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RATEXCHANGE CORP  
Form 10-Q/A  
December 26, 2001

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

-----  
FORM 10-Q/A

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

For the quarterly period ended June 30, 2001  
Commission File No. 33-19139-NY

RATEXCHANGE CORPORATION

-----  
(Exact Name of Registrant as Specified in Its Charter)

Delaware

11-2936371

-----  
(State or Other Jurisdiction of  
Incorporation or Organization)

-----  
(IRS Employer ID Number)

185 Berry Street, Suite 3515, San Francisco, CA

94107

-----  
(Address of Principal Executive Offices)

-----  
(Zip Code)

Registrant's telephone number, including area code: (415) 371-9800

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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

17,783,000 shares common stock as of August 13, 2001  
(Title of Class)

RATEXCHANGE CORPORATION  
FORM 10-Q  
FOR THE QUARTER ENDED JUNE 30, 2001

PART I - FINANCIAL INFORMATION

Page

Item 1 -

Financial Statements (Restated)

Consolidated balance sheet as of June 30, 2001  
(unaudited) and December 31, 2000

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### Part I - Financial Information

#### Item 1. Financial Statements

RATEXCHANGE CORPORATION  
(A Development Stage Company)  
CONSOLIDATED BALANCE SHEET

#### ASSETS

##### Current assets

Cash and cash equivalents  
Accounts receivable (net of an allowance for doubtful accounts of \$9,460 at June 30, 2001 and \$4,960 at December 31, 2000)  
Investment securities available for sale  
Interest receivable  
Prepaid expenses

Total current assets

Property, equipment and Software (net of accumulated depreciation of \$1,095,589 and \$240,791 in 2001 and 2000)  
Other assets  
Investment in affiliate  
Deposits

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Total assets

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities

Accrued expenses  
Accounts payable  
Notes payable

Total current liabilities

Convertible Note Payable and Accrued Interest

Total Liabilities

Stockholders' equity

Preferred stock, \$.0001 par value, 60,000,000 shares authorized;  
2,000,000 issued and outstanding  
Common stock, \$.0001 par value; 300,000,000 shares  
authorized; issued and outstanding: 17,783,000 shares  
in 2001 and 2000  
Additional paid-in capital  
Accumulated deficit  
Deferred compensation  
Notes receivable on sales of common stock  
Accumulated other comprehensive loss

Total stockholders' equity

Total liabilities and stockholders' equity

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RATEXCHANGE CORPORATION  
(A Development Stage Company)

CONSOLIDATED STATEMENT OF OPERATIONS

Three Months ended June 30, (unaudited)		Six Months e (unau
2001	2000	2001
(restated)		(restated)

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REVENUE			
Trading and consulting	\$ 370,516	\$ 4,500	\$ 710,344
EXPENSES			
Selling, general and administrative (includes non-cash expenses of \$2,965,000 and \$2,458,000 for the three month periods in 2001 and 2000 and \$4,510,000 and \$11,547,000 for the six month periods in 2001 and 2000)	5,499,449	6,778,223	12,690,365
Write off advances to potential investee	--	--	
Depreciation and amortization	458,803	77,182	854,797
Purchase of subsidiaries (non-cash)	--	--	--
	-----	-----	-----
Total Expenses	5,958,252	6,855,405	13,545,162
OTHER INCOME (EXPENSE)			
Interest income	124,003	305,502	274,280
Interest expense	(11,512)	(301,184)	(11,512)
Loss on securities	(199,923)		(744,197)
Other expenses (net)		(1,500,000)	
	-----	-----	-----
Loss before taxes	(5,675,168)	(8,346,587)	(13,316,247)
Income tax provision (benefit)	--	--	--
	-----	-----	-----
NET LOSS	\$ (5,675,168)	(8,346,587)	\$ (13,316,247)
	=====	=====	=====
Basic and diluted net loss per share	\$ (0.32)	\$ (0.49)	\$ (0.75)
Weighted average number of shares of common stock	17,783,000	17,133,613	17,783,000

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RATEXCHANGE CORPORATION  
(A Development Stage Company)  
CONSOLIDATED STATEMENT OF CASH FLOWS

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	For the si ended 2001 ----- (Unaudited) (restated)
CASH FLOWS FROM OPERATING ACTIVITIES	
Net loss	\$(13,316,247)
Adjustments to reconcile net loss to net cash used in operating activities	
Depreciation and amortization	854,797
Write off advances to potential investee	
Stock options and warrants granted to service providers and strategic partners	540,000
Stock options granted to employees below fair market value	1,135,000
Stock options - termination adjustment	565,875
Warrants issued in relation to bridge financing	--
Warrants for purchase of common stock issued for services	--
Purchase of outstanding shares of RateXchange	--
Deferred lease payments	643,000
Deferred compensation and other	733,371
Loss on securities	744,197
(Increase) decrease in security deposits	9,741
(Increase) decrease in receivables and other advances	(105,125)
Increase (decrease) in accounts payable and accrued expenses	(97,593)
	-----
Net cash used in operating activities	(8,292,984)
CASH FLOWS FROM INVESTING ACTIVITIES	
Payment for purchase of equipment	(42,900)
Purchase of Halo Stock	
Purchase of investments available for sale	
Sale of investments available for sale	11,580,361
Investment in Affiliates	(500,000)
	-----
Net cash provided by (used in) investing activities	11,037,461
CASH FLOWS FROM FINANCING ACTIVITIES	
Loans and other debt	--
Proceeds from common stock sales (net)	--
Proceeds from notes receivable	--
Loan to employee stock purchase program	--
	-----
Net cash provided by financing activities	--
	-----
INCREASE IN CASH AND CASH EQUIVALENTS	2,744,477
CASH and CASH EQUIVALENTS BEGINNING OF PERIOD	2,115,152
	-----
CASH and CASH EQUIVALENTS END OF PERIOD	\$ 4,859,630
	=====

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### RATEXCHANGE CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### NOTE 1 INTERIM FINANCIAL STATEMENTS -- AS RESTATED; COMPANY BACKGROUND AND HISTORY

The interim financial statements presented herein are unaudited and have been prepared in accordance with the instructions to Form 10-Q. These statements should be read in conjunction with the financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2000. The accompanying financial statements have not been audited. The results of operations and cash flows for the six months ended June 30, 2001 may not be indicative of the results that may be expected for the year ended December 31, 2001.

The Company has restated its Form 10Q for the period ending June 30, 2001. As discussed in Note 11, the Company modified its severance agreement with a former executive which was not properly reflected in the previously filed 10-Q. To correct this misstatement, the revised financial statements reflect a \$425,000 increase in compensation expense not previously recorded, offset by a \$68,000 reduction in compensation related to the continued amortization of option related expense which should not have been reported. Additionally, the company recorded the related note payable plus accrued interest totaling \$402,762.

RateXchange Corporation (the Company) is a consolidated group of companies including the parent corporation, RateXchange Corporation (RateXchange Corp.), and its subsidiaries, RateXchange I, Inc., Xpit Corporation, RMG Partners Corporation, and PolarCap, Inc. (PolarCap). PolarCap is in the process of being liquidated.

RateXchange Corp. (formerly NetAmerica.com Corporation) is a Delaware corporation organized on May 6, 1987 for the purpose of seeking out and developing any general business opportunity. The Company's operating subsidiary RateXchange I, Inc., a Delaware corporation organized in June 1999, has developed proprietary trading software to support its electronic trading system for bandwidth and other telecommunications products. In March 2001, the Company acquired Xpit.com. This acquisition enables the Company to offer trading and risk management systems to the futures industry. In April 2001, RateXchange formed RMG Partners Corporation, a wholly owned subsidiary, to provide market-based solutions through the use of derivative trading strategies.

The Company has generated nominal revenues from its planned operations. The Company is defined as a development stage company in accordance with Financial Accounting Standard No. 7. The Company had no operations or business before September 30, 1998. Cumulative results of operations since the start of the development stage, September 30, 1998, when the Company purchased PolarCap, have been reported separately.

From inception, the Company has been primarily engaged in organizational activities, including designing and developing its website, recruiting personnel, establishing office facilities, raising

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capital, developing infrastructure and developing a marketing plan. The Company began revenue generation activities in 1999 but nominal revenue has been generated as of June 30, 2001. Accordingly, the Company is classified as a development stage company. Successful completion of the Company's development program and, ultimately, the attainment of profitable operations is dependent upon future events, including increasing its customer base, implementing and successfully executing its business and marketing strategy and hiring and retaining quality personnel. Negative developments in any of these events could have a material adverse effect on the Company's business, financial condition and results of operations.

As previously disclosed in the 2000 Form 10K, in April 2001, the Company received an irrevocable commitment from two investors to acquire a total of \$9 million of newly issued common shares. During the second quarter, management was informed by those investors that they did not expect to honor the original commitment due to the decline in the Company's share price. As a result of this development, management is seeking a reduced amount of financing from the original investors, as well as other potential investors.

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### RATEXCHANGE CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company will need to raise additional capital prior to year end. In November 2000, new management began to implement cost cuts in order to more closely tie costs to revenue. Significant expense reductions have continued through July, which included, among other things, staff reductions and completion of certain development efforts that have significantly reduced expenditures for outside consulting expertise. The Company may sell additional debt or equity securities or enter into new credit facilities to meet its cash needs. The Company cannot make assurances that it will be able to complete any financing, that such financing will be adequate for the Company's needs, or that a financing will be completed prior to the Company running out of funds.

The factors discussed above create substantial doubt about the Company's ability to continue as a going concern and an uncertainty as to the recoverability and classification of recorded asset amounts and the amounts and classification of liabilities. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

#### NOTE 2 CASH, CASH EQUIVALENTS AND SHORT TERM INVESTMENTS

We consider all highly liquid investment securities with original maturities of three months or less from date of purchase to be cash equivalents. Short-term investments consist of debt securities with maturities between three months and twelve months.

Management determines the appropriate classification of investments at the time of purchase and reevaluates such determination at each balance sheet date. To date, all marketable securities have been classified as available-for-sale and are carried at fair value with unrealized gains and losses, if any, included in stockholders' equity. At June 30, the

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company had no investments in securities available for sale. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other income, net. Interest and dividends on all securities are included in other income, net.

### NOTE 3 SERIES A PREFERRED STOCK

In the first quarter of 2001, the Company issued 2,000,000 shares of its Series A Convertible Preferred Stock with a cumulative dividend of 6% based on a share price of \$2.75 per share. Dividends are paid in shares of Series A Preferred Stock. The Series A Preferred Stock is convertible on a one for one basis into common shares of the Company at the discretion of the holders. The holder of each share of Series A Preferred Stock has the right to one vote for each share of Common Stock into which such share of Series A Preferred Stock could then be converted. In the event of any liquidation, dissolution, or winding up of the Company, whether voluntary or involuntary, the holders of the Series A Preferred Stock are entitled to receive, prior and in preference to any distribution of any assets or surplus funds of the Company to the holders of common stock, the aggregate amount of \$2.75 per share (as adjusted for any stock dividend, combinations, or splits with respect to such shares). The Series A preferred stock is not redeemable.

### NOTE 4 LOSS PER SHARE AND AVERAGE SHARES OUTSTANDING

Basic loss per share is computed by dividing the net loss, less accrued dividends on preferred stock (\$99,500 and \$82,500 for the first six months and second quarter of 2001), by the weighted average number of common shares

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outstanding. Options, warrants and convertible preferred stock on shares of common stock were not included in computing diluted loss per share because their effects were antidilutive. (10,774,000 options, 5,910,000 warrants and 2,000,000 convertible preferred shares).

### NOTE 5 COMMITMENTS AND CONTINGENCIES

The Company is involved in the following lawsuits:

Concentric v. NetAmerica, Inc.

On February 24, 2000, Concentric Network Corporation filed a lawsuit against NetAmerica, Inc., aka Al Internet, Inc., and the Company in the Superior Court of California for the County of Santa Clara (CV 784335). The lawsuit involves claims for breach of contract and common counts based on Al Internet's nonperformance in a service agreement between Al Internet and Concentric related to the Company's former operations during 1999. The matter was heard in binding arbitration on April 4, 2001. The arbitrator awarded Concentric \$197,245.60, plus interest thereon at the legal rate of 10% per annum from July 1, 1999, until paid in full.

Switch & Data Facilities Company v. RateXchange Corporation

On May 18, 2001, Switch & Data Facilities Company filed a lawsuit against the Company in the Superior Court of California for the County of San Francisco (Action No. 321470). The lawsuit involves a claim for breach of contract based on a lease for colocation space in North America. The suit specifies damages in the amount of \$566,600.



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See note 11 for events subsequent to June 30, regarding these lawsuits.

NOTE 6 COMPREHENSIVE LOSS

The comprehensive loss for the first six months and second quarter of 2001 and 2000 was:

	Three Months Ended June 30	
	2001	2000
	-----	-----
Net loss	\$ (5,675,168)	\$ (8,346,587)
Other Comprehensive Income:		
Unrealized gains on short term investments net of realized losses		159,798
	-----	-----
Comprehensive loss	\$ (5,675,168)	\$ (8,186,789)
	=====	=====

NOTE 7 OPERATING LEASES

In connection with the Company's business activities, it has entered into various leases for office space and related office equipment, including computers. In addition, the Company entered into various operating leases associated with its delivery hubs, including various telecommunications routing equipment and other infrastructure.

Future annual minimum lease payments related to equipment and office space under noncancelable operating leases as of June 30, 2001 were:

Year	
-----	
2001 (Last six months)	\$ 607,520
2002	1,790,059
2003	4,776,996
	-----
	\$7,174,575
	=====

During the second quarter the Company restructured its equipment lease. The terms of the restructured lease are 12 monthly payments of \$74,056 beginning on May 1, 2001, 12 monthly payments of \$148,113 beginning on May 1, 2002 followed by one payment on May 1, 2003 of \$4,184,544. The Company issued 467,000 warrants to the lessor to purchase stock in connection with this restructuring. This table excludes one lease which was cancelled in August. (See footnote 11 for events subsequent to June 30, 2001).

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### NOTE 8 ACQUISITION OF SUBSIDIARY

On March 12, 2001, the Company completed the acquisition of Xpit.com, Inc., a privately held Idaho Corporation for \$5.5 million in preferred stock, cash and notes payable. The acquisition enables the Company to offer trading and risk management systems to the futures industry via the RateXchange Futures System (RFS). Xpit will operate as a wholly-owned subsidiary of RateXchange. Under the terms of the transaction, the Company acquired 100% of the outstanding common shares of Xpit in exchange for \$500,000 in cash; a \$500,000 two-year note bearing interest at 7%; 2,000,000 Series A Convertible Preferred Shares; and \$4.9 million in royalty payments tied to the achievement of Xpit's projected revenues from 2001 through 2003. The acquisition price of \$5.5 million has been allocated primarily to the software technology acquired.

### NOTE 9 STOCK COMPENSATION

In April 2001, the Company formed RMG Partners Corporation (RMG) as a wholly owned subsidiary created to provide market based solutions through the use of derivative trading strategies. Certain employees of RMG have been given the right to acquire a specific number of shares of the Company with additional purchase rights upon achievement of revenue targets in the future. This deferred compensation is reflected as a component of equity in the balance sheet.

### NOTE 10 NEW ACCOUNTING STANDARD

In the first quarter of 2001, the Company was required to adopt the provisions of Financial Accounting Standard Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133) as amended by FAS 137 and FAS 138. This statement establishes accounting and reporting standards for derivative contracts and for hedging activities. As the Company does not currently use any derivative instruments or engage in hedging activities, adoption of this new standard had no impact on the Company's consolidated results of operations or consolidated financial position.

### NOTE 11 SEVERANCE AGREEMENT WITH FORMER OFFICER

In May 2001, the Company renegotiated the terms of the severance included in its employment agreement with Donald Sledge, former Chairman and CEO of RateXchange Corporation. Upon his leaving the Company, Mr. Sledge was originally to receive one year's salary, or \$300,000, in addition to a \$150,000 severance payment in cash and the accelerated vesting of certain stock option grants. In lieu of the original agreement, the Company renegotiated these terms to payments of \$25,000 cash in May 2001, \$25,000 cash in July 2001 and the issuance of a \$400,000 two-year convertible promissory note from the Company with interest at 7.0% per annum. The principal can be converted to shares of common stock at \$2.75 per share conversion rate at any time during the term. Additionally, an option to purchase 300,000 shares of common stock that was granted to Mr. Sledge was terminated as part of the negotiation.

### NOTE 12 SUBSEQUENT EVENTS

Concentric v. NetAmerica, Inc.

The Court entered the arbitrator's award as a judgment on July 13, 2001. On August 6, 2001, the Company paid Concentric (now known as XO Communications, Inc.) \$239,991 in full and complete satisfaction of Concentric's claims. This matter is closed. The Company had fully accrued for this liability.

The arbitrator's award also granted the Company's request for express and equitable indemnity against co-Defendant NetAmerica, Inc. By the terms of the

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arbitrator's award, the Company has made a demand to NetAmerica, Inc. for reimbursement of all damages paid by the Company to Concentric. The demand letter also seeks to recover the Company's costs and attorney's fees associated with the lawsuit. During the handling of the case, counsel for NetAmerica, Inc. represented that NetAmerica, Inc. was insolvent. The Company has not received a response from NetAmerica, Inc. to its demand.

Other

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In August the Company renegotiated the terms of one of its leases by providing consideration of \$275,000 in cash and a note payable of \$95,000 in return for elimination of all liabilities related to the lease, which approximated \$1.2 million, to eliminate all future payments. The cost of this agreement will be reflected in the third quarter results.

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### Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our Consolidated Financial Statements and the notes thereto presented in "Item 1 - Financial Statements." The information set forth in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" includes forward-looking statements that involve risks and uncertainties. Many factors could cause actual results to differ materially from those contained in the forward-looking statements below. See "Outlook."

#### General Development of Business

On June 28, 2001, RateXchange announced that Teleglobe Communications Corp. was posting bids and offers for capacity on the RateXchange Trading System (RTS). Signing on in the first quarter of 2001, Teleglobe is one of 30 companies currently using the RTS to buy and sell bandwidth.

On June 27, 2001 RateXchange announced it had selected Telseon's IP (Internet Protocol) Service to distribute its metropolitan area bandwidth traffic. Combining RateXchange's long-haul customers with Telseon's dense metro footprint will enable buyers, sellers, and traders of IP bandwidth to reduce lapsed time between the completion of a transaction and its actual delivery over a secure, national IP network.

On April 26, 2001, RateXchange announced the establishment of a licensing agreement with Refco Group Ltd., LLC, the world's largest non-bank futures commission merchant (FCM) to use the RateXchange Futures System to electronically execute futures trades entered into by it's clients.

On April 9, 2001, announced its continued expansion into risk management services through the formation of RMG Partners Corporation ("RMG"), a wholly owned subsidiary created to provide market based solutions through the use of derivative trading strategies.

Subsequent to the end of the second quarter, on July 16, 2001, RateXchange announced an agreement with Avantrust, LLC, a joint venture between

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American International Group, Inc. and Dun & Bradstreet, whereby Avantrust Passport and TradeCredit Insurance will be provided to participants on all RateXchange telecom markets.

Results of Operations for Three and Six Months Ended June 30, 2001

The following table summarizes our results of operations for the first six months and second quarter of 2001, compared to the same periods of 2000.

	Six Months Ended June 30	
	2001	2000
		(restated)
Revenue	\$ 710,344	\$ 4,500
Expenses (including selling, general and administrative)	\$ 13,545,162	\$ 19,360,711
Net income (loss)	\$ (13,316,247)	\$ (20,943,922)

### Revenue

We generated revenue of \$710,000 during the first six months of 2001 and \$371,000 during the second quarter of 2001. Revenue in both periods was primarily from consulting and trading commissions. In the comparable periods of 2000, we generated \$4,500 from banner advertising.

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### Expenses

Our total expenses for the first six months of 2001 were \$13,545,000 compared to \$19,361,000 in the first six months of 2000. The major components of our expenses for the six month periods were:

#### Non-cash Expenses

- o \$1,135,000 in the first half of 2001 compared to \$7,644,000 in the first half of 2000 for amortization expense associated with the year 2000 grant of below market stock options to employees;
- o \$566,000 in the first half of 2001 for option revaluation related to terminated employees. There were no such expenses in the first half of 2000;
- o \$540,000 in the first half of 2001 compared to \$3,653,000 for the first half of 2000 for options and warrants granted to

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service providers.

- o \$1,116,000 for deferred and accrued compensation. There were no such expenses in the first half of 2000.
- o \$643,000 related to amortization of deferred lease payments. There were no such expenses in the first half of 2000.
- o \$310,000 of accruals related to contingent liabilities. The comparable amount in 2000 period was \$250,000.
- o \$200,000 related to a write down in value of a security, where the decline in value was judged to be other than temporary.

### Cash Expenses

- o \$2,322,000 in payroll costs during the first half of 2001 compared to \$2,243,000 in the first half of 2000;
- o \$1,775,000 in outside services during the first half of 2001 compared to \$1,875,000 during the first half of 2000, and;
- o \$2,436,000 in the first half of 2001 compared to \$711,000 in the first half of 2000 for delivery equipment costs.

For the second quarter of 2001 our total expenses were \$5,958,000 compared to \$6,855,000 in the second quarter of 2000. The major components of our expenses for the second quarter were:

### Non-cash Expenses

- o \$411,000 in the second quarter of 2001 compared to \$1,540,000 in the second quarter of 2000 for amortization expense associated with the year 2000 grant of below market stock options to employees;
- o \$285,000 in the second quarter of 2001 compared to \$668,000 in the second quarter of 2000 for options and warrants granted to service providers.
- o \$1,116,000 for deferred and accrued compensation. There were no such expenses in the second quarter of 2000.
- o \$643,000 related to amortization of deferred lease payments. There were no such expenses in the second quarter of 2000.
- o \$310,000 of accruals related to contingent liabilities. The comparable amount in the 2000 period was \$250,000.

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- o \$200,000 related to a write down in value of a security, where the decline in value was judged to be other than temporary.

### Cash Expenses

- o \$1,037,000 in payroll costs during the second quarter of 2001 compared to \$1,127,000 in the second quarter of 2000;
- o \$743,000 in outside services during the second quarter of 2001 compared to \$1,293,000 during the second quarter of 2000, and;
- o \$613,000 in the second quarter of 2001 compared to \$420,000 in the second quarter of 2000 for delivery equipment costs.

### Interest Income:

Interest income for the first six months of 2001 was \$274,000 compared to \$212,000 for the same period in 2000. Interest income for the second quarter of 2001 was \$124,000 compared to \$305,000 for the second quarter of 2000. The decrease in interest income is due to less interest earned on a smaller average investment portfolio.

### Net Loss:

During the first half of 2001, we incurred a loss of \$13,316,000 compared to \$20,944,000 during the same period of 2000. The major components of the net loss for the first half of 2001, were non cash expenses for stock options and warrants to purchase company stock of \$2,241,000 and additional expenditures associated with developing the business of \$12,059,000. During the second quarter of 2001 we incurred a loss of \$5,675,000 compared to a loss of \$8,347,000 in the second quarter of 2000 and a loss of \$7,641,000 in the first quarter of 2001. The second quarter loss of 2001 comprised non cash expenses for stock options and warrants to purchase company stock of \$698,000 and additional expenditures associated with developing the business of \$5,472,000. Cash expenditures in the first quarter were \$6,396,000. Because we are developing liquidity in new marketplaces, we anticipate that we will continue to incur operating losses and cash flow deficiencies for the foreseeable future.

### Liquidity and Capital Resources

We have financed our operations to date primarily through the sale of equity securities. We have been unprofitable since inception and we have incurred net losses in each year.

We had working capital of \$2,114,000 at June 30, 2001 compared to \$12,001,000 on December 31, 2000.

As previously disclosed in the 2000 Form 10K, in April, 2001, the Company received an irrevocable commitment from two investors to acquire a total of \$9 million of newly issued common shares of the Company. During the second quarter, management was informed by those investors that they do not expect to honor the original commitment due to the decline in the Company's share price. As a result of this development, management is seeking a reduced amount of financing from the original investors, as well as other potential investors.

The Company will need to raise additional capital prior to year end. In November 2000, new management began to implement cost cuts in order to more closely tie costs to revenue. Significant expense reductions have continued

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through July, which included, among other things, staff reductions and the elimination of nearly all outside consulting services. We may sell additional debt or equity securities or enter into new credit facilities to meet our cash needs. We cannot assure you that we will be able to complete any financing, that such financing will be adequate for the Company's needs, or that a financing will be completed prior to the Company running out of funds.

The factors discussed above create substantial doubt about the Company's ability to continue as a going

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concern and an uncertainty as to the recoverability and classification of recorded asset amounts and the amounts and classification of liabilities. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

The Company has continued to lower its operating costs, including a reduction in its workforce, a further reduction in management salaries and the elimination of additional operating expenses, including all consulting expenses. Management is working aggressively on these factors to ensure that it is fully able to execute on its current business plan. We are taking the following steps to achieve profitability:

- o We are pursuing additional revenue generating opportunities such as acquisition of profitable securities broker-dealers that may accelerate our development of a financial services business model;
- o We are reviewing our options regarding the delivery hub business, which include: exploring potential sales to operators of delivery hubs whereby they would operate and own our delivery hub equipment, or redeploying the hubs toward one of our developing revenue lines,
- o We have restructured and deferred payments on the operating lease underlying our delivery equipment, resulting in a net savings of \$75,000 per month for 12 months,
- o We have reduced our headcount and associated personnel costs; our employee headcount in our San Francisco location has been reduced from 37 at December 31, 2000 to 17 currently. In addition the formation of RMG Partners and Xpit Corporation added 12 new employees in these new lines of business; and
- o We have significantly reduced our marketing and public relations costs.

In addition, we have substantially completed the development of the RateXchange Trading System and do not anticipate significant expenditures related to it. Nevertheless, we need to seek additional financing during the remainder of 2001 in order to accelerate market penetration through the execution of our business plan. As the Company is determining how it will utilize its delivery hub equipment, we are currently in the process of assessing the status and likely use of the operating leases covering the related equipment. We expect to make final determination as to the likely use of these leases in the near future and may take a non-cash charge at that time.

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Our operating activities used \$8.3 million during the first six months of 2001 due primarily to:

- o Costs associated with the development of the RateXchange Futures System;
- o Costs associated with accelerating the deployment of the RateXchange Trading System;
- o increased and ongoing business development activities.

Our investing activities generated \$11.0 million during the first six months of 2001, due to sales of investments.

We are executing an overall business plan that will require additional capital for among other uses:

- o expansion into new domestic and international markets;
- o development of additional products and services, and
- o acquisitions.

Furthermore, our funding of working capital and current and future operating losses will require additional capital investment. We do not currently possess a bank source of financing and we have had nominal revenues.

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Our business and operations have not been materially affected by inflation during the periods for which financial information is presented.

### OUTLOOK

We provide trading, consulting and information services enabling market participants to maximize their assets. These trading solutions allow network providers, energy merchants, financial institutions, and commodity managers engaged on the RateXchange Trading System (RTS) and RateXchange Futures System (RFS) the ability to trade bandwidth and futures globally. Our consulting solutions practice provides asset valuation tools, risk management strategies and analytics. The information solutions group provides pricing information, market research, and industry background. We are a trading solutions company enabling the creation of liquid marketplaces for bandwidth and other telecommunications products. We plan to move into the brokering of additional products following the consulting, trading and information solutions model and are pursuing the acquisition of profitable securities broker-dealers that may accelerate the development of a financial services business model.

We are a development stage company and we are subject to all the risks inherent in the establishment of a new business enterprise. To address these risks, we must:

- o Establish market acceptance for our electronic trading system and other products and services;
- o Continue to retain, attract and motivate qualified personnel;



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- o Effectively manage our capital to support the expenses of developing and marketing new products and services;
- o Implement and successfully execute our business and marketing strategy;
- o Respond to competitive developments and market conditions in the global communications industry; and
- o Continue to develop and upgrade our electronic trading system.

The foregoing contains forward-looking statements that involve risks and uncertainties, including but not limited to changes in our business strategy, our inability to raise sufficient capital, general market trends and conditions, and other risks detailed below in "Factors That May Affect Future Results." Actual results may vary materially from any future results expressed or implied by the forward-looking statements.

### Forward-Looking Statements

This Outlook section, and other sections of this document, include certain "forward-looking statements" within the meaning of that term in Section 27A of the Securities Act of 1933, and Section 21E of the Securities Act of 1934, including, among others, those statements preceded by, following or including the words "believe," "expect," "intend," "anticipate" or similar expressions. These forward-looking statements are based largely on our current expectations and are subject to a number of risks and uncertainties. Our actual results could differ materially from these forward-looking statements. Important factors to consider in evaluating such forward-looking statements include:

- o changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the market;
- o our ability to raise sufficient capital to meet operating requirements;
- o various competitive factors that may prevent us from competing successfully in the marketplace;
- o changes in external competitive market factors or in our internal budgeting process which might impact trends in our results of operations, and
- o other risks described below in "Factors That May Affect Future Results."

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In light of these risks and uncertainties, there can be no assurance that the events contemplated by the forward-looking statements contained in this Form 10-Q will in fact occur.

### FACTORS THAT MAY AFFECT FUTURE RESULTS

We operate in a highly competitive and rapidly changing market that involves a number of risks. While we are optimistic about our long-term prospects, the following discussion highlights some risks and uncertainties that should be considered in evaluating our growth outlook.

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We will need additional capital in the future and it may not be available on acceptable terms.

As previously discussed, we will need additional working capital for enhancement of the RateXchange Futures System, marketing and general and administrative costs and to fund losses before achieving profitability. We will need to raise additional funds through additional equity and/or debt financing to meet our capital requirements. We cannot assure you that such financings will be available in amounts or on terms needed to meet our requirements, or at all. Further, our lack of tangible assets to pledge could prevent us from establishing a source of financing. The inability to raise all needed funding would adversely affect our ability to successfully implement the objectives of our business plan.

As a development stage company with a limited operating history in a new and rapidly changing industry, it is difficult to evaluate our business and prospects.

We are a development stage company. Our activities to date have concentrated primarily on planning and developing our electronic trading system for trading bandwidth and other telecommunications products. In September 2000, we began operating the RateXchange Trading System for trading bandwidth. Accordingly, we have a limited operating history on which to base an evaluation of our business and prospects. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early stage of development, particularly companies in new and rapidly evolving markets such as online commerce. There can be no assurance that we will be successful in addressing these risks and our failure to do so could have a material adverse effect on our business and results of operations.

We have a history of losses and expect to incur losses in the future, and we may never achieve profitability.

At June 30, 2001, our accumulated deficit since inception was \$70,129,000, including \$38,137,000 related to stock grants, options and warrants. For the second quarter of 2001, we incurred a net loss of \$5,315,000, including \$2,999,000 related to stock grants and warrants. We have incurred a net loss in each year of our existence, and have financed our development stage operations primarily through sales of equity securities. We have recorded nominal revenues from operations. We expect to incur net losses for the foreseeable future. We may never achieve or sustain significant revenues or profitability on a quarterly or annual basis.

If the RateXchange Trading System and RateXchange Futures System do not achieve commercial acceptance, our results will suffer.

We expect to rely largely on fees and commissions from transactions facilitated on the RateXchange Trading System, RateXchange Futures System and related consulting and brokerage services, for the foreseeable future. Online trading of telecommunications bandwidth and minutes currently has only limited market acceptance, as does online trading of futures contracts. As a result, our future ability to gain commercial acceptance of the RateXchange Trading System and RateXchange Futures System is critical to our success. Any failure to successfully gain commercial acceptance of the RateXchange Trading System and RateXchange Futures System would not only have a material adverse effect on our business and operating results, but also on our ability to seek additional revenue opportunities.

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We depend on the efforts of the Amerex Bandwidth, Ltd. brokers who execute trades on our trading system to generate revenues for us.

In September 2000, we entered into a strategic alliance with Amerex Bandwidth, Ltd., a leading energy and power broker. Under our agreement with Amerex, Amerex brokers execute trades for the sale or purchase of telecommunications capacity, Internet protocol products and/or other telecommunications-related products on our trading system, and we share with Amerex the revenues generated by these trades. As a result, we depend on the efforts of the Amerex brokers who execute those trades to generate revenues for us. There can be no assurance that these brokers will be successful in expanding our business.

We may not be able to compete successfully against current and future competitors.

The market for online bandwidth, minutes and derivatives trading services is new, rapidly evolving and highly competitive, as are the online commerce and business-to-business markets generally. We expect competition in this market to intensify in the future. Several of the existing online exchanges, such as E-Speed, Intercontinental Exchange and Altra currently operate online marketplaces in commodities and have large established customer bases. These companies may start bandwidth trading marketplaces. Our ability to compete with them will depend largely upon our ability to capture market share by obtaining sufficient customers for the RateXchange Trading System and our brokerage activities.

In addition, we compete with companies who trade, broker or otherwise assist in the buying and selling of telecommunications bandwidth and minutes. Therefore, we currently or potentially compete with a variety of other companies, including lead-generation services and traditional offline brokers. Many companies, such as Band-X, and Arbinet, offer services to buyers and sellers of bandwidth and other telecommunications products. The increased use and acceptance of any other method of facilitating the buying and selling of excess telecommunications bandwidth and minutes may adversely impact the commercial viability of the RateXchange Trading System.

Large telecommunications and energy companies have the ability and resources to compete in the online bandwidth and minutes trading services market if they choose to do so, including launching their own online exchanges or other trading services. Many of our competitors 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. In addition, a number of these competitors may combine or form strategic partnerships. As a result, our competitors may be able to offer, or bring to market earlier, products and services that are superior to our own in terms of features, quality, pricing or other factors. Our failure to compete successfully with any of these companies could have a material adverse effect on our business and results of operations.

Increased pressure created by any present or future competitors, or by our competitors collectively, could have a material adverse effect on our business and operating results. Increased competition may result in reduced commissions and loss of market share. Further, as a strategic response to changes in the competitive environment, we may from time to time make certain pricing, service or marketing decisions or acquisitions that could have a material adverse effect on our business and operating results. There can be no assurance that we will be able to compete successfully against current and future competitors. In addition, new technologies and the expansion of existing technologies may increase the competitive pressures on us.

We face online commerce security risks.

We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary to effect secure transmission of confidential information, such as bank account or credit information. There can be no assurance that advances in computer capabilities, new discoveries in the field of cryptography, or other events or developments will not result in a compromise or breach of the algorithms used by us to protect transaction data. Any compromise of our security could have a material adverse effect on our reputation and us. A party who is able to circumvent our security measures could misappropriate proprietary information or cause interruptions in our operations. We may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. To the extent that our activities or those of third party contractors involve the storage and transmission of proprietary information, such as bank account or credit information, security breaches could damage our reputation and expose us to a risk of loss or litigation and possible liability which could have a material adverse effect on our business and results of operations.

Our operating results could be impaired if we are or become subject to burdensome governmental regulation of online commerce.

We are not currently subject to direct regulation by any domestic or foreign governmental agency, other than regulations applicable to businesses generally, including online companies. However, due to the increasing popularity and use of the Internet and other online services, it is possible that a number of laws and regulations may be adopted with respect to the Internet or other online services covering issues such as:

- o User privacy;
- o Pricing;
- o Content;
- o Intellectual property;
- o Distribution; and
- o Characteristics and quality of products and services.

The adoption of any additional laws or regulations may decrease the growth of the Internet or other online services, which could, in turn, decrease the demand for our products and services and increase our cost of doing business, or otherwise have an adverse effect on our business and results of operations. Moreover, the applicability of existing law to the Internet and other online services governing issues such as property ownership, sales and other taxes and personal privacy to the Internet and other online services is uncertain and may take years to resolve.

We plan to facilitate transactions between numerous customers residing

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in various states and foreign countries, and such jurisdictions may claim that we are required to qualify to do business as a foreign corporation in each such state and foreign country. Our failure to qualify as a foreign corporation in a jurisdiction where it is required to do so could subject us to taxes and penalties. Any new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our business, or the application of existing laws and regulations to the Internet and other online services could have a material adverse effect on our business and results of operations.

We may face liability for information retrieved from our web site.

Due to the fact that material may be downloaded from our web site and subsequently distributed to others, there is a potential that claims may be made against us for negligence, copyright or trademark infringement or other theories based on the nature and content of such material. Although we carry general liability insurance, our insurance may not cover potential claims of this type or may not be adequate to cover all costs incurred in defense of potential claims or to indemnify us for all liability that may be imposed. Any costs or imposition of liability that is not covered by insurance or in excess of insurance coverage could have a material adverse effect on our business and results of operations.

We are at risk of capacity constraints and face system development risks.

The satisfactory performance, reliability and availability of the RateXchange Trading System and RateXchange Futures System is critical to our reputation and our ability to attract and retain users and maintain adequate customer service levels. Our revenues depend on the number of users of our systems and the volume of trading that is facilitated. Any system interruptions that result in the unavailability of our web site or reduced performance of these Systems could reduce the volume of bandwidth and futures traded.

There may be a significant need to upgrade the capacity of the RateXchange Trading System and RateXchange Futures System in order to handle thousands of simultaneous users and transactions. Our inability to add additional software and hardware or to develop and upgrade further our existing technology, transaction processing systems or physical infrastructure to accommodate increased traffic on these systems or increased trading volume through our online trading or transaction processing systems may cause unanticipated system disruptions, slower response times, degradation in levels of customer service and impaired quality and speed of trade processing, any of which could have a material adverse effect on our business and operating results.

Our business and operations would suffer in the event of system failures.

Our success, in particular our ability to successfully facilitate bandwidth and derivative trades and provide high quality customer service, largely depends on the efficient and uninterrupted operation of our computer and communications hardware systems. Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunication failures, break-ins, earthquake and similar events. Despite the implementation of network security measures, our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of data or the inability to accept and fulfill customer orders.

If we do not respond effectively to technological change, our service could become obsolete and our business will suffer.

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To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of the RateXchange Trading System and RateXchange Futures System. The Internet and the online commerce industry are characterized by rapid technological change, changes in user and customer requirements and preferences, frequent new product and service introductions embodying new technologies and the emergence of new industry standards and practices that could render our existing systems and proprietary technology obsolete. Our success will depend, in part, on our ability to license leading technologies useful in our business, enhance our existing services, develop new services and technology that address the increasingly sophisticated and varied needs of our prospective customers, and respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

The development of the RateXchange Trading System and RateXchange Futures System and other proprietary technology entails significant technical and business risks. There can be no assurance that we will successfully use new technologies effectively or adapt our systems and proprietary technology to user requirements or emerging industry standards. Our failure to adapt in a timely manner for technical, legal, financial or other reasons, to changing market conditions or customer requirements, could have a material adverse effect on our business and results of operations.

If we do not effectively manage growth, our ability to provide trading services will suffer.

To manage the expected growth of our operations and personnel, we will be required to improve existing, and implement new, transaction-processing, operational and financial systems, procedures and controls, and to expand, train and manage a growing employee base. Further, we will be required to maintain and expand our relationships with various hardware and software vendors, Internet and other online service providers and other third parties necessary to our business. If we are unable to manage growth effectively, we will be materially adversely affected.

We need to hire and retain qualified personnel to sustain our business.

We are currently managed by a small number of key management and operating personnel. We do not maintain "key man" insurance on any employee. Our future success depends, in part, on the continued service of our key executive, management and technical personnel, many of whom have recently been hired, and our ability to attract highly skilled employees. If any key officer or employee were unable or unwilling to continue in his or her present position, our business could be harmed. From time to time we have experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees. If we are unable to retain our key employees or attract, assimilate or retain other highly qualified employees in the future, that may have a material adverse effect on our business and results of operations.

Our success is dependent on our ability to protect our intellectual property.

Our performance and ability to compete is dependent to a significant degree on our proprietary technology, including, but not limited to the design of the RateXchange Trading System and RateXchange Futures System. We regard our copyrighted material, software design, trade secrets and similar intellectual property as critical to our success, and we rely on trademark and copyright laws, trade secret protection and confidentiality and/or license agreements with our employees, customers, partners and others to protect our proprietary rights. We cannot assure you that we will be able to secure significant protection for any of our intellectual property. It is possible that our competitors or others

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will adopt product or service names similar to our marks, thereby inhibiting our ability to build brand identity and possibly leading to customer confusion.

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We generally have entered into agreements containing confidentiality and non-disclosure provisions with our employees and consultants who have limited access to and distribution of our software, documentation and other proprietary information. We cannot assure you that the steps we take will prevent misappropriation of our technology or that agreements entered into for that purpose will be enforceable. Notwithstanding the precautions we have taken, it might be possible for a third party to copy or otherwise obtain and use our software independently. Policing unauthorized use of our technology is difficult, particularly because the global nature of the Internet makes it difficult to control the ultimate destination or security of software or other data transmitted. The laws of other countries may afford us little or no effective protection of our intellectual property.

Effective trademark, service mark, copyright and trade secret protection may not be available in every country where our services are made available online. In the future, we may also need to file lawsuits to enforce our intellectual property rights, protect our trade secrets and determine the validity and scope of the proprietary rights of others. Such litigation, whether successful or unsuccessful, could result in substantial costs and diversion of resources, which could have a material adverse effect on our business and operating results.

The volatility of our securities prices may increase.

The market price of our common stock has in the past been, and may in the future continue to be, volatile. A variety of events may cause the market price of our common stock to fluctuate significantly, including:

- o Quarter to quarter variations in operating results;
- o Adverse news announcements;
- o The introduction of new products and services;
- o Market conditions in the telecommunications industry in general, Internet-based services and e-commerce; and
- o General market conditions.

In addition, the stock market in recent years has experienced significant price and volume fluctuations that have particularly affected the market prices of equity securities of many companies in our business and that often have been unrelated to the operating performance of such companies. These market fluctuations have adversely impacted the price of our common stock and may do so in the future.

Any exercise of outstanding options and warrants will dilute then-existing stockholders' percentage of ownership of our common stock.

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We have a significant number of outstanding options and warrants. The exercise of all of the outstanding options and warrants would dilute the then-existing stockholders' percentage ownership of our common stock. Any sales resulting from the exercise of options and warrants in the public market could adversely affect prevailing market prices for our common stock. Moreover, our ability to obtain additional equity capital could be adversely affected since the holders of outstanding options and warrants may exercise their options and warrants at a time when we would also wish to enter the market to obtain capital on terms more favorable than those provided by the options. We lack control over the timing of any exercise or the number of shares issued or sold if exercises occur.

### ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Short Term Investments

Our exposure to market risks for changes in interest rates relate primarily to investments in debt securities issued by U.S. government agencies and corporate debt securities. We place our investments with high credit quality issuers and, by policy, limit the amount of the credit exposure to any one issuer.

Our general policy is to limit the risk of principal loss and ensure the safety of invested funds by limiting market and credit risk. All highly liquid investments with less than three months to maturity are considered to be cash equivalents. Investments with maturities between three and twelve months are considered to be short-term investments. Investments with maturities in excess of twelve months are considered to be long-term investments. We do not expect any material loss with respect to our short term investment portfolio.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings.

#### Switch & Data Facilities Company v. RateXchange Corporation

On May 18, 2001, Switch & Data Facilities Company filed a lawsuit against the Company in the Superior Court of California for the County of San Francisco (Action No. 321470). The lawsuit involves a claim for breach of contract based on a lease for colocation space in North America. The suit prays for damages in the amount of \$566,600. The Company answered the complaint and discovery has begun.

### Item 2. Changes in Securities and Use of Proceeds.

- a) Not applicable.
- b) Not applicable.
- c) Not applicable
- d) Not applicable.

### Item 6. Exhibits and Reports on Form 8-K

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- a) Exhibits



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Exhibit No. -----	Exhibit Name -----
10.1	Employment agreement with Robert Ford
10.2	Contract by and between RMG Partners and RateXchange

b) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized. Dated this 18th day of August, 2001.

RATEXCHANGE CORPORATION

By: /s/ D. Jonathan Merriman

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D. Jonathan Merriman  
Chairman and Chief Executive Officer

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