CMGI INC
Form 10-Q
December 11, 2006
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

(Mark One)

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

For the quarterly period ended October 31, 2006

OR

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

For the transition period from to

Commission File Number 000-23262

# CMGI, INC.

**(Exact name of registrant as specified in its charter)**

| **DELAWARE**<br>**(State or other jurisdiction of incorporation or organization)** | **04-2921333**<br>**(I.R.S. Employer Identification No.)** |
|---|---|
| **1100 Winter Street**<br>**Waltham, Massachusetts**<br>**(Address of principal executive offices)** | **02451**<br>**(Zip Code)** |

**(781) 663-5001**

**(Registrant s telephone number, including area code)**

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

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

As of December 4, 2006, there were 487,002,819 shares outstanding of the registrant s Common Stock, $.01 par value per share.

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**Table of Contents**

**CMGI, INC.**

**FORM 10-Q**

**INDEX**


| | | Page Number |
|---|---|---|
| **Part I.** | **FINANCIAL INFORMATION** | |
| Item 1. | Condensed Consolidated Financial Statements | |
| | Condensed Consolidated Balance Sheets October 31, 2006 and July 31, 2006 (unaudited) | 3 |
| | Condensed Consolidated Statements of Operations Three months ended October 31, 2006 and 2005 (unaudited) | 4 |
| | Condensed Consolidated Statements of Cash Flows Three months ended October 31, 2006 and 2005 (unaudited) | 5 |
| | Notes to Condensed Consolidated Financial Statements (unaudited) | 6 |
| Item 2. | Management s Discussion and Analysis of Financial Condition and Results of Operations | 18 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 30 |
| Item 4. | Controls and Procedures | 31 |
| **Part II.** | **OTHER INFORMATION** | |
| Item 1. | Legal Proceedings | 32 |
| Item 1A. | Risk Factors | 32 |
| Item 5. | Other Information | 34 |
| Item 6. | Exhibits | 34 |
| **SIGNATURE** | | 35 |
| **EXHIBIT INDEX** | | 36 |

Table of Contents

**CMGI, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands, except share and per share amounts)**

**(Unaudited)**

| | October 31, 2006 | July 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 130,280 | $ 131,728 |
| Available-for-sale securities | 1,756 | 2,554 |
| Short-term investments | 90,200 | 94,450 |
| Accounts receivable, trade, net of allowance for doubtful accounts of $1,157 and $1,123 at October 31, 2006 and July 31, 2006, respectively | 201,602 | 175,391 |
| Inventories | 93,832 | 77,887 |
| Prepaid expenses and other current assets | 14,323 | 11,638 |
| Current assets of discontinued operations | 103 | 1,962 |
| Total current assets | 532,096 | 495,610 |
| Property and equipment, net | 50,003 | 46,020 |
| Investments in affiliates | 24,461 | 20,655 |
| Goodwill | 181,388 | 181,239 |
| Other intangible assets, net | 15,334 | 16,540 |
| Other assets | 2,981 | 3,139 |
| Non-current assets of discontinued operations | 14 | 16 |
| | $ 806,277 | $ 763,219 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Current installments of obligations under capital lease | $ 341 | $ 321 |
| Accounts payable | 181,509 | 151,077 |
| Current portion of accrued restructuring | 4,679 | 5,368 |
| Accrued income taxes | 6,328 | 5,502 |
| Accrued expenses | 50,593 | 43,526 |
| Other current liabilities | 2,775 | 2,819 |
| Current liabilities of discontinued operations | 3,326 | 4,775 |
| Total current liabilities | 249,551 | 213,388 |
| Revolving line of credit | 24,786 | 24,786 |
| Long-term portion of accrued restructuring | 5,755 | 6,831 |
| Obligations under capital leases, less current installments | 488 | 548 |
| Other long-term liabilities | 13,010 | 15,629 |
| Non-current liabilities of discontinued operations | 3,315 | 4,122 |
| Stockholders equity: | | |
| Preferred stock, $0.01 par value per share. Authorized 5,000,000 shares; zero issued or outstanding at October 31, 2006 and July 31, 2006 | | |
| Common stock, $0.01 par value per share. Authorized 1,405,000,000 shares; issued and outstanding 484,607,756 at October 31, 2006 and 483,948,888 shares at July 31, 2006 | 4,870 | 4,865 |

| | | |
|---|---|---|
| Additional paid-in capital | 7,456,387 | 7,455,076 |
| Accumulated deficit | (6,957,988) | (6,968,315) |
| Accumulated other comprehensive income | 6,103 | 6,289 |
| Total stockholders equity | 509,372 | 497,915 |
| | $ 806,277 | $ 763,219 |

See accompanying notes to interim unaudited condensed consolidated financial statements

3

Table of Contents

**CMGI, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share amounts)**

**(Unaudited)**

| | Three Months Ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| Net revenue | $ 283,636 | $ 303,409 |
| Operating expenses: | | |
| Cost of revenue | 253,593 | 272,437 |
| Selling | 3,765 | 5,388 |
| General and administrative | 20,206 | 21,117 |
| Amortization of intangible assets | 1,206 | 1,206 |
| Restructuring, net | (187) | 977 |
| Total operating expenses | 278,583 | 301,125 |
| Operating income | 5,053 | 2,284 |
| Other income (expense): | | |
| Interest income | 2,192 | 1,173 |
| Interest expense | (604) | (552) |
| Other gains (losses), net | 922 | 3,236 |
| Equity in income (losses) of affiliates, net | 736 | (403) |
| | 3,246 | 3,454 |
| Income from continuing operations before income taxes | 8,299 | 5,738 |
| Income tax expense (benefit) | (1,440) | 943 |
| Income from continuing operations | 9,739 | 4,795 |
| Discontinued operations, net of income taxes: | | |
| Income (loss) from discontinued operations | 588 | (2,663) |
| Net income | $ 10,327 | $ 2,132 |
| Basic and diluted earnings per share: | | |
| Earnings from continuing operations | $ 0.02 | $ 0.01 |
| Loss from discontinued operations | $ 0.00 | $ (0.01) |
| Net earnings | $ 0.02 | $ 0.00 |
| Shares used in computing basic earnings per share: | 484,387 | 482,063 |
| Shares used in computing diluted earnings per share: | 485,729 | 487,435 |

See accompanying notes to interim unaudited condensed consolidated financial statements

4

**Table of Contents**

**CMGI, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(in thousands)**

**(Unaudited)**

| | Three Months Ended October 31, | |
|---|---|---|
| | **2006** | **2005** |
| Cash flows from operating activities of continuing operations: | | |
| Net income | $ 10,327 | $ 2,132 |
| Income (loss) from discontinued operations | 588 | (2,663) |
| | 9,739 | 4,795 |
| Adjustments to reconcile net income to cash provided by (used for) continuing operations: | | |
| Depreciation | 2,903 | 2,508 |
| Amortization of intangible assets | 1,206 | 1,206 |
| Stock-based compensation | 1,270 | 2,010 |
| Non-operating (gains) losses, net | (922) | (2,713) |
| Equity in income (losses) of affiliates | (736) | 403 |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | (25,837) | (62,323) |
| Inventories | (15,928) | (20,126) |
| Prepaid expenses and other current assets | (2,634) | (617) |
| Accounts payable, accrued restructuring and accrued expenses | 36,285 | 43,844 |
| Refundable and accrued income taxes, net | (2,324) | 547 |
| Other assets and liabilities | (225) | (229) |
| Net cash provided by (used for) operating activities of continuing operations | 2,797 | (30,695) |
| Cash flows from investing activities of continuing operations: | | |
| Additions to property and equipment | (7,432) | (3,448) |
| Proceeds from affiliate distributions | 1,535 | |
| Redemption of short-term investments | 4,250 | |
| Net proceeds from sale of building | | 2,749 |
| Net investments in affiliates | (3,071) | (4,654) |
| Net cash used for investing activities of continuing operations | (4,718) | (5,353) |
| Cash flows from financing activities of continuing operations: | | |
| Repayments of long-term debt | | (1,583) |
| Repayments of capital lease obligations | (43) | (91) |
| Proceeds from issuance of common stock | 46 | 130 |
| Net cash provided by (used for) financing activities of continuing operations | 3 | (1,544) |
| Cash flows from discontinued operations: | | |
| Operating cash flows | (44) | 266 |
| Investing cash flows | | (293) |
| Net cash used for discontinued operations | (44) | (27) |

| | | |
|---|---|---|
| Net effect of exchange rate changes on cash and cash equivalents | 514 | (231) |
| Net decrease in cash and cash equivalents | (1,448) | (37,850) |
| Cash and cash equivalents at beginning of period | 131,728 | 192,483 |
| Cash and cash equivalents at end of period | $ 130,280 | $ 154,633 |

See accompanying notes to interim unaudited condensed consolidated financial statements

Table of Contents

CMGI, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**A. NATURE OF OPERATIONS**

CMGI, Inc. (together with its consolidated subsidiaries, CMGI or the Company ), through its subsidiary, ModusLink Corporation ( ModusLink ), provides industry-leading global supply chain management services that help businesses market, sell and distribute their products and services. In addition, CMGI s venture capital business, @Ventures, invests in a variety of technology ventures. The Company previously operated under the name CMG Information Services, Inc. and was incorporated in Delaware in 1986. CMGI s address is 1100 Winter Street, Suite 4600, Waltham, Massachusetts 02451.

CMGI s business strategy in recent years has led to the development, acquisition and operation of majority-owned subsidiaries focused on supply chain management services, as well as the strategic investment in emerging, innovative and promising technology companies. ModusLink is a supply chain management market leader with fiscal 2006 revenue of $1.1 billion and 41 locations in 13 countries (including four locations in Japan operated by an entity in which the Company has a 40% interest), including a significant presence in Asia and Europe. ModusLink has a widely diversified client base that includes leaders in the hardware, software, consumer electronics, telecommunications and storage markets.

**B. BASIS OF PRESENTATION**

The accompanying Condensed Consolidated Financial Statements have been prepared by CMGI in accordance with accounting principles generally accepted in the United States of America ( US GAAP ). In the opinion of management, the accompanying Condensed Consolidated Financial Statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of the Company s financial position, results of operations and cash flows at the dates and for the periods indicated. While the Company believes that the disclosures presented are adequate to make the information not misleading, these Condensed Consolidated Financial Statements should be read in conjunction with the audited financial statements and related notes for the year ended July 31, 2006 which are contained in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC ) on October 16, 2006. The results for the three-month period ended October 31, 2006 are not necessarily indicative of the results to be expected for the full fiscal year. Certain prior year amounts in the Condensed Consolidated Financial Statements have been reclassified in accordance with US GAAP to conform to the current year presentation. Discontinued operations reporting has been applied for certain of the Company s divestitures.

The Company reports three operating segments, Americas, Asia, and Europe. In addition to its three current operating segments, the Company reports an Other category. The Other category represents corporate expenses consisting primarily of directors and officers insurance costs, costs associated with maintaining certain of the Company s information technology systems and certain corporate administrative functions such as legal and finance, as well as certain administrative costs related to the Company s venture capital business. The Other category also consists of any residual results from operations that exist through the cessation of operations of Equilibrium, CMGI Solutions, MyWay, iCast, NaviPath, ExchangePath, and Activate, each of which have been divested or substantially wound down, as these entities do not meet the aggregation criteria under Statement of Financial Standards ( SFAS ) No. 131 with respect to the Company s current reporting segments and were not reported as discontinued operations as they did not meet the criteria in SFAS No. 144. The historical results of these companies were previously reported in the Enterprise Software and Services (Equilibrium and CMGI Solutions), Portals (MyWay and iCast) and Managed Application Services (NaviPath, ExchangePath, and Activate) segments, respectively. The Other category s balance sheet information includes certain cash

Table of Contents

equivalents, available-for-sale securities, investments and other assets, which are not identifiable to the operations of the Company s operating business segments.

In accordance with accounting principles generally accepted in the United States of America, all significant intercompany transactions and balances have been eliminated in consolidation. Accordingly, segment results reported by the Company exclude the effect of transactions between the Company and its subsidiaries and between the Company s subsidiaries.

**C. NEW ACCOUNTING PRONOUNCEMENTS**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for the Company beginning in fiscal 2009. The Company is currently evaluating the impact, if any, that SFAS No. 157 may have on its results of operations or financial position.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132 (R) ( SFAS No. 158 ). SFAS No. 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 also requires the measurement of defined benefit plan assets and obligations as of the date of the employer s fiscal year-end statement of financial position (with limited exceptions). Under SFAS No. 158, the Company will be required to recognize the funded status of its defined benefit postretirement plan and to provide the required disclosures commencing as of July 31, 2007. The Company is currently evaluating the impact, if any, that SFAS No. 158 may have on its results of operations or financial position.

In September 2006, the United States Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin ( SAB ) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. This SAB provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 establishes an approach that requires quantification of financial statement errors based on the effects of each of the company s balance sheet and statement of operations financial statements and the related financial statement disclosures. The SAB permits existing public companies to record the cumulative effect of initially applying this approach in the first fiscal year ending after November 15, 2006 by recording the necessary correcting adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of retained earnings. Additionally, the use of the cumulative effect transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose. The Company is currently evaluating the impact that SAB 108 may have on the Company s results of operations or financial position.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. SFAS No. 48 is effective for the Company beginning in fiscal 2008. The Company is currently evaluating the impact, if any, that FASB No. 48 may have on the Company s results of operations or financial position.

In March 2006, the FASB issued EITF 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net

Table of Contents

Presentation) that clarifies how a company discloses its recording of taxes collected that are imposed on revenue producing activities. EITF 06-03 is effective for the first interim reporting period beginning after December 15, 2006. The Company is evaluating the impact, if any, that EITF 06-03 may have on the Company s results of operations or financial position.

**D. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS**

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Investments, which generally have maturities between three and twelve months at the time of acquisition, are considered short-term and classified as available-for-sale.

As of October 31, 2006, the Company had short-term investments in Auction Rate Securities ( ARS ) of approximately $90.2 million. ARS generally have long-term stated maturities of 20 to 30 years. However, these securities have certain economic characteristics of short-term investments due to a rate-setting mechanism and the ability to liquidate them through a Dutch auction process that occurs on pre-determined intervals of less than 90 days. These ARS are classified as short-term investments on the accompanying condensed consolidated balance sheets due to management s intent regarding these securities and are accounted for as available-for-sale, in accordance with SFAS No. 115 Accounting for Certain Investments in Debt and Equity Securities. As of October 31, 2006, there were no unrealized gains or losses associated with these investments.

**E. GOODWILL AND INTANGIBLE ASSETS**

The purchase price of the assets acquired and the liabilities assumed in a business combination are subject to an allocation period in accordance with SFAS 141, Business Combinations. In connection with the Modus acquisition, the allocation period for all adjustments other than those related to tax carryforwards and contingencies expired during the quarter ended October 31, 2005, while the allocation period for certain tax adjustments and contingencies will remain open in accordance with SFAS 109 Accounting for Income Taxes. The total of the purchase accounting adjustments recorded during the quarter was $0.1 million. A $0.6 million adjustment was recorded related to an audit from the local tax authorities in Asia for a period prior to the acquisition of Modus, which was offset by adjustments related to the utilization of pre-acquisition net operating losses in the Americas, Europe and Asia regions of approximately ($0.1) million, ($0.3) million and ($0.1) million, respectively.

The changes in the carrying amount of goodwill for the quarter ended October 31, 2006 are as follows:

| | Americas | Europe | Asia | Total |
|---|---|---|---|---|
| | | (in thousands) | | |
| Balance as of July 31, 2006 | $ 78,625 | $ 30,743 | $ 71,871 | $ 181,239 |
| Purchase price adjustments from acquisition of Modus | (79) | (286) | 514 | 149 |
| Balance as of October 31, 2006 | $ 78,546 | $ 30,457 | $ 72,385 | $ 181,388 |

The amortization of intangible assets for the quarter ended October 31, 2006 would have been primarily allocated to selling expenses had the Company recorded the expenses within the functional operating expense categories.

**F. EMPLOYEE STOCK BENEFIT PLANS**

*Stock Option Valuation and Expense Information under SFAS No. 123(R)*

On August 1, 2005, the Company adopted SFAS No. 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company s employees and directors, including employee stock options and employee stock purchases, based on estimated fair values. The

**Table of Contents**

following table summarizes stock-based compensation expense related to employee stock options, employee stock purchases and nonvested shares under SFAS No. 123(R) for the three months ended October 31, 2006 and 2005 which was allocated as follows:

| | For the three months ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| | (in thousands) | |
| Cost of goods sold | $ 126 | $ 137 |
| Selling | 134 | 205 |
| General and administrative | 1,010 | 1,668 |
| | $ 1,270 | $ 2,010 |

The Company utilizes a binomial-lattice model to estimate grant date fair value, which requires the use of extensive actual employee exercise behavior data and the use of a number of complex assumptions including expected volatility, risk-free interest rate and expected term. The weighted-average fair value of employee stock options granted during the three months ended October 31, 2006 and 2005 was $0.49 and $1.04, per share, respectively using the binomial-lattice model with the following weighted-average assumptions:

| | For the three months ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| Expected volatility | 51.29% | 81.73% |
| Risk-free interest rate | 4.77% | 4.22% |
| Expected term (in years) | 4.12 | 4.29 |

The volatility assumption is based on the weighted average of the most recent volatility measures of the Company s stock as of the grant date.

The risk-free interest rate assumption is based upon the interpolation of various U.S. Treasury rates, as of the month of the grants.

The expected term of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the binomial-lattice model. The determination of the expected term of employee stock options assumes that employees exercise behavior is a function of the option s remaining vested life and the extent to which the option is in-the-money. The binomial-lattice model estimates the probability of exercise as a function of these two variables based on the entire history of exercises and cancellations on all past option grants made by the Company. The expected term generated by these probabilities reflects actual and anticipated exercise behavior of options granted historically.

As stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations for the three months ended October 31, 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based primarily on historical experience.

Table of Contents

*Stock Options*

The status of the plans during the quarter ended October 31, 2006 is as follows:

| | 2006 | |
|---|---|---|
| | **Number of shares** | **Weighted average exercise price** |
| | **(in thousands, except exercise price)** | |
| Stock options outstanding, beginning of quarter | 17,010 | $ 1.69 |
| Granted | 1,675 | 1.14 |
| Exercised | (11) | 0.49 |
| Forfeited | (332) | 2.78 |
| Stock options outstanding, end of quarter | 18,342 | $ 1.62 |

As of October 31, 2006, unrecognized stock-based compensation related to stock options was approximately $7.7 million. This cost is expected to be expensed over a weighted average period of 2.0 years. The aggregate intrinsic value and weighted average remaining contractual life of stock options outstanding as of October 31, 2006 is approximately $2.9 million and 4.9 years, respectively. The aggregate intrinsic value and weighted average remaining contractual life of stock options exercisable as of October 31, 2006 is approximately $2.0 million and 4.0 years, respectively. The aggregate intrinsic value of options exercised during the three months ended October 31, 2006 is approximately $8,000.

The following table summarizes information about the Company s stock options outstanding at October 31, 2006:

| | Outstanding | | | Exercisable | |
|---|---|---|---|---|---|
| **Range of exercise prices** | **Number of shares** | **Weighted average remaining contractual life** | **Weighted average exercise price** | **Number of shares** | **Weighted average exercise price** |
| | | (number of shares in thousands) | | | |
| $0.00 $1.00 | 2,085 | 4.8 years | $ 0.52 | 2,000 | $ 0.51 |
| $1.01 $2.50 | 15,146 | 5.0 | 1.45 | 6,799 | 1.48 |
| $2.51 $5.00 | 1,054 | 4.0 | 3.86 | 1,030 | 3.88 |
| $5.01 $25.00 | 10 | 1.1 | 23.24 | 10 | 23.24 |
| $25.01 $50.00 | 38 | 1.1 | 30.13 | 38 | 30.13 |
| $50.01 $150.00 | 9 | 3.2 | 132.44 | 9 | 132.44 |
| | 18,342 | 4.9 years | $ 1.62 | 9,886 | $ 1.79 |

*Nonvested Stock*

Nonvested stock are shares of common stock that are subject to restrictions on transfer and risk of forfeiture until the fulfillment of specified conditions. Nonvested stock is expensed ratably over the term of the restriction period, ranging from one to five years. Nonvested stock compensation expense for the three months ended October 31, 2006 and 2005 is approximately $0.3 million and $0.5 million, respectively.

Table of Contents

A summary of the status of our nonvested stock for the quarter ended October 31, 2006, is as follows:

| | Number of shares (in thousands) | Weighted average grant date fair value |
|---|---|---|
| Nonvested stock outstanding, beginning of quarter | 2,560 | $ 1.95 |
| Granted | 450 | 1.03 |
| Vested | (606) | .56 |
| Nonvested stock outstanding, end of quarter | 2,404 | $ 2.13 |

The fair value of nonvested shares is determined based on market price of the Company s common stock on the grant date. The total fair value of nonvested stock that vested during the three months ended October 31, 2006 was approximately $0.6 million. As of October 31, 2006, there was approximately $4.6 million of total unrecognized compensation cost related to nonvested stock to be recognized over a weighted-average period of 2.6 years.

**G. OTHER GAINS (LOSSES), NET**

The following table reflects the components of Other gains (losses), net :

| | Three Months Ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| | (in thousands) | |
| Loss on impairment of marketable securities | $ | $ (77) |
| Foreign exchange gains (losses) | (538) | 537 |
| Gain on sale of building | | 2,749 |
| Gain on sale of investments | 1,535 | |
| Other, net | (75) | 27 |
| | $ 922 | $ 3,236 |

During the three months ended October 31, 2006, the Company recorded a gain of approximately $1.2 million to adjust a previously recorded gain on the sale of Molecular Inc. and a gain of approximately $0.3 million to adjust a previously recorded gain on the sale of Alibris Inc., both due to the release of funds held in escrow. Molecular Inc. and Alibris Inc. were @Ventures portfolio companies that were acquired by third parties in previous reporting periods. Also, during the three months ended October 31, 2006, the Company recorded foreign exchange losses of approximately $0.5 million. These foreign exchange losses related primarily to unhedged foreign currency exposures in Asia of approximately $0.3 million and $0.3 million in Europe as a result of fair value changes on outstanding forward currency exchange contracts. The Company has operations in various countries throughout the world and its operating results and financial position can be affected by significant fluctuations in foreign currency exchange rates. The Company has historically used derivative financial instruments to manage the exposure that results from such fluctuations, and the Company expects to continue such practice.

During the three months ended October 31, 2005, the Company recorded impairment charges related to its available-for-sale securities. The impairment charge consisted of approximately $0.1 million related to the Company s holdings of shares of Navisite. The Company also recorded foreign exchange gains of approximately $0.5 million and a gain of approximately $2.7 million on the sale of a building in Ireland.

Table of Contents

## H. RESTRUCTURING CHARGES

The following table summarizes the activity in the restructuring accrual for the three months ended October 31, 2006:

| | Employee Related Expenses | Contractual Obligations | Total |
|---|---|---|---|
| | | (in thousands) | |
| Accrued restructuring balance at July 31, 2006 | $ 1,521 | $ 10,678 | $ 12,199 |
| Restructuring charges | 198 | 2 | 200 |
| Restructuring adjustments | (17) | (370) | (387) |
| Cash charges | (852) | (726) | (1,578) |
| Accrued restructuring balance at October 31, 2006 | $ 850 | $ 9,584 | $ 10,434 |

It is expected that the payments of employee-related expenses will be substantially completed by February 2007. The remaining contractual obligations primarily relate to facility lease obligations for vacant space resulting from the previous restructuring activities of the Company, including excess plant capacity relating to the Company s Modus acquisition on August 2, 2004. The Company anticipates that contractual obligations will be settled by May 2012.

The net restructuring charges for the three months ended October 31, 2006 and 2005 would have been allocated as follows had the Company recorded the expense and adjustments within the functional department of the restructured activities:

| | Three Months Ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| | (in thousands) | |
| Cost of revenue | $ 57 | $ 526 |
| Selling | 229 | 156 |
| General and administrative | (473) | 295 |
| | $ (187) | $ 977 |

During the three months ended October 31, 2006, the Company recorded a net restructuring adjustment of approximately $0.2 million. The adjustments consisted of ($0.4) million in reductions to estimates for previously recorded facilities lease obligations primarily based on changes to the underlying assumptions regarding the estimated length of time required to sublease vacant space and the expected rent recovery rates. These adjustments were partially offset by restructuring charges of approximately $0.2 million as a result of workforce reductions of 7 employees primarily related to the reorganization of the global sales team in Europe and the elimination of redundant positions related to the Company s Hub & Spoke initiative.

During the three months ended October 31, 2005, the Company recorded net restructuring charges of approximately $1.0 million. These charges consisted of approximately $0.5 million relating to a workforce reduction of 34 employees, and $0.5 million relating to unutilized facilities for which the Company expects to realize no future economic benefit. These charges were partially offset by a $0.2 million reduction of a previously recorded employee severance accrual.

In addition, during the three months ended October 31, 2005, the Company accrued a purchase accounting adjustment to goodwill of approximately $4.3 million for restructuring activities related to the acquisition of Modus. These restructuring activities occurred primarily in the Americas and Europe regions in the amounts of ($0.4) million and ($3.9) million, respectively. The restructuring in the Americas region was employee severance

Table of Contents

related in connection with the elimination of redundant positions. The restructuring in Europe primarily related to the closure of a plant in Scotland and consists of approximately $3.1 million of severance for 130 employees and $0.8 million relating to unoccupied facilities for which the Company expects to realize no future economic benefit.

The following table summarizes the regional activity in the restructuring accrual for the three months ended October 31, 2006:

| | Americas | Asia | Europe<br>(in thousands) | Others | Consolidated Total |
|---|---|---|---|---|---|
| Amounts accrued at July 31, 2006 | $ 5,864 | $ 51 | $ 6,037 | $ 247 | $ 12,199 |
| Amounts charged to restructuring expenses | 87 | | 95 | 18 | 200 |
| Adjustment recorded to restructuring | (380) | (18) | 10 | 1 | (387) |
| Cash paid to restructuring | (812) | 55 | (624) | (197) | (1,578) |
| Amounts accrued at October 31, 2006 | $ 4,759 | $ 88 | $ 5,518 | $ 69 | $ 10,434 |

**I. DERIVATIVES AND FINANCIAL INSTRUMENTS**

The Company enters into forward currency exchange contracts to manage exposures to certain foreign currencies. The fair value of the Company s foreign currency exchange contracts is estimated based on the foreign exchange rates as of October 31, 2006. The Company s policy is not to allow the use of derivatives for trading or speculative purposes. At October 31, 2006, the notional value of the Company s foreign currency exchange contracts was to sell 18.8 million Euro and 14.0 million Czech Koruna and to buy 788.2 million Hungarian Forints and 20.7 million U.S. Dollars.

The Company believes that its forward currency exchange contracts economically function as effective hedges of the underlying exposures; however the foreign currency contracts do not meet the specific criteria for hedge accounting defined in SFAS No. 133, thus requiring the Company to record all changes in the fair value of these contracts in earnings in the period of the change. During the period ended October 31, 2006, the Company recorded a loss of approximately $0.3 million as a result of fair value changes on its outstanding forward currency exchange contracts. This loss has been included in Other gains (losses), net in the Company s consolidated statement of operations.

**J. SEGMENT INFORMATION**

Based on the information provided to the Company s Chief Operating Decision-Maker ( CODM ) for purposes of making decisions about allocating resources and assessing performance, the Company reports three operating segments, Americas, Asia and Europe.

In addition to its three current operating segments, the Company reports an Other category. The Other category represents corporate expenses consisting primarily of directors and officers insurance costs, costs associated with maintaining certain of the Company s information technology systems and certain corporate administrative functions such as legal and finance, as well as certain administrative costs related to the Company s venture capital affiliates. The Other category also consists of any residual results from operations, that exist through the cessation of operations of Equilibrium, CMGI Solutions, MyWay, iCast, NaviPath, ExchangePath, and Activate, each of which have been divested or substantially wound down, as these entities do not meet the aggregation criteria under SFAS No. 131 with respect to the Company s current reporting segments and were not reported as discontinued operations as they did not meet the criteria in SFAS No. 144. The historical results of these companies were previously reported in the Enterprise Software and Services

**Table of Contents**

(Equilibrium and CMGI Solutions), Portals (MyWay and iCast) and Managed Application Services (NaviPath, ExchangePath, and Activate) segments, respectively. The Other category s balance sheet information includes certain cash equivalents, available-for-sale securities, investments and other assets, which are not identifiable to the operations of the Company s operating business segments.

Management evaluates segment performance based on segment net revenue, operating income (loss) and Non-GAAP operating income (loss) , which is defined as the operating income/(loss) excluding net charges related to depreciation, long-lived asset impairment, restructuring, and amortization of intangible assets and stock-based compensation. The Company believes that its Non-GAAP measure of operating income/(loss) provides investors with a useful supplemental measure of the Company s operating performance by excluding the impact of non-cash charges and restructuring activities. Each of the excluded items (depreciation, long-lived asset impairment, amortization of intangible assets and stock-based compensation and restructuring) were excluded because they may be considered to be of a non-operational or non-cash nature. Historically, the Company has recorded significant impairment and restructuring charges and therefore management uses Non-GAAP operating income/(loss) to assist in evaluating the performance of the Company s core operations. Non-GAAP operating income/(loss) does not have any standardized definition and therefore is unlikely to be comparable to similar measures presented by other reporting companies. These Non-GAAP results should not be evaluated in isolation of, or as a substitute for the Company s financial results prepared in accordance with US GAAP.

Two clients, Hewlett-Packard and Advanced Micro Devices, accounted for approximately 31% and 11%, respectively, of CMGI s consolidated net revenue for the three months ended October 31, 2006. Two clients, Hewlett-Packard and Kodak, accounted for approximately 29% and 15%, respectively, of CMGI s consolidated net revenue for the three months ended October 31, 2005.

Summarized financial information of the Company s continuing operations by business segment is as follows:

| | Three Months Ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| | (in thousands) | |
| Net revenue: | | |
| Americas | $ 106,165 | $ 129,364 |
| Asia | 66,447 | 60,717 |
| Europe | 111,024 | 113,328 |
| | $ 283,636 | $ 303,409 |
| Operating income (loss): | | |
| Americas | $ 5,446 | $ 2,748 |
| Asia | 6,973 | 5,491 |
| Europe | (3,427) | (1,923) |
| Total | 8,992 | 6,316 |
| Other | (3,939) | (4,032) |
| | $ 5,053 | $ 2,284 |
| Non-GAAP operating income (loss): | | |
| Americas | $ 6,770 | $ 4,910 |
| Asia | 8,807 | 7,014 |
| Europe | (2,081) | 33 |
| Total | 13,496 | 11,957 |
| Other | (3,251) | (2,972) |
| | $ 10,245 | $ 8,985 |

14

Table of Contents

The following table reconciles non-GAAP operating income to GAAP operating income and net income (loss):

| | Three Months Ended October 31, 2006 | Three Months Ended October 31, 2005 |
|---|---|---|
| | (in thousands) | |
| Non-GAAP Operating income | $ 10,245 | $ 8,985 |
| Adjustments: | | |
| Depreciation | (2,903) | (2,508) |
| Amortization of intangible assets | (1,206) | (1,206) |
| Stock-based compensation | (1,270) | (2,010) |
| Restructuring, net | 187 | (977) |
| GAAP Operating income | 5,053 | 2,284 |
| Other income, net | 3,246 | 3,454 |
| Income tax expense (benefit) | (1,440) | 943 |
| Income (loss) from discontinued operations | 588 | (2,663) |
| Net income | $ 10,327 | $ 2,132 |

| | October 31, 2006 | July 31, 2006 |
|---|---|---|
| | (in thousands) | |
| Total assets of continuing operations: | | |
| Americas | $ 263,267 | $ 239,387 |
| Asia | 201,950 | 204,164 |
| Europe | 203,671 | 177,049 |
| Total | 668,888 | 620,600 |
| Other | 137,272 | 140,641 |
| | $ 806,160 | $ 761,241 |

**K. EARNINGS PER SHARE**

The Company calculates earnings per share in accordance with SFAS No. 128, Earnings per Share. Basic earnings per share are computed based on the weighted average number of common shares outstanding during the period. The dilutive effect of common stock equivalents is included in the calculation of diluted earnings per share only when the effect of the inclusion would be dilutive.

Approximately 1.3 million weighted average common stock equivalents were included in the denominator in the calculation of dilutive earnings per share for the three months ended October 31, 2006. Approximately 15.3 million common stock equivalent shares and approximately 3.1 million nonvested shares were excluded from the denominator in the diluted earnings per share calculation as their inclusion would have been antidilutive. For the three months ended October 31, 2005, approximately 5.3 million weighted average common stock equivalents were included in the denominator in the calculation of dilutive earnings per share. Approximately 3.9 million common stock equivalent shares and approximately 0.4 million nonvested shares were excluded from the denominator in the diluted earnings per share calculation as their inclusion would have been antidilutive.

Table of Contents

**L. COMPREHENSIVE INCOME (LOSS)**

The components of comprehensive income (loss), net of income taxes, are as follows:

| | Three Months Ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| | (in thousands) | |
| Net income | $ 10,327 | $ 2,132 |
| Net unrealized holding loss on securities | (798) | (33) |
| Reclassification adjustment for net realized loss on securities included in net income | | 77 |
| | (798) | 44 |
| Foreign currency translation adjustment | 612 | (616) |
| Comprehensive income | $ 10,141 | $ 1,560 |

The components of accumulated other comprehensive income are as follows:

| | October 31, 2006 | July 31, 2006 |
|---|---|---|
| | (in thousands) | |
| Net unrealized holding gains on securities | $ 1,530 | $ 2,328 |
| Cumulative foreign currency translation adjustment | 4,573 | 3,961 |
| Accumulated other comprehensive income | $ 6,103 | $ 6,289 |

**M. CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS SUPPLEMENTAL INFORMATION**

| | Three Months Ended October 31, | |
|---|---|---|
| | 2006 | 2005 |
| | (in thousands) | |
| Cash paid for interest | $ 607 | $ 912 |
| Cash paid for income taxes | $ 926 | $ 452 |

Significant non-cash activities during the three months ended October 31, 2006 included the issuance of approximately 0.4 million shares of nonvested CMGI common stock (valued at approximately $0.5 million) to certain executives and employees of the Company.

Significant non-cash activities during the three months ended October 31, 2005 included the issuance of approximately 1.0 million shares of nonvested CMGI common stock (valued at approximately $1.4 million) to certain executives and employees of the Company.

**N. INVENTORIES**

Inventories are stated at the lower of cost or market. Cost is primarily determined by the first-in, first-out ( FIFO ) method. Inventories at October 31, 2006 and July 31, 2006 consisted of the following:

| | October 31, 2006 | July 31, 2006 |
|---|---|---|
| | (in thousands) | |
| Raw materials | $ 64,444 | $ 48,539 |
| Work-in-process | 1,902 | 1,248 |
| Finished goods | 27,486 | 28,100 |
| | $ 93,832 | $ 77,887 |

16

**O. BORROWING ARRANGEMENTS**

The Company s subsidiary, ModusLink, has a revolving credit agreement ( the Loan Agreement ) with a bank syndicate. The Loan Agreement is a three-year $60.0 million revolving credit facility, with a scheduled maturity of October 31, 2008. Advances under the Loan Agreement may be in the form of loans or letters of credit. Outstanding borrowings under the former Loan Agreement have been assumed by the new loan facility such that at October 31, 2006, approximately $24.8 million of borrowings were outstanding under the facility, and approximately $0.2 million had been reserved in support of outstanding letters of credit. Interest on the revolving credit facility is based on Prime or LIBOR plus an applicable margin (ranging from 1.25 1.75%). The effective interest rate was 6.63% and 5.59% at October 31, 2006 and 2005, respectively. The Loan Agreement is secured by all assets of ModusLink and includes certain restrictive financial covenants, all of which ModusLink was in compliance with at October 31, 2006. These covenants include balance sheet leverage, liquidity and profitability measures and restrictions that limit the ability of ModusLink, among other things, to merge, acquire or sell assets without prior approval from the lenders.

**P. DISCONTINUED OPERATIONS AND DIVESTITURES**

During fiscal year 2006, CMGI s Board of Directors authorized the divestiture of SalesLink s marketing distribution services business. On June 28, 2006, SalesLink was sold to Automatic Data Processing, Inc. ( ADP ). The operations of SalesLink have been classified in the Company s financial statements as discontinued operations. This business unit had previously been included within the Company s Americas reporting segment.

For the three months ended October 31, 2006, the Company recorded income from discontinued operations of approximately $0.6 million primarily related to changes to previously recorded estimates for facility lease obligations based on changes to the underlying assumptions regarding the estimated length of time required to sublease the vacant space and the expected rent recovery rate for the SalesLink divestiture.

For the three months ended October 31, 2005, the Company recorded a loss from discontinued operations of approximately $2.7 million. The loss from discontinued operations is composed of a $2.6 million impairment charge for an other than temporary decline in the carrying value of a note receivable and warrant as well as the discontinued operating results of SalesLink.

**Q. CONTINGENCIES**

From time to time, the Company may become involved in litigation relating to claims arising out of operations in the normal course of business, which it considers routine and incidental to its business. The Company currently is not a party to any legal proceedings, the adverse outcome of which, in management s opinion, would have a material adverse effect on the Company s business, results of operation or financial condition.

**R. SUBSEQUENT EVENT**

On November 15, 2006, EMC Corporation ( EMC ) completed its acquisition of one of CMGI s @Ventures portfolio companies, Avamar Technologies, Inc. ( Avamar ). Under the terms of the merger agreement, EMC acquired Avamar in a cash transaction valued at approximately $165 million. The Company s allocation of the cash proceeds paid at closing was approximately $28.7 million, and the Company expects to record a pre-tax gain on this transaction of approximately $28.7 million in its second fiscal quarter ended January 31, 2007. The Company may also receive up to an additional $3.3 million of consideration currently held in escrow, subject to the satisfaction of certain indemnification provisions of the transaction. These potential proceeds from escrow have not been included in the estimated gain of $28.7 million.

Table of Contents

**Item 2.** ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The matters discussed in this report contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, that involve risks and uncertainties. All statements other than statements of historical information provided herein may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes , anticipates , plans , expects and similar expressions are intended to identify forward-looking statements. Factors that could cause actual results to differ materially from those reflected in the forward-looking statements include, but are not limited to, those discussed in Part II Item 1A below and elsewhere in this report and the risks discussed in the Company s Annual Report on Form 10-K filed with the SEC. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s analysis, judgment, belief or expectation only as of the date hereof. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof.

**Overview**

CMGI, through its subsidiary, ModusLink, provides industry-leading global supply chain management services. ModusLink provides extended supply chain management services and solutions to the technology industry on a global basis. These services and solutions include consulting and demand planning, sourcing and supply base management, manufacturing and product configuration, logistics management, marketing distribution and print-on demand, e-commerce, sales support and the complete range of after market services, from testing and repair to asset disposition.

We also invest in emerging, innovative and promising technologies and industries through our venture capital business, @Ventures. During the three months ended October 31, 2006, an aggregate of $3.1 million was invested by @Ventures and $1.5 million of proceeds were received from liquidity events from portfolio companies.

Management evaluates operating performance based on net revenue, operating income (loss), and net income (loss), and, across its segments, on the basis of non-GAAP operating income (loss), which is defined as the operating income (loss) excluding net charges related to depreciation, long-lived asset impairment, restructuring, amortization of intangible assets and stock-based compensation. See Note J of Notes to Condensed Consolidated Financial Statements for segment information, including a reconciliation of non-GAAP operating income (loss) to net income (loss).

During the latter part of fiscal 2005, we developed a set of strategic initiatives and an operating plan focused on increasing both revenue and profitability. We view the continued development of our global operational infrastructure and footprint as a primary source of differentiation in the marketplace. We believe that by leveraging our global footprint we will be able to optimize our client s supply chains using multi-facility, multi-geographic solutions. In line with this focus, during fiscal 2005, we made our initial investment in the implementation of a new global systems infrastructure, the foundation of which will be run on SAP s Enterprise Resource Planning ( ERP ) system.

During fiscal 2007, our focus is on executing against our strategic plan, including the continued implementation of the following initiatives to achieve our goals:

*Drive sales growth through a combination of existing client penetration, and targeting new vertical markets;* A significant portion of our revenues are currently generated from clients in the computing and software verticals. These verticals are mature and, as a result, gross margins in these verticals are low. To address this, we have expanded our sales focus to include three new markets, in addition to the computing and software verticals, that we believe can benefit from our supply chain expertise. We believe these verticals, communications, including broadband, storage devices, and consumer electronics, are experiencing faster growth than our

**Table of Contents**

historical markets, and represent opportunities to realize higher gross margins on our services. Companies in these markets often are early in their product life cycles and have significant need for a supply chain partner who will be an extension to their business models.

*Increase the value delivered to clients through service expansion;* We will continue to focus on and invest in expanding our e-commerce and logistics management services offerings, which we believe will increase the overall value of the supply chain solutions we deliver to our existing clients and to new clients. We expect these solutions will enhance our gross margins and drive greater profitability. Further, we believe that the addition of new services to existing clients will strengthen our relationship with these clients, and further integrate us with their business.

*Drive operational efficiencies throughout our organization;* As a result of the acquisition of Modus Media, Inc. in August 2004, the Company has been running multiple information technology systems at a significant cost. Our strategy is to offer an integrated supply chain system infrastructure that extends from front-end order management through distribution and returns management. This end-to-end solution will enable clients to link supply and demand in real time, improve visibility and performance throughout the supply chain, and provide real-time access to information for greater collaboration and making informed business decisions. We believe our clients will benefit greatly from a global integrated business solution while we too reduce our operating costs. We currently expect to invest a total of approximately $31.5 million in this initiative, approximately half of which has been incurred to date. Our cost estimate has increased from our earlier estimates, primarily as a result of changes to our implementation schedule and infrastructure requirements. Another program that we expect will drive further operational efficiencies in the future is the implementation of a global shared services model utilizing centralized hub locations to service multiple spoke locations across the Americas, Asia and Europe regions. We believe this initiative will yield improved process standardization and operating efficiency gains, as well as lower our operating costs.

We believe that successful execution of these initiatives will enable the Company to increase its gross margin percentage to approximately 12% to 14%, compared to the fiscal 2006 gross margins of approximately 10.6%. We also believe that these initiatives will allow us to reduce our overall selling, general and administrative, restructuring and amortization costs to approximately 7% of revenue. These actions are expected to result in an operating margin between 5% and 7%. We expect to make steady progress toward these goals and to be operating at this level by the end of fiscal year 2008. Among the key factors that will influence our performance against these goals are successful execution and implementation of our strategic initiatives, global economic conditions, especially in the technology sector, demand for our clients products, and demand for outsourcing services.

For the three months ended October 31, 2006, CMGI reported net revenue of $283.6 million, an operating profit of $5.1 million, income from continuing operations of $8.3 million and net income of $10.3 million. We currently conduct business in The Netherlands, Hungary, France, Singapore, Taiwan, China, Malaysia, Ireland, the Czech Republic, Mexico and other foreign locations, in addition to the Company s United States operations. At October 31, 2006, we had cash and cash equivalents, available for sale securities and short-term investments of $222.2 million, and working capital of $282.5 million. Our primary use of cash during the three months ended October 31, 2006 was for working capital requirements in support of new client programs.

As a large portion of our revenue comes from outsourcing services provided to clients such as hardware manufacturers, software publishers, telecommunications carriers, broadband and wireless service providers and consumer electronics companies, our operating performance could be adversely affected by declines in the overall performance of the technology sector. The market for our supply chain management products and services is very competitive. We also face pressure from our clients to continually realize efficiency gains in order to help our clients maintain their gross margins and profitability. Increased competition and client demands for efficiency improvements may result in price reductions, reduced gross margins and in some cases loss of

Table of Contents

market share. As a result of these competitive and client pressures, the gross margins in our business are low. Increased competition arising from industry consolidation and/or low demand for our clients products and services may hinder our ability to maintain or improve our gross margins, profitability and cash flows. We must continue to focus on margin improvement, through implementation of our strategic initiatives, cost reductions and asset and employee productivity gains in order to improve the profitability of our business and maintain our competitive position. We are reacting to margin and pricing pressures in several ways, including efforts to target new vertical markets, expand our service offerings and to lower our infrastructure costs. Our ERP and hub and spoke initiatives are key enablers to drive efficiencies and lower our operating costs. We also seek to lower our cost to service clients by moving work to lower-cost venues, establishing facilities closer to our clients to gain efficiencies, and other actions designed to improve the productivity of our operations.

Historically, a limited number of key clients have accounted for a significant percentage of our revenue. For the three months ended October 31, 2006, sales to Hewlett-Packard and Advanced Micro Devices, accounted for approximately 31% and 11%, respectively, of the Company s consolidated net revenues. During the three months ended October 31, 2006, five clients accounted for approximately 62% of the Company s net revenues. In fiscal 2007, we expect to realize lower annual revenues from Kodak, which accounted for 11% of our consolidated net revenues in fiscal 2006, as a result of changes to certain programs that we currently execute on their behalf. We expect to continue to derive the vast majority of our operating revenue from sales to a small number of key clients. We currently do not have any agreements which obligate any client to buy a minimum amount of products or services from us or designate us as an exclusive service provider. Consequently, our sales are subject to demand variability by our clients. The level and timing of orders placed by our clients vary for a variety of reasons, including seasonal buying by end-users, the introduction of new technologies and general economic conditions.

**Basis of Presentation**

The Company reports three operating segments, Americas, Asia, and Europe. In addition to its three current operating segments, the Company reports an Other category. The Other category represents corporate expenses consisting primarily of directors and officers insurance costs, costs associated with maintaining certain of the Company s information technology systems and certain corporate administrative functions such as legal and finance, as well as certain administrative costs related to the Company s venture capital business. The Other category also consists of any residual results from operations that exist through the cessation of operations of Equilibrium, MyWay, iCast, NaviPath, ExchangePath, and Activate, each of which have been divested or substantially wound down, as these entities do not meet the aggregation criteria under SFAS No. 131 with respect to the Company s current reporting segments. The Other category s balance sheet information includes certain cash equivalents, available-for-sale securities, investments and other assets, which are not identifiable to the operations of the Company s operating business segments.

Certain prior year amounts in the Condensed Consolidated Financial Statements have been reclassified in accordance with US GAAP to conform to the current year presentation.

In accordance with accounting principles generally accepted in the United States of America, all significant intercompany transactions and balances have been eliminated in consolidation. Accordingly, segment results reported by the Company exclude the effect of transactions between the Company and its subsidiaries and between the Company s subsidiaries.

Table of Contents

**Results of Operations**

**Three months ended October 31, 2006 compared to the three months ended October 31, 2005**

***Net Revenue:***

| | Three Months Ended October 31, 2006 | As a % of Total Net Revenue | Three Months Ended October 31, 2005 | As a % of Total Net Revenue | $ Change | % Change |
|---|---|---|---|---|---|---|
| | | | (in thousands) | | | |
| Americas | $ 106,165 | 37% | $ 129,364 | 43% | $ (23,199) | (18)% |
| Asia | 66,447 | 23% | 60,717 | 20% | 5,730 | 9% |
| Europe | 111,024 | 39% | 113,328 | 37% | (2,304) | (2)% |
| Total | $ 283,636 | 100% | $ 303,409 | 100% | $ (19,773) | (7)% |

Net revenue decreased for the three months ended October 31, 2006, as compared to the same period in the prior year, primarily as a result of lower revenue of approximately $20.2 million from Kodak in connection with the anticipated change in their supply chain model. This decline affected the Americas, Asia and Europe segments by approximately $13.3 million, $1.9 million, and $5.0 million, respectively. In addition to the decline mentioned above, the net revenue in the Americas region was also negatively impacted by a combination of lower revenue of approximately $4.0 million as a result of decreased order volumes for a certain client and lower revenue of approximately $6.7 million due to a change in a client s program. Within the Asia region, the net revenue growth of $5.7 million resulted primarily from approximately $9.0 million of higher revenues due to increased order volumes for certain clients programs partially offset by a decline from the change in Kodak s supply chain model mentioned above. Within the Europe region, the net revenue decline was the result of the change in a Kodak s supply chain model, as well as lower order volume for another client of approximately $6.8 million. These declines were partially offset by approximately $7.0 million of revenue for a new client program.

The Company continues to see volatility in the global consumer electronics markets and as such maintains a conservative view on order volumes and revenue. Our current ability to forecast the amount and timing of future order volumes is low, and we expect such condition to continue for the foreseeable future, as the Company is highly dependent upon the business needs of its clients, whose businesses, in turn, depend upon various factors related to the high tech sector generally and demand for products and services in that industry. The Company sells primarily on a purchase order basis, rather than pursuant to contracts with minimum purchase requirements. These purchase orders are generally for quantities necessary to support near-term demand for our clients products. A significant portion of our client base operates in the technology sector, which is intensely competitive and very volatile. Our clients order volumes vary from quarter to quarter for a variety of reasons, including market acceptance of their new product introductions and overall demand for their products. This business environment, and our mode of transacting business with our clients, does not lend itself to precise measurement of the amount and timing of future order volumes, and as a result, future sales volumes and revenues could vary significantly from period to period.

***Cost of Revenue:***

| | Three Months Ended October 31, 2006 | As a % of Segment Net Revenue | Three Months Ended October 31, 2005 | As a % of Segment Net Revenue | $ Change | % Change |
|---|---|---|---|---|---|---|
| | | | (in thousands) | | | |
| Americas | $ 94,368 | 89% | $ 118,086 | 91% | $ (23,718) | (20)% |
| Asia | 52,299 | 79% | 48,812 | 80% | 3,487 | 7% |
| Europe | 106,926 | 96% | 105,539 | 93% | 1,387 | 1% |
| Total | $ 253,593 | 89% | $ 272,437 | 90% | $ (18,844) | (7)% |

Cost of revenue consists primarily of expenses related to the cost of products purchased for sale or distribution as well as salaries and benefit expenses, consulting and contract labor costs, fulfillment and shipping costs, and applicable facilities costs. In total, the decrease in cost of revenue for the three months ended October 31, 2006 was consistent with the change in revenues for the three operating segments as compared to the prior year. Overall net revenue and cost of revenue both decreased 7% compared to the prior year. Gross margins for the first quarter of fiscal 2007 were 10.6% as compared to 10.2% in the prior year quarter.

For the three months ended October 31, 2006, the Company s gross margin percentages within the Americas, Asia and Europe regions were 11%, 21% and 4%, as compared to 9%, 20% and 7%, respectively, for the same period of the prior year. Within the Americas region, the $0.5 million or two-percentage point increase in gross margin percentage was primarily attributable to an improvement in the sales mix to higher margin business and cost reduction initiatives implemented to improve operational efficiencies. Within the Asia region, the $2.2 million or one-percentage point increase in gross margin percentage was attributable to an increase in volume for certain client programs with higher margins. Within the Europe region, the $3.7 million or three-percentage point decline in gross margin percentage was primarily attributable to an increase in contract labor of approximately $1.9 million of which a portion related to start up costs incurred for two new client programs.

As a result of the lower overall cost of delivering the Company s products and services in the Asia region, particularly China, and the increasing demand for supply chain management services in that region, we expect gross margin levels in Asia to continue to exceed those earned in the Americas and Europe regions. However, we expect that there will continue to be pressure on gross margin levels in Asia as the market, particularly China, matures. Our gross margins are impacted by a number of factors, including competition, order volumes, pricing, client and product mix and configuration, and overall demand for our clients products. A significant portion of the costs required to deliver our products and services is fixed in nature.

As outlined in our strategic initiative discussion in the Overview section above, the Company remains focused on margin improvement through several revenue and operating efficiency initiatives designed to improve the profitability of our business and maintain our competitive position. We are reacting to margin and pricing pressures in several ways including efforts to target new vertical markets, expand our service offerings and lower our infrastructure costs. We believe our ERP and hub and spoke initiatives are key enablers to drive efficiencies and lower our operating costs. We also seek to lower our cost to service clients by moving work to lower-cost venues and establishing facilities closer to our clients to gain efficiencies.

***Selling Expenses:***

| | Three Months Ended October 31, 2006 | As a % of Segment Net Revenue | Three Months Ended October 31, 2005 | As a % of Segment Net Revenue | $ Change | % Change |
|---|---|---|---|---|---|---|
| | | | (in thousands) | | | |
| Americas | $ 1,200 | 1% | $ 1,963 | 2% | $ (763) | (39)% |
| Asia | 1,142 | 2% | 1,388 | 2% | (246) | (18)% |
| Europe | 1,423 | 1% | 2,037 | 2% | (614) | (30)% |
| Total | $ 3,765 | 1% | $ 5,388 | 2% | $ (1,623) | (30)% |

Selling expenses consist primarily of compensation and employee-related expenses, sales commissions, facilities costs, consulting fees, marketing expenses and travel costs. Selling expenses during the three months ended October 31, 2006 decreased by approximately $1.6 million, primarily as a result of lower employee-related and travel and entertainment costs of approximately $1.2 million and $0.2 million, respectively. The decrease in employee related costs throughout the regions is the result of the reorganization of the global sales team. The $0.8 million decrease in selling expenses within the Americas region is largely the result of lower

Table of Contents

employee-related costs of approximately $0.7 million. The $0.6 million decrease in selling expenses within the Europe region is primarily the result of lower employee-related costs as a result of lower headcount. For the three months ended October 31, 2006 and 2005, employee related costs represented approximately 62% and 67% of the total selling expense, respectively. The Company expects its selling expenses to continue to approximate 1% of net revenue for the foreseeable future.

***General and Administrative Expenses:***

| | Three Months Ended October 31, 2006 | As a % of Segment Net Revenue | Three Months Ended October 31, 2005 | As a % of Segment Net Revenue | $ Change | % Change |
|---|---|---|---|---|---|---|
| | | | (in thousands) | | | |
| Americas | $ 4,894 | 5% | $ 5,675 | 4% | $ (781) | (14)% |
| Asia | 5,542 | 8% | 4,516 | 7% | 1,026 | 23% |
| Europe | 5,833 | 5% | 6,681 | 6% | (848) | (13)% |
| Sub-total | 16,269 | 6% | 16,872 | 6% | (603) | (4)% |
| Other | 3,937 | | 4,245 | | (308) | (7)% |
| Total | $ 20,206 | 7% | $ 21,117 | 7% | $ (911) | (4)% |

General and administrative expenses within the Americas, Asia, and Europe operating segments consist primarily of compensation and other employee-related costs, facilities costs, depreciation expense and fees for professional services. The general and administrative expenses for these operating segments decreased during the three months ended October 31, 2006, as compared to the same period in the prior year, primarily as a result of lower costs associated with the Company s migration to a new ERP platform of approximately $1.2 million and lower employee-related costs of approximately $0.3 million. These cost reductions were partially offset by approximately $0.4 million of higher hardware and software maintenance costs and $0.3 million of higher depreciation. Within the Americas region, the $0.8 million decrease in general and administrative expenses were primarily the result of lower employee-related costs of approximately $0.5 million as a result of lower headcount year-over-year. Within the Asia region, the $1.0 million increase in general and administrative expenses were primarily associated with the ERP initiative of approximately $0.2 million, IT infrastructure costs of approximately $0.2 million, accounting and professional fees of approximately $0.1 million and travel and entertainment fees of $0.1 million. Within the Europe region, the $0.8 million decrease in general and administrative expenses was primarily the result of lower costs associated with migration to the new ERP platform of approximately $0.4 million and $0.7 million of lower employee-related costs primarily due to the Company s hub and spoke initiative, partially offset by approximately $0.1 million in marketing costs.

The general and administrative expenses within the Other category primarily reflect the cost of the Company s directors and officers insurance, costs associated with certain corporate administrative functions such as legal and finance which are not fully allocated to the Company s subsidiaries, and administration costs related to the Company s venture capital business. General and administrative expenses within the Other category decreased by approximately $0.3 million from the prior fiscal year primarily as a result of lower stock based compensation expense of approximately $0.6 million and legal fees of approximately $0.1 million. These decreases were partially offset by higher employee related costs of $0.3 million.

The Company expects its general and administrative expenses to continue to approximate 8% of net revenue in fiscal 2007 due primarily to higher information technology expenditures associated with the Company s migration to a common ERP platform and stock compensation expense related to the continued application of SFAS No. 123(R). These decreased general and administrative costs are expected to be partially offset by expenses in connection with the implementation of the hub and spoke shared services model during the remainder of fiscal 2007.

Table of Contents

***Amortization of Intangible Assets:***

| | Three Months Ended October 31, 2006 | As a % of Segment Net Revenue | Three Months Ended October 31, 2005 | As a % of Segment Net Revenue | $ Change | % Change |
|---|---|---|---|---|---|---|
| | | | (in thousands) | | | |
| Americas | $ 531 | 1% | $ 531 | % | $ | % |
| Asia | 510 | 1% | 510 | 1% | | % |
| Europe | 165 | % | 165 | % | | % |
| Total | $ 1,206 | % | $ 1,206 | % | $ | % |

The intangible asset amortization relates to certain amortizable intangible assets acquired by the Company in connection with its acquisition of Modus. These intangible assets are being amortized over lives ranging from 3 to 7 years.

***Restructuring:***

| | Three Months Ended October 31, 2006 | As a % of Segment Net Revenue | Three Months Ended October 31, 2005 | As a % of Segment Net Revenue | $ Change | % Change |
|---|---|---|---|---|---|---|
| | | | (in thousands) | | | |
| Americas | $ (277) | % | $ 361 | % | $ (638) | (177)% |
| Asia | (18) | % | | % | (18) | % |
| Europe | 105 | % | 829 | 1% | (724) | (87)% |
| Sub-total | (190) | % | 1,190 | % | (1,380) | (116)% |
| Other | 3 | | (213) | | 216 | (101)% |
| Total | $ (187) | % | $ 977 | % | $ (1,164) | (119)% |

During the three months ended October 31, 2006, the Company recorded a net restructuring adjustment of approximately $0.2 million. The adjustments consisted of ($0.4) million in reductions to estimates for previously recorded facilities lease obligations primarily based on changes to the underlying assumptions regarding the estimated length of time required to sublease vacant space and the expected rent recovery rates. These adjustments were partially offset by restructuring charges of approximately $0.2 million as a result of workforce reductions of 7 employees primarily related to the reorganization of the global sales team in Europe and the elimination of redundant positions related to the Company s Hub & Spoke initiative.

During the three months ended October 31, 2005, the Company recorded net restructuring charges of approximately $1.0 million. These charges consist of approximately $0.5 million related to a workforce reduction of 34 employees, and approximately $0.5 million relating to unoccupied facilities for which the Company expects to realize no future economic benefit.

***Interest Income/Expense:***

During the three months ended October 31, 2006, interest income increased $1.0 million to $2.2 million from $1.2 million for the same period in the prior fiscal year. The increase in interest income was the result of both higher average interest rates and higher average cash and cash equivalent and short-term investment balances during the current period compared to the same period in the prior fiscal year.

Interest expense totaled approximately $0.6 million for each of the three months ended October 31, 2006 and 2005. In both periods, interest expense of approximately $0.2 million related to the Company s stadium

obligation, and the remaining interest expense related primarily to outstanding borrowings on a revolving bank credit facility.

***Other Gains (Losses), net:***

Other gains (losses) net, totaled a gain of $0.9 million for the three months ended October 31, 2006 as compared to a gain of $3.2 million for the same period of the prior fiscal year. During the three months ended October 31, 2006, the Company recorded a gain of approximately $1.2 million to adjust a previously recorded gain on the sale of Molecular Inc. and a gain of approximately $0.3 million to adjust a previously recorded gain on the sale of Alibris Inc., both due to the release of funds held in escrow. Molecular Inc. and Alibris Inc. were @Ventures portfolio companies that were acquired by third parties in previous reporting periods. In addition, the Company incurred foreign exchange losses of approximately $0.5 million during the three months ended October 31, 2006, primarily related to unhedged foreign currency exposures in Asia of approximately $0.3 million and $0.3 million in Europe as a result of fair value changes on outstanding forward currency exchange contracts. During the three months ended October 31, 2005, the Company recognized a gain of approximately $2.7 million on the sale of a building in Ireland and incurred foreign exchange gains of approximately $0.5 million, primarily related to unhedged foreign currency exposures in Asia.

***Equity in Income (Losses) of Affiliates, net:***

Equity in income (losses) of affiliates, net, resulted from the Company s minority ownership in certain investments that are accounted for under the equity method. Under the equity method of accounting, the Company s proportionate share of each affiliate s operating income (losses) is included in equity in income (losses) of affiliates. Equity in income (losses) of affiliates increased to income of approximately $0.7 million for the three months ended October 31, 2006 from a loss of $0.4 million for the same period in the prior fiscal year, primarily as a result of an increase in net income recognized by certain of the affiliate companies.

***Income Tax Expense/(Benefit):***

During the three months ended October 31, 2006, the Company recorded an income tax benefit of approximately $1.4 million, as compared to income tax expense of $0.9 million for the prior fiscal year. Included in the tax provision for the three months ended October 31, 2006 were income tax benefits of approximately $3.0 million primarily as a result of a reduction in our valuation allowance for certain net operating loss carryforwards in Europe. The reduction in the valuation allowance is the result of the implementation of certain tax strategies that have resulted in the Company now projecting to recognize the tax benefits associated with the utilization of these net operating loss carryforwards in future periods.

For the three months ended October 31, 2006 and 2005, the Company s U.S. taxable income has been offset by net operating loss carryovers from prior years. The Company continues to maintain a full valuation allowance against its deferred tax asset in the U.S. and certain of its foreign subsidiaries due to the uncertainty of realizing such benefits. The Company provides income tax expense related to federal alternative minimum tax, state taxes and foreign taxes.

***Discontinued Operations:***

For the three months ended October 31, 2006, the Company recorded income from discontinued operations of approximately $0.6 million primarily related to changes to previously recorded estimates for facility lease obligations based on changes to the underlying assumptions regarding the estimated length of time required to sublease the vacant space and the expected rent recovery rate.

During the three months ended October 31, 2005, the Company recorded a $2.6 million impairment charge for an other than temporary decline in the carrying value of a note receivable and warrant.

The Company does not expect any future residual costs related to discontinued operations to be significant.

**Liquidity and Capital Resources**

Historically, the Company has financed its operations and met its capital requirements primarily through funds generated from operations, the issuance of CMGI common stock, the sale of our interests in subsidiaries, returns generated by our venture capital business and borrowings from lending institutions. As of October 31, 2006, the Company s primary sources of liquidity consisted of cash and cash equivalents and short-term investments of $220.5 million. In addition, ModusLink has a revolving credit agreement (the Loan Agreement ) with a bank syndicate. The Loan Agreement is a three-year $60.0 million revolving credit facility, with a scheduled maturity of October 31, 2008. Advances under the Loan Agreement may be in the form of loans or letters of credit. At October 31, 2006, approximately $24.8 million of borrowings were outstanding under the Loan Agreement, and approximately $0.2 million had been reserved in support of outstanding letters of credit. The Company s working capital at October 31, 2006 was approximately $282.5 million.

Net cash provided by operating activities of continuing operations was $2.8 million for the three months ended October 31, 2006, compared to net cash used for operating activities of continuing operations of $30.7 million for the three months ended October 31, 2005. Cash provided by (used for) operating activities of continuing operations represents net income (loss) as adjusted for non-cash items and changes in working capital. During the three months ended October 31, 2006, non-cash items primarily included $2.9 million of depreciation expense, $1.2 million of amortization of intangible assets and $1.3 million of stock-based compensation. Cash flow from operating activities of continuing operations includes an increase in inventories and accounts payable of $15.9 million and $36.3 million, respectively, in order to support the seasonality based increase in demand for certain customer products in our second quarter. In addition, cash flow from operating activities of continuing operations also includes an increase in accounts receivable of approximately $25.8 million primarily as a result of approximately $19.5 million of higher sales during the last month of the current quarter versus the last month of the prior quarter. During the three months ended October 31, 2005, non-cash items primarily included $2.5 million of depreciation expense, $1.2 million of amortization of intangible assets and $2.0 million of stock-based compensation expense. During the three months ended October 31, 2005, net cash used from operating activities includes increases in accounts receivable, inventories and accounts payable of approximately $62.3 million, $20.1 million and $43.8 million, respectively, largely related to seasonality based demand.

The Company believes that its cash flows related to operating activities of continuing operations is dependent on several factors, including increased profitability, effective inventory management practices, and optimization of the credit terms of certain vendors of the Company. Our cash flows from operations are dependent on several factors including the overall performance of the technology sector, and the market for outsourcing services. The intensity of the competition in our markets is expected to continue to increase and this increased competition may result in price reductions, reduced gross margins and loss of market share. A one-percentage point decline in our gross margins earned during the three months ended October 31, 2006, would have resulted in a $2.8 million decline in our cash flows from operating activities. We continue to focus on margin improvement, through our efforts to target new vertical markets, expand our service offerings and lower our infrastructure costs in order to improve the profitability and cash flows of our business and maintain our competitive position. We believe our ERP and hub and spoke initiatives are key enablers to drive efficiencies and lower our operating costs. We also seek to lower our cost to service clients, by moving work to lower-cost venues and establishing facilities closer to our clients to gain efficiencies.

Investing activities of continuing operations used cash of $4.7 million and $5.4 million for the three months ended October 31, 2006 and 2005, respectively. The $4.7 million of cash used for investing activities during the three months ended October 31, 2006 resulted from the Company investing approximately $7.4 million in capital expenditures and $3.1 million in investments in affiliates. These cash uses were partially offset by $1.5 million of proceeds from the release of funds held in escrow related to a previously recorded gain on the sale of Molecular of approximately $1.2 million and an adjustment to a previously recorded gain on the sale of Alibris of approximately $0.3 million and $4.3 million from the redemption of short-term investments. The $5.4 million of cash used for investing activities during the three months ended October 31, 2005 consists of $3.4 million of

capital expenditures and $4.7 million of investments in affiliates, partially offset by $2.7 million of proceeds from the sale of a building in Europe. As of October 31, 2006, the Company had $24.5 million of investments in affiliates, which may be a potential source of future liquidity. However, the Company does not anticipate being dependent on liquidity from these investments to fund either its short-term or long-term operating activities. During the three months ended October 31, 2006, the Company invested approximately $2.4 million in a new Enterprise Resource Planning System in connection with its strategy to create a global integrated supply-chain system infrastructure that extends from front-end order management through distribution returns management. We currently expect to invest a total of approximately $31.5 million in this initiative, approximately half of which has been incurred to date.

Financing activities of continuing operations used cash of $1.5 million for the three months ended October 31, 2005. The $1.5 million of cash used for financing activities of continuing operations during the three months ended October 31, 2005 primarily related to the repayment of a mortgage in connection with the sale of a building in Europe. The Company is not dependent on liquidity from its financing activities to fund either its short-term or long-term operating activities; however, we have utilized our revolving line of credit to meet operating requirements in the past.

Cash used for discontinued operations totaled $44,000 and $27,000 for the three months ended October 31, 2006 and 2005, respectively.

Given the Company s cash resources as of October 31, 2006, the Company believes that it has sufficient working capital and liquidity to support its operations, as well as continue to make investments through its venture capital business over the next fiscal year and for the foreseeable future. However, should additional capital be needed to fund future investment and acquisition activity, the Company may seek to raise additional capital through offerings of the Company s stock, or through debt financing. There can be no assurance, however, that the Company will be able to raise additional capital on terms that are favorable to the Company, or at all.

**Off-Balance Sheet Financing Arrangements**

The Company does not have any off-balance sheet financing arrangements.

**Contractual Obligations**

The Company leases facilities and certain other machinery and equipment under various non-cancelable operating leases and executory contracts expiring through November 2020.

In August 2000, the Company announced it had acquired the exclusive naming and sponsorship rights to the New England Patriots new stadium for a period of fifteen years. In August 2002, the Company finalized an agreement with the owner of the stadium to amend the sponsorship agreement. Under the terms of the amended agreement, the Company relinquished the stadium naming rights and remains obligated for a series of annual payments of $1.6 million per year through 2015.

ModusLink has a revolving bank credit facility of $60.0 million. As of October 31, 2006, the effective interest rate on the credit facility was LIBOR rates plus 1.25%. Approximately $24.8 million of borrowings were outstanding under the facility and approximately $0.2 million had been reserved in support of outstanding letters of credit.

Purchase obligations represent an estimate of all open purchase orders and contractual obligations in the ordinary course of business for which the Company has not received the goods or services. Although open purchase orders are considered enforceable and legally binding, the terms generally allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to the delivery of goods or performance of services.

Table of Contents

Future minimum payments, including previously recorded restructuring obligations, as of October 31, 2006 are as follows:

| Contractual Obligations | Total | Less than 1 year | 1 3 years | 3 5 years | After 5 years |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Operating leases | $ 85,623 | $ 24,761 | $ 36,777 | $ 18,281 | $ 5,804 |
| Capital leases | 829 | 341 | 488 | | |
| Stadium obligations | 14,400 | 1,600 | 3,200 | 3,200 | 6,400 |
| Long-term debt | 98 | 65 | 33 | | |
| Purchase obligations | 88,809 | 88,809 | | | |
| Revolving line of credit | 24,786 | | 24,786 | | |
| Total | $ 214,545 | $ 115,576 | $ 65,284 | $ 21,481 | $ 12,204 |

The table above excludes obligations related to the Company s defined benefit pension plan. See Note 17 of the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the fiscal year ended July 31, 2006 for a summary of our expected contributions and benefit payments for this plan.

Total future minimum lease payments have been reduced by future minimum sublease rentals of approximately $0.8 million.

Total rent and equipment lease expense charged to continuing operations was approximately $5.8 million and $6.2 million for the quarter ended October 31, 2006 and 2005, respectively.

From time to time, the Company provides guarantees of payment to vendors doing business with certain of the Company s subsidiaries or former subsidiaries. These guarantees require that in the event that the subsidiary cannot satisfy its obligations with certain of its vendors, the Company will be required to settle the obligation. In 1999, a subsidiary of the Company entered into a facility lease with a term ending in November 2006. The Company issued a guaranty in connection with this lease. The Company divested of its interest in the subsidiary in 2002. During the quarter ended October 31, 2006, the Company became aware that this lease recently had been amended to extend the lease term through November 2016 with cumulative base rent of approximately $17.3 million. The Company is currently evaluating the effect of this extension on its prior guaranty.

From time to time, the Company agrees to provide indemnification to its clients in the ordinary course of business. Typically, the Company agrees to indemnify its clients for losses caused by the Company including with respect to certain intellectual property, such as databases, software masters, certificates of authenticity and similar valuable intellectual property. As of October 31, 2006, the Company had no recorded liabilities with respect to these arrangements.

**Critical Accounting Policies**

The preparation of our unaudited quarterly financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and reported amounts of revenues and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, stock-based compensation expense, inventories, investments, income taxes, restructuring, impairment of long-lived assets, goodwill and other intangible assets, contingencies and litigation. Of the accounting estimates we routinely make relating to our critical accounting policies, those estimates made in the process of: preparing investment valuations; determining discounted cash flows for purposes of evaluating goodwill and intangible assets for impairment; determining future lease assumptions related to restructured facility lease obligations; and

establishing income tax liabilities are the estimates most likely to have a material impact on our financial position and the results of operations. Some accounting policies may have a significant impact on amounts reported in these financial statements. A description of our critical accounting policies is contained in our Annual Report on Form 10-K for the fiscal year ended July 31, 2006 in the Critical Accounting Policies section of Management s Discussion and Analysis of Financial Condition and Results of Operations.

**New Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Standards ( SFAS ) No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 is effective for the Company beginning in fiscal 2009. The Company is currently evaluating the impact, if any, that SFAS No. 157 may have on its results of operations or financial position.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132 (R) ( SFAS No. 158 ). SFAS No. 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 also requires the measurement of defined benefit plan assets and obligations as of the date of the employer s fiscal year-end statement of financial position (with limited exceptions). Under SFAS No. 158, the Company will be required to recognize the funded status of its defined benefit postretirement plan and to provide the required disclosures commencing as of July 31, 2007. The Company is currently evaluating the impact, if any, that SFAS No. 158 may have on its results of operations or financial position.

In September 2006, the United States Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin ( SAB ) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. This SAB provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 establishes an approach that requires quantification of financial statement errors based on the effects of each of the company s balance sheet and statement of operations financial statements and the related financial statement disclosures. The SAB permits existing public companies to record the cumulative effect of initially applying this approach in the first fiscal year ending after November 15, 2006 by recording the necessary correcting adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of retained earnings. Additionally, the use of the cumulative effect transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose. The Company is currently evaluating the impact that SAB 108 may have on the Company s results of operations or financial position.

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. SFAS No. 48 is effective for the Company beginning in fiscal 2008. The Company is currently evaluating the impact, if any, that FASB No. 48 may have on the Company s results of operations or financial position.

In March 2006, the FASB issued EITF 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation) that clarifies how a company discloses its recording of taxes collected that are imposed on revenue producing activities. EITF 06-03 is effective for the first interim reporting period beginning after December 15, 2006. The Company is evaluating the impact, if any, that EITF 06-03 may have on the Company s results of operations or financial position; which will be adopted beginning the second quarter of fiscal 2007.

Table of Contents

**Item 3.** ***Quantitative and Qualitative Disclosures About Market Risk***

The Company is exposed to the impact of interest rate changes, foreign currency fluctuations and changes in the market values of its investments. The carrying values of financial instruments including cash and cash equivalents, accounts receivable, accounts payable and the revolving line of credit, approximate fair value because of the short-term nature of these instruments. The carrying value of long-term debt and capital lease obligations approximates fair value, as estimated by using discounted future cash flows based on the Company s current incremental borrowing rates for similar types of borrowing arrangements. As a matter of policy, the Company does not enter into derivative financial instruments for trading purposes. All derivative positions are used to reduce risk by hedging underlying economic or market exposure and are valued at their fair value on our Condensed Consolidated Balance Sheet.

***Interest Rate Risk***

The Company has from time to time used derivative financial instruments to reduce exposure to adverse fluctuations in interest rates on its borrowing arrangements. The derivatives the Company uses are straightforward instruments with liquid markets. At October 31, 2006, the Company was primarily exposed to the Prime Rate, London Interbank Offered Rate (LIBOR) and Euro Interbank Offered Rates (EURIBOR) on its outstanding borrowing arrangements, and the Company had no open derivative positions with respect to its borrowing arrangements. A hypothetical 100 basis point increase in our interest rates would result in an approximate 10%, or $0.1 million, increase in our interest expense for the three months ended October 31, 2006.

We maintain a portfolio of highly liquid cash equivalents typically maturing in three months or less as of the date of purchase. We place our investments in instruments that meet high credit quality standards, as specified in our investment policy.

Our exposure to market risk for changes in interest rates relates primarily to our investment in short-term investments. At October 31, 2006, the Company had available-for-sale securities, a significant portion which are classified as short-term investments in our Condensed Consolidated Balance Sheet. These short-term investments include corporate and state municipal obligations such as commercial paper and auction rate securities (ARS), but may also include certificates of deposit and institutional market funds. The auction rate securities are adjustable-rate securities with dividend rates that are reset periodically by bidders through Dutch auctions generally conducted every 7 to 90 days by a trust company or broker/dealer on behalf of the issuer. We believe these securities are highly liquid investments through the related auctions; however, the collateralizing securities have stated terms of up to thirty years. We mitigate default risk by investing in instruments that are rated AAA by Moody s and Fitch Ratings, or equivalent. Our short-term investments are intended to establish a high-quality portfolio that preserves principal, meets liquidity needs, avoids inappropriate concentrations and delivers an appropriate yield in relationship to our investments guidelines and market conditions.

***Foreign Currency Risk***

Prior to the Modus acquisition, the Company had minimal exposure to changes in foreign currency exchange rates, and as such, it had not used derivative financial instruments to manage foreign currency fluctuation risk. As a result of the acquisition of Modus, the Company has added operations in various countries and currencies throughout the world and its operating results and financial position are subject to greater exposure from significant fluctuations in foreign currency exchange rates. Modus historically used derivative financial instruments, principally foreign currency exchange contracts, to manage the exposure that results from such fluctuations, and the Company continues such practice.

International revenues from our foreign operating segments accounted for approximately 64% of total revenues during the three months ended October 31, 2006. A portion of our international sales made by our foreign business units in their respective countries is denominated in the local currency of each country. These business units also incur a portion of their expenses in the local currency.

Primary currencies include Euros, Singapore Dollars, Chinese Yuan Renminbi, Czech Koruna and Taiwan Dollars. The income statements of our international operations are translated into U.S. dollars at the average exchange rates in each applicable period. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency denominated transactions results in increased revenues, operating expenses and net income for our international operations. Similarly, our revenues, operating expenses and net income will decrease for our international operations when the U.S. dollar strengthens against foreign currencies.

We are also exposed to foreign exchange rates fluctuations as we convert the financial statements of our foreign subsidiaries into U.S. dollars in consolidation. When there is a change in foreign currency exchange rates, the conversion of the foreign subsidiaries financial statements into U.S. dollars will lead to a translation gain or loss which is recorded as a component of other comprehensive income (loss). For the three months ended October 31, 2006, we recorded foreign currency translation gains of approximately $0.6 million. In addition, certain of our foreign subsidiaries have assets and liabilities that are denominated in currencies other than the relevant entity s functional currency. Changes in the functional currency value of these assets and liabilities create fluctuations that will lead to a transaction gain or loss. For the three months ended October 31, 2006, we recorded foreign currency transaction losses of approximately $0.5 million which are recorded in other gains (losses), net in our consolidated statements of operations.

Our international business is subject to risks, including, but not limited to differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility when compared to the United States. Accordingly, our future results could be materially adversely impacted by changes in these or other factors. As exchange rates vary, our international financial results may vary from expectations and adversely impact our overall operating results.

**Item 4.** ***Controls and Procedures.***

***Disclosure Controls and Procedures.*** Our management, with the participation of our Chief Executive Officer and Interim Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Interim Chief Financial Officer concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective in ensuring that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Interim Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

***Internal Control Over Financial Reporting.*** There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the fiscal quarter to which this report relates that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

## PART II. OTHER INFORMATION

**Item 1.** ***Legal Proceedings.***

From time to time, we may become involved in litigation relating to claims arising out of operations in the normal course of business, which we consider routine and incidental to our business. We currently are not a party to any legal proceedings, the adverse outcome of which, in management s opinion, would have a material adverse effect on our business, results of operation or financial condition.

**Item 1A.** ***Risk Factors.***

In addition to the other information set forth in this report, including in the first paragraph under Management s Discussion and Analysis of Financial Condition and Results of Operation, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended July 31, 2006, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. Other than with respect to the risk factors below, there have been no material changes from the risk factors disclosed in our Annual Report on Form 10-K. The four risk factors below were disclosed on our Annual Report on Form 10-K and have been updated as of October 31, 2006.

***We may have difficulty achieving and sustaining operating profitability, and if we deplete our working capital balances, our business will be materially and adversely affected.***

During the fiscal quarter ended October 31, 2006, we reported operating income of approximately $5.1 million. While we have reported operating profitability in recent past periods, as a result of a variety of factors discussed in this report, our revenue for a particular quarter is difficult to predict and may fluctuate significantly. We anticipate that we will continue to incur significant operating expenses in the future, including significant costs of revenue and general and administrative expenses. We also have significant commitments and contingencies, including borrowings under a revolving line of credit, real estate leases, continuing stadium sponsorship obligations, and inventory purchase obligations. Therefore, we cannot assure you that we will sustain operating profitability in the future. We may also use significant amounts of cash to grow and expand our operations, including through additional acquisitions. At October 31, 2006, we had a consolidated cash, cash equivalents, marketable securities and short-term investment balance of approximately $222.2 million and fixed contractual obligations of $214.5 million. If we are unable to sustain operating profitability, we risk depleting our working capital balances and our business will be materially adversely affected.

***We derive a substantial portion of our revenue from a small number of clients and adverse industry trends or the loss of any of those clients could significantly damage our business.***

We derive a substantial portion of our revenue by providing supply chain management services to a small number of clients. Our business and future growth will continue to depend in large part on the industry trend towards outsourcing supply chain management and other business processes. If this trend does not continue or declines, demand for our supply chain management services would decline and our financial results could suffer.

In addition, the loss of any one or more of our key clients would cause our revenues to decline. For the three months ended October 31, 2006, sales to Hewlett-Packard and Advanced Micro Devices, accounted for approximately 31% and 11%, respectively, of our consolidated net revenue. During the three months ended October 31, 2006, five clients accounted for approximately 62% of our net revenues. We do not have any agreements which obligate any client to buy a minimum amount of products or services. We do not have any agreements which designate us as the sole supplier of any particular products or services. The loss of a significant amount of business with Hewlett-Packard or any other key clients, or a decision by any one of our key

clients to significantly change or reduce the services we provide, could have a material adverse effect on our business. We cannot assure you that our revenue from key clients will not decline in future periods.

In addition, ModusLink has been designated as an authorized replicator for Microsoft. This designation provides a license to replicate Microsoft software products and documentation for clients who want to bundle licensed software with their hardware products. This designation is annually renewable at Microsoft s discretion. A failure to maintain authorized replicator status could result in a reduction in our business and our revenues.

***We may encounter problems in our efforts to increase operational efficiencies.***

Following our acquisition of Modus in August 2004, we continue to identify ways to increase efficiencies and productivity and effect cost savings. We have undertaken and implemented projects designed to increase our operational efficiencies, including the standardization to a global business solutions platform through the investment of approximately $31.5 million in an Enterprise Resource Planning system. Our cost estimate has increased from our earlier estimates, primarily as a result of changes to our implementation schedule and infrastructure requirements. We have also begun the implementation of a shared services model utilizing centralized hub locations to service multiple spoke locations across the Americas, Asia and Europe regions. We cannot assure you that the completion of these projects will result in the realization of the expected benefits that we anticipate in a timely manner or at all. We may encounter problems with these projects that will divert the attention of management and/or result in additional costs. If we are unable to complete these projects in a timely manner and without significant problems, or do not achieve expected results, our business, financial position and operating results may be adversely affected.

***We are subject to risks of operating internationally.***

We maintain significant operations outside of the United States, and we will likely continue to expand these operations. Our success depends, in part, on our ability to manage and expand our international operations. This international expansion requires significant management attention and financial resources. Our operations will continue to be subject to numerous and varied regulations worldwide, some of which may have an adverse effect on our ability to develop our international operations in accordance with our business plans or on a timely basis.

We currently conduct business in Mexico, China, Taiwan, Singapore, Malaysia, Hungary, Ireland, the Czech Republic, France, The Netherlands and other foreign locations, in addition to our United States operations. International sales accounted for 64% of our total revenue for the three months ended October 31, 2006. A portion of our international revenue, cost of revenue and operating expenses are denominated in foreign currencies. Changes in exchange rates between foreign currencies and the U.S. dollar may adversely affect our operating margins. There is also additional risk if the currency is not freely traded. Some currencies, such as the Chinese Renminbi, are subject to limitations on conversion into other currencies, which can limit or delay our ability to repatriate funds or engage in hedging activities. While we often enter into forward currency exchange contracts to manage a portion of our exposure to foreign currencies, future exchange rate fluctuations may have a material adverse effect on our business and operating results.

There are other risks inherent in conducting international operations, including:

- added fulfillment complexities in operations, including multiple languages, currencies, bills of materials and stock keeping units;
- the complexity of ensuring compliance with multiple U.S. and foreign laws, particularly differing laws on intellectual property rights, export control, taxation and duties; and
- labor practices, difficulties in staffing and managing foreign operations, political and social instability, health crises or similar issues, and potentially adverse tax consequences.

Table of Contents

In addition, a substantial portion of our business is now conducted in China, where we face additional risks, including the following:

- the challenge of navigating a complex set of licensing and tax requirements and restrictions affecting the conduct of business in China by foreign companies;
- difficulties and limitations on the repatriation of cash;
- currency fluctuation and exchange rate risks;
- protection of intellectual property, both for us and our clients;
- evolving regulatory systems and standards; and
- difficulty retaining management personnel and skilled employees.

Our international operations increase our exposure to international laws and regulations. Noncompliance with foreign laws and regulations, which are often complex and subject to variation and unexpected changes, could result in unexpected costs and potential litigation. For example, the governments of foreign countries might attempt to regulate our products and services or levy sales or other taxes relating to our activities; foreign countries may impose tariffs, duties, price controls or other restrictions on foreign currencies or trade barriers; or a governmental authority could make an unfavorable determination regarding our operations, any of which could make it more difficult to conduct our business and have a material adverse effect on our business and operating results.

If we are unable to manage these risks, we may face significant liability, our international sales may decline and our financial results may be adversely affected.

**Item 5.** ***Other Information.***

During the quarter ended October 31, 2006, we made no material changes to the procedures by which stockholders may recommend nominees to our Board of Directors, as described in our most recent proxy statement.

**Item 6.** ***Exhibits.***

The Exhibits listed in the Exhibit Index immediately preceding such Exhibits are filed with, or incorporated by reference in, this report.

Table of Contents

**SIGNATURE**

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.

CMGI, INC.

Date: December 11, 2006

By: /s/ DAVID J. RILEY

**David J. Riley**
**Interim Chief Financial Officer and Treasurer**

35

Table of Contents

**EXHIBIT INDEX**

| | |
|---|---|
| 10.1 | CMGI FY2007 Executive Management Incentive Plan is incorporated herein by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K dated October 11, 2006 (File No. 000-23262). |
| 10.2 | Summary of CMGI FY2007 Performance-Based Restricted Stock Bonus Plain is incorporated herein by reference to Exhibit 10.2 to the Registrant s Current Report on Form 8-K dated October 11, 2006 (File No. 000-23262). |
| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Chief Executive Officer Pursuant to 18 U.S.C Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of the Chief Financial Officer Pursuant to 18 U.S.C Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |