

**QUARTERLY REPORT FOR  
THE THREE MONTHS ENDED  
September 30, 2009**

**LIVEWORLD, INC.**

*(Exact Name of issuer as specified in its charter)*

**Delaware**  
*(State of Incorporation)*

**77-0426524**  
*(IRS Employer Identification No.)*

**4340 Stevens Creek Blvd. Suite 101  
San Jose, California 95129**  
*(Address of principal executive offices)*

**(408) 871-5200**  
*(Company's telephone number)*

**ISSUER'S EQUITY SECURITIES**

**COMMON STOCK**

**\$0.001 Par Value  
100,000,000 Common Shares Authorized  
33,151,981 Shares Issued and Outstanding**

**LIVEWORLD, INC.**  
**UNAUDITED CONDENSED BALANCE SHEETS**  
(In thousands, except share data)

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalent	\$ 1,545	\$ 1,363
Accounts receivable, net	1,094	1,237
Prepaid expenses	152	140
Total current assets	2,791	2,741
Property and equipment, net	326	588
Investment in joint venture	849	837
Other assets	18	5
Total assets	\$ 3,984	\$ 4,170
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$ 214	\$ 121
Accrued employee expenses	436	396
Other accrued liabilities	43	71
Current portion of capital lease obligations	135	177
Current portion of note payable	24	74
Deferred revenue	493	737
Total current liabilities	1,345	1,575
Long-term capital lease obligation	52	145
Total liabilities	1,397	1,720
Stockholders' equity		
Common stock: \$0.001 par value, 100,000,000 shares authorized 33,151,981 issued and outstanding as of December 31, 2008 and September 30, 2009 respectively	33	33
Additional paid-in capital	140,632	140,345
Accumulated deficit	(138,078)	(137,929)
Total stockholders' equity	2,587	2,450
Total liabilities and stockholders' equity	\$ 3,984	\$ 4,170

See accompanying notes to the unaudited financial statements

**LIVEWORLD, INC.**  
**UNAUDITED CONDENSED STATEMENT OF OPERATIONS**  
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Total revenues	\$ 2,549	\$ 2,664	\$ 7,441	\$ 8,758
Cost of revenues	858	1,020	2,428	3,158
Gross Margin	1,690	1,644	5,014	5,600
Operating Expense				
Product development	548	766	1,643	2,393
Sales and marketing	513	715	1,606	2,058
General and administrative	530	682	1,598	2,101
Stock-based compensation	96	104	286	276
Total operating expense	1,687	2,266	5,135	6,827
Income (loss) from operations	3	(622)	(121)	(1,227)
Interest Income (expense), net	(8)	(2)	(28)	24
Other income	----	6	----	----
Loss before tax	(5)	(618)	(149)	(1,204)
Provision for income taxes	2	(1)	(13)	(4)
Equity in net loss of unconsolidated affiliate	10	17	13	(35)
Net income (loss)	7	(602)	(149)	(1,243)
Basic income (loss) per share	\$ 0.00	\$ (0.02)	\$ (0.00)	\$ (0.04)
Shares used in computing basic income (loss) per share	33,151,981	30,862,811	33,151,981	30,862,811
Diluted net income (loss) per share	\$ 0.00	\$ (0.02)	\$ (0.00)	\$ (0.04)
Shares used in computing diluted net income (loss) per share	39,129,214	30,862,811	33,151,981	30,862,811
Departmental allocation of stock-based compensation:				
Product development	\$ 50	\$ 51	\$ 143	\$ 137
Sales and marketing	19	24	66	63
General and administrative	27	28	78	76
Total stock-based compensation	\$ 96	\$ 104	\$ 286	\$ 276

See accompanying notes to the unaudited financial statements

**LIVEWORLD, INC.**  
**UNAUDITED CONDENSED STATEMENTS OF CASH FLOWS**  
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Cash flows from operating activities:				
Net income (loss)	\$ 7	\$ (602)	\$ (149)	\$ (1,243)
Adjustments to reconcile net income (loss) provided by (used in) operating activities:				
Depreciation of long-lived assets	80	149	301	473
Stock-based compensation	96	104	286	276
Equity in net loss of unconsolidated affiliate	(10)	(17)	(12)	35
Changes in operating assets and liabilities:				
Accounts receivable	53	42	143	232
Other assets	30	37	(24)	(73)
Accounts payable	91	(45)	93	(282)
Accrued liabilities	6	(50)	12	40
Deferred revenue	(252)	88	(245)	(44)
Net cash provided by (used in) operating activities	<u>100</u>	<u>(294)</u>	<u>405</u>	<u>(586)</u>
Cash flows from investing activities:				
Purchase of property and equipment	----	(25)	(39)	(253)
Net cash provided by (used in) investing activities	<u>----</u>	<u>(25)</u>	<u>(39)</u>	<u>(253)</u>
Cash flows from financing activities:				
Capital lease financing	(46)	19	(134)	214
Note payable financing	(25)	(67)	(50)	----
Net cash provided by (used for) financing activities	<u>(71)</u>	<u>(48)</u>	<u>(184)</u>	<u>214</u>
Change in cash and cash equivalent	29	(367)	182	(625)
Cash and cash equivalents, beginning of period	<u>1,516</u>	<u>1,762</u>	<u>1,363</u>	<u>2,020</u>
Cash and cash equivalents, end of period	<u>\$ 1,545</u>	<u>\$ 1,395</u>	<u>\$ 1,545</u>	<u>\$ 1,395</u>

See accompanying notes to the unaudited financial statements

## 1. ORGANIZATION

LiveWorld Incorporated (the “Company”) was incorporated in California on April 10, 1996 and reincorporated in Delaware in July 1999. In April 1999 the Company changed its name from LiveWorld Productions to Talk City, Inc. On May 8, 2001, the Company changed its name from Talk City, Inc. to LiveWorld, Inc. The Company’s principal business is the creation and management of social network services as marketing, support and insight solutions for brands. The Company builds and operates central brand community sites, creates brand social presence across Internet social networks, and provides moderation, community management and strategy services.

Clients use our services for loyalty relationship marketing, customer support and business insight. The Company’s clients are a diverse group and include, but are not limited to media, consumer packaged goods, technology, and automobile industries, and most but not all are located in the United States.

## 2. INTERIM FINANCIAL STATEMENTS

The unaudited condensed interim financial information furnished herein reflects all adjustments, consisting only of normal recurring items, which in the opinion of management are necessary to fairly state our financial position, results from operations and cash flows for the dates and periods presented and to make such information presented not misleading. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted; nevertheless, the Company believes that the disclosures herein are adequate to make the information presented not misleading. Operating results for the three months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009 or future periods. The balance sheet, operating results, and statements of cash flows for the periods ended September 30, 2008, December 31, 2008, and September 30, 2009 were neither audited nor reviewed by an independent accounting firm and are subject to change upon such a review or audit being completed.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Revenues* — The Company recognizes revenues in accordance with Staff Accounting Bulletin No. 104, “Revenue Recognition in Financial Statements” (“SAB 104”) when the following criteria have been met: persuasive evidence of an arrangement exists, the fees are fixed or determinable, no obligations remain, and collection of the related receivable is reasonably assured.

The Company has certain contracts which are multiple element arrangements and provide for several deliverables to the customer that may include service development, community set-up, on-line community hosting, on-line community management, moderation services, and consulting. Accordingly, these contracts are accounted for in accordance with Emerging Issues Task Force No. 00-21, “Revenue Arrangements with Multiple Deliverables” (“EITF 00-21”). EITF 00-21 requires that the Company assess whether the different elements qualify for separate accounting. Because the Company does not believe that service development and community set-up activities have value to the customer on a standalone basis, this element does not qualify for separate accounting. Accordingly, fees received from service development and set-up activities are combined with the amounts allocable to the relevant undelivered item(s) within the contract. All other elements qualify for separate accounting and have objective and reliable evidence of fair value.

Revenues from service development and community set-up activities are deferred and are recognized ratably over the related development and service portions of the contract. Revenues from online community hosting, online community management, moderation services, and consulting are recognized as the services are provided.

*Cost of Revenues* – Cost of revenues is comprised of direct costs associated with the sales of online social network and community services to clients; the expense associated with the development, set-up and operation of communities, including expenses associated with server costs for hosting the communities, license fees for specified aspects of our platform used to develop the standard set-up for clients, as well as expenses associated with any custom development the client may desire; and the cost of providing moderators and any enhancements the client may request after the community has been set up. These expenses consist primarily of salaries, payroll taxes, benefits and related expenditures for development, set-up, additional add-on enhancements or upgrades, as well as software license fees, hardware costs, and salary and related moderation expenses.

*Deferred Revenues* — Deferred revenues are the amounts associated with the initial service development and set-up of an online social network and community for our clients. These service development and set-up revenues are paid up-front but recognized ratably as the development and operational service contract is recognized.

*Product Development* — Product development expenses consist primarily of salaries, payroll taxes, benefits and related expenditures for technology, software development, project management and support personnel. Costs related to the development of new products and enhancements to existing products are charged to operations as incurred. Software development costs are required to be capitalized when a product’s technological feasibility has been established by completion of a working model of the product. To date, completion of a working

model of the Company's products and general release have substantially coincided. As a result, the Company has not capitalized any software development costs because such costs have not been significant.

*Sales and Marketing* – Sales and marketing expenses consist primarily of salaries, payroll taxes, benefits and related expenditures for sales and marketing and community management. Community management expenses are costs associated with account management and client services.

*General and Administrative* — General and administrative expenses are the consolidated expenses of the operations, facilities, finance, human resources, legal and other administrative functions. The expenses associated with these functions consist primarily of salaries, payroll taxes, benefits, professional fees, and related expenditures for our overall management and administration.

*Earnings Per Share* — Basic income or loss per share is computed using the net income or loss and the weighted average number of common shares outstanding during the period. Diluted income per share is computed using the net income and the weighted average number of common shares and potential dilutive common shares outstanding during the period. Potential dilutive common shares include, for some or all of the periods presented, outstanding stock options and warrants. The computation of diluted income per share does not assume conversion, or exercise of securities that would have an anti-dilutive effect on earnings. The dilutive effect of outstanding stock options and warrants is computed using the treasury stock method. As of September 30, 2009 there were 23,921,681 outstanding options and warrants to purchase shares of the Company's common stock; and as of September 30, 2008 there were 25,744,052 outstanding options and warrants to purchase shares of the Company's common stock.

The following table sets forth the computation of basic and diluted net income or loss attributable to common stockholders:

<u>In thousands, except per share amounts</u>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Numerator:	\$ 7	\$ (602)	\$ (149)	\$ (1,243)
Net income (loss) attributable to common Stockholders				
Denominator:				
Weighted-average shares used to compute basic EPS	33,152	30,863	33,152	30,863
Effect of dilutive securities:				
Diluted common shares	5,977	----	----	----
Weighted-average shares used to compute diluted EPS	39,129	30,863	33,152	30,863
Net earnings per share:				
Basic	\$ 0.00	\$ (0.02)	\$ (0.00)	\$ (0.04)
Diluted	\$ 0.00	\$ (0.02)	\$ (0.00)	\$ (0.04)

#### 4. STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FAS 123(R) "Share-Based Payment," ("FAS 123(R)") which is a revision of Statement of Financial Accounting Standards No. 123. FAS 123(R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Compensation Arrangements" and amends Statement of Financial Accounting Standards No. 95, "Statement of Cash Flow." FAS 123(R) generally requires share-based payments to employees, including grants of employee stock options and other equity awards, to be recognized in the statement of operations based on their fair values. In addition, FAS 123(R) requires the benefits of tax deductions in excess of recognized compensation expense to be reported as a financing cash flow, rather than as an operating cash flow as prescribed under previous accounting rules.

##### *Determining Fair Value*

*Valuation Method* – The Company estimates the fair value of stock options granted using the Black-Scholes option-pricing model and a single option award approach.

*Expected Term* – The expected term represents the period the Company’s stock-based awards are expected to be outstanding and was determined based on historical experience with similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of its stock-based awards.

*Expected Volatility* — A volatility of 69% was used as an estimate of the expected future volatility of the Company’s common stock.

*Risk-Free Interest Rate* – The risk-free interest rate used in the Black-Scholes valuation method is based on the implied yield currently available on U.S. Treasury securities with an equivalent remaining term.

*Expected Dividend* – No dividends are expected to be paid.

*Estimated Forfeitures* – When estimating forfeitures, the Company considers voluntary termination behavior as well as analysis of actual option forfeitures.

The Company estimated the fair value of its stock options using the Black-Scholes option-pricing model, by using the following assumptions for the options granted during the nine months ended September 30, 2009:

	<b>Stock Options</b>
Dividend yield	0%
Expected volatility	69%
Risk-free interest rate	3.79%
Estimated term	4 Years
Forfeiture rate	19%

A summary of the stock option activity is as follows:

	<b>Shares Available for Grant</b>	<b>Options Outstanding</b>	<b>Weighted Average Exercise Price Per Share</b>	<b>Weighted Average Remaining Contractual Life (in years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Balance as of December 31, 2008	9,274,493	20,354,882	\$ 0.14		
Granted	(110,000)	110,000	\$ 0.06		
Forfeited	181,138	(181,138)	\$ 0.54		
Exercised	----	----	\$ 0.00		
Balance as of September 30, 2009	<u>9,345,631</u>	<u>20,283,744</u>	<u>\$ 0.14</u>	<u>4.7</u>	<u>\$ 485</u>

The aggregate intrinsic value in the table above represents the difference between the exercise price of the underlying awards and the quoted price of our common stock for the options that were in-the-money as of September 30, 2009.

The 1996 Stock Option Plan (“1996 Plan”) provides for stock options to be granted to employees, independent contractors, officers, and directors. Prior to 2004, options were generally granted at an exercise price which approximates eighty-five percent (85%) to one hundred percent (100%) of the estimated fair market value per share at the date of grant, as determined by our Board of Directors. Since 2004, options have generally been granted at one hundred percent (100%) of their estimated fair market value per share at the date of grant, as determined by our Board of Directors. All options issued under the 1996 Plan and the 2007 Stock Option Plan (“2007 Plan”) have a term of ten (10) years, and generally have a vesting schedule such that they vest ratably over four (4) years, twenty-five percent (25%) one (1) year after the grant date and the remainder at a rate of 1/36 per month thereafter. As of December 31, 2005, all outstanding stock options under the 1996 plan were exercisable. The 1996 Plan expired in October of 2006 and was replaced by our 2007 Plan. Under the 2007 Plan, the number of shares authorized for grant is 9,345,631. As of September 30, 2009 there were a total of 20,283,744 outstanding options under the 1996 Plan and the 2007 Plan. As of September 30, 2009, there was approximately \$456,000 of total unrecognized compensation expense related to non-vested stock based compensation arrangements granted under the 1996 Plan and the 2007 Plan, as well as stand alone option grants. The unrecognized compensation cost is expected to be recognized over the next 3.5 years.

## 5. PROPERTY AND EQUIPMENT

Property, furniture and equipment consisted of the following items:

(\$ in thousands)	September 30, 2009	December 31, 2008
Computer equipment	\$ 2,265	\$ 2,264
Software	1,189	1,182
Furniture and fixtures	37	25
Leasehold improvements	23	23
Leased equipment	418	418
Accumulated depreciation	(3,606)	(3,324)
Property, furniture and equipment, net	<u>\$ 326</u>	<u>\$ 588</u>

Depreciation expense was approximately \$607,000 and \$301,000 for the twelve months ended December 31, 2008 and nine months ended September 30, 2009, respectively.

### Management's Discussion and Analysis of Financial Condition and Results of Operation

#### Special Note Regarding Forward-Looking Statements

*This report contains forward-looking statements. All statements other than statements of historical fact contained in this document are forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other comparable terminology. These statements are only current predictions and are subject to known and unknown risks, uncertainties, and other factors that may cause our or our industry's actual results, levels of activity, performance, or achievements to be materially different from those anticipated by the forward-looking statements.*

The balance sheet, operating results, and statements of cash flows for the period ended September 30, 2009, December 31, 2008 and September 30, 2008 were neither audited nor reviewed by an independent accounting firm and are subject to change upon such a review or audit being completed.

#### Overview

We provide Social Brand Flow solutions to brands that enable them to create and manage brand engagement across the social media landscape. Our services and products include: strategy & community relations management, moderation & integration services, building & operating private label central branded community sites as well as building and operating distributed social applications on broad social networks such as Facebook or with our patent pending LiveBar™ application platform. Our clients use these services to generate dialogue and relationships with and among their customers and other constituencies. Clients use these services for loyalty relationship marketing, customer support and business intelligence. Our services consist of the following products delivered on a complete end-to-end or modular basis:

**Social Strategy & Community Relations Management Services:** Social Strategy & Community Relations Management Services include working with brands to develop a social strategy and social view of their brand aligned to business goals, creative, community content programming and client management services to help design, organize, manage, oversee and evolve the feature, content, and user participation aspects of an online community. LiveWorld provides these services for sites using LiveWorld's application platforms, client or 3<sup>rd</sup> Party application platforms and on broad destination social networks such as Facebook.

**Moderation & Interaction Services:** Moderation & Interaction Services include content moderation, social engagement moderation and editorial moderation as well as overall moderation management and moderation reporting. Moderators are trained personnel that read and review user content for adherence to website guidelines, and take appropriate action when content violates those guidelines. Such action might include permitting, hiding (or deleting), or escalating such content to a supervisor. Moderation can also involve trained personnel leading topical discussions, or selecting or editing site content for featured display. LiveWorld provides Moderation Services for sites using LiveWorld's application platforms, client or 3<sup>rd</sup> Party application platforms and on broad destination social networks such as Facebook. When moderating 3<sup>rd</sup> Party or broad destination social networks, LiveWorld does so using client or platform-provided moderation tools or

LiveWorld's advanced moderation tools and systems, depending on the specific client's needs. We provide moderation in 70 country/language combinations

**Central Destination Sites:** We design, develop, host and manage private label central branded community destination sites. Application Hosting includes operating applications on our system infrastructure on behalf of our clients. These sites are based on the LiveWorld Community Center, which is an integrated social network/online community that includes expressive profiles (user name, photo, interests, recent posts, guestbooks and friends lists), message forums, blogs, polls, community showcase galleries, and community calendars. The LiveWorld Community Center is available in three as a standard out of the box package, on a customized basis or as an application development platform. We provide our application platforms in dozens of local languages.

**Distributed Social Networking:** We create and manage brand presence on broad social networks such as Facebook, or across multiple Internet sites. These services include setting up, managing and moderating Facebook pages –using Facebook provided applications or LiveWorld provided applications. In addition our LiveBar distributed social networking application platform is used by brands to add social networking to their content sites or sites they advertise on. LiveBar is a unique new paradigm for social networking that distributes the social applications to be integrated with content pages. We set up, host, community manage and moderate LiveBar social networking.

For a majority of our clients we provide our services through our flagship product, the LiveWorld Community Center, which combines a full range of social networking and community services into an integrated branded community. Our services include working with our clients to develop their basic social networking/community brand definition, their overall site design with an emphasis on the community architecture, development and set-up of the social network/community site, ongoing application hosting operations, moderation, community management and reporting.

For other clients, we provide only the specific modules they request. For example, we may provide moderation services deployed on a client's in-house or third-party platform or alternatively we may simply provide application hosting with the client using our tools to moderate the service themselves. For some clients we only provide message forums and for others we only provide support for live events such as online interactive webcasts.

We offer our services to end-user clients as well as advertising agencies. In 2006 we entered into a non-exclusive joint venture with WPP to market our products and services to WPP clients. Pursuant to this joint venture, WPP has the opportunity to earn warrants to purchase our common stock based on the joint venture's contribution to our total revenue. Although WPP is under no contractual obligation to introduce us to WPP clients, we believe our relationship with WPP provides us access to companies that need and embrace online social networks and community services. We further believe that this relationship enhances our overall market visibility and credibility. Our relationship with WPP is non-exclusive and we enjoy close working partnerships with other agencies such as Digitas and Beam Interactive.

## **Total Revenues**

Our business is primarily based on building recurring revenue streams through the operations of private-label online social network and communities for our clients. Our revenues are derived principally from two sources: (i) service development and set-up revenues, and (ii) operational revenues.

We define service development and set-up revenues as follows: Service development revenues are fees we charge for customizing the standard service we provide to our clients. Set-up revenues are fees we charge for setting up services based on our standard menu of services provided; and we charge add-ons, or enhancements fees for any additional customized work the client requests after we have begun to provide services to the client. Development and set-up revenues are paid up-front but recognized ratably as the development and operational services are provided.

We define operational revenues as follows: Application hosting revenues are fees we charge for hosting a client's community on our servers and these fees are generally based on pageviews per month; community management revenues are fees derived from services provided to the client on a monthly basis to manage the community and the community needs of the customer, generally involving a monthly minimum fee for a specified minimum volume of hours with any additional time being charged at an hourly rate; and moderation revenues are fees we charge our clients for moderating their community. These revenues are recognized monthly as the services are delivered.

## **Cost of Revenues**

Cost of revenues is comprised of direct costs associated with the sales of online social network and community services to clients; the expense associated with the development, set-up and operation of communities, including expenses associated with server costs for hosting the communities, license fees for specified aspects of our platform used to develop the standard set-up for clients, as well expenses associated with any custom development the client may desire; and the cost of providing moderators and any enhancements the client may request after the community has been set up. These expenses consist primarily of salaries, payroll taxes, benefits and related expenditures for

development, set-up, additional add-on enhancements or upgrades, as well as software license fees, hardware costs, and salary and related moderation expenses.

## Operating Expenses

*Product Development.* Product development expenses consist primarily of salaries, payroll taxes, benefits and related expenditures for technology, software development, project management and support personnel. Costs related to the development of new products and enhancements to existing products are charged to operations as incurred.

*Sales and Marketing.* Sales and marketing expenses consist primarily of salaries, payroll taxes, benefits and related expenditures for sales and marketing, and community management. Community management expenses are costs associated with account management and client services.

*General and Administrative.* General and administrative expenses are the consolidated expenses of the operations, facilities, finance, human resources, legal and other administrative functions. The expenses associated with these functions consist primarily of salaries, payroll taxes, benefits, professional fees, and related expenditures for our overall management and administration.

*Stock Based Compensation.* Stock based compensation expenses include amounts related to the grant of options and warrants to employees and non-employee service providers.

## Results From Operations

The following table sets forth our historical operating results as a percentage of total revenues for the periods indicated:

### LIVEWORLD, INC. STATEMENT OF OPERATIONS

	Three Months Ended September 30, <b>2009</b>	Three Months Ended September 30, <b>2008</b>	Nine Months Ended September 30, <b>2009</b>	Nine Months Ended September 30, <b>2008</b>
Total revenues	100%	100%	100%	100%
Cost of revenues	34	38	33	36
Gross Margin	66	62	67	64
Operating Expense				
Product development	21	29	22	27
Sales and marketing	20	27	22	24
General and administrative	21	26	21	24
Stock-based compensation	4	4	4	3
Total operating expense	66	85	69	78
Income (loss) from operations	----	(24)	(2)	(14)
Other income (expense)	----	----	----	----
Income (loss) before tax	----%	(23)%	(2)%	(14)%

## Backlog

We maintain a positive outlook for 2009, and our current backlog for the remainder of the fiscal year is approximately \$2.1 million.

## Three and Nine Months Ended September 30, 2009 and 2008

### Total Revenues

Our revenues for the three months ended September 30, 2009 were approximately \$2.5 million, as compared to \$2.7 million for the three months ended September 30, 2008. This was a reduction of approximately \$115,000 or 4% period-over-period. Revenues decreased primarily as a result of reduced spending and fewer projects from existing clients and fewer new client projects.

For the three months ended September 30, 2009, revenues from eBay comprised 30% of our total revenues and Johnson & Johnson accounted for approximately 9% of our total revenues while all other clients represented approximately 61% of our total revenues. This compares to the three months ended September 30, 2008 where revenues from eBay comprised 27% and Johnson & Johnson accounted for approximately 1% of our total revenues while all other clients represented approximately 72% of our total revenues.

Our revenues for the nine months ended September 30, 2009 were approximately \$7.4 million, as compared to \$8.8 million for the nine months ended September 30, 2008. This was a reduction of approximately \$1.3 million or 15% period-over-period. Revenues decreased primarily as a result of fewer projects from existing clients and fewer new client projects. Over the first nine months of the year, the global economic environment has had an impact on revenues as clients and potential clients have reduced their overall budgets and suspended projects in the short term.

For the nine months ended September 30, 2009, revenues from eBay comprised 29% of our total revenues and Johnson & Johnson accounted for approximately 10% of our total revenues while all other clients represented approximately 61% of our total revenues. This compares to the nine months ended September 30, 2008 where revenues from eBay comprised 26% and the revenues generated from Johnson & Johnson were not material.

### **Cost of Revenues**

Cost of revenues were approximately \$858,000, or 34% of total revenues for the three months ended September 30, 2009, and \$1.0 million or 38% of total revenues for the three months ended September 30, 2008. This represented a decrease of approximately \$162,000 or 24% period-over-period. Cost of revenues for the nine months ended September 30, 2009 were approximately \$2.4 million, or 33% as compared to \$3.2 million, or 36% for the nine months ended September 30, 2008. This represented a decrease of approximately \$730,000, or 23% period-over-period. The reduction in cost of revenues was driven primarily by the reduction moderation expenses, the use of fewer outside consultants to complete projects for our clients, and overall cost reductions by the company.

### **Operating Expenses**

*Product Development.* Expenditures for product development were approximately \$548,000, or 21% of total revenues for the three months ended September 30, 2009, and approximately \$766,000, or 29% of total revenues for the three months ended September 30, 2008. This represented a decrease of approximately \$218,000, or 28% period-over-period. The decrease was driven by reducing our dependency on outside contractors, as well as, reducing our overall employee cost.

For the nine months ended September 30, 2009, expenditures for product development were approximately \$1.6 million or 22% of total revenues. This compares to \$2.4 million, or 27% for the nine months ended September 30, 2008 or 27% of total revenues. This represented a cost savings of approximately \$750,000 or 31% period-over-period. The decrease was driven by reducing our dependency on outside contractors, as well as reducing our overall employee cost.

The majority of product development costs are personnel related. We are committed to our product development efforts and expect product development expense will remain relatively flat in absolute dollar terms in the near future but could fluctuate as a percentage of revenues. Such efforts may not result in additional new services and any new services may not generate sufficient revenues, if any, to offset expenses.

*Sales and Marketing.* Sales and marketing costs were approximately \$513,000, or 20% of total revenues for the three months ended September 30, 2009, and \$715,000, or 27% of total revenues for the three months ended September 30, 2008 representing a decrease of approximately \$202,000 or 28% period-over-period. The period-over-period decrease in sales and marketing expenses was a result of a decrease in overall employee costs associated with our community management group, as well as an overall reduction in marketing expenses.

For the nine months ended September 30, 2009 costs related to sales and marketing were approximately \$1.6 million or 22% of total revenues. This compares to \$2.1 million for the nine months ended September 30, 2008 or 24% of total revenues. This represented a cost savings of approximately \$452,000 or 22% period-over-period. The period-over-period decrease in sales and marketing expenses was a result of a decrease in overall employee costs associated with our community management group, as well as, the overall reduction in marketing expenses.

The substantial majority of sales and marketing expenses are associated with our ongoing community management services, which are the costs associated with the servicing of existing clients, as opposed to those costs derived from new business development. Expenses from sales and marketing activities to attract new clients have been minimal. We expect sales and marketing costs to be relatively flat in absolute dollar terms, and will fluctuate as a percentage of total revenues. If our product development efforts are successful and new products or services are created, we may incur increased sales and marketing expense to promote these products or services to new and existing clients.

*General and Administrative.* General and administrative expenses were approximately \$530,000, or 21% of total revenues for the three months ended September 30, 2009, and \$682,000, or 26% of total revenues for the three months ended September 30, 2008. This represented a decrease of approximately \$152,000, or 22% period-over-period. The decrease in general and administrative expenses period-over-period was related to the elimination of outside advisory costs associated with the filing of quarterly reports with the SEC.

For the nine months ended September 30, 2009 general and administrative expenses were approximately \$1.6 million or 21% of total revenues. This compares to approximately \$2.1 million, or 24% of total revenues for the nine months ended September 30, 2008. This represented a cost savings of approximately \$503,000 or 24% period-over-period. The vast majority of the cost savings was related to the elimination of outside advisory costs and a reduction in employee related expenses. We anticipate that general and administrative expenses to remain relatively flat in absolute terms, and will fluctuate as a percentage of total revenues

### **Financial Condition, Liquidity and Capital Resources**

Our total assets were approximately \$4.0 million as of September 30, 2009, and \$4.2 million as of December 31, 2008. This represented a decrease of approximately \$186,000 or 4% of total assets. Our cash and cash equivalents were \$1.5 million as of September 30, 2009 which is an increase of approximately \$182,000 or 13% from the cash and cash equivalents balances of approximately \$1.4 million as of December 30, 2008. This increase was a result of our reduction in overall operating expenses, and tighter controls of and accounts receivables.

Accounts receivable was approximately \$1.1 million as of September 30, 2009 which is a decrease of approximately \$143,000 or 12% from the accounts receivable balance of approximately \$1.2 million as of December 30, 2008. We believe accounts receivable balances will fluctuate with the levels of new client acquisition and enhancement activity.

Property and equipment decreased approximately \$262,000 to \$326,000 as of September 30, 2009 from \$588,000 as of December 31, 2008. For the remainder of 2009 we do not anticipate a material increase in capital spending, therefore we expect property and equipment will continue to decrease in the short term.

Our current assets, which are made up of cash and cash equivalents, accounts receivable, and prepaid expenses as of September 30, 2009 were approximately \$2.8 million while our current liabilities, which are made up of our accounts payable, accrued liabilities and current portions of long-term liabilities were approximately \$1.3 million. This represented a positive working capital position of approximately \$1.4 million, which was an increase of approximately \$280,000 from the period ended December 31, 2008. Additionally, our current assets are approximately \$1.4 million greater than our total liabilities as of September 30, 2009, which represented an increase of approximately \$373,000 from the period ended December 31, 2008.

For the three months ended September 30, 2009 we had positive total cash flows of approximately \$29,000 while for the three months ended September 30, 2008 we had negative total cash flows of approximately \$367,000. This represented an increase in our total cash flows of approximately \$396,000 period-over-period.

For the nine months ended September 30, 2009 we had positive total cash flows of approximately \$182,000 while for the nine months ended September 30, 2008 we had negative total cash flows of approximately \$626,000. This represented an increase in our total cash flows of approximately \$808,000 period-over-period. The primary reason for the improvement in total cash flows for both the three month and nine months ended September 30, 2009 was the reduction in overall operating expenses, improved working capital management which was offset by a reduction in revenues.

We believe that the combination of cash balances, cash flow from operations, and available credit facilities will be sufficient to satisfy cash needs for the current level of operations and planned operations for at least the next twelve months.

In the future, we may strategically seek to take advantage of opportunities in the equity and capital markets to raise additional funds in order to take advantage of opportunities that may become available to us, including expansion of operating activities and acquisition of businesses, products or technologies, or otherwise to respond to competitive pressures. There can be no assurance that we will be able to raise additional capital on favorable terms or at all.

Our non-GAAP net income or earnings before interest, taxes, depreciation and amortization, and non-cash stock-based compensation (“Adjusted EBITDA”), were approximately \$189,000, or 7% of total revenues for the three months ended September 30, 2009 as compared to an Adjusted EBITDA loss of approximately \$352,000, or 13% of total revenues for the three months ended September 30, 2008. The increase in Adjusted EBITDA of approximately \$541,000 period-over-period was primarily due to the improvement in the net income for the three months ended September 30, 2009 as compared to the three months ended September 30, 2008.

For the nine months ended September 30, 2009 Adjusted EBITDA was approximately \$479,000 or 6% of total revenues. This compares to an Adjusted EBITDA loss of approximately \$514,000 for the nine months ended September 30, 2008. The increase in Adjusted EBITDA of approximately \$993,000 is primarily due to the reduction in the reported net loss period-over-period.

We define Adjusted EBITDA as net income or (loss) excluding net interest income, income taxes, depreciation and amortization, and non-cash stock-based compensation expense. The following table reconciles Adjusted EBITDA to the reported net income or loss:

**LIVEWORLD**  
**RECONCILIATION OF ADJUSTED EBITDA TO NET LOSS**  
(In thousands)

\$ in 000's	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Reported net income (loss)	\$ 7	\$ (602)	\$ (149)	\$ (1,243)
Depreciation and amortization	80	149	301	473
Stock-based compensation	96	104	286	276
Interest income, net	8	(4)	28	(24)
Provisions for income taxes	(2)	1	13	4
Adjusted EBITDA	<u>\$ 189</u>	<u>\$ (352)</u>	<u>\$ 479</u>	<u>\$ (514)</u>

Adjusted EBITDA does not represent funds available for management’s discretionary use and is not intended to represent cash flow from operations. Adjusted EBITDA has limitations and should not be construed as a substitute for net income loss or as a better measure of liquidity than cash flows from operating activities, which are determined in accordance with United States Generally Accepted Accounting Principles (“GAAP”) and therefore Adjusted EBITDA should only be used as supplemental information. Adjusted EBITDA excludes components that are significant in understanding and assessing our results of operations and cash flows. In addition, Adjusted EBITDA is not a term defined by GAAP and as a result, our measure of Adjusted EBITDA might not be comparable to similarly titled measures used by other companies.

However, Adjusted EBITDA is used by management to evaluate, assess and benchmark our performance as a service provider. We believe understanding the costs directly related to the delivery of our services is beneficial to the management of the Company. Adjusted EBITDA is relevant and useful information, which is often reported and widely used by analysts, investors and other interested parties as a measurement of the delivery of a product or service. Accordingly, we are disclosing this information to permit a more comprehensive analysis of our operating performance, to provide an additional measure of performance and liquidity and to provide additional information with respect to our ability to meet future debt service, capital expenditure and working capital requirements.

Our Adjusted EBITDA financial information is also comparable to net cash provided by operating activities. The table below reconciles Adjusted EBITDA to the GAAP disclosure of net cash provided (used in) operating activities:

**LIVEWORLD**  
**RECONCILIATION OF ADJUSTED EBITDA TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES**  
(In thousands)

\$ in 000's	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net Cash Provided by (used in) operating activities	\$ 100	\$ (294)	\$ 405	\$ (587)
Interest income, net	8	(4)	28	(24)
Taxes	(2)	1	13	4
Equity in net loss of unconsolidated affiliate	10	17	12	(35)
Changes in accounts receivable	(53)	(42)	(143)	(232)
Changes in other assets	(30)	(37)	24	73
Changes in accounts payable	(91)	45	(93)	282
Changes in accrued liabilities	(6)	50	(12)	(40)
Changes in deferred revenues	252	88	245	44
Adjusted EBITDA	<u>\$ 189</u>	<u>\$ (352)</u>	<u>\$ 479</u>	<u>\$ (514)</u>

The reconciliation of Adjusted EBITDA to net cash provided by (used in) operating our Company should be viewed as supplemental information to our statement of cash flows and not as a substitute.

**LIVEWORLD, INC.**  
**UNAUDITED CONDENSED STATEMENTS OF CASH FLOWS**  
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Cash flows from operating activities:				
Net income (loss)	\$ 7	\$ (602)	\$ (149)	\$ (1,243)
Adjustments to reconcile net income (loss) provided by (used in) operating activities:				
Depreciation of long-lived assets	80	149	301	473
Stock-based compensation	96	104	286	276
Equity in net loss of unconsolidated affiliate	(10)	(17)	(12)	35
Changes in operating assets and liabilities:				
Accounts receivable	53	42	143	232
Other assets	30	37	(24)	(73)
Accounts payable	91	(45)	93	(282)
Accrued liabilities	6	(50)	12	40
Deferred revenue	(252)	88	(245)	(44)
Net cash provided by (used in) operating activities	<u>100</u>	<u>(294)</u>	<u>405</u>	<u>(586)</u>
Cash flows from investing activities:				
Purchase of property and equipment	----	(25)	(39)	(253)
Net cash provided by (used in) investing activities	<u>----</u>	<u>(25)</u>	<u>(39)</u>	<u>(253)</u>
Cash flows from financing activities:				
Capital lease financing	(46)	19	(134)	214
Note payable financing	(25)	(67)	(50)	----
Net cash provided by (used for) financing activities	<u>(71)</u>	<u>(48)</u>	<u>(184)</u>	<u>214</u>
Change in cash and cash equivalent	29	(367)	182	(625)
Cash and cash equivalents, beginning of period	1,516	1,762	1,363	2,020
Cash and cash equivalents, end of period	<u>\$ 1,545</u>	<u>\$ 1,395</u>	<u>\$ 1,545</u>	<u>\$ 1,395</u>

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. Additionally, we are not a party to any derivative contracts or synthetic leases.