six members of management of SendTec for approximately \$11.6 million in cash pursuant to a Redemption Agreement dated August 23, 2005. Approximately \$7.6 million of the redemption payment was allocated to the SendTec sale transaction and recorded as a reduction of the gain on the sale, with the remaining \$4.0 million of the redemption payment attributed to the “fair value” of the shares of theglobe’s Common Stock redeemed and recorded as treasury shares. The “fair value” of the shares for financial accounting purposes was calculated based on the closing price of the Company’s Common Stock as reflected on the OTCBB on August 10, 2005, the date the principal terms of the Redemption Agreement were announced publicly. The closing of the redemption occurred on October 31, 2005. SendTec was originally acquired on September 1, 2004, for a total purchase price consisting of the payment of \$6.0 million in cash, excluding transaction costs, and the issuance of debt and equity securities then valued at a total of approximately \$12.4 million. As of the date of acquisition, SendTec held approximately \$3.6 million of cash. Thus, we used a net amount of approximately \$2.4 million of cash to acquire SendTec in 2004.

We used \$1.2 million of cash and cash equivalents in financing activities during 2005. As discussed previously in the comparison of the results of operations for the year ended December 31, 2006 compared to the year ended December 31, 2005, we received proceeds of \$4.0 million from the issuance of Convertible Notes during 2005. We also paid \$1.4 million of outstanding debt balances during 2005. As mentioned above, approximately \$4.0 million of the total \$11.6 million cash paid for the redemption of the 28.9 million shares of our Common Stock from the former management of SendTec was attributed to the “fair value” of the Common Stock issued for financial accounting purposes. During the year ended December 31, 2004, \$28.9 million of cash and cash equivalents were provided by financing activities. During March 2004, the Company completed a private offering of its Common Stock and warrants to acquire its Common Stock, for net proceeds totaling approximately \$27.0 million. In addition, in February 2004, the Company issued a \$2.0 million Bridge Note which was subsequently converted into our Common Stock in connection with the March 2004 private offering.

## **CAPITAL TRANSACTIONS**

On November 22, 2006, the Company entered into certain Marketing Services Agreements (the “Marketing Services Agreements”) with two entities whereby the entities agreed to market certain of the Company’s products in exchange for certain commissions and promotional fees and which granted the Company exclusive right to certain uses of a tradename in connection with certain of the Company’s websites. Additionally, on November 22, 2006, in connection with the Marketing Services Agreements, the Company entered into a Warrant Purchase Agreement with Carl Ruderman, the controlling shareholder of the entities. The Warrant Purchase Agreement provides for the issuance to Mr. Ruderman of one warrant to purchase 5,000,000 shares of the Company’s Common Stock at an exercise price of \$0.15 per share with a three year term and a second warrant to purchase 5,000,000 shares of the Company’s Common Stock at an exercise price of \$0.15 per share with a term of four years. Each warrant provides for the extension of the exercise term by an additional three years if certain criteria are met under the Marketing Services Agreements. The Warrant Purchase Agreement grants to Mr. Ruderman “piggy-back” registration rights with respect to the shares of the Company’s Common Stock issuable upon exercise of the warrants.

In connection with the issuance of the warrants, on November 22, 2006, Mr. Ruderman entered into a Stockholders’ Agreement with the Company’s chairman and chief executive officer, the Company’s president and certain of their affiliates. Pursuant to the Stockholders’ Agreement, Mr. Ruderman granted an irrevocable proxy over the shares issuable upon exercise of the warrants to E&C Capital Partners, LLLP and granted a right of first refusal over his shares to all of the other parties to the Stockholders’ Agreement. Mr. Ruderman also agreed to sell his shares under certain circumstances in which the other parties to the Stockholders’ Agreement have agreed to sell their respective shares. Mr. Ruderman was also granted the right to participate in certain sales of the Company’s Common Stock by the

other parties to the Stockholders' Agreement.

On August 10, 2005, we entered into an Asset Purchase Agreement with RelationServe Media, Inc. ("RelationServe") whereby we agreed to sell all of the business and substantially all of the net assets of our SendTec marketing services subsidiary to RelationServe for \$37.5 million in cash, subject to certain net working capital adjustments. On August 23, 2005, we entered into Amendment No. 1 to the Asset Purchase Agreement with RelationServe (the "1<sup>st</sup> Amendment" and together with the original Asset Purchase Agreement, the "Purchase Agreement"). On October 31, 2005, we completed the asset sale. Including adjustments to the purchase price related to excess working capital of SendTec as of the date of sale, we received an aggregate of approximately \$39.9 million in cash pursuant to the Purchase Agreement. In accordance with the terms of an escrow agreement established as a source to secure our indemnification obligations under the Purchase Agreement, \$1.0 million of the purchase price and an aggregate of 2,272,727 shares of theglobe's unregistered Common Stock (valued at \$750 thousand pursuant to the terms of the Purchase Agreement based upon the average closing price of the stock in the 10 day period preceding the closing of the sale) were placed into escrow. During 2006, the escrowed cash and shares of theglobe's Common Stock were released to the Company and the common shares were retired.

Additionally, as contemplated by the Purchase Agreement, immediately following the asset sale, we completed the redemption of 28,879,097 shares of our Common Stock owned by six members of management of SendTec for approximately \$11.6 million in cash pursuant to a Redemption Agreement dated August 23, 2005. The 28,879,097 common shares redeemed were retired effective October 31, 2005. Pursuant to a separate Termination Agreement, we also terminated and canceled 1,275,783 stock options and the contingent interest in 2,062,785 earn-out warrants held by the six members of management in exchange for approximately \$400 thousand in cash. We also terminated 829,678 stock options of certain other non-management employees of SendTec and entered into bonus arrangements with a number of other non-management SendTec employees for amounts totaling approximately \$600 thousand.

On May 9, 2005, we exercised our option to acquire all of the outstanding capital stock of Tralliance. The purchase price consisted of the issuance of 2,000,000 shares of our Common Stock, warrants to acquire 475,000 shares of our Common Stock and \$40 thousand in cash. The warrants are exercisable for a period of five years at an exercise price of \$0.11 per share. As part of the transaction, 10,000 shares of our Common Stock were also issued to a third party in payment of a finder's fee resulting from the acquisition. The Common Stock issued as a result of the acquisition of Tralliance is entitled to certain "piggy-back" registration rights.

On April 22, 2005, E&C Capital Partners, LLLP and E&C Capital Partners II, LLLP (the "Noteholders"), entities controlled by the Company's Chairman and Chief Executive Officer, entered into a Note Purchase Agreement (the "Agreement") with theglobe pursuant to which they acquired secured demand convertible promissory notes (the "Convertible Notes") in the aggregate principal amount of \$1.5 million. Under the terms of the Agreement, the Noteholders were also granted the optional right, for a period of 90 days from the date of the Agreement, to purchase additional Convertible Notes such that the aggregate principal amount of Convertible Notes issued under the Agreement could total \$4.0 million (the "Option"). On June 1, 2005, the Noteholders exercised a portion of the Option and acquired an additional \$1.5 million of Convertible Notes. On July 18, 2005, the Noteholders exercised the remainder of the Option and acquired an additional \$1.0 million of Convertible Notes.

The Convertible Notes are convertible at the option of the Noteholders into shares of our Common Stock at an initial price of \$0.05 per share. Through December 31, 2006, an aggregate of \$600 thousand of Convertible Notes were converted by the Noteholders into an aggregate of 12,000,000 shares of our Common Stock. Assuming full conversion of all Convertible Notes which remain outstanding as of December 31, 2006, an additional 68,000,000 shares of our Common Stock would be issued to the Noteholders. The Convertible Notes provide for interest at the rate of ten percent per annum and are secured by a pledge of substantially all of the assets of the Company. The Convertible Notes are due and payable five days after demand for payment by the Noteholders.

On September 1, 2004, we closed upon an agreement and plan of merger dated August 31, 2004, pursuant to which we acquired all of the issued and outstanding shares of capital stock of SendTec. Pursuant to the terms of the Merger, in consideration for the acquisition of SendTec, we paid consideration consisting of: (i) \$6.0 million in cash, excluding transaction costs, (ii) the issuance of an aggregate of 17,500,024 shares of theglobe's Common Stock, (iii) the issuance of an aggregate of 175,000 shares of Series H Automatically Converting Preferred Stock (which was converted into 17,500,500 shares of theglobe's Common Stock on December 1, 2004, the effective date of the amendment to the Company's certificate of incorporation increasing its authorized shares of Common Stock from 200,000,000 shares to 500,000,000 shares), and (iv) the issuance of a subordinated promissory note in the amount of \$1.0 million. The subordinated promissory note provided for interest at the rate of four percent per annum and was due on September 1, 2005. We paid the principal and interest due under the terms of the subordinated promissory note on October 31, 2005, including default interest at a rate of 15% per annum for the period the debt was outstanding subsequent to the original due date.

In addition, warrants to acquire shares of our Common Stock would be issued to the former shareholders of SendTec when and if SendTec exceeded forecasted operating income, as defined, of \$10.125 million, for the year ended December 31, 2005. The number of earn-out warrants issuable ranged from an aggregate of approximately 250,000 to 2,500,000 (if actual operating income exceeded the forecast by at least 10%). Pursuant to the Termination Agreement described above, the contingent interest in approximately 2,063,000 of the earn-out warrants was canceled effective October 31, 2005. The remainder of the earn-out warrants expired on December 31, 2005, as the operating income target was not achieved.

We also issued an aggregate of 3,974,165 replacement options to acquire shares of our Common Stock for each of the issued and outstanding options to acquire shares of SendTec held by the former employees of SendTec. Of these replacement options, approximately 3,273,668 had exercise prices of \$0.06 per share and 700,497 had exercise prices of \$0.27 per share. The terms of these replacement options were as negotiated between representatives of theglobe and the Stock Option Committee for the SendTec 2000 Amended and Restated Stock Option Plan. We also agreed to grant an aggregate of 250,000 options to other employees and a consultant of SendTec at an exercise price of \$0.34 per share. In addition, we also granted 1,000,000 stock options at an exercise price of \$0.27 per share in connection with the establishment of a bonus option pool pursuant to which various employees of SendTec could vest in such options on terms substantially similar to the circumstances in which the earn-out warrants would have been earned. Pursuant to the Termination Agreement mentioned above, we terminated and canceled an aggregate of 2,105,461 stock options held by employees of SendTec effective October 31, 2005. The remaining 477,000 outstanding stock options related to the bonus option pool which was established as of the acquisition were terminated as the forecasted operating income targets for the year ended December 31, 2005 had not been achieved.

In March 2004, we completed a private offering of 333,816 units (the "Units") for a purchase price of \$85 per Unit (the "PIPE Offering"). Each Unit consisted of 100 shares of our Common Stock, \$0.001 par value (the "Common Stock"), and warrants to acquire 50 shares of our Common Stock (the "Warrants"). The Warrants are exercisable for a period of five years commencing 60 days after the initial closing at an initial exercise price of \$0.001 per share. The aggregate number of shares of Common Stock issued in the PIPE Offering was 33,381,647 shares for an aggregate consideration of approximately \$28.4 million, or approximately \$0.57 per share assuming the exercise of the 16,690,824 Warrants. As of December 31, 2006, approximately 510,000 of the Warrants remained outstanding.

Halpern Capital, Inc., acted as placement agent for the PIPE Offering, and was paid a commission of \$1.2 million and issued a warrant to acquire 1,000,000 shares of our Common Stock at \$0.001 per share. All of the shares underlying the warrant had been issued by year-end 2005.

In connection with the PIPE Offering, Michael S. Egan, our Chairman, Chief Executive Officer and principal stockholder, together with certain of his affiliates, including E&C Capital Partners, LLLP converted a \$2,000,000 Convertible Bridge Note, \$1,750,000 of Secured Convertible Notes and all of the outstanding shares of Series F Preferred Stock, and exercised (on a "cashless" basis) all of the warrants issued in connection with the foregoing \$1,750,000 Secured Convertible Notes and Series F Preferred Stock, together with certain warrants issued to Dancing Bear Investments, an affiliate of Mr. Egan. As a result of such conversions and exercises, we issued an aggregate of 48,775,909 additional shares of our Common Stock.

On February 2, 2004, Michael S. Egan and his wife, S. Jacqueline Egan, entered into a Note Purchase Agreement with the Company pursuant to which they acquired a convertible promissory note due on demand (the "Bridge Note") in the aggregate principal amount of \$2,000,000. The Bridge Note was convertible into shares of our Common Stock. The Bridge Note provided for interest at the rate of ten percent per annum and was secured by a pledge of substantially all of the assets of the Company. Such security interest was shared with the holders of our \$1,750,000 Secured Convertible Notes issued on May 22, 2003 to E&C Capital Partners, LLLP and certain affiliates of Michael S. Egan. In addition, the Egans were issued a warrant to acquire 204,082 shares of our Common Stock at an exercise price of \$1.22 per share. This warrant is exercisable at any time on or before February 2, 2009. The exercise price of the

warrant, together with the number of shares for which such warrant is exercisable, is subject to adjustment upon the occurrence of certain events.

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**CONTRACTUAL OBLIGATIONS**

The following table summarizes theglobe's contractual obligations as of December 31, 2006. These contractual obligations are more fully disclosed in Note 9, "Debt," and Note 13, "Commitments," in the accompanying Notes to Consolidated Financial Statements.

	Total	Payments Due By Period			
		Less than 1 year	1-3 years	4-5 years	After 5 years
Notes payable*	\$ 3,400,000	\$ 3,400,000	\$ —	\$ —	\$ —
Network commitments	539,000	503,000	36,000	—	—
Registry commitments	1,254,000	329,000	311,000	220,000	394,000
Operating leases	264,000	248,000	16,000	—	—
Other purchase obligations	240,000	240,000	—	—	—
Total contractual obligations	\$ 5,697,000	\$ 4,720,000	\$ 363,000	\$ 220,000	\$ 394,000

\* Excludes accrued and unpaid interest of approximately \$556,000 as of December 31, 2006.

**OFF-BALANCE SHEET ARRANGEMENTS**

As of December 31, 2006, we did not have any material off-balance sheet arrangements that have or are reasonably likely to have a material effect on our current or future financial condition, revenues or expenses, results of operations, liquidity, or capital resources.

**EFFECTS OF INFLATION**

Due to relatively low levels of inflation in 2006, 2005 and 2004, inflation has not had a significant effect on our results of operations.

**MANAGEMENT'S DISCUSSION OF CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us 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 revenue and expenses during the reporting period. Our estimates, judgments and assumptions are continually evaluated based on available information and experience. Because of the use of estimates inherent in the financial reporting process, actual results could differ from those estimates.

Certain of our accounting policies require higher degrees of judgment than others in their application. These include revenue recognition, valuation of customer receivables, valuation of inventories, valuation of goodwill, intangible assets and other long-lived assets and capitalization of computer software costs. Our accounting policies and procedures related to these areas are summarized below.

**REVENUE RECOGNITION**

The Company's revenue from continuing operations was derived principally from the sale of print advertisements under short-term contracts in our magazine publications; through the sale of our magazine publications through newsstands and subscriptions; from the sale of video games and related products through our e-commerce games distribution business; from the sale of Internet domain registrations and from the sale of VoIP telephony services. There is no certainty that events beyond anyone's control such as economic downturns or significant decreases in the

demand for our services and products will not occur and accordingly, cause significant decreases in revenue.

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## **COMPUTER GAMES BUSINESSES**

Advertising revenues for the Company's magazine publications are recognized at the on-sale date of the magazines.

Newsstand sales of the Company's magazine publications are recognized at the on-sale date of the magazines, net of provisions for estimated returns. Subscription revenue, which is net of agency fees, is deferred when initially received and recognized as income ratably over the subscription term.

Sales of games and related products from the online store are recognized as revenue when the product is shipped to the customer. Amounts billed to customers for shipping and handling charges are included in net revenue. The Company provides an allowance for returns of merchandise sold through its online store. The allowance provided to date has not been significant.

## **INTERNET SERVICES**

Internet services net revenue consists principally of registration fees for Internet domain registrations, which generally have terms of one year, but may be up to ten years. Such registration fees are reported net of transaction fees paid to an unrelated third party which serves as the registry operator for the Company. Net registration fee revenue is recognized on a straight line basis over the registrations term.

## **VOIP TELEPHONY SERVICES**

VoIP telephony services revenue represents fees charged to customers for voice services and is recognized based on minutes of customer usage or as services are provided. The Company records payments received in advance for prepaid services as deferred revenue until the related services are provided.

## **VALUATION OF CUSTOMER RECEIVABLES**

Provisions for the allowance for doubtful accounts are made based on historical loss experience adjusted for specific credit risks. Measurement of such losses requires consideration of the Company's historical loss experience, judgments about customer credit risk, and the need to adjust for current economic conditions.

## **VALUATION OF INVENTORIES**

Inventories are recorded on a first-in, first-out basis and valued at the lower of cost or market value. We generally manage our inventory levels based on internal forecasts of customer demand for our products, which is difficult to predict and can fluctuate substantially. Our inventories include high technology items that are specialized in nature or subject to rapid obsolescence. If our demand forecast is greater than the actual customer demand for our products, we may be required to record charges related to increases in our inventory valuation reserves. The value of our inventory is also dependent on our estimate of future average selling prices, and, if our projected average selling prices are over estimated, we may be required to adjust our inventory value to reflect the lower of cost or market.

## **GOODWILL AND INTANGIBLE ASSETS**

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that certain acquired intangible assets in a business combination be recognized as assets separate from goodwill. SFAS No. 142 requires that goodwill and other intangibles with indefinite lives should no longer be amortized, but rather tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of the asset has decreased below its carrying value.



Our policy calls for the assessment of the potential impairment of goodwill and other identifiable intangibles with indefinite lives whenever events or changes in circumstances indicate that the carrying value may not be recoverable or at least on an annual basis. Some factors we consider important which could trigger an impairment review include the following:

- significant under-performance relative to historical, expected or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and
- significant negative industry or economic trends.

When we determine that the carrying value of goodwill or other identified intangibles with indefinite lives may not be recoverable, we measure any impairment based on a projected discounted cash flow method.

### **LONG-LIVED ASSETS**

Historically, the Company's long-lived assets, other than goodwill, have primarily consisted of property and equipment, capitalized costs of internal-use software, values attributable to covenants not to compete, acquired technology and patent costs.

Long-lived assets held and used by the Company and intangible assets with determinable lives are reviewed for impairment whenever events or circumstances indicate that the carrying amount of assets may not be recoverable in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." We evaluate recoverability of assets to be held and used by comparing the carrying amount of the assets, or the appropriate grouping of assets, to an estimate of undiscounted future cash flows to be generated by the assets, or asset group. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair values are based on quoted market values, if available. If quoted market prices are not available, the estimate of fair value may be based on the discounted value of the estimated future cash flows attributable to the assets, or other valuation techniques deemed reasonable in the circumstances.

### **CAPITALIZATION OF COMPUTER SOFTWARE COSTS**

The Company capitalizes the cost of internal-use software which has a useful life in excess of one year in accordance with Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Subsequent additions, modifications, or upgrades to internal-use software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance and training costs are expensed in the period in which they are incurred. Capitalized computer software costs are amortized using the straight-line method over the expected useful life, or three years.

### **IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS**

In February 2007, the Financial Accounting Standards Board ("FASB") issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 expands the scope of what entities may carry at fair value by offering an irrevocable option to record many types of financial assets and liabilities at fair value. Changes in fair value would be recorded in an entity's income statement. This accounting standard also establishes presentation and disclosure requirements that are intended to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for the Company on

January 1, 2008. Earlier application is permitted under certain circumstances. We are currently evaluating the requirements of SFAS No. 159 and have not yet determined the impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosure about fair value measurements. SFAS No. 157 applies to other accounting standards that require or permit fair value measurements. Accordingly, this statement does not require any new fair value measurement. This statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We are currently evaluating the requirements of SFAS No. 157 and have not determined the impact on our consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB No. 108 requires companies to quantify misstatements using a balance sheet and income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. SAB No. 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii) recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying value of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Use of the "cumulative effect" transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose. The adoption of this standard did not have a material impact on the Company's financial condition, results of operations or liquidity.

In June 2006, the FASB issued Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes," an interpretation of FASB Statement No. 109, "Accounting for Income Taxes," which clarifies accounting for and disclosure of uncertainty in tax positions. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact of adopting FIN No. 48 on our consolidated financial statements. At this point, the Company does not believe that the adoption of FIN No. 48 will have a material effect on its consolidated financial position, cash flows and results of operations.

#### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Interest Rate Risk.** Interest rate risk refers to fluctuations in the value of a security resulting from changes in the general level of interest rates. Investments that we classify as cash and cash equivalents have original maturities of three months or less and therefore, are not affected in any material respect by changes in market interest rates. At December 31, 2006, debt was composed of \$3.4 million of fixed rate instruments due to affiliates on demand with an aggregate average interest rate of 10.0%.

**Foreign Currency Risk.** We transact business in U.S. dollars. Foreign currency exchange rate fluctuations do not have a material effect on our results of operations.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**CONSOLIDATED FINANCIAL STATEMENTS**

**THEGLOBE.COM, INC. AND SUBSIDIARIES**

**INDEX TO FINANCIAL STATEMENTS**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders  
theglobe.com, inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of theglobe.com, inc. and Subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of theglobe.com, inc. and Subsidiaries as of December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States.

The accompanying 2006 consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has suffered recurring net losses and has a significant deficit that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**RACHLIN COHEN & HOLTZ LLP**

Fort Lauderdale, Florida  
March 28, 2007

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**THEGLOBE.COM, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

<u>ASSETS</u>	DECEMBER 31, 2006	DECEMBER 31, 2005
Current Assets:		
Cash and cash equivalents	\$ 5,316,218	\$ 16,480,660
Restricted cash	—	1,031,764
Accounts receivable, less allowance for doubtful accounts of of approximately \$20,000 and \$128,000, respectively	589,180	452,398
Inventory, less reserves of approximately \$370,000 and \$434,000, respectively	37,736	66,271
Prepaid expenses	508,082	1,022,771
Other current assets	21,546	146,889
<b>Total current assets</b>	<b>6,472,762</b>	<b>19,200,753</b>
Property and equipment, net	365,524	1,455,653
Intangible assets	526,824	715,035
Other assets	40,000	40,000
<b>Total assets</b>	<b>\$ 7,405,110</b>	<b>\$ 21,411,441</b>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</u></b>		
Current Liabilities:		
Accounts payable	\$ 2,796,637	\$ 2,564,988
Accrued expenses and other current liabilities	4,284,655	2,177,815
Income taxes payable	—	806,406
Deferred revenue	1,294,532	985,981
Notes payable due affiliates	3,400,000	3,400,000
Current portion of long-term debt	—	28,447
<b>Total current liabilities</b>	<b>11,775,824</b>	<b>9,963,637</b>
Deferred revenue	232,433	173,003
<b>Total liabilities</b>	<b>12,008,257</b>	<b>10,136,640</b>
Commitments and Contingencies (Notes 13 and 14)		
Stockholders' Equity (Deficit):		
Common stock, \$0.001 par value; 500,000,000 shares authorized; 172,484,838 and 174,373,091 shares issued at December 31, 2006 and December 31, 2005, respectively	172,485	174,373
Additional paid-in capital	289,088,557	288,740,889
Escrow shares	—	(750,000)
Accumulated deficit	(293,864,189)	(276,890,461)
<b>Total stockholders' equity (deficit)</b>	<b>(4,603,147)</b>	<b>11,274,801</b>

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Total liabilities and stockholders' equity (deficit)	\$	7,405,110	\$	21,411,441
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See notes to consolidated financial statements.

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**THEGLOBE.COM, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Year Ended December 31,		
	2006	2005	2004
Net Revenue	\$ 3,482,024	\$ 2,395,378	\$ 3,498,791
<b>Operating Expenses:</b>			
Cost of revenue	4,160,675	8,424,959	9,054,739
Sales and marketing	3,988,051	2,717,700	7,098,062
Product development	1,379,145	1,390,859	1,053,886
General and administrative	9,866,521	11,142,169	7,246,774
Depreciation	887,645	1,189,097	1,295,442
Intangible asset amortization	188,211	75,201	102,834
Impairment charge	—	—	1,661,975
Loss on settlement of contractual obligation	—	—	406,750
	20,470,248	24,939,985	27,920,462
Operating Loss from Continuing Operations	(16,988,224)	(22,544,607)	(24,421,671)
<b>Other Income (Expense), net:</b>			
Interest income (expense), net	120,171	(4,143,229)	(666,348)
Other income (expense), net	18,638	(274,082)	(158,550)
	138,809	(4,417,311)	(824,898)
<b>Loss from Continuing Operations</b>			
Before Income Tax	(16,849,415)	(26,961,918)	(25,246,569)
Income Tax Provision (Benefit)	124,313	(13,613,538)	(370,891)
Loss from Continuing Operations	(16,973,728)	(13,348,380)	(24,875,678)
<b>Discontinued Operations, net of tax:</b>			
Income from operations	—	68,801	602,477
Gain on sale of discontinued operations	—	1,769,531	—
Income from Discontinued Operations	—	1,838,332	602,477
Net Loss	\$ (16,973,728)	\$ (11,510,048)	\$ (24,273,201)
<b>Earnings (Loss) Per Share -</b>			
<b>Basic and Diluted:</b>			
Continuing Operations	\$ (0.10)	\$ (0.07)	\$ (0.19)
Discontinued Operations	\$ —	\$ 0.01	\$ —
Net Loss	\$ (0.10)	\$ (0.06)	\$ (0.19)
Weighted Average Common Shares Outstanding	174,674,000	182,539,000	127,843,000

See notes to consolidated financial statements.

**THEGLOBE.COM, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**  
**AND COMPREHENSIVE INCOME (LOSS)**

	Preferred Stock	Common Shares	Stock Amount	Additional Paid-in Capital	Escrow Shares	Treasury Stock	Accumulated Deficit	Total
Balance, December 31, 2003	\$ 500,000	50,245,574	\$ 50,246	\$ 238,301,862	-	\$ (371,458)	\$ (236,300,111)	\$ 2,180,53
Year Ended December 31, 2004:								
Net loss	-	-	-	-	-	-	(24,273,201)	(24,273,201)
Realized gain on securities	-	-	-	-	-	-	(1,562)	(1,562)
Comprehensive loss	-	-	-	-	-	-	-	(24,274,763)
Issuance of common stock:								
Private offering, net of offering costs	-	33,381,647	33,382	26,939,363	-	-	-	26,972,747
Conversion of Series F Preferred Stock and exercise of associated warrants	(500,000)	19,639,856	19,640	480,360	-	-	-	
Conversion of \$1,750,000 Convertible Notes	-	22,829,156	22,829	1,654,546	-	-	-	1,677,375
Conversion of \$2,000,000 Bridge Note	-	3,527,337	3,527	1,996,473	-	-	-	2,000,000
Acquisition of SendTec	17,500	17,500,024	17,500	11,163,275	-	-	-	11,198,275
Conversion of Series H Preferred Stock	(17,500)	17,500,500	17,500	-	-	-	-	
Exercise of warrants owned by Dancing Bear Investments	-	2,779,560	2,780	(2,780)	-	-	-	
	-	639,000	639	183,907	-	-	-	184,546

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Exercise of stock options								
Exercise of warrants	-	6,273,024	6,273	5,151	-	-	-	11,42
Beneficial conversion feature of \$2,000,000								
Bridge Note and warrants	-	-	-	687,000	-	-	-	687,00
Employee stock-based compensation	-	-	-	416,472	-	-	-	416,47
Issuance of stock options to non-employees	-	-	-	463,775	-	-	-	463,77
Balance, December 31, 2004	-	174,315,678	174,316	282,289,404	-	(371,458)	(260,574,874)	21,517,38
Year Ended December 31, 2005:								
Net loss	-	-	-	-	-	-	(11,510,048)	(11,510,04
Issuance of common stock:								
Settlement of contractual obligation	-	300,000	300	73,950	-	-	-	74,25
Acquisition of Tralliance	-	2,010,000	2,010	196,877	-	-	-	198,88
Conversion of Convertible Notes	-	12,000,000	12,000	588,000	-	-	-	600,00
Exercise of stock options	-	2,001,661	2,001	164,840	-	-	-	166,84
Exercise of warrants	-	11,051,403	11,051	-	-	-	-	11,05
Beneficial conversion features of \$4,000,000								
Convertible Notes	-	-	-	4,000,000	-	-	-	4,000,00
Employee stock-based compensation	-	-	-	48,987	-	-	-	48,98
Issuance of stock options to non-employees	-	-	-	176,050	-	-	-	176,05

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Stock-based compensation related to discontinued operations	-	-	-	455,054	-	-	-	455,054					
Issuance of escrow shares	-	2,272,727	2,273	747,727	(750,000)	-	-						
Redemption of common stock	-	-	-	-	-	(4,043,074)	-	(4,043,074)					
Repurchase of vested stock options	-	-	-	-	-	-	(420,585)	(420,585)					
Retirement of treasury stock	-	(29,578,378)	(29,578)	-	-	4,414,532	(4,384,954)						
Balance, December 31, 2005	-	174,373,091	174,373	288,740,889	(750,000)	-	(276,890,461)	11,274,801					
Net loss	-	-	-	-	-	-	(16,973,728)	(16,973,728)					
Issuance of common stock for services rendered	-	35,000	35	3,115	-	-	-	3,115					
Issuance of warrants	-	-	-	515,262	-	-	-	515,262					
Exercise of stock options	-	349,474	350	18,070	-	-	-	18,420					
Employee stock-based compensation	-	-	-	449,749	-	-	-	449,749					
Issuance of stock options to non-employees	-	-	-	109,199	-	-	-	109,199					
Retirement of escrow shares	-	(2,272,727)	(2,273)	(747,727)	750,000	-	-						
Balance, December 31, 2006	\$	-	172,484,838	\$	172,485	\$	289,088,557	\$	-	\$	(293,864,189)	\$	(4,603,141)

See notes to consolidated financial statements.

**THEGLOBE.COM, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,		
	2006	2005	2004
<b>Cash Flows from Operating Activities:</b>			
Net loss	\$ (16,973,728)	\$ (11,510,048)	\$ (24,273,201)
(Income) from discontinued operations	—	(1,838,332)	(602,477)
Net loss from continuing operations	(16,973,728)	(13,348,380)	(24,875,678)
<b>Adjustments to reconcile net loss from continuing operations to net cash flows from operating activities:</b>			
Depreciation and amortization	1,075,856	1,264,298	1,398,276
Non-cash expense related to issuance of warrants	515,262	—	—
Employee stock compensation	449,749	48,987	182,970
Loss on sale of property and equipment	130,424	—	—
Compensation related to non-employee stock options	109,199	176,050	463,046
Provision for uncollectible accounts receivable	17,076	125,000	183,149
Non-cash settlements of liabilities	(384,060)	—	(352,455)
Gain on sale of Now Playing magazine	(130,000)	—	—
Non-cash interest expense	—	4,000,000	735,416
Reserve against amounts loaned to Tralliance prior to acquisition	—	280,000	506,500
Provision for excess and obsolete inventory	—	191,261	1,289,196
Write-down of inventory deposit	—	77,250	221,450
Deferred tax benefit	—	(13,613,538)	—
Non-cash impairment charge	—	—	1,661,975
Loss on settlement of contractual obligation	—	—	406,750
Other, net	6,839	(136,284)	212,821
<b>Changes in operating assets and liabilities, net of acquisitions and dispositions:</b>			
Accounts receivable, net	(153,858)	542,912	(327,756)
Inventory, net	28,535	332,047	(1,108,461)
Prepaid and other current assets	640,032	86,824	28,681
Accounts payable	634,383	1,425,050	(751,595)
Accrued expenses and other current liabilities	2,106,840	(90,057)	548,169
Income taxes payable	(806,406)	—	—
Deferred revenue	367,981	995,269	(12,876)
Net cash flows from operating activities of continuing operations	(12,365,876)	(17,643,311)	(19,590,422)
Net cash flows from operating activities of discontinued operations	—	2,990,299	1,857,790
Net cash flows from operating activities	(12,365,876)	(14,653,012)	(17,732,632)
<b>Cash Flows from Investing Activities:</b>			

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Purchases of property and equipment	(86,158)	(296,170)	(2,643,018)
Net cash released from / (placed in) escrow	1,031,764	(938,357)	(93,407)
Proceeds from the sale of property and equipment	137,626	—	—
Proceeds from the sale of Now Playing magazine	130,000	—	—
Amounts loaned to Tralliance prior to acquisition	—	(280,000)	(466,500)
Other, net	—	119,814	141,385
Net cash flows from investing activities of continuing operations	1,213,232	(1,394,713)	(3,061,540)

(Continued)

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**THEGLOBE.COM, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Continued)

	2006	Year Ended December 31,	
		2005	2004
Sale of discontinued operations, net of cash sold	—	34,762,384	—
Redemption agreement payment allocation to sale	—	(7,560,872)	—
Acquisition of discontinued operations, net of cash acquired	—	—	(2,389,520)
Purchases of property and equipment by discontinued operations	—	(184,115)	(40,324)
Net cash flows from investing activities	1,213,232	25,622,684	(5,491,384)
<b>Cash Flows from Financing Activities:</b>			
Proceeds from exercise of stock options and warrants	18,420	177,892	195,970
Borrowings on notes payable and long-term debt	—	4,000,000	2,000,000
Payments on notes payable and long-term debt	(30,218)	(1,358,623)	(151,898)
Redemption of common stock	—	(4,043,074)	—
Proceeds from issuance of common stock, net	—	—	26,972,745
Payments of other long-term liabilities, net	—	—	(119,710)
Net cash flows from financing activities	(11,798)	(1,223,805)	28,897,107
Net Increase / (Decrease) in Cash and Cash Equivalents	(11,164,442)	9,745,867	5,673,091
Cash and Cash Equivalents, at beginning of period	16,480,660	6,734,793	1,061,702
Cash and Cash Equivalents, at end of period	\$ 5,316,218	\$ 16,480,660	\$ 6,734,793

See notes to consolidated financial statements.

**THEGLOBE.COM, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Continued)

	2006	Year Ended December 31, 2005	2004
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the period for:			
Interest	\$ 12,958	\$ 87,140	\$ 184,093
Income taxes	\$ 930,719	\$ —	\$ —
Supplemental Disclosure of Non-Cash Transactions:			
Conversion of debt and equity securities into common stock	\$ —	\$ 600,000	\$ 4,177,375
Additional paid-in capital attributable to the beneficial conversion features of debt and equity securities	\$ —	\$ 4,000,000	\$ 687,000
Common stock and warrants issued in connection with the acquisition of Tralliance Corporation	\$ —	\$ 198,887	\$ —
Common stock, preferred stock and stock options issued in connection with the acquisition of SendTec, Inc.	\$ —	\$ —	\$ 11,198,275
Note payable issued in connection with the acquisition of SendTec, Inc.	\$ —	\$ —	\$ 1,000,009
Common stock issued in connection with the settlement of a contractual obligation	\$ —	\$ 74,250	\$ —

See notes to consolidated financial statements.

**THEGLOBE.COM, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**DESCRIPTION OF THE COMPANY**

theglobe.com, inc. (the "Company" or "theglobe") was incorporated on May 1, 1995 (inception) and commenced operations on that date. Originally, theglobe.com was an online community with registered members and users in the United States and abroad. That product gave users the freedom to personalize their online experience by publishing their own content and by interacting with others having similar interests. However, due to the deterioration of the online advertising market, the Company was forced to restructure and ceased the operations of its online community on August 15, 2001. The Company then sold most of its remaining online and offline properties. The Company continued to operate its Computer Games print magazine and the associated CGOnline website ([www.cgonline.com](http://www.cgonline.com)), as well as the e-commerce games distribution business of Chips & Bits, Inc. ([www.chipsbits.com](http://www.chipsbits.com)). On June 1, 2002, Chairman Michael S. Egan and Director Edward A. Cespedes became Chief Executive Officer and President of the Company, respectively.

On November 14, 2002, the Company acquired certain Voice over Internet Protocol ("VoIP") assets. In exchange for the assets, the Company issued warrants to acquire 1,750,000 shares of its Common Stock and an additional 425,000 warrants as part of an earn-out structure upon the attainment of certain performance targets. The earn-out performance targets were not achieved and the 425,000 earn-out warrants expired on December 31, 2003.

On May 28, 2003, the Company acquired Direct Partner Telecom, Inc. ("DPT"), a company engaged in VoIP telephony services in exchange for 1,375,000 shares of the Company's Common Stock and the issuance of warrants to acquire 500,000 shares of the Company's Common Stock. The Company acquired all of the physical assets and intellectual property of DPT and originally planned to continue to operate the company as a subsidiary and engage in the provision of VoIP services to other telephony businesses on a wholesale transactional basis. In the first quarter of 2004, the Company decided to suspend DPT's wholesale business and dedicate the DPT physical and intellectual assets to its retail VoIP business. As a result, the Company wrote-off the goodwill associated with the purchase of DPT as of December 31, 2003.

On September 1, 2004, the Company acquired SendTec, Inc. ("SendTec"), a direct response marketing services and technology company for a total purchase price of approximately \$18.4 million. As more fully discussed in Note 3, "Discontinued Operations - SendTec Inc.," on October 31, 2005, the Company completed the sale of all of the business and substantially all of the net assets of SendTec for approximately \$39.9 million in cash.

As more fully discussed in Note 4, "Acquisition of Tralliance Corporation," on May 9, 2005, the Company exercised its option to acquire Tralliance Corporation ("Tralliance"), a company which had recently entered into an agreement to become the registry for the ".travel" top-level Internet domain. The Company issued 2,000,000 shares of its Common Stock, warrants to acquire 475,000 shares of its Common Stock and paid \$40,000 in cash to acquire Tralliance.

As of December 31, 2006, sources of the Company's revenue were derived principally from the operations of its games related businesses and its Internet services business conducted by Tralliance. The Company's retail VoIP products and services have not produced any significant revenue. See Note 19, "Subsequent Events," regarding the March 2007 decision by the Company's management and Board of Directors to discontinue the operations of the Company's computer games and VoIP telephony services businesses.



## PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries from their respective dates of acquisition. All significant intercompany balances and transactions have been eliminated in consolidation.

## USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates and assumptions relate to estimates of collectibility of accounts receivable, the valuation of inventory, accruals, the valuations of fair values of options and warrants, the impairment of long-lived assets and other factors. Actual results could differ from those estimates. In addition, the accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business (See Note 2, "Going Concern Considerations").

## CASH AND CASH EQUIVALENTS

Cash equivalents consist of money market funds and highly liquid short-term investments with qualified financial institutions. The Company considers all highly liquid securities with original maturities of three months or less to be cash equivalents.

## RESTRICTED CASH

Included in restricted cash in the accompanying consolidated balance sheet at December 31, 2005, was approximately \$1,000,000 of cash held in escrow in connection with the October 31, 2005 sale of all of the business and substantially all of the net assets of SendTec (see Note 3, "Discontinued Operations - SendTec, Inc." for further discussion). In addition, at December 31, 2005, restricted cash included \$31,764 of cash held in escrow for purposes of sweepstakes promotions being conducted by the VoIP telephony division. The Company has no restricted cash balances as of December 31, 2006.

## MARKETABLE SECURITIES

The Company accounts for its investment in debt and equity securities in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." All such investments were classified as held-to-maturity as of December 31, 2006 and 2005 and were being accounted for at amortized cost. The following is a summary of securities:

	December 31, 2006		December 31, 2005	
	Cost	Amortized Cost Basis	Cost	Amortized Cost Basis
Commercial Paper	\$ 995,561	\$ 999,704	\$ 4,981,666	\$ 4,992,666
Municipal Bond Funds	—	—	1,000,000	1,000,071
Amount classified as cash equivalents	\$ 995,561	\$ 999,704	\$ 5,981,666	\$ 5,992,737

During the years ended December 31, 2006, 2005 and 2004, the Company had no significant gross realized gains or losses on sales of securities.

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## **FAIR VALUE OF FINANCIAL INSTRUMENTS**

The carrying amount of certain of the Company's financial instruments, including cash, cash equivalents, restricted cash, marketable securities, accounts receivable, accounts payable, accrued expenses and short-term deferred revenue, approximate their fair value at December 31, 2006 and 2005 due to their short maturities.

## **INVENTORY**

Inventories are recorded on a first in, first out basis and valued at the lower of cost or market value. The Company's reserve for excess and obsolete inventory as of December 31, 2006 and 2005, was approximately \$370,000 and \$434,000, respectively.

During the years ended December 31, 2005 and 2004, the Company's VoIP telephony services business recorded charges to cost of revenue totaling approximately \$71,000 and \$1,477,000, respectively, as a result of write-downs required to state its inventory on-hand and related deposits for inventory on order at the lower of cost or market value.

Effective January 31, 2005, the Company formally terminated its contract with a supplier for VoIP telephony handsets and reached an agreement with the supplier to settle the unconditional purchase obligation under such contract. As a result, the Company recorded charges to cost of revenue which increased the inventory reserves related to its VoIP handset inventory by approximately \$300,000 as of December 31, 2004. During the third quarter of 2004, the Company had recorded a \$600,000 charge to cost of revenue and a corresponding increase to its reserve for excess and obsolete inventory related to the VoIP handset inventory.

In January 2005, the Company sold essentially all of its VoIP adapter inventory on-hand for \$235,000 in cash. As a result, approximately \$356,000 of additional provisions for excess and obsolete inventory were recorded in order to reflect the VoIP adapter inventory at net realizable value as of December 31, 2004. During 2004, the Company also made advance payments of approximately \$299,000 towards future purchases of adapter inventory. The Company recorded charges of approximately \$77,250 and \$221,000 during the years ended December 31, 2005 and 2004, respectively, to write down the value of such deposits on inventory purchases.

The Company manages its inventory levels based on internal forecasts of customer demand for its products, which is difficult to predict and can fluctuate substantially. In addition, the Company's inventories include high technology items that are specialized in nature or subject to rapid obsolescence. If the Company's demand forecast is greater than the actual customer demand for its products, the Company may be required to record additional charges related to increases in its inventory valuation reserves in future periods. The value of inventories is also dependent on the Company's estimate of future average selling prices, and, if projected average selling prices are over estimated, the Company may be required to further adjust its inventory value to reflect the lower of cost or market.

## **GOODWILL AND INTANGIBLE ASSETS**

The Company accounts for goodwill and intangible assets in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 requires that goodwill and other intangibles with indefinite lives should no longer be amortized, but rather be tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of the asset has decreased below its carrying value.

At December 31, 2006, the Company had no goodwill and had no other intangible assets with indefinite lives. Intangible assets subject to amortization and included in the accompanying consolidated balance sheet as of December 31, 2006, which consist of the values assigned to certain non-compete agreements, are being amortized on a straight-line basis over an estimated useful life of five years. See Note 5, "Impairment Charge," for a discussion of the charges recorded by the Company as a result of the review of goodwill and intangible assets for impairment in

connection with the preparation of the consolidated financial statements as of December 31, 2004.

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**LONG-LIVED ASSETS**

Long-lived assets, including property and equipment and intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." If events or changes in circumstances indicate that the carrying amount of an asset, or an appropriate grouping of assets, may not be recoverable, the Company estimates the undiscounted future cash flows to result from the use of the asset, or asset group. If the sum of the undiscounted cash flows is less than the carrying value, the Company recognizes an impairment loss, measured as the amount by which the carrying value exceeds the fair value of the assets. Fair values are based on quoted market values, if available. If quoted market values are not available, the estimate of fair value may be based on the discounted value of the estimated future cash flows attributable to the assets, or other valuation techniques deemed reasonable in the circumstances.

See Note 5, "Impairment Charge," for discussion of the impairment charge recorded by the Company as a result of the review of long-lived assets for impairment in connection with the preparation of the accompanying consolidated statement of operations for the year ended December 31, 2004.

Property and equipment is stated at cost, net of accumulated depreciation and amortization. Property and equipment is depreciated using the straight-line method over the estimated useful lives of the related assets, as follows:

	Estimated Useful Lives
VoIP network equipment	3 years
Capitalized software	3 years
Other equipment	3 years
Furniture and fixtures	3-7 years
Leasehold improvements	3-4 years

The Company capitalizes the cost of internal-use software which has a useful life in excess of one year in accordance with Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Subsequent additions, modifications, or upgrades to internal-use software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance and training costs are expensed in the period in which they are incurred.

**CONCENTRATION OF CREDIT RISK**

Financial instruments which subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities and trade accounts receivable. The Company maintains its cash and cash equivalents with various financial institutions and invests its funds among a diverse group of issuers and instruments. The Company performs ongoing credit evaluations of its customers' financial condition and establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of customers, historical trends and other information.

Concentration of credit risk in the Company's Internet services division is generally limited due to the large number of customers of the business. Two customers of the computer games division represented an aggregate of approximately \$155,000, or 26%, of net consolidated accounts receivable as of December 31, 2006. Trade accounts receivable of the VoIP telephony services division as of December 31, 2006, which approximated \$25,000, consisted entirely of funds held as a deposit by our credit card processor.



## **REVENUE RECOGNITION**

### **Continuing Operations**

#### **COMPUTER GAMES BUSINESSES**

Advertising revenue from the sale of print advertisements under short-term contracts in the Company's magazine publications are recognized at the on-sale date of the magazines.

The Company participates in barter transactions whereby the Company trades marketing data in exchange for advertisements in the publications of other companies. Barter revenue and expenses are recorded at the fair market value of services provided or received, whichever is more readily determinable in the circumstances. Revenue from barter transactions is recognized as income when advertisements or other products are delivered by the Company. Barter expense is recognized when the Company's advertisements are run in other companies' magazines, which typically occurs within one to six months from the period in which barter revenue is recognized. The Company had no barter revenue during the years ended December 31, 2006 and 2005. Barter revenue represented approximately 2% of consolidated net revenue from continuing operations for the year ended December 31, 2004.

Newsstand sales of the Company's magazine publications are recognized at the on-sale date of the magazines, net of provisions for estimated returns. Subscription revenue, which is net of agency fees, is deferred when initially received and recognized as income ratably over the subscription term.

Sales of games and related products from the Company's online store are recognized as revenue when the product is shipped to the customer. Amounts billed to customers for shipping and handling charges are included in net revenue. The Company provides an allowance for returns of merchandise sold through its online store. The allowance for returns provided to date has not been significant.

#### **INTERNET SERVICES**

Internet services revenue consists principally of registration fees for Internet domain registrations, which generally have terms of one year, but may be up to ten years. Such registration fees are reported net of transaction fees paid to an unrelated third party which serves as the registry operator for the Company. Payments of registration fees are deferred when initially received and recognized as revenue on a straight-line basis over the registration terms.

#### **VOIP TELEPHONY SERVICES**

VoIP telephony services net revenue represents fees charged to customers for voice services and is recognized based on minutes of customer usage or as services are provided. The Company records payments received in advance for prepaid services as deferred revenue until the related services are provided. Sales of peripheral VoIP telephony equipment are recognized as revenue when the product is shipped to the customer. Amounts billed to customers for shipping and handling charges are included in net revenue.

#### **MARKETING SERVICES -Discontinued Operations**

Revenue from the distribution of Internet advertising was recognized when Internet users visited and completed actions at an advertiser's website. Revenue consisted of the gross value of billings to clients, including the recovery of costs incurred to acquire online media required to execute client campaigns. Recorded revenue was based upon reports generated by the Company's tracking software.

Revenue derived from the purchase and tracking of direct response media, such as television and radio commercials, was recognized on a net basis when the associated media was aired. In many cases, the amount the Company billed to clients significantly exceeded the amount of revenue that was earned due to the existence of various "pass-through" charges such as the cost of the television and radio media. Amounts received in advance of media airings were deferred.

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Revenue generated from the production of direct response advertising programs, such as infomercials, was recognized on the completed contract method when such programs were complete and available for airing. Production activities generally ranged from eight to twelve weeks and the Company usually collected amounts in advance and at various points throughout the production process. Amounts received from customers prior to completion of commercials were included in deferred revenue and direct costs associated with the production of commercials in process were deferred.

## **ADVERTISING COSTS**

Advertising costs are expensed as incurred and are included in sales and marketing expense. Advertising costs were approximately \$1,019,000, \$463,000 and \$2,294,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Barter advertising costs were approximately 2% and 4% of total net revenue from continuing operations for the years ended December 31, 2006 and 2005, respectively. The Company incurred no barter advertising costs for the year ended December 31, 2004.

## **PRODUCT DEVELOPMENT**

Product development expenses include salaries and related personnel costs; expenses incurred in connection with website development, testing and upgrades of our computer games websites; editorial and content costs; and costs incurred in the development of our VoIP products. Product development costs and enhancements to existing products are charged to operations as incurred.

## **STOCK-BASED COMPENSATION**

In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment." This statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation", supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and amends SFAS No. 95, "Statement of Cash Flows." The statement eliminates the alternative to use the intrinsic value method of accounting that was provided in SFAS No. 123, which generally resulted in no compensation expense recorded in the financial statements related to the issuance of equity awards to employees. The statement also requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. It establishes fair value as the measurement objective in accounting for share-based payment arrangements and generally requires all companies to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees. The Company adopted SFAS No. 123R effective January 1, 2006, using the modified prospective application method in accordance with the statement. This application requires the Company to record compensation expense for all awards granted to employees and directors after the adoption date and for the unvested portion of awards that are outstanding at the date of adoption. The Company's consolidated financial statements as of and for the year ended December 31, 2006, reflect the impact of SFAS No. 123R. In accordance with the modified prospective application method, the Company's consolidated financial statements for prior periods have not been restated to reflect and do not include the impact of SFAS No. 123R.

Prior to January 1, 2006, the Company had historically followed SFAS No. 123, "Accounting for Stock-Based Compensation," which permitted entities to continue to apply the provisions of Accounting Principles Board Opinion No. 25 ("APB 25") and provide pro forma net earnings (loss) disclosures for employee stock option grants as if the fair-value-based method defined in SFAS No. 123 had been applied. Under this method, compensation expense was recorded on the date of grant only if the then current market price of the underlying stock exceeded the exercise price. The following table presents the Company's pro forma historical net loss had the Company determined compensation cost based on the fair value at the grant date for all of its employee stock options issued under SFAS No. 123:

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	Year Ended December 31,	
	2005	2004
Net loss - as reported	\$ (11,510,048)	\$ (24,273,201)
Add: Stock-based employee compensation expense included in net loss as reported	502,217	416,472
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards	(1,242,169)	(1,606,271)
Net loss - pro forma	\$ (12,250,000)	\$ (25,463,000)