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THEGLOBE COM INC
Form 10KSB
March 30, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-KSB

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003 COMMISSION FILE NO.: 0-25053

THEGLOBE.COM, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

14-1782422
(I.R.S. Employer
Identification Number)

110 East Broward Blvd., Suite 1400
Fort Lauderdale, FL
(Address of principal executive offices)

33301
(Zip Code)

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

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 whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B (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-KSB or any amendment to this Form 10-KSB .

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

Registrant's revenues for the fiscal year ended December 31, 2003 were \$ 6,580,452.

The number of shares outstanding of the Registrant's Common Stock, \$.001 par value (the "Common Stock") as of March 24, 2004 was 131,990,349.

Aggregate market value of the voting Common Stock held by non-affiliates of the registrant as of the close of business on March 24, 2004: \$68,114,123.

*Includes voting stock held by third parties, which may be deemed to be

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beneficially owned by affiliates, but for which such affiliates have disclaimed beneficial ownership.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this report, to the extent not set forth herein, is incorporated by reference from the registrant's definitive proxy statement relating to the annual meeting of stockholders to be held in 2004 which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

THEGLOBE.COM, INC. 2003 ANNUAL REPORT ON FORM 10-KSB

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FORWARD LOOKING STATEMENTS

This Form 10-KSB, including without limitation Management's Discussion and Analysis or Plan of Operation, contains "forward-looking statements" within the

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meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements can be identified by the use of predictive, future-tense or forward-looking terminology, such as "believes," "anticipates," "expects," "estimates," "plans," "may," "intends," "will," or similar terms. Investors are cautioned that any forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors described under "Risk Factors" and elsewhere in this report. The following discussion should be read together with the consolidated financial statements and notes to those statements included elsewhere in this report, as well as the "Risk Factors" set forth in Part II, Item 6 below.

PART I

ITEM 1. BUSINESS

OVERVIEW AND BUSINESS STRATEGY

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, but continued to operate its Computer Games print magazine and the associated website Computer Games Online (www.cgonline.com), as well as the games distribution business of Chips & Bits, Inc. (www.chipsbit.com). The Company continues to operate those businesses today.

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 from Brian Fowler (now Chief Technology Officer of the Company) and is now aggressively pursuing opportunities related to this acquisition under the brand name, voiceglo. 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 transaction included an earn-out arrangement whereby the former shareholders of DPT may earn additional warrants to acquire up to 2,750,000 shares of the Company's Common Stock at an exercise price of \$0.72 per share upon the attainment of certain performance targets by DPT over approximately a three year period following the date of acquisition. DPT was a specialized international facilities-based communications carrier providing VoIP communications services to emerging countries. DPT was formed in 2002 to leverage its management's international relationships and network operations experience in the deployment of international voice and multimedia networks. DPT is a licensed facilities-based carrier headquartered in Ft. Lauderdale, Florida with switching facilities in New York, New York and Miami, Florida. The DPT network provides "next generation" packet-based telephony and value added data services to carriers and businesses in the United States and Internationally.

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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 further wholesale telephony business in DPT and to dedicate the DPT physical and intellectual assets to its developing retail VoIP business, which is conducted under the name "voiceglo". As a result, the Company wrote down the goodwill associated with the purchase of DPT and intends to employ these physical assets in the build out of the VoIP network.

In March 2004, theglobe.com, inc. completed a private offering of 333,816 units (the "Units") for a purchase price of \$85 per Unit (the "Private Offering"). Each Unit consisted of 100 shares of the Company's Common Stock, \$0.001 par value (the "Common Stock"), and warrants to acquire 50 shares of the 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 Private Offering was 33,381,647 shares for an aggregate consideration of \$28,374,400, or approximately \$0.57 per share assuming the exercise of the 16,690,824 Warrants. The Private Offering was directed solely to investors who are sophisticated and accredited within the meaning of applicable securities laws, most of whom were not affiliates with the Company. The purpose of the Private Offering was to raise funds for use primarily in the Company's developing voiceglo business, including the deployment of networks, website development, marketing, and capital infrastructure expenditures and working capital. Proceeds may also be used in connection with theglobe's other existing or future business operations. (See "Management's Discussion and Analysis or Plan of Operation - Liquidity and Capital Resources").

As of December 31, 2003, the Company's revenue sources were principally from the sale of print advertising in its Computer Games magazine; the sale of video games and related products through Chips & Bits, Inc., its games distribution business; and the sale of its Computer Games magazine through newsstands and subscriptions. Management's intent, going forward, is to devote substantial monetary, management and human resources to the Company's "voiceglo" VoIP business.

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OUR PRODUCTS AND SERVICES

As of December 31, 2003, we managed two primary lines of business. One line consists of our historical network of three wholly-owned businesses, each of which specializes in the games business by delivering games information and selling games in the United States and abroad. These businesses are: our print publication Computer Games Magazine; our Computer Games Online website (www.cgonline.com), which is the online counterpart to Computer Games Magazine; and our Chips & Bits, Inc. (www.chipsbits.com) games distribution company. Management of the Company continues to actively explore a number of strategic alternatives for its remaining online and offline game properties, including continuing its existing operations and using its cash on hand, selling some or all of these properties and/or entering into new or different lines of business.

The second line of business, VoIP telephony services, includes voiceglo Holdings, Inc., a wholly-owned subsidiary of theglobe.com that offers VoIP-based phone service to anyone with an Internet connection anywhere in the world. The term "VoIP" refers to a category of hardware and software that enables people to use the Internet as the transmission medium for telephone calls.

"VOICEGLO" AND OUR VOICE OVER INTERNET PROTOCOL ("VoIP") BUSINESS.

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Overview. The use of the Internet to provide voice communications services is becoming more prevalent as new providers enter the market and the technology becomes more accepted. According to Insight Research, VoIP-based services will grow from \$13.0 billion in 2002 to nearly \$197.0 billion in 2007. VoIP technology translates voice into data packets, transmits the packets over data networks and reconverts them into voice at their destination. Unlike traditional telephone networks, VoIP does not require dedicated circuits to complete telephone calls. Instead, VoIP networks can be shared by multiple users for voice, data and video simultaneously. These types of data networks are more efficient than dedicated circuit networks because they are not restricted by "one-call, one-line" limitations of traditional telephone networks. Accordingly, improved efficiency creates cost savings that can be passed on to the consumer in the form of lower rates.

Development of our VoIP Business. We entered the VoIP business by acquiring certain software assets from Brian Fowler on November 14, 2002. Today those assets serve as the foundation of the products we offer and market under the brand name, "voiceglo."

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 facilities-based 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, "voiceglo".

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During the third quarter of 2003, the Company launched its first suite of consumer and business level VoIP services. These services allow consumers and enterprises to communicate using VoIP technology for dramatically reduced pricing compared to traditional telephony networks. The services also offer all traditional telephony features such as voicemail, caller ID, call forwarding, and call waiting for no additional cost to the consumer, as well as incremental services that are not currently supported by the public switched telephone network ("PSTN") like the ability to use numbers remotely and voice to email services.

The Company now offers VoIP services, on a retail basis, to individual consumers and small businesses and currently offers two primary types of services:

- o Browser-Based - a full functioning telephone that resides on the computer desktop and also includes a web-based solution. The only system requirements are a browser and an Internet connection. The Company is seeking a patent to protect its position.
- o SIP Based Soft Phone - a traditional phone line replacement service. Requires a voiceglo adapter, a regular phone and an Internet connection. The service works on broadband, dial-up and wi-fi Internet connections and can be used with a USB phone directly over a user's computer if desired.

The browser-based product is marketed under the name "GloPhone":

- o Users acquire the GloPhone by downloading a simple "plug-in" to their browsers. The download is a simple process and once it's completed, the user's browser is enabled for voice communications;
- o Users choose their GloPhone service from a variety of packages offered as part of the download process and are enabled with a working United States

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telephone number;

- o GloPhone users speak free to other GloPhone users;
- o The GloPhone is used by either utilizing the computer's microphone and speakers or using an external device, such as a USB phone; and
- o GloPhone users can use their service when traveling through the "GloPhone express" web-based application.

The home and business replacement products are marketed as different "packages" under the voiceglo brand:

- o The home and business replacement products are meant to "replace" existing traditional phone service with voiceglo's service;
- o User's can purchase a voiceglo adapter that allows use of traditional telephone handsets with the voiceglo service;
- o All voiceglo packages include full feature sets such as caller ID, call waiting, etc.; and
- o voiceglo users speak free to other voiceglo users.

Sales and Marketing. The Company is currently developing its product sales and distribution strategy. The Company may market its services over a wide range of distribution channels that may include: television infomercials, print media advertising and Internet advertising and structured customer referral programs. The Company is currently selling some of its services through both direct and indirect sales channels (value-added resellers).

Development of our Network and Carrier Relationships; Equipment Suppliers. In order to offer our services we have invested substantial time, capital and other resources on the development of the voiceglo network. The voiceglo network is comprised of switching hardware and software, servers, billing and inventory systems, and telecommunication carrier services. We own and operate VoIP switch equipment in Miami and New York, and interconnect these switches utilizing a leased transport network through numerous carrier agreements with third party providers. Through these carrier relationships we are able to carry the traffic of our customers over the Internet and interact with the PSTN. In general, we enter into from one to five year agreements with these carriers pursuant to which, in exchange for allocating and dedicating availability on their networks, we undertake to provide minimum usage of these networks. The greater the minimum usage, the lower our per minute charge for such usage, assuming full utilization of such minutes. Given the recent introduction of our voiceglo service offerings, our minimum commitments under these carrier agreements presently greatly exceed our actual usage. These Carrier relationships also provide voiceglo with a leased network for telephone numbers, or "footprint", in more than 100 area codes in approximately 34 states. The network also provides for both domestic and international call termination. Although other sources of supply are available, to assure a reliable source of supply for our voiceglo offering, we have entered into contracts with two principal suppliers for telephony handsets and adapters related to our VoIP services. Handsets or adapters allow our customers to more easily use their computers as telephones. Pursuant to our agreement with the handset supplier we have committed to purchase, subject to satisfaction of certain performance criteria relating to the handsets, a substantial number of handsets by the end of 2004. See "Management's Discussion and Analysis or Plan of Operation - Liquidity and Capital Resources".

Research and Development

Internet telephony is a technical service offering. As a technology, basic VoIP service, although complex, is well-understood and has been adapted by many companies that are selling basic services to consumers and businesses worldwide. voiceglo, however, believes that in order to be competitive and differentiate itself among its peers, it must continuously upgrade its service offering. To that end, the Company is engaged in a program of continuous development of its products. Since the initial launch of its VoIP service, the Company has introduced a number of new features which have increased the functionality of the products. Several major upgrades to the Company's offerings are anticipated in 2004.

OUR COMPUTER GAMES BUSINESS

COMPUTER GAMES MAGAZINE. Computer Games Magazine is a consumer print magazine for gamers.

- As a leading consumer print publication for games, Computer Games magazine boasts: a reputation for being a reliable, trusted, and engaging games magazine; more editorial, tips and hints than most other similar magazines; a knowledgeable editorial staff providing increased editorial integrity and content; and, broad-based editorial coverage, appealing to a wide audience of gamers.
- One of the most popular features of Computer Games is a CD ROM containing game demos, which comes bundled monthly with the magazine in all newsstand editions and a portion of copies mailed to subscribers.

COMPUTER GAMES ONLINE. Computer Games Online (www.cdmag.com) is the online counterpart to Computer Games magazine. Computer Games Online is a source of free computer games news and information for the sophisticated gamer, featuring news, reviews and previews, along with a powerful Web-wide search engine.

- Features of Computer Games Online include: game industry news; truthful, concise reviews; first looks, tips and hints; multiple content links; thousands of archived files; and, easy access to game buying.

CHIPS & BITS. Chips & Bits (www.chipsbits.com) is a games distribution business that attracts customers in the United States and abroad. Chips & Bits covers all the major game platforms available, including Macintosh, Window-based PCs, Sony PlayStation, Sony PlayStation2, Microsoft's Xbox, Nintendo 64, Nintendo's GameCube, Nintendo's Game Boy, and Sega Dreamcast, among others.

Advertising. We continue to attract major advertisers to our Computer Games print magazine, which is a widely respected consumer print magazine for gamers. In 2003, no single advertiser accounted for more than 10% of total revenues. For the twelve months ended December 31, 2003, over 40 clients advertised in our Computer Games magazine. Following a series of cost reduction measures and restructuring, we currently have an internal advertising sales staff of two (2) professionals, both of whom are dedicated to selling advertising space in our Computer Games print magazine. Although these professionals focus on developing long-term strategic relationships with clients as they sell advertisements in our Computer Games print magazine, most of our actual advertising contracts are

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for periods of one to three months. All compensation to our sales personnel is commission based.

In 2003 we hired an entertainment editor based in Los Angeles to develop an entertainment publication that will be delivered within Computer Games magazine starting in Spring, 2004. The new magazine, NowPlaying, will cover movies, DVD, television, music, games, comics and anime, and is designed to fulfill the wider pop culture interests of our current readers and to attract a more diverse group of advertisers; autos, television, telecommunications and film to name a few. Additional sales staff needs are anticipated to be minimal.

COMPETITION

Telephony Business

The telecommunications industry has experienced a great deal of instability during the past several years. During the 1990s, forecasts of very high levels of future demand brought a significant number of new entrants and new capital investments into the industry. New global carriers were joined by many of the largest traditional carriers and built large global or regional networks to compete with the global wholesalers. However, in the last three years many of the new global carriers and many industry participants have either gone through bankruptcy or no longer exist. The networks were built primarily to meet the expected explosion in bandwidth demand from data, with specific emphasis upon Internet applications. Those forecasts have not materialized, telecommunications capacity now far exceeds actual demand, and the resulting marketplace is characterized by fierce price competition as traditional and next generation carriers compete to secure market share. Resulting lower prices have eroded margins and have kept many carriers from attaining positive cash flow from operations.

During the past several years, a number of companies have introduced services that make Internet telephony or voice services over the Internet available to businesses and consumers. All major telecommunications companies, including entities like AT&T, Sprint and MCI, as well as iBasis, Net2Phone and deltathree.com, compete or can compete directly with us.

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Our competitors can be divided into domestic competitors and international competitors. The international market is highly localized. In markets where telecommunications have been fully deregulated, the competition continues to increase. In newly deregulated markets even new entrants to the VoIP space can rapidly capture significant market share. Competitors in these markets include both government-owned and incumbent phone companies, as well as emerging competitive carriers. The principle competitive factors in this marketplace include: price, quality of service, distribution, customer service, reliability, network capacity, and brand recognition. The long distance market in the US, against whom the Company competes, is highly competitive. There are numerous competitors in the pure play VoIP space and we expect to face continuing competition from these existing, as well as new, competitors. The principle competitive factors in the marketplace include those identified above, as well as enhanced communications services. Our competitors include such VoIP services companies such as Net2Phone, Skype, Vonage, Go2Call and DeltaThree.

Many of our competitors have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, greater brand recognition and more established relationships in the industry than we

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have. As a result, certain of these competitors may be able to adopt more aggressive pricing policies which may hinder our ability to market our voice services. We believe that our key competitive advantages are a function of our continuing research and development, including our two method patents pending:

- o Linking a telephone number to an IP address, allowing anyone, anywhere in the world to dial a traditional telephone number to originate a call to the distinct IP address of a voiceglo customer; and
- o Browser to telephone interface, which turns any browser into a voice enabled communications device and includes many features commonly available from traditional telephone service providers.

There can be no assurance that we will be successful in our efforts to patent this technology.

Computer Games Business

Competition among games print magazines is high. We compete for advertising and circulation revenues principally with publishers of other technology and games magazines with similar editorial content as our magazine. The technology magazine industry has traditionally been dominated by a small number of large publishers. We believe that we compete with other technology and games publications based on the nature and quality of our magazines' editorial content and the attractive demographics of our readers. In recent years, demand for online and PC based games has decreased as non PC based game consoles, including those from Sony (PlayStation II), Microsoft (X-Box) and Nintendo (Game Boy and GameCube), have made major product advancements.

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 and are seeking to develop additional propriety technology. 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 and we are currently pursuing patent protection for certain of our VoIP technology, including certain technology related to our linkage of a telephone number to an IP address and our browser to telephone interface.

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. Should this happen, we would lose a significant competitive advantage. 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. (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 and telecommunications, including internet telephony (VoIP). In addition, a number of federal, state, local and foreign legislative and regulatory proposals are under consideration. Laws or regulations may be adopted with respect to the Internet relating to, among other things, fees and taxation of VoIP telephony services, liability for information retrieved from or transmitted over the Internet, online content regulation, user privacy and quality of products and services. Changes in tax laws relating to electronic commerce could materially affect our business, prospects and financial condition. 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. Any new legislation or regulation, or the application or interpretation of existing laws or

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regulations, may decrease the growth in the use of the Internet or VoIP telephony services, may impose additional burdens on electronic commerce or may alter how we do business.

New laws and regulations 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.

Internet Telephony (VoIP) Regulation

The use of the Internet and private IP networks to provide voice communications services over the Internet is a relatively recent market development. Although the provision of such services is currently permitted by United States federal law and largely unregulated within the United States, several foreign governments have adopted laws and/or regulations that could restrict or prohibit the provision of voice communications services over the Internet or private IP networks.

In the United States, the Federal Communications Commission ("FCC") has so far declined to conclude that IP telephony services constitute telecommunications services (rather than information services). The FCC held a forum on VoIP issues on December 1, 2003, which included regulatory classification issues. On March 10, 2004, the FCC released guidelines and questions upon which it is seeking public comment to determine what regulation, if any, will govern companies that provided VoIP services. Specifically, the FCC has expressed an intention to further examine the question of whether certain forms of phone-to-phone VOIP services are information services or telecommunications services. The two are treated differently in several respects, with certain information services being regulated to a lesser degree. The FCC has noted that certain forms of phone-to-phone VOIP services bear many of the same characteristics as more traditional voice telecommunications services and lack the characteristics that would render them information services. The FCC has indicated that the mechanisms for contributing to the Universal Service Fund, issues as to applicability of access charges and other matters will be considered in that context. The FCC had previously opened a proceeding in response to a petition by

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AT&T which seeks a declaration to preclude local exchange carriers from imposing access charges on certain AT&T phone-to-phone IP services asserted to be provided over the Internet. The FCC has recently ruled that so called "pure" VoIP services which flow entirely over the Internet and never interconnect with the public switched telephone network, such as a computer to computer call, are not telecommunications services subject to regulation. The ruling specifically does not address whether traditional phone regulations might apply to VoIP services (like those offered by voiceglo) to end users that interconnect with the traditional telephone system.

If the FCC or any state determines to regulate VoIP, they may impose surcharges, taxes, licensing or additional regulations upon providers of Internet telephony. These surcharges could include access charges payable to local exchange carriers to carry and terminate traffic, contributions to the universal service fund or other charges. Regulations requiring compliance with the Communications Assistance for Law Enforcement Act, or provision of enhanced 911 services could also place a significant financial burden on us. The imposition of any such additional fees, charges, taxes, licenses and regulations on VoIP services could materially increase our costs and may reduce or eliminate the competitive pricing advantage we seek to enjoy. We cannot predict what regulations, if any the FCC will impose.

Although Internet telephony and VoIP services are presently largely unregulated by the state governments, such state governments and their regulatory authorities may assert jurisdiction over the provision of intrastate IP communications services where they believe that their telecommunications regulations are broad enough to cover regulation of IP services. Various state regulatory authorities have initiated proceedings to examine the regulatory status of Internet telephony services, and in several cases rulings have been obtained to the effect that the use of the Internet to provide certain intrastate services does not exempt an entity from paying intrastate access charges in the jurisdictions in question. As state governments, courts, and regulatory authorities continue to examine the regulatory status of Internet telephony services, they could render decisions or adopt regulations affecting providers of Internet telephony services or requiring such providers to pay intrastate access charges or to make contributions to universal service funding. Should the FCC determine to regulate IP services, states may decide to follow the FCC's lead and impose additional obligations as well.

The regulatory treatment of IP communications outside the United States varies significantly from country to country. Some countries currently impose little or no regulation on Internet telephony services, as in the United States. Other countries, including those in which the governments prohibit or limit competition for traditional voice telephony services, generally do not permit Internet telephony services or strictly limit the terms under which those services may be provided. Still other countries regulate Internet telephony services like traditional voice telephony services, requiring Internet telephony companies to make various telecommunications service contributions and pay other taxes.

More aggressive regulation of Internet telephony providers and VoIP services may adversely affect our VoIP business operations, and ultimately our financial condition, operating results and future prospects.

Certain Other Regulation Affecting the Internet

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

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protection, Internet fraud, privacy and digital signatures. Various states have adopted and are considering Internet-related legislation. Increased U.S.

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regulation of the Internet 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. Legislation has also been proposed that would clarify the regulatory status of VoIP service. 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.

Internationally, the European Union has also 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.

EMPLOYEES

As of December 31, 2003, we had approximately 42 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 2. PROPERTIES

Our corporate headquarters is located in Fort Lauderdale, Florida, where we lease approximately 15,000 square feet of office space from a company which is controlled by our Chairman. We maintain approximately 9,500 square feet of office space in two separate locations in Vermont in connection with the operations of our Computer Games magazine and Chips & Bits, Inc. We own one property and the other is a lease which expires in September 2005. Additionally, we have obtained collocation space in secure telecommunications data centers located in Florida, Georgia and New York which is used to house certain Internet routing and computer equipment.

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ITEM 3. LEGAL PROCEEDINGS

On and after August 3, 2001 and as of the date of this filing, six putative shareholder class action lawsuits were filed against the Company, certain of its current and former officers and directors, and several investment banks that were the underwriters of the Company's November 23, 1998 initial public offering and its May 19, 1999 secondary offering. The lawsuits were filed in the United States District Court for the Southern District of New York. The complaints against the Company have been consolidated into a single action and a Consolidated Amended Complaint, which is now the operative complaint, was filed on April 19, 2002.

The lawsuit purports to be a class action 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. The action seeks damages in an unspecified amount.

The action is being coordinated with approximately 300 other nearly identical actions filed against other companies. On July 15, 2002, the Company moved to dismiss all claims against it and the Individual Defendants. On October 9, 2002, the Court dismissed the Individual Defendants from the case without prejudice based on stipulations of dismissal filed by the plaintiffs and the Individual Defendants. On February 19, 2003, the Court denied the motion to dismiss the complaint against the Company. The Company has approved a Memorandum of Understanding ("MOU") and related agreements which set forth the terms of a settlement between the Company, the plaintiff class and the vast majority of the other approximately 300 issuer defendants. Among other provisions, the settlement contemplated by the MOU 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. It is anticipated that any potential financial obligation of the Company to plaintiffs pursuant to the terms of the MOU and related agreements will be covered by existing insurance. Therefore, the Company does not expect that the settlement will involve any payment by the Company. The MOU and related agreements are subject to a number of contingencies, including the negotiation of a settlement agreement and its approval by the Court. We cannot opine as to whether or when a settlement will occur or be finalized and,

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consequently, are unable at this time to determine whether the outcome of the litigation will have a material impact on our results of operations or financial condition in any future period.

On July 3, 2003, an action was commenced against one of the Company's subsidiaries, Direct Partner Telecom, Inc. ("DPT"). Global Communications Consulting Corp. v. Michelle Nelson, Jason White, VLAN, Inc., Geoffrey Amend, James Magruder, Direct Partner Telecom, Inc., et al. was filed in the Superior Court of New Jersey, Monmouth County, and removed to the United States District Court for the District of New Jersey on September 16, 2003. Plaintiff is the former employer of Michelle Nelson, a consultant of DPT. Plaintiff alleges that while Nelson was its employee, she provided plaintiff's confidential and

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proprietary trade secret information, to among others, DPT and certain employees, and diverted corporate opportunities from plaintiff to DPT and the other named defendants. Plaintiff asserts claims against Nelson including breach of fiduciary duty, breach of the duty of loyalty and tortious interference with contract. Plaintiff also asserts claims against Nelson and DPT, among others, for contractual interference, tortious interference with prospective economic advantage and misappropriation of proprietary information and trade secrets. Plaintiff seeks injunctive relief and damages in an unspecified amount, including punitive damages.

The Answer to the Complaint, with counterclaims, was served on October 20, 2003, denying plaintiff's allegations of improper and unlawful conduct in their entirety. The parties have recently reached an amicable resolution of this matter, including a mutual release of all claims. We anticipate that the release agreement will be finalized and a Stipulation of Dismissal will be filed with the Court by the end of April 2004.

The Company is currently a party to certain other legal proceedings, claims, disputes and litigation arising in the ordinary course of business, including those noted above. The Company currently believes that the ultimate outcome of these other proceedings, 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 litigation, should the outcome of these actions 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

No matters were submitted to our stockholders for a vote during the three months ended December 31, 2003.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES

MARKET INFORMATION

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, 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:

	2003		2002	
	High	Low	High	Low
Fourth Quarter	\$2.12	\$1.30	\$0.17	\$0.05
Third Quarter	\$1.97	\$1.12	\$0.10	\$0.015
Second Quarter	\$2.56	\$0.13	\$0.07	\$0.03
First Quarter	\$0.20	\$0.06	\$0.07	\$0.025

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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.")

HOLDERS OF COMMON STOCK

We had approximately 667 holders of record of Common Stock as of March 24, 2004. 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.

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SECURITIES OFFERED UNDER EQUITY COMPENSATION PLANS

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 available for future grants
Equity Compensation plans approved by security holders	4,421,810	\$ 1.55	400,177
Equity Compensation plans not approved by security holders	5,521,000	\$ 0.05	959,000
Total	9,942,810	\$ 0.72	1,359,177

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

- o 230,000 shares of Common Stock of theglobe.com, inc., par value \$0.001 per share, issued to Charles Peck pursuant to the Non-Qualified Stock Option Agreement dated June 1, 2002 at an exercise price of \$0.035 per share. These stock options vested immediately and have a life of ten years from date of grant.
- o 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.

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- o 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.
- o 500,000 shares of Common Stock of theglobe.com, inc., issued to Robin M. 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.
- o 500,000 shares of Common Stock of theglobe.com, inc., issued to Kellie Smythe pursuant to the Non-Qualified Stock Option Agreement dated July 17, 2003 at an exercise price of \$0.20 per share. 125,000 of these stock options vested immediately with the balance of 375,000 vesting quarterly on a pro-rata basis over three years. These stock options have a life of ten years from date of grant. Ms. Smythe terminated her employment with theglobe.com effective February 10, 2004 and has 90 days from that date to exercise any of her vested options.
- o 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 10 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.

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ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

OVERVIEW AND PLAN OF OPERATION

OVERVIEW

During 2000 and 2001, the Company restructured its business operations and sold off or closed most of its businesses. As of December 31, 2003, we managed two primary lines of business. One line consists of our historical network of three wholly owned businesses, each of which specializes in the games business by delivering games information and selling games in the United States and abroad. These businesses are: our print publication Computer Games Magazine; our

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Computer Games Online website (www.cgonline.com), which is the online counterpart to Computer Games Magazine; and our Chips & Bits, Inc. (www.chipsbits.com) games distribution company. Management of the Company continues to actively explore a number of strategic alternatives for its remaining online and offline game properties, including continuing its existing operations and using its cash on hand, selling some or all of these properties and/or entering into new or different lines of business.

The second line of business, voice over Internet protocol ("VoIP") telephony services, includes voiceglo Holdings, Inc., a wholly-owned subsidiary of theglobe.com that offers VoIP web-based, home and business phone service to anyone anywhere in the world. The term "VoIP" refers to a category of hardware and software that enables people to use the Internet as the transmission medium for telephone calls.

At the current time, our revenues are derived principally from the sale of print advertisements under short-term contracts in our games information magazine Computer Games, through the sale of video games and related products through our games distribution business Chips & Bits, Inc.; through the sale of our games information magazine through newsstands and subscriptions; and through limited sale of online advertisements. Given their recent launch, our voiceglo VoIP products and services have yet to produce any significant revenue.

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2003 COMPARED TO YEAR ENDED DECEMBER 31, 2002

NET REVENUE. Our revenue sources were principally from the sale of print advertisements under short-term contracts in our games information magazine Computer Games; the sale of video games and related products through our games distribution business Chips & Bits, Inc.; the sale of our games information magazine through newsstands and subscriptions; and the sale of VoIP telephony services (primarily from our wholesale VoIP services and not our recently launched voiceglo retail VoIP services).

Net revenue totaled \$6.6 million for the year ended December 31, 2003 as compared to \$9.7 million for the year ended December 31, 2002. The \$3.1 million decline in total net revenue was primarily attributable to decreases in magazine sales, electronic commerce revenue and advertising, partially offset by net revenue generated by our VoIP telephony services division.

Advertising revenue from the sale of print advertisements in our games magazine was \$2.6 million, or 39%, of total net revenue for the year ended December 31, 2003, versus \$3.1 million, or 32%, of total net revenue for the prior year. Barter advertising revenue represented approximately 2% and 1% of total net revenue for the years ended December 31, 2003 and 2002, respectively.

Net revenue attributable to the sale of our games information magazine was \$2.0 million, or 31%, of total net revenue for the 2003 year as compared to \$3.5 million, or 36%, of total net revenue in 2002. The decline in net revenue from the sale of our games magazine as compared to the previous year was primarily the result of a decrease in the circulation base of our games magazine. As rates for print advertising charged to advertisers are driven largely by the circulation of the publication, the decline in the circulation base of our games magazine has also contributed to the decrease in our advertising revenue.

Electronic commerce and other net revenue is principally comprised of sales of video games and related products through Chips & Bits, Inc. Sales of our online store accounted for \$1.5 million, or 22%, of total net revenue for the year ended December 31, 2003 as compared to \$3.1 million, or 32%, of total net revenue for 2002. The \$1.6 million decrease was primarily the result of advances

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in and releases of console and online games, which traditionally have less sales loyalty to our online store, coupled with the continued decline in the number of major PC game releases, on which our online store relies for the majority of sales. In addition, an increasing number of major retailers have increased the selection of video games offered by both their traditional "bricks and mortar" locations and their online commerce sites resulting in increased competition.

Net revenue from telephony services totaled \$0.5 million for the year ended December 31, 2003. As part of the Company's strategy to enter the VoIP business, the Company acquired DPT on May 28, 2003, an international licensed telecommunications carrier engaged in the purchase and resale of telecommunications services over the Internet. Telephony services net revenue generated by DPT during 2003 represented approximately 89% of total telephony services net revenue and was derived principally from the charges to customers for international call completion based on the volume of minutes utilized. As a result of management's decision during the first quarter of 2004 to suspend DPT's wholesale business and dedicate the DPT physical and intellectual assets to its retail VoIP business, net revenue derived from the wholesale business of DPT is not expected to represent a significant component of telephony services net revenue in the near term. Net revenue attributable to the launch of the Company's voiceglo products represented the remaining 11% of total 2003 telephony services net revenue. Although the Company launched its basic suite of VoIP offerings on a "national" basis during the fourth quarter of 2003, the

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Company has continued to focus significant resources on further development of its voiceglo product line, most recently evidenced by the 2004 first quarter launch of its "GloPhone" product line. In addition, the Company has continued to formulate its marketing strategy and distribution network for its voiceglo products.

COST OF PRODUCTS AND PUBLICATIONS SOLD. Cost of products and publications sold related to our games division consists primarily of printing costs of our games magazine, Internet connection charges, personnel costs, maintenance costs of website equipment and the costs of merchandise sold and shipping fees in connection with our online store. Cost of products and publications sold by our games division totaled approximately \$3.1 million and \$5.6 million for the years ended December 31, 2003 and 2002, respectively. The gross margin of the Company's games division approximated 48% in 2003 as compared to 42% in 2002. The overall improvement in the gross margin of the games division as compared to the prior year resulted from the increase in advertising revenue as a percentage of total net revenue, coupled with an improvement in the gross profit margin of Chips & Bits. The remaining \$0.2 million of cost of products sold for 2003 consisted primarily of customer equipment costs related to the sale of the Company's voiceglo service launched during mid-August 2003.

DATA COMMUNICATIONS, TELECOM AND NETWORK OPERATIONS. This expense category relates to the Company's entry into the VoIP business in 2003 and includes termination and circuit costs related to the Company's wholesale telephony services business marketed by DPT and the Company's retail telephony services business marketed under the voiceglo brand name. Personnel and consulting costs incurred in support of the Company's Internet telecommunications network are also included in this expense category. Data communications, telecom and network operations expenses are expected to increase in the future as the Company further expands its data communications network and expands its telecommunications carrier relationships in order to support its voiceglo product line.

SALES AND MARKETING. Sales and marketing expenses consist primarily of salaries

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and related expenses of sales and marketing personnel, commissions, advertising and marketing costs, public relations expenses, promotional activities and barter expenses. Sales and marketing expenses were \$3.3 million for the year ended December 31, 2003 as compared to \$3.5 million for the year ended December 31, 2002. A decline of \$1.6 million in sales and marketing expenses incurred by the Company's games division was partially offset by \$1.4 million of sales and marketing expenses of the VoIP telephony services division. Sales and marketing expenses of the games division represented approximately 31% and 36% of total net revenue attributable to the games division's operations for the years ended December 31, 2003 and 2002, respectively. The 38% reduction in net revenue generated by the Company's games division as compared to 2002 and the corresponding decreases in agency subscription expense, were the principal factors contributing to the decrease in sales and marketing expenses of the games division. Costs incurred in staffing internally, the identification and continuing development of a potential independent sales network and advertising the voiceglo product line were the principal components of sales and marketing expenses of the VoIP telephony services operations during the year ended December 31, 2003.

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 voiceglo branded products. Product development expenses increased to \$0.9 million for the year ended December 31, 2003, as compared to \$0.7 million for the year ended December 31, 2002. The increase was principally attributable to personnel costs and consulting expenses relating to the development of our VoIP telephony products and services, which totaled approximately \$0.3 million during 2003.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses consist primarily of salaries and related personnel costs for general corporate functions including finance, human resources and facilities, outside legal and professional fees, directors and officers insurance, bad debt expenses and general corporate overhead costs. General and administrative expenses were \$5.3 million for the year ended December 31, 2003, as compared to \$2.8 million for the year ended December 31, 2002. Increases in headcount and the resulting personnel expenses, as well as other general and administrative expenses directly attributable to the Company's new line of business, VoIP telephony services, were major factors contributing to the \$2.5 million increase in total general and administrative expenses. Other expense categories which increased as compared to 2002 largely as a result of the Company's entrance into the VoIP business, included legal fees, other professional fees and facilities costs.

AMORTIZATION OF INTANGIBLE ASSETS. Amortization expense of approximately \$0.1 million recorded during 2003 represented the amortization of the non-compete agreement recorded in connection with the acquisition of DPT prior to its write-off at year-end and amortization of capitalized patent costs related to our voiceglo products.

IMPAIRMENT CHARGE. During the first quarter of 2004, the Company decided to suspend DPT's wholesale business and decided to dedicate the DPT physical and intellectual assets to its retail VoIP business, which is conducted under the name of "voiceglo". As a result, management reviewed the long-lived assets associated with the wholesale VoIP business for impairment. Goodwill of approximately \$0.6 million and the unamortized balance of the non-compete intangible asset of approximately \$0.3 million recorded in connection with the May 2003 acquisition of DPT were written off and recorded as an impairment loss. No impairment charges were recorded during 2002.

INTEREST INCOME (EXPENSE), NET. Non-cash interest expense of \$1.5 million was recorded in the second quarter of 2003 related to the beneficial conversion feature of the \$1,750,000 in Convertible Notes issued on May 22, 2003. The

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expense resulted as the Convertible Notes were convertible into our Common Stock at a price below the fair market value of our Common Stock (for accounting purposes), based on the closing price of our Common Stock as reflected on the OTCBB on the issuance date of the notes. In addition, the warrant to acquire 3,888,889 shares of our Common Stock issued to one of the note holders was exercisable at a price below the fair market value of our Common Stock (for accounting purposes), based on the closing price of our Common Stock as reflected on the OTCBB on the date of issuance. The value assigned to the

warrant was recorded as a discount to the face value of the Convertible Notes to be amortized to interest expense over the term of the Convertible Notes. Discount amortization of approximately \$0.2 million was included in interest expense, net, during the year ended December 31, 2003.

OTHER EXPENSE, NET. Other expense, net, of \$0.4 million was reported for the year ended December 31, 2003. Other expense in 2003 includes reserves against the amounts loaned by the Company to a development stage Internet related business venture totaling \$0.5 million.

INCOME TAXES. No tax benefit was recorded for the year ended December 31, 2003 as we recorded a 100% valuation allowance against our otherwise recognizable deferred tax assets due to the uncertainty surrounding the timing or ultimate realization of the benefits of our net operating loss carryforwards in future periods. The income tax provision recorded for the year ended December 31, 2002 was based solely on state and local taxes on business and investment capital. Our effective tax rate differs from the statutory Federal income tax rate, primarily as a result of the uncertainty regarding our ability to utilize our net operating loss carryforwards. As of December 31, 2003, the Company had net operating loss carryforwards available for U.S. and foreign tax purposes of approximately \$144 million. These carryforwards expire through 2023. 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 the change in our ownership interests in August 1997 and May 1999 and the Company's recently completed private offering in March 2004 (together with the exercise and conversion of various securities in connection with such private offering), as defined in the Internal Revenue Code of 1986, as amended, the Company may have substantially limited or eliminated the availability of its net operating loss carryforwards. There can be no assurance that the Company will be able to avail itself of any net operating loss carryforwards..

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOW ITEMS. As of December 31, 2003, we had approximately \$1.1 million in cash and cash equivalents as compared to \$0.7 million as of December 31, 2002. Net cash used in operating activities was \$6.9 million and \$2.0 million for the years ended December 31, 2003 and 2002, respectively. The year-over-year increase in net cash used in operating activities resulted primarily from an increase in our net operating losses, partially offset by the impact of non-cash charges and gains recorded in 2003 and 2002. The most significant of these non-cash charges during 2003 included the non-cash interest expense recorded as a result of the beneficial conversion feature of the \$1.75 million in Convertible Notes and associated warrants, as well as the non-cash impairment charge related to the write-off of goodwill and a non-compete intangible recorded as a result of the acquisition of DPT.

Net cash of \$3.2 million was used in investing activities during the year ended December 31, 2003. As further described below, the Company incurred \$2.4 million in capital expenditures during 2003, primarily within the VoIP telephony services division. These expenditures included costs in the development of the

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data communications network used to support the voiceglo product line, as well as the Company's historical wholesale VoIP business. Additionally, in February 2003, the Company committed to fund operating expenses of a development stage Internet venture at the Company's discretion in the form of a loan. As of December 31, 2003, approximately \$0.5 million had been advanced to the venture. During 2003, the Company invested approximately \$10.3 million in marketable securities, the funds of which were principally from the proceeds received in connection with the issuance of the Company's Series G Preferred Stock. Approximately \$10.1 million of investments were sold throughout the second half of 2003 as working capital was required to fund operations. Partially offsetting these uses of funds in 2003 was the \$0.1 million in net cash acquired upon the May 2003 acquisition of DPT. The purchase price of DPT consisted of the issuance of 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. Warrants to acquire an additional 2,750,000 shares of our Common Stock could be issued if certain performance or other criteria are satisfied. Net cash provided by investing activities in 2002 was \$0.1 million principally resulting from the sale of the assets of the Happy Puppy website.

Net cash provided by financing activities in 2003 totaled \$10.5 million. As discussed below and in the notes to the consolidated financial statements, the Company issued \$0.5 million in Series F Convertible Preferred Stock in March 2003; \$1.75 million of Convertible Notes in May 2003, and approximately \$8.6 million, net of offering costs, of Series G Preferred Stock and associated warrants in July 2003. Immediately after the May 2003 closing of the DPT acquisition, the Company paid \$0.5 million in cash to the former shareholders of DPT in repayment of certain loans which they had extended to DPT prior to its acquisition by theglobe.com.

In order to offer our VoIP services we have invested substantial capital and made substantial commitments related to the development of the voiceglo network and telephony handsets and related adapters. The voiceglo network is comprised of switching hardware and software, servers, billing and inventory systems, and telecommunication carrier services. We own and operate VoIP switch equipment in Miami and New York, and interconnect these switches utilizing leased transport network through numerous carrier agreements with third party providers. Through these carrier relationships we are able to carry the traffic of our customers over the Internet and interact with the PSTN. We generally enter into from one to five year agreements with these carriers pursuant to which, in exchange for allocating and dedicating availability on their networks, we undertake to provide minimum usage of these networks. In general, the larger our commitment the lower our per minute cost of usage of the network. Given the recent introduction of our voiceglo service offerings, our minimum commitments under these carrier agreements presently greatly exceed our actual usage.

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Based upon our existing contractual commitments, we anticipate that our capital needs for our network over the next twelve months will be substantially as follows:

- o Planned network hardware expenditures for switching and server equipment are projected to be approximately \$1.5 - \$2.0 million;
- o Planned network software expenditures are projected to be approximately \$300,000; and
- o Planned carrier transport and interconnection services are projected to be approximately \$3.5 million.

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We have entered into a contract with a supplier for telephony handsets related to our VoIP services. Subject to the supplier's compliance with the terms of the contract, we have committed to purchase additional equipment from this supplier during 2004 totaling approximately \$3.4 million. In addition, we anticipate acquiring other non-network VoIP equipment of approximately \$1.0 to \$2.0 million. See Note 9, "Commitments and Contingencies" for further discussion of the Company's contractual obligations and commitments.

As a result of the proceeds raised from our March 2004 private offering, as further described below, management does not presently anticipate that the Company will need to raise additional funds within at least the next twelve months in order to implement its business plans for its existing businesses. However, there can be no assurance that the capital needs of the Company will not change, that we will not enter into additional lines of business or that forecasted expenses will not substantially exceed our expectations. In addition, our financial position would be adversely affected if we became liable for any substantial penalties relating to our registration obligations under the private offering. In any of such events, we may be required to raise additional capital. We currently have no access to credit facilities with traditional third party lenders and there can be no assurance that we would be able to raise any such capital. In addition, any financing that could be obtained (or any shares of common stock issued in payment of any registration penalties relating to the March 2004 private offering) would likely significantly dilute existing shareholders.

CAPITAL TRANSACTIONS. In March 2004, theglobe.com, inc. completed a private offering of 333,816 units (the "Units") for a purchase price of \$85 per Unit (the "Private Offering"). Each Unit consisted of 100 shares of the Company's Common Stock, \$0.001 par value (the "Common Stock"), and warrants to acquire 50 shares of the Company's 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 Private Offering was 33,381,647 shares for an aggregate consideration of \$28,374,400, or approximately \$0.57 per share assuming the exercise of the 16,690,824 Warrants. The securities offered in the Private Offering were not registered under the Securities Act of 1933 and may not be offered or resold in the United States absent registration or an applicable exemption from such registration requirements. Pursuant to the terms of the Private Offering, the Company is contractually obligated to file a registration statement relating to the resale of the Securities on or about April 22, 2004 and to cause such registration statement to become effective on or about July 6, 2004 (or 30 days earlier if such registration statement is not reviewed by the Securities and Exchange Commission). In the event the Company is late in any of its registration obligations, it will be liable for payment of a late fee of 5% of the amount raised in the Private Offering per month, not to exceed 25% in the aggregate. Any such late fee may be payable in either cash or additional shares of Common Stock (valued for such purpose at \$0.57 per share), or any combination of the two, at the option of the Company. Any shares so issued would be included in the foregoing registration statement. Any such issuance of shares of our common stock may be substantially dilutive of existing shareholders (other than the investors in the Private Offering to whom such shares would be issued). The purpose of the Private Offering was to raise funds for use primarily in the Company's developing voiceglo business, including the deployment of networks, website development, marketing, and capital infrastructure expenditures and working capital. Proceeds may also be used in connection with the Company's other existing or future business operations.

In connection with the Private Offering, Mr. Egan, our Chairman, Chief Executive Officer and principal stockholder, together with certain of his affiliates, including E&C Capital Partners, converted a \$2,000,000 of Convertible Bridge Note, \$1,750,000 of Secured Convertible Notes and all of the Company's outstanding shares of Series F Preferred Stock, and exercised all of the

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warrants issued in connection with the foregoing 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, the Company issued an aggregate of 48,775,909 additional shares of Common Stock. After giving effect to the 33,381,647 shares of Common Stock issued in the Private Offering (excluding the Warrants) and the foregoing conversions and exercises, the Company as of March 24, 2004, had issued and outstanding 131,990,349 shares of Common Stock and 27,004,384 warrants to acquire shares of 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 the Company's 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 the Company's \$1,750,000 Convertible Notes issued on May 22, 2003 to E&C Capital Partners and certain affiliates of Michael S. Egan. In addition, the Egans were issued a warrant to acquire 204,082 shares of theglobe.com Common Stock at an exercise price of \$1.22 per share. The 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.

On July 2, 2003, theglobe.com, inc. completed a private offering of Series G Preferred Stock for an aggregate purchase price of approximately \$8.7 million. In accordance with the terms of such Preferred stock, the Series G Preferred shares converted into common stock at \$0.50 per share (or an aggregate of approximately 17.4 million shares) upon the filing of an amendment to the Company's certificate of incorporation to increase its authorized shares of Common Stock from 100,000,000 shares to 200,000,000 shares. Such an amendment was filed on July 29, 2003. Investors also received warrants to acquire approximately 3.5 million shares of common stock. The warrants are exercisable for a period of five years at an exercise price of \$1.39 per common share. The exercise price of the warrants, together with the number of warrants issuable upon exercise, are subject to adjustment upon the occurrence of certain events. The purpose of the Series G Preferred Stock offering was to raise funds for use

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primarily in the Company's VoIP telephony services business, including the deployment of networks, website development, marketing, and limited capital infrastructure expenditures and working capital. Pursuant to the terms of the Series G Offering the Company is contractually obligated, subject to certain limitations, to register the securities upon demand anytime commencing one year after the sale of the securities.

On May 22, 2003, E&C Capital Partners together with certain affiliates of Michael S. Egan, entered into a Note Purchase Agreement with the Company pursuant to which they acquired \$1,750,000 of Convertible Notes. The Convertible Notes were convertible into a maximum of approximately 19,444,000 shares of the Company's common stock at a blended rate of \$0.09 per share. The Convertible Notes provided for interest at the rate of ten percent per annum payable semi-annually, a one year maturity and were secured by a pledge of substantially all of the assets of the Company. Effective October 3, 2003, the holders of the Convertible Notes waived the option of receiving accrued interest payable in shares of the Company's Common Stock. Additionally, each of the holders of the Convertible Notes agreed to defer receipt of interest until June 1, 2004. In addition, E&C Capital Partners was issued a Warrant to acquire 3,888,889 shares

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of the Company's Common Stock at an exercise price of \$0.15 per share. The Warrant was exercisable at any time on or before May 22, 2013.

On March 28, 2003, E&C Capital Partners signed a Preferred Stock Purchase Agreement and other related documentation pertaining to a \$500,000 investment via the purchase of shares of a new Series F Preferred Stock of theglobe.com and closed on the investment. Pursuant to the Preferred Stock Purchase Agreement, E&C Capital Partners received 333,333 shares of Series F Preferred Stock convertible into shares of the Company's Common Stock at a price of \$0.03 per share. The Series F Preferred Stock had a liquidation preference of \$1.50 per share, provided for payment of a dividend at the rate of 8% per annum and entitled the holder to vote on an "as-converted" basis with the holders of Common Stock. In addition, as part of the \$500,000 investment, E&C Capital Partners received warrants to purchase approximately 3,333,333 shares of theglobe.com Common Stock at an exercise price of \$0.125 per share. The warrants were exercisable at any time on or before March 28, 2013 and both the warrants' exercise price and number were subject to adjustment.

As a result of the preferential conversion features of the Series G Preferred Stock and the Series F Preferred Stock, a total of \$8,120,000 in non-cash dividends to preferred shareholders were recognized during the year ended December 31, 2003.

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. The trading volume of our shares has dramatically declined since the delisting. In addition, we are now subject to a Rule promulgated by the Securities and Exchange Commission that, if we fail to meet criteria set forth in such Rule, various practice requirements are imposed on broker-dealers who sell securities governed by the Rule to persons other than established customers and accredited investors. For these types of transactions, the broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transactions prior to sale. Consequently, the Rule may have a materially adverse effect on the ability of broker-dealers to sell the securities, which may materially affect the ability of shareholders to sell the securities in the secondary market. Consequently, it has also made it more difficult for us to raise additional capital. We will also incur additional costs under state blue sky laws if we sell equity due to our delisting.

EFFECTS OF INFLATION

Due to relatively low levels of inflation in 2003 and 2002, inflation has not had a significant effect on our results of operations since inception.

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 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, impairment of intangible assets and income tax recognition of deferred tax items. Our policies and related procedures for revenue recognition, valuation of customer receivables, capitalization of computer

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software costs and goodwill and other intangible assets are summarized below.

REVENUE RECOGNITION

The Company's revenues were derived principally from the sale of print advertisements under short-term contracts in our games information magazine Computer Games; through the sale of our games information magazine through newsstands and subscriptions; from the sale of video games and related products through our online store Chips & Bits; 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 print advertisement will not occur and accordingly, cause significant decreases in revenue.

The Company's games division participates in barter transactions. Barter revenues 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 on other companies' websites or in their magazines, which typically occurs within one to six months from the period in

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which the related barter revenue is recognized. Barter advertising revenues represented approximately 2% and 1% of consolidated net revenue for the years ended December 31, 2003 and 2002, respectively.

Advertising. Advertising revenues for the games information magazine are recognized at the on-sale date of the magazine.

Magazine Sales. Newsstand sales of the games information magazine are recognized at the on-sale date of the magazine, net of provisions for estimated returns. Subscriptions are recorded as deferred revenue when initially received and recognized as income ratably over the subscription term.

Electronic Commerce and Other. Sales 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.

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. 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.

VALUATION OF CUSTOMER RECEIVABLES

Provisions for 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.

CAPITALIZATION OF COMPUTER SOFTWARE COSTS

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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 three years.

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 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:

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

When we determine that the carrying value of goodwill or other identified intangibles may not be recoverable, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model.

As a result of management's decision during the first quarter of 2004, to suspend the wholesale business of Direct Partner Telecom, Inc. ("DPT") and to dedicate the DPT physical and intellectual assets to its retail VoIP business, we reviewed the long-lived assets associated with the Company's wholesale VoIP business for impairment. As a result, the goodwill and non-compete intangible asset recorded in connection with the May 2003 acquisition of Direct Partner Telecom, Inc. were written off and recorded as an impairment loss in the Company's statement of operations for the year ended December 31, 2003.

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IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2003, the FASB issued Interpretation No. 46R, "Consolidation of Variable Interest Entities," an Interpretation of ARB 51. This statement requires under certain circumstances consolidation of variable interest entities (primarily joint ventures and other participating activities). The Company has not yet evaluated the impact of this pronouncement on the Company.

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In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 affects the issuer's accounting for three types of freestanding financial instruments. One type is mandatorily redeemable shares, which the issuing company is obligated to buy back in exchange for cash or other assets. A second type, which includes put options and forward purchase contracts, involves instruments that do or may require the issuer to buy back some of its shares in exchange for cash or other assets. The third type of instrument consists of obligations that can be settled with shares, the monetary value of which is fixed, tied solely or predominantly to a variable such as a market index, or varies inversely with the value of the issuers' shares. SFAS No. 150 does not apply to features embedded in a financial instrument that is not a derivative in its entirety. SFAS No. 150 also requires disclosures about alternative ways of settling the instruments and the capital structure of entities, whose shares are mandatorily redeemable. Most of the guidance in SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective from the start of the first interim period beginning after June 15, 2003. The adoption of this standard did not have a material impact on the Company's results of operations or financial position.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments Hedging Activities." This statement amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. SFAS No. 149 became effective during the third quarter of 2003 and did not have a material impact on the Company's results of operations or financial position.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS No. 148 amends SFAS No. 123 as it relates to the transition by an entity to the fair value method of accounting for stock-based employee compensation. The provisions of SFAS No. 148 are effective for financial statements for fiscal years ending after December 15, 2002. The adoption of this statement did not have a significant impact on the Company's financial position or results of its operations.

In November 2002, the FASB issued Interpretation 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" and an interpretation of SFAS No. 5, 57, and 107 and rescission of SFAS Interpretation No. 34. This statement addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. This interpretation also clarifies the requirements related to the recognition of a liability by a guarantor at the inception of a guarantee for the obligations the guarantor has undertaken in issuing that guarantee. The adoption of this statement did not have a significant impact on the Company's financial position or results of operations.

In November 2002, the EITF addressed the accounting for revenue arrangements with multiple deliverables in Issue 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables," ("EITF 00-21"). EITF 00-21 provides guidance on how the arrangement consideration should be measured, whether the arrangement should be divided into separate units of accounting, and how the arrangement consideration should be allocated among the separate units of accounting. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21 did not have a significant impact on the Company's financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses financial accounting and reporting for costs associated with exit or disposal activities. SFAS 146 became effective in the first quarter of 2003 and did not have a significant

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impact on the results of operations or financial position of the Company.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." The statement addresses accounting for and reporting obligations relating to the retirement of long lived assets by requiring that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The adoption of SFAS No. 143 did not have a material effect on the consolidated financial statements.

OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2003, 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.

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RISK FACTORS

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

FUTURE ACQUISITIONS, JOINT VENTURES OR STRATEGIC TRANSACTIONS ENTAIL NUMEROUS RISKS AND UNCERTAINTIES. WE INTEND TO ENTER NEW LINES OF BUSINESS.

We have entered into a new business line, Voice over Internet Protocol ("VoIP") telephony services. In November 2002, we acquired certain VoIP assets from an entrepreneur in exchange for 1,750,000 warrants to purchase our common stock. On May 28, 2003, we acquired Direct Partner Telecom, Inc. ("DPT"), an international licensed telecommunications carrier engaged in the purchase and resale of telecommunication services over the Internet. The purchase price consisted of 1,375,000 shares of theglobe.com common stock and 500,000 warrants to purchase theglobe.com common stock, together with the ability to earn an additional 2,750,000 warrants. We may also enter into new or different lines of business, as determined by management and our Board of Directors. The acquisitions of VoIP assets and of DPT, as well as any future acquisitions or joint ventures could result, and in some instances have resulted (particularly as it pertains to DPT), in numerous risks and uncertainties, including:

- o potentially dilutive issuances of equity securities, which may be issued at the time of the transaction or in the future if certain performance or other criteria are met or not met, as the case may be. These securities may be freely tradable in the public market or subject to registration rights which could require us to publicly register a large amount of Common Stock, which could have a material adverse effect on our stock price;
- o large and immediate write-offs;
- o significant write-offs if we determine that the business acquisition does not fit or perform up to expectations;
- o the incurrence of debt and contingent liabilities or amortization expenses related to goodwill and other intangible assets;
- o difficulties in the assimilation of operations, personnel, technologies, products and information systems of the acquired companies;

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- o the risks of entering a new or different line of business;
- o regulatory and tax risks relating to the new or acquired business;
- o the risks of entering geographic and business markets in which we have no or limited prior experience; and
- o the risk that the acquired business will not perform as expected.

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

Since our inception, we have incurred net losses in each quarter, except the fourth quarter of 2002 where we had net income of approximately \$17,000. We expect that we will continue to incur net losses for the foreseeable future. We had net losses of approximately \$11 million and \$2.6 million for the years ended December 31, 2003 and 2002, respectively. The principal causes of our losses are likely to continue to be:

- o costs resulting from the operation of our businesses;
- o costs relating to entering new business lines;
- o failure to generate sufficient revenue; and
- o general and administrative expenses.

Although we have restructured our businesses, we still expect to continue to incur losses as we develop our VoIP telephony services business and while we explore a number of strategic alternatives for our online and offline games properties, including continuing to operate the properties, acquisition or development of complementary products, selling some or all of the properties or other changes to our business.

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

Our VoIP telephony services business and games properties are substantially dependent upon the continued growth in the general use of the Internet. The VoIP business is also dependent on the growth in the use of the Internet for telephones, personal computers and other devices. Internet and electronic commerce growth may be inhibited for a number of reasons, including:

- o inadequate network infrastructure;
- o security and authentication concerns;

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- o ease of access;
- o inconsistent quality of service;
- o availability of cost-effective, high-speed service; and
- o bandwidth availability.

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

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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:

- o delays in the development or adoption of new operating and technical standards and performance improvements required to handle increased levels of activity;
- o increased government regulation;
- o potential governmental taxation of such services; and
- o insufficient availability of telecommunications services which could result in slower response times and adversely affect usage of the Internet.

THE VOIP MARKET IS SUBJECT TO RAPID TECHNOLOGICAL CHANGE AND WE WILL NEED TO DEPEND ON NEW PRODUCT INTRODUCTIONS AND INNOVATIONS IN ORDER TO ESTABLISH, MAINTAIN AND GROW OUR BUSINESS.

VoIP is an emerging market that is characterized by rapid changes in customer requirements, frequent introductions of new and enhanced products, and continuing and rapid technological advances. To enter and compete successfully in this emerging market, we must continually design, develop, manufacture, and sell new and enhanced VoIP products and services that provide increasingly higher levels of performance and reliability at lower costs. These new and enhanced products must take advantage of technological advancements and changes, and respond to new customer requirements. Our success in designing, developing, manufacturing, and selling such products and services will depend on a variety of factors, including:

- o the identification of market demand for new products;
- o access to sufficient capital to complete our development efforts;
- o product and feature selection;
- o timely implementation of product design and development;
- o product performance;
- o cost-effectiveness of products under development;
- o effective manufacturing processes; and
- o success of promotional efforts.

Additionally, we may also be required to collaborate with third parties to develop our products and may not be able to do so on a timely and cost-effective basis, if at all. If we are unable, due to resource constraints or technological or other reasons, to develop and introduce new or enhanced products in a timely manner or if such new or enhanced products do not achieve sufficient market acceptance, our operating results will suffer and our business will not grow.

THE INTERNET TELEPHONY BUSINESS IS HIGHLY COMPETITIVE AND ALSO COMPETES WITH TRADITIONAL TELEPHONY PROVIDERS.

The long distance telephony market and the Internet telephony market are highly competitive. There are several large and numerous small competitors, and we expect to face continuing competition based on price and service offerings from existing competitors and new market entrants in the future. The principal

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competitive factors in our market include price, quality of service, breadth of geographic presence, customer service, reliability, network size and capacity, and the availability of enhanced communications services. Our competitors will include major and emerging telecommunications carriers in the U.S. and abroad. Financial difficulties in the past several years of many telecommunications providers are rapidly altering the number, identity and competitiveness of the marketplace. Many of the competitors for our current and planned voiceglo

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service offerings and of our subsidiary, Direct Partner Telecom, have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, greater name recognition and more established relationships in the industry than we have. As a result, certain of these competitors may be able to adopt more aggressive pricing policies which could hinder our ability to market our voice services.

During the past several years, a number of companies have introduced services that make Internet telephony or voice services over the Internet available to businesses and consumers. All major telecommunications companies, including entities like AT&T, Sprint and MCI, as well as ITXC, iBasis, Net2Phone and deltathree.com either presently or potentially route traffic to destinations worldwide and compete or can compete directly with us. Other Internet telephony service providers focus on a retail customer base and compete with us. These companies may offer the kinds of voice services we currently offer or intend to offer in the future. In addition, companies currently in related markets have begun to provide voice over the Internet services or adapt their products to enable voice over the Internet services. These related companies may potentially migrate into the Internet telephony market as direct competitors. A number of cable operators have also begun to offer VoIP telephony services via cable modems which provide access to the Internet. These companies, which tend to be large entities with substantial resources, generally have large budgets available for research and development, and therefore may further enhance the quality and acceptance of the transmission of voice over the Internet.

WE MAY FACE INCREASED GOVERNMENT REGULATION, TAXATION AND LEGAL UNCERTAINTIES IN OUR INDUSTRY, WHICH COULD HARM OUR BUSINESS.

There are an increasing number of federal, state, local and foreign laws and regulations pertaining to the Internet and telecommunications. In addition, a number of federal, state, local and foreign legislative and regulatory proposals are under consideration. Laws or regulations may be adopted with respect to the Internet relating to, among other things, fees and taxation of VoIP telephony services, liability for information retrieved from or transmitted over the Internet, online content regulation, user privacy and quality of products and services. Changes in tax laws relating to electronic commerce could materially affect our business, prospects and financial condition. 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. 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 or VoIP telephony services, 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.

Our ability and plans to provide telecommunication services at attractive rates

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arise in large part from the fact VoIP services are not currently subject to the same regulation as traditional telephony. Because their services are not currently regulated to the same extent as traditional telephony, VoIP providers can currently avoid paying charges that traditional telephone companies must pay. Many traditional telephone operators are lobbying the Federal Communications Commission (FCC) and the states to regulate VoIP on the same or similar basis as traditional telephone services. The FCC and several states are examining this issue. The FCC held a forum on VoIP issues on December 1, 2003, which included regulatory classification issues. On March 10, 2004, the FCC released guidelines and questions upon which it is seeking public comment to determine what regulation, if any, will govern companies that provided VoIP services. Specifically, the FCC has expressed an intention to further examine the question of whether certain forms of phone-to-phone VOIP services are information services or telecommunications services. The two are treated differently in several respects, with certain information services being regulated to a lesser degree. The FCC has noted that certain forms of phone-to-phone VOIP services bear many of the same characteristics as more traditional voice telecommunications services and lack the characteristics that would render them information services. The FCC has indicated that the mechanisms for contributing to the Universal Service Fund, issues as to applicability of access charges and other matters will be considered in that context. The FCC had previously opened a proceeding in response to a petition by AT&T which seeks a declaration to preclude local exchange carriers from imposing access charges on certain AT&T phone-to-phone IP services asserted to be provided over the Internet. The FCC has recently ruled that so called "pure" VoIP services which flow entirely over the Internet and never interconnect with the public switched telephone network, such as a computer to computer call, are not telecommunications services subject to regulation. The ruling specifically does not address whether traditional phone regulations might apply to VoIP services (like those offered by voiceglo) to end users that interconnect with the traditional telephone system.

If the FCC or any state determines to regulate VoIP, they may impose surcharges, taxes or additional regulations upon providers of Internet telephony. These surcharges could include access charges payable to local exchange carriers to carry and terminate traffic, contributions to the universal service fund or other charges. Regulations requiring compliance with the Communications Assistance for Law Enforcement Act, or provision of enhanced 911 services could also place a significant financial burden on us. The imposition of any such additional fees, charges, taxes, licenses and regulations on VoIP services could materially increase our costs and may reduce or eliminate the competitive pricing advantage we seek to enjoy.

A number of state regulators have recently taken the position that VoIP providers are telecommunications providers and must register as such within their states. VoIP operators have resisted such registration on the position that VoIP is not, and should not be, subject to such regulations because VoIP is an information service, not a telecommunication service. In a recent federal court decision, the Minnesota Public Utilities Commission was enjoined in their attempt to enforce traditional phone regulations against Vonage, a VoIP provider. However, other states are not bound by that decision and may reject the VoIP operator's position and may seek to subject us to regulation and require us to pay associated charges and taxes. If states are successful in such regulatory efforts, our business, financial condition and results of operations could be materially and adversely affected.

Our ability to offer services outside the U.S. is also subject to the local regulatory environment, which may be complicated and often uncertain. Regulatory

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treatment of Internet telephony outside the United States varies from country to country.

PRICING PRESSURES AND INCREASING USE OF VoIP TECHNOLOGY MAY LESSEN OUR COMPETITIVE PRICING ADVANTAGE.

One of the main competitive advantages of our current and planned VoIP service offerings is the ability to provide discounted local and long distance telephony services by taking advantage of cost savings achieved by carrying voice traffic employing VoIP technology, as compared to carrying calls over traditional networks. In recent years, the price of telephone service has fallen. The price of telephone service may continue to fall for various reasons, including the adoption of VoIP technology by other communications carriers. Many carriers have adopted pricing plans such that the rates that they charge are not always substantially higher than the rates that VoIP providers charge for similar service. In addition, other providers of long distance services are offering unlimited or nearly unlimited use of some of their services for increasingly lower monthly rates.

WE RELY ON INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS.

We regard substantial elements of our websites and underlying technology, as well as certain assets relating to our VoIP business and other opportunities we are investigating, 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 internationally. We are also seeking 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 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 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 may assert claims of alleged infringement by us of their intellectual property rights. Any litigation claims or counterclaims could impair our business because they could:

- o be time-consuming;

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- o result in significant costs;
- o subject us to significant liability for damages;
- o result in invalidation of our proprietary rights;
- o divert management's attention;
- o cause product release delays; or
- o 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 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 services or could adversely affect the performance of our existing services until equivalent technology can be identified, licensed and integrated.

The regulation of domain names in the United States and in foreign countries may change. Regulatory bodies could establish additional top-level domains, 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

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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.

IF WE DO NOT DEVELOP AND MAINTAIN SUCCESSFUL PARTNERSHIPS FOR VOIP PRODUCTS, WE MAY NOT BE ABLE TO SUCCESSFULLY MARKET ANY OF OUR VOIP PRODUCTS CURRENTLY UNDER DEVELOPMENT.

We have entered into the VoIP market and our success is partly dependent on our ability to forge marketing, engineering and carrier partnerships. VoIP communication systems are extremely complex and no single company possesses all the technology components needed to build a complete end to end solution. We will likely need to enter into partnerships to augment our development programs and to assist us in marketing complete solutions to our targeted customers. We may not be able to develop such partnerships in the course of our operations and product development. Even if we do establish the necessary partnerships, we may not be able to adequately capitalize on these partnerships to aid in the success of our business.

THE FAILURE OF VOIP NETWORKS TO MEET THE RELIABILITY AND QUALITY STANDARDS REQUIRED FOR VOICE COMMUNICATIONS COULD RENDER OUR PRODUCTS OBSOLETE.

Circuit-switched telephony networks feature very high reliability, with a guaranteed quality of service. In addition, such networks have imperceptible delay and consistently satisfactory audio quality. Emerging VoIP networks or emerging last mile technologies such as cable, digital subscriber lines, and

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wireless local loop, will not be a viable alternative to traditional circuit switched telephony unless such networks and technologies can provide reliability and quality consistent with these standards.

WE ARE UNABLE TO PREDICT THE VOLUME OF USAGE AND OUR CAPACITY NEEDS FOR OUR VOIP BUSINESS; DISADVANTAGEOUS CONTRACTS WOULD REDUCE OUR OPERATING MARGINS.

We have entered into a number of, and may have to enter into additional, long-term agreements (generally from one to five years) for leased communications transmission capacity with various carriers. Many of these agreements have minimum use requirements pursuant to which we are able to negotiate lower overall per minute usage rates assuming the utilization of all of such minutes. To the extent that we have overestimated (or in the future overestimate) our call volume, we are obligated to pay for more transmission capacity than we actually use, resulting in costs without corresponding revenue. Given the recent introduction of our voiceglo VoIP service offerings, our minimum commitments under existing carrier agreements presently greatly exceed our actual usage. Conversely, in the future, if we underestimate our capacity needs, we may be required to obtain additional transmission capacity through more expensive means or such capacity may not be available. As a result, our margins could be reduced and our business, financial condition and results of operations could be materially and adversely affected.

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

Our success in the Internet telephony market will depend on our ability to create and maintain brand awareness for our product offerings. This may require a significant amount of capital to allow us to market our products and establish brand recognition and customer loyalty. Many of our competitors in the Internet telephony services market are larger than us and have substantially greater financial resources. Additionally, many of the companies offering VoIP services have already established their brand identity within the marketplace. We can offer no assurances th