

2008 Annual Report

For the Year Ended December 31, 2008

LIVEWORLD, INC.

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)

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

	Unaudited December 31, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalent	\$ 1,363	\$ 2,020
Accounts receivable, net	1,237	1,394
Prepaid expenses	140	82
Other current assets	----	8
Total current assets	<u>2,741</u>	<u>3,504</u>
Property and equipment, net	588	908
Investment in joint venture	837	817
Other assets	5	5
Total assets	<u>\$ 4,170</u>	<u>\$ 5,234</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 121	\$ 555
Accrued employee expenses	396	460
Other accrued liabilities	71	130
Current portion of capital lease obligations	177	100
Current portion of note payable	74	----
Deferred revenue	737	727
Total current liabilities	<u>1,575</u>	<u>1,972</u>
Long-term capital lease obligation	145	150
Total liabilities	<u>1,720</u>	<u>2,122</u>
Stockholders' equity		
Common stock: \$0.001 par value, 100,000,000 shares authorized 30,862,811 issued and outstanding at December 31, 2007 and 33,151,981 at December 31, 2008, respectively	33	31
Additional paid-in capital	140,345	139,932
Accumulated deficit	(137,929)	(136,851)
Total stockholders' equity	<u>2,450</u>	<u>3,112</u>
Total liabilities and stockholders' equity	<u>\$ 4,170</u>	<u>\$ 5,234</u>

See accompanying notes to the unaudited financial statements

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

	<u>Three Months Ended</u> <u>December 31,</u>		<u>Year Ended</u> <u>December 31,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Total revenues	\$ 3,003	\$ 2,977	\$ 11,761	\$ 10,863
Cost of revenues	1,035	1,342	4,193	4,368
Gross Margin	1,968	1,635	7,568	6,495
Operating Expense				
Product development	610	835	3,003	2,804
Sales and marketing	602	633	2,660	2,463
General and administrative	544	680	2,644	3,296
Stock based compensation	97	76	373	293
Total operating expense	1,853	2,224	8,680	8,856
Income (loss) from operations	115	(589)	(1,112)	(2,361)
Interest Income (expense), net	(5)	24	19	162
Income (loss) before tax	110	(565)	(1,093)	(2,199)
Provision for income taxes	----	----	(4)	(14)
Equity in net gain / (loss) of unconsolidated affiliate	55	(19)	20	(161)
Net income (loss)	165	(584)	(1,078)	(2,373)
Basic net income (loss) per share	\$ 0.01	\$ (0.02)	\$ (0.03)	\$ (0.08)
Shares used in computing basic income (loss) per share	31,396,951	30,862,811	30,996,346	30,785,005
Diluted net income (loss) per share	\$ 0.00	\$ (0.02)	\$ (0.03)	\$ (0.08)
Shares used in computing diluted income (loss) per share	36,894,111	30,862,811	30,996,346	30,785,005
Departmental allocation of stock-based compensation:				
Product development	\$ 49	\$ 36	\$ 186	\$ 143
Sales and marketing	22	16	85	60
General and administrative	26	24	102	90
Total stock-based compensation	\$ 97	\$ 76	\$ 373	\$ 293

See accompanying notes to the unaudited financial statements

LIVEWORLD, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2006, 2007, and 2008
(In thousands, except share data)

	<u>Common Stock</u> <u>Share</u>	<u>Amount</u>	<u>Additional</u> <u>Paid-in</u> <u>Capital</u>	<u>Accumulated</u> <u>Deficit</u>	<u>Stockholders'</u> <u>Equity</u>
Balance December 31, 2006	30,682,811	\$ 31	\$ 139,589	\$ (134,478)	\$ 5,142
Common stock options exercised	180,000	0	49		50
Stock-based compensation			293		293
Net income (loss)				(2,373)	(2,373)
Balance December 31, 2007	30,862,811	31	139,932	(136,851)	3,112
Common stock options exercised	2,289,170	2	32		35
Stock-based compensation			373		373
Warrants			8		8
Net income (loss)				(1,078)	(1,078)
Balance December 31, 2008	<u>33,151,981</u>	<u>\$ 33</u>	<u>\$ 140,345</u>	<u>\$ (137,929)</u>	<u>\$ 2,450</u>

See accompanying notes to the unaudited financial statements

LIVEWORLD, INC.
UNAUDITED CONDENSED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended December 31,		Year Ended December 31,	
	2008	2007	2008	2007
Cash flows from operating activities:				
Net income (loss)	\$ 165	\$ (584)	\$ (1,078)	\$ (2,373)
Adjustments to reconcile net income (loss) provided by (used in) operating activities:				
Depreciation of long-lived assets	133	162	607	619
Stock-based compensation	97	76	373	293
Equity in net loss of unconsolidated affiliate	(55)	19	(20)	160
Changes in operating assets and liabilities:				
Accounts receivable	(74)	(236)	157	(172)
Accrued development and setup	----	----	----	72
Other assets	22	60	(51)	(31)
Accounts payable	(152)	(56)	(434)	212
Accrued liabilities	(162)	39	(122)	114
Deferred revenue	54	236	10	200
Net cash provided by (used in) operating activities	<u>28</u>	<u>(283)</u>	<u>(558)</u>	<u>(906)</u>
Cash flows from investing activities:				
Purchase of property and equipment	(33)	(76)	(287)	(417)
Net cash provided by (used in) investing activities	<u>(33)</u>	<u>(76)</u>	<u>(287)</u>	<u>(417)</u>
Cash flows from financing activities:				
Capital lease financing	(45)	57	72	76
Proceeds from exercise of stock options	32	-	32	50
Note payable financing	(24)	-	74	-
Net cash provided by (used for) financing activities	<u>(37)</u>	<u>57</u>	<u>180</u>	<u>126</u>
Change in cash and cash equivalent	(32)	(302)	(657)	(1,197)
Cash and cash equivalents, beginning of period	1,395	2,322	2,020	3,217
Cash and cash equivalents, end of period	<u>\$ 1,363</u>	<u>\$ 2,020</u>	<u>\$ 1,363</u>	<u>\$ 2,020</u>

See accompanying notes to the unaudited financial statements

LIVEWORLD, INC.
NOTES TO FINANCIAL STATEMENTS
FOR THE FISCAL YEARS ENDED 2007 and 2008

1. ORGANIZATION

LiveWorld Incorporated (the “Company”) was incorporated in California in April 1996 and reincorporated in Delaware in July 1999. In April 1999 the Company changed its name from LiveWorld Productions to Talk City, Inc. In May 2001, the Company changed its name from Talk City, Inc. to LiveWorld, Inc. The Company’s principal business is to build, operate and moderate private label online social network and community services for clients who 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. 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. 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 applications hosting, on-line 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-ons enhancements or upgrades, as well as, software license fees, hardware costs, and salary and related moderation expenses.

Deferred Revenues — Deferred revenues are the amount associated with the initial service development and set-up of the community for our clients. These service development and set-up revenues are paid upfront 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, as well as the community management which 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 dilutive potential 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. In 2007 there were 23,689,277 outstanding options and warrants to purchase shares of the Company's common stock; and in 2008 there were 22,354,882 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:

In thousands, except per share amounts	December 31,	
	2008	2007
Numerator:		
Net income (loss) attributable to common Stockholders	\$ (1,078)	\$ (2,373)
Denominator:		
Weighted-average shares used to compute basic EPS	30,996	30,805
Effect of dilutive securities:		
Diluted common shares	----	----
Weighted-average shares used to compute diluted EPS	<u>30,996</u>	<u>30,805</u>
Net earnings per share:		
Basic	<u>\$ (0.03)</u>	<u>\$ (0.08)</u>
Diluted	<u>\$ (0.03)</u>	<u>\$ (0.08)</u>

The outstanding options and warrants of 23,689,277 and 22,354,882 for 2007 and 2008 respectively are excluded from the determination of diluted net loss per share as their effect is anti-dilutive.

Concentrations of Credit Risk — Financial instruments which potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents and accounts receivable. Cash and cash equivalent balances consist of deposits and money market funds held with a local commercial bank. Deposits in the United States may exceed federally insured limits. Management believes that the financial institutions that hold the Company's investments are financially credit worthy and, accordingly, minimal credit risk exists with respect to those investments.

The Company's accounts receivable are derived primarily from customers who have signed contracts with the Company, for the Company to provide Community venues for the customer. The Company performs ongoing credit evaluations of its customers, does not require collateral and does maintain allowances for potential credit losses when deemed necessary. In 2007 AOL US and eBay accounted for 13% and 31% of total revenues respectively; in 2008 AOL US and eBay accounted for 0% and 25% of total revenues respectively, and no other client represented greater than 10% of total revenues for the Company in either year.

Comprehensive Income or Loss — The Company has no significant components of other comprehensive income or loss, and accordingly, the comprehensive income or loss is the same as the net income or loss for all periods.

Allowances for Doubtful Accounts — The Company's allowance for accounts uncollectible has been approximately \$0 in 2007 and 2008 respectively. The Company maintains an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unable to make required payments. Management specifically analyzes the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payments terms when making estimates of the un-collectability of the Company's accounts receivable balances. If the Company determines that the financial conditions of any of its customers deteriorated, whether due to customer specific or general economic issues, an increase in the allowance will be made. Accounts receivable are written off when all collection attempts have failed.

Use of Estimates — The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Segment Reporting — The Company has one operating segment because it is not organized by multiple segments for purposes of making operating decisions or assessing performance. The chief operating decision maker evaluates performance, makes operating decisions, and allocates resources based on financial data consistent with the presentation in the accompanying financial statements.

3. STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FAS 123(R) “Share-Based Payment,” 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.

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.

For the year ended December 31, 2008 we issued a total of 2,657,000 options with an approximate fair value of \$287,000 for the option grants, and total expense for the period was approximately \$65,000.

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 three months ended December 31, 2008:

	Stock options
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:

	Shares Available for Grant	Options Outstanding	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Balance as of December 31, 2007	10,229,268	21,689,277	\$ 0.14		
Granted	(2,657,000)	2,657,000	\$ 0.21		
Forfeited	1,702,225	(1,702,225)	\$ 0.16		
Exercised	----	(2,289,170)	\$ 0.02		
Balance as of December 31, 2008	<u>9,274,493</u>	<u>20,354,882</u>	<u>\$ 0.14</u>	<u>5.4</u>	<u>\$82</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 December 31, 2008.

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 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 10,696,768. As of December 31, 2008 there were a total of 20,354,882 outstanding options under the 1996 Plan and the 2007 Plan. As of December 31, 2008, there was approximately \$739,000 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 cost is expected to be recognized over the next 4.5 years.

4. PROPERTY AND EQUIPMENT

Property, furniture and equipment consisted of the following items:

(\$ in thousands)	December 31, 2008	December 31, 2007
Computer equipment	\$ 2,264	\$ 2,198
Software	1,182	1,119
Furniture and fixtures	25	24
Leasehold improvements	23	----
Leased equipment	418	285
Accumulated depreciation	(3,324)	(2,718)
Property, furniture and equipment, net	<u>\$ 588</u>	<u>\$ 908</u>

The depreciation expense was approximately \$619,000 and \$607,000 for the twelve months ended December 31, 2007 and 2008, respectively.

5. CAPITAL LEASE AGREEMENT

Master Lease Agreement — In October of 2006 the Company entered into a master lease agreement for equipment with Bank of America. The total available line was \$800,000, and the company terminated this lease agreement in August of 2008. As of December 31, 2008 the Company has committed to approximately \$350,000 of equipment on the lease agreement with payments of approximately \$16,200 per month.

As of December 31, 2008, the future minimum lease payments under non-cancelable capital leases are as follows:

Year Ending December 31,	Capital Lease Obligations
2008	\$ 193
2009	122
2010	35
Total minimum lease payments	350
Less amounts representing interest	(27)
Present value of capital lease obligations	322
Less current portion	(177)
Long-term maturities	<u>\$ 145</u>

6. EQUITY INVESTMENT

In July 2006, the Company entered into a non-exclusive joint venture with WPP where each party is a 50% owner in the joint venture (see Note 7). Pursuant to the joint venture we formed a limited liability company, LiveWorld-WPP, L.L.C., to market and sell our products and services to WPP clients with and/or through WPP agencies. Upon the setting up of the joint venture and the hiring of a Chief Executive Officer of the joint venture each partner made a capital contribution of \$250,000 to joint venture.

The Company has reviewed its operations to determine if the LiveWorld-WPP entity is required to be consolidated under FIN 46-R. As a result of this review, the Company did not consolidate its investment in the LiveWorld-WPP, L.L.C. and instead uses the equity method to recognize its investment in the joint venture.

7. STOCKHOLDER'S EQUITY

Common Stock - The Company had 100,000,000 shares of common stock authorized and 30,862,811 shares of common stock issued and outstanding for the fiscal year end December, 31 2007 and 33,151,981 shares of common stock issued and outstanding for the fiscal year end December, 31 2008.

In December of 2008 the Chairman and Chief Executive Officer, Peter H. Friedman exercised 2,289,170 options, when combined with the 708,160 shares he previously owned his ownership in the Company increased to 9% of the total shares outstanding as of December 31, 2008.

Warrants - In July 2006, the Company entered into a joint venture with WPP. Pursuant to the joint venture the Company formed an L.L.C., LiveWorld-WPP, L.L.C., to market and sell LiveWorld products and services to WPP clients with and/or through WPP agencies. WPP group PLC is one of the world's leading marketing and communications firms and includes in its company portfolio JWT, Ogilvy & Mather Worldwide, Y&R, The Voluntarily United Group, Grey Worldwide, MindShare, MediaCom, Mediaedge:cia, Millward Brown, Research International, KMR Group, OgilvyOne Worldwide, Wunderman, 141 Worldwide, Hill & Knowlton, Ogilvy Public Relations Worldwide, Burson-Marsteller, Cohn & Wolfe, CommonHealth, Sudler & Hennessey, Ogilvy Healthworld, Enterprise IG, Landor and Fitch among others.

LiveWorld and WPP each contributed \$250,000 to fund the joint venture's operations. In addition, the Company entered into an agreement that provides for the granting of a substantial number of warrants to WPP to purchase common stock. Specifically, at the formation of the joint venture WPP was granted a warrant to purchase 1,000,000 shares of common stock at a per share exercise price of \$1.00 and an additional warrant to purchase 1,000,000 shares of Common Stock at a per share exercise price of \$1.10. The warrants are exercisable for a period of ten years. The fair value of the warrants was deemed to be approximately \$761,000. The fair value of warrants was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: (i) a dividend yield of zero percent (0%) for all periods; (ii) expected volatility of one hundred percent (100%); (iii) risk-free interest rate of five point fourteen percent (5.14%); (iv) an expected life of ten (10) years. These warrants were issued as an incentive for WPP to enter into the joint venture with the Company, and were capitalized as part of the investment in the joint venture.

WPP has been granted the opportunity to earn a substantial number additional warrants based on the performance of the joint venture in generating revenue for LiveWorld for each of the years 2007, 2008, 2009, and 2010. Under these terms, WPP might earn additional warrants based on the percentage of LiveWorld's revenue that is attributable to the joint venture and the number of shares of capital stock outstanding or issuable upon the exercise or conversion of other securities.

For 2007, there was not a warrant issued to WPP. For 2008, there was a warrant issued for 1,637,937 shares of common stock with a strike price of \$1.20 per share. The aggregate number of warrants issued to date to WPP cannot exceed 20% of the number of shares of LiveWorld stock that is then outstanding or issuable upon the exercise of all outstanding options and warrants and the conversion of all convertible securities for 2008; that limit increases to 30%, and for 2009. In 2010, the maximum total number of warrants that may be required to be issued under this relationship is 53% of the fully diluted share count of the company.

8. RETIREMENT PLAN

The Company sponsors a 401(k) savings and retirement plan for substantially all of its employees in the United States. Employees meeting the eligibility requirements may contribute specified percentages of their salaries to this plan up to a statutory maximum amount. Under the plan, which is qualified under Section 401(k) of the federal tax laws, the Company's Board of Directors, in its sole discretion, may make discretionary matching contributions to the plan. To date, the Company has not made any contributions to the plan.

9. SUBSEQUENT EVENT

In February WPP was granted a warrant to purchase 1,637,937 shares of common stock at a per share exercise price of \$1.20. The warrant is exercisable for a period of ten years. The fair value of the warrants was deemed to be approximately \$8,000. The fair value of warrants was estimated at the date of grant using the Black-Scholes option pricing model. The warrant was expensed as part of the Company's General and Administrative expense in the fourth quarter of 2008.

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 following discussion and analysis should be read in conjunction with our financial statements and the notes to those statements included elsewhere in this report. This discussion contains forward-looking statements reflecting our current expectations that involve risks and uncertainties. Actual results may differ materially from those discussed in these forward-looking statements due to a number of factors, including those set forth in the section entitled "Risk Factors" contained in our 2007 Form 10-K.

The balance sheet, operating results, and statements of cash flows for the period ended December 31, 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 build, operate (application hosting), and moderate private label online social network and community services for clients who 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:

Professional Services: Professional Services include development and set-up of standard systems; customization of the standard system and internationalization and localization. Professional Services also include brand strategy and community consulting and design services that provide expertise in developing social networking/community brand definition, web site design focusing on community architecture, and online community management.

Application Hosting: Application Hosting includes operating applications on our system infrastructure on behalf of our clients. These applications include:

- The LiveWorld Community Center, which is an integrated social network/online community that includes expressive profiles (user name, photo, interests, guestbooks and friends lists), message forums, blogs, photo albums, user video, polls, community galleries, and community calendars.
- Standalone services such as blogs, user videos, message forums, groups, chats and live events (interactive webcasts).

Community Management Services: Community Management Services include creative, community programming and client management services to help design, organize, manage, oversee and evolve the feature, content, and user participation aspects of an online community.

Moderation Services: Moderation Services include content moderation, social engagement and editorial moderation. Moderators are trained personnel that read and view user content for adherence to web site 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.

Reporting Services: Reporting Services provide clients with metrics and analysis of the online community.

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 setup 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, with our Moderation Server 2.0 product 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.

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) operations revenues.

We define service development and set-up revenues work 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 the 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 our client. Development and set-up revenues are paid upfront but recognized ratably as the development and operational services are provided.

We define operation revenues as follows: Application hosting revenues are fees we charge for hosting their 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 on 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-ons 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, as well as the community management, which 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

	<u>Three Months Ended</u> <u>December 31,</u>		<u>Year Ended</u> <u>December 31,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Total revenues	100%	100%	100%	100%
Cost of revenues	34	45	36	40
Gross Margin	66	55	64	60
Operating Expense				
Product development	20	28	26	26
Sales and marketing	20	21	23	23
General and administrative	18	23	22	30
Stock based compensation	3	3	3	3
Total operating expense	62	75	74	82
Income (loss) from operations	4	(20)	(10)	(22)
Other income (expense)	----	1	----	1
Income (loss) before tax	4%	(19)%	(10)%	(22)%

Backlog

We maintain a positive outlook for 2009, and our current backlog for the remainder of the fiscal year is approximately \$6.8 million.

Three Months Ended and Twelve Months Ended December 31, 2007 and 2008

Total Revenues

Our revenues were flat for the three months ended December 31, 2008 when compared to the three months ended December 31, 2007 as both periods were approximately \$3.0 million. Total revenues were flat primarily as a result of the reduction of Total AOL Revenues which represented approximately \$460,000 and \$0 for the three months ended December 31, 2007 and 2008 respectively. This loss of revenues was offset by increased sales of services to new and existing clients other than AOL, this represented growth of approximately 19% period-over-period, or approximately \$486,000 from \$2.5 million to \$3.0 million. We define Total AOL Revenues as revenues earned from both the AOL US and the AOL UK business units.

For the three months ended December 31, 2007, revenues from AOL comprised approximately 19% of our total revenues and eBay accounted for approximately 31% of our total revenues while all other clients represented approximately 50% of our total revenues. For the three months ended December 31, 2008, revenues from AOL comprised 0% of our total revenues and eBay accounted for approximately 23% of our total revenues while all other clients represented approximately 77% of our total revenues.

Revenues from clients excluding AOL and eBay were approximately \$1.6 million for the three months ended December 31, 2007 and were approximately \$2.3 million for the three months ended December 31, 2008. This represented a 45% growth rate period-over-period.

Our revenues increased from approximately \$10.9 million for the twelve months ended December 31, 2007 to \$11.8 million for the twelve months ended December 31, 2008, representing an increase of approximately 8% year-over-year. Revenues increased primarily as a result of increased sales of services to our non-AOL clients, which represented growth of approximately 38% year-over-year, or approximately \$3.3 million from \$8.5 million to \$11.8 million which was offset in part by the decrease in AOL revenues which dropped from approximately \$2.3 million for the twelve months ended December 31, 2007 to \$0 for the twelve months ended December 31, 2008.

For the twelve months ended December 31, 2007, revenues from AOL comprised approximately 22% of our total revenues and eBay accounted for approximately 31% of our total revenues while all other clients represented approximately 47% of our total revenues. For the twelve months ended December 31, 2008, revenues from AOL comprised 0% of our total revenues and eBay accounted for approximately 25% of our total revenues while all other clients represented approximately 75% of our total revenues.

Revenues from clients excluding AOL and eBay were approximately \$5.2 million for the twelve months ended December 31, 2007 and were approximately \$8.9 million for the twelve months ended December 31, 2008. This represented a 71% growth rate period-over-period.

Operating Expenses

In the fourth quarter of 2008 we took steps to reduce the overall expenses of the company and align our operating expenses with our current opportunities in the market place. We determined it was necessary to reduce our headcount, overall payroll expenses, and other operational spending. We achieved these reductions by reducing our dependency on outside contractors, which augmented our Product Development group, as well as other third party service providers. Additionally, we reduced salary where the average reduction was approximately 8% of the annual base salary. While the average for the employee base was approximately 8% the executives of the company each took a reduction of 33% of their base salary. We are also considering an incentive compensation program which will be based on the financial and overall performance of the company. We believe as a result of taking these actions the total cost savings for the company will be approximately \$1.7 million annually.

Product Development. Expenditures for product development were approximately \$835,000, or 28% of total revenues for the three months ended December 31, 2007, and approximately \$610,000 or approximately 20% of total revenues for the three months ended December 31, 2008. This represented a decrease in absolute dollars of approximately \$225,000, or 27% period-over-period. This decrease was driven by reducing our dependency on outside contractors, as well as, reducing our overall employee cost.

Product development costs were approximately \$2.8 million, or 26% of total revenues for the twelve months ended December 31, 2007, and approximately \$3.0 million or approximately 26% of total revenues for the twelve months ended December 31, 2008. This represented an increase in absolute dollars of approximately \$199,000, or 7% year-over-year. This increase was driven by our use of outside contractors, as well as, expanding our employee base in anticipation of growth in the first half of the year.

The majority of these costs were personnel related, including salary costs in connection with the ongoing development and enhancement of our products and services. Such efforts may not result in additional new products and any new products may not generate sufficient revenues, if any, to offset the expenses. We anticipate our product development costs to decrease in both absolute dollars and as a percentage of revenues in the near future.

Sales and Marketing. Sales and marketing costs were approximately \$633,000, or 21% of total revenues for the three months ended December 31, 2007, and \$602,000, representing a decrease of approximately \$31,000 or 5% period-over-period. The period-over-period decrease in sales and marketing expenses were a result of our decrease on overall employee costs associated with our community management group.

Sales and marketing costs were approximately \$2.5 million, or 23% of total revenues for the twelve months ended December 31, 2007, and \$2.7 million, or 23% of total revenues for the twelve months ended December 31, 2008, representing an increase of approximately \$197,000 or 8% year-over-year. The year-over-year increase in sales and marketing expenses were a result of our efforts to provide additional services (and associated community management services) to existing and new clients, as well as a material increased sales and marketing program efforts to develop new revenues with existing and new clients.

The substantial majority of the sales and marketing expenses were 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. We expect sales and marketing costs to be relatively flat in the near future. We will anticipate an increase in expenses associated with our sales and marketing efforts to new clients. This increase in marketing expense will be partially off-set by the reduction in overall employee costs. In addition, 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 \$680,000, or 23% of total revenues for the three months ended December 31, 2007, and \$544,000, or 18% of total revenues for the three months ended December 31, 2008. This represented a decrease in absolute dollars of approximately \$136,000, or 20% period-over-period. The decrease in general and administrative expenses for the three months ended December 31, 2008 were related to the elimination of outside advisory costs associated with the filing of quarterly reports with the SEC.

General and administrative expenses were approximately \$3.3 million, or 30% of total revenues for the twelve months ended December 31, 2007, and \$2.6 million, or 22% of total revenues for the twelve months ended December 31, 2008. This represented a decrease in absolute dollars of approximately \$652,000, or 20% year-over-year.

The general and administrative expenses for both the three and twelve months ended December 31, 2007 included outside advisory costs related to the filing of a Form 10-SB and the Form 10-Q, with the SEC. The three and twelve months ended December 31, 2008 contain only minimal outside advisory costs related to the filing of our 2007 10-K and our Form 15 with the SEC. We expect in the near future for the general and administrative expenses to stabilize in absolute dollar terms.

We filed a Form 15 with the SEC to voluntarily deregister our Common Stock under Section 12(g) of the Securities Exchange Act of 1934, as amended. The Board of Directors determined this was the best course of action after carefully considering the high costs of remaining on the OTC Bulletin Board, especially those associated with being a public reporting company including the additional costs of being compliant with the Sarbanes-Oxley Act by the end of 2008. Upon the filing of the Form 15, LiveWorld became a non-reporting public company.

Financial Condition, Liquidity and Capital Resources

Our total assets were approximately \$5.2 million as of December 31, 2007, and \$4.2 million as of December 31, 2008. This represented a decrease of approximately \$1.1 million or 25% of total assets. Our cash decreased by approximately \$657,000 from approximately \$2.0 million as of December 31, 2007 to \$1.4 million as of December 31, 2008. Our accounts receivable balance as of December 31, 2007 was approximately \$1.4 million which decreased approximately \$157,000 to \$1.2 million as of December 31, 2008. The remaining reductions in total assets were the decreases associated with depreciation of our property and equipment, which was slightly off-set by the increases in other assets. These assets were used in the day-to-day operations of the company.

Our current liabilities were approximately \$2.0 million as of December 31, 2007 and \$1.6 million as of December 31, 2008. This represented a decrease of approximately \$396,000 or 20% year-over-year. The primary cause for the reduction in our current liabilities was the decrease in our accounts payable from approximately \$555,000 as of December 31, 2007 to approximately \$121,000 as of December 31, 2008 or a reduction of \$434,000. This was driven by the drop in our usage of outside advisory services and consultants.

Our current assets, which are made up of cash and cash equivalents, accounts receivable, and prepaid expenses as of December 31, 2008 were approximately \$2.7 million while our current liabilities which are made up of our accounts payable, accrued liabilities and current portions of long-term liabilities were approximately \$1.6 million. This represented a positive working capital position of approximately \$1.2 million, which was an increase of approximately \$288,000 from the period ended September 30, 2008. Additionally our current assets are approximately \$1.0 million greater than our total liabilities as of December 31, 2008, which represented an increase of approximately \$350,000 from the period ended September 30, 2008. We feel we have enough working capital to fund operations for the foreseeable future.

For the three months ended December 31, 2007 we had negative cash flows of approximately \$302,000 while for the three months ended December 31, 2008 we materially reduced this use of cash by \$270,000 or a use of cash of approximately \$33,000. The primary reason for this decline in the use of cash period-over-period was the positive cash flows provided by operating activities of approximately \$28,000 for the three months ended December 31, 2008 as compared to the negative cash flows used in operating activities of \$283,000 for the three months ended December 31, 2007. This was an improvement of approximately \$311,000 period-over-period which was slightly off-set by our investing activities for the period.

For the twelve months ended December 31, 2007 our use of cash was approximately \$1.2 million while for the twelve months ended December 31, 2008 our use of cash was approximately \$657,000. This was a material decrease in our use of cash of approximately \$540,000. The central reason for this improvement in cash flows was the cash used in operating activities went from \$906,000 for the twelve months ended December 31, 2007 to a use of cash in operating activities of \$558,000 for the twelve months ended December 31, 2008. This represented an improvement in the cash flows of approximately \$348,000 year-over-year. Additionally, we reduced our purchase of property and equipment from approximately \$417,000 to \$287,000 for the twelve months ended December 31, 2007 to December 31, 2008, or a savings of approximately \$130,000 in cash.

Our primary uses of cash are the operating costs related to the delivery of the private label online social network and community services. These costs include but are not limited to salaries, payroll taxes, benefits, related expenditures and professional fees. Given the current state of the economy and stock market we took steps to improve our cash flows in the fourth quarter, and anticipate the \$1.7 million in annual saving will help us to achieve our goal of being approximately cash flow break-even in the first quarter of 2009. Cash flow from operating activities may or may not be net positive and will vary from quarter to quarter. However we intend to manage the cash flow such that cash flow from operating activities and from our current cash balance is more than enough to sustain the business.

Our net cash provided by operating activities of approximately \$28,000 differed from the income from operations of approximately \$115,000 for the three months ended December 31, 2008. The differences were due to stock-based compensation expense, depreciation expense, and the various changes in operating assets and liabilities.

We believe that the combination of cash balances, cash flow from operations will be sufficient to satisfy cash needs for the current level of operations and planned operations for 2009.

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 earnings before interest, taxes, depreciation and amortization, and stock based compensation (“Adjusted EBITDA”), were approximately \$400,000, or 13% of total revenues and (\$370,000), or (12%) of total revenues for the three months ended December 31, 2008 and 2007, respectively. Our Adjusted EBITDA was approximately (\$1,609,000) or, (15%) of total revenues for the twelve months ended December 31, 2007 and (\$112,000), or (1%) of total revenues for the twelve months ended December 31, 2008. The reduction in the loss was primarily attributable to our improvement in the net reported loss period-over-period. We define Adjusted EBITDA as net income or (loss) with an add-back for depreciation and amortization, non-cash stock-based compensation expense, interest income net, and income taxes. 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 December 31,		Twelve Months Ended December 31,	
	2008	2007	2008	2007
Reported net income or (loss)	\$ 165	\$ (584)	\$ (1,078)	\$ (2,373)
Depreciation and amortization	133	162	607	619
Stock-based compensation	97	76	373	293
Interest income, net	5	(24)	(19)	(162)
Provisions for income taxes	----	1	4	14
Adjusted EBITDA	<u>\$ 400</u>	<u>\$ (370)</u>	<u>\$ (112)</u>	<u>\$ (1,609)</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 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 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, not of any expenses, or income not related to the delivery of our services. 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 000's	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2008	2007	2008	2007
Net cash provided by (used in) operating activities:	\$ 28	\$ (283)	\$ (558)	\$ (906)
Interest income, net	5	(24)	(19)	(162)
Taxes	----	----	4	14
Equity in net loss of unconsolidated affiliate	55	(19)	20	(161)
Changes in accounts receivable	74	236	(157)	172
Changes in accrued development and setup	----	----	----	(72)
Changes in other assets	(22)	(60)	51	30
Changes in accounts payable	152	56	434	(212)
Changes in accrued liabilities	162	(39)	122	(114)
Changes in deferred revenues	(54)	(236)	(10)	(200)
Adjusted EBITDA	\$ 400	\$ (370)	\$ (112)	\$ (1,609)

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 December 31,		Year Ended December 31,	
	2008	2007	2008	2007
Cash flows from operating activities:				
Net income (loss)	\$ 165	\$ (584)	\$ (1,078)	\$ (2,373)
Adjustments to reconcile net income (loss) provided by (used in) operating activities:				
Depreciation of long-lived assets	133	162	607	619
Stock-based compensation	97	76	373	293
Equity in net loss of unconsolidated affiliate	(55)	19	(20)	160
Changes in operating assets and liabilities:				
Accounts receivable	(74)	(236)	157	(172)
Accrued development and setup	----	----	----	72
Other assets	22	60	(51)	(31)
Accounts payable	(152)	(56)	(434)	212
Accrued liabilities	(162)	39	(122)	114
Deferred revenue	54	236	10	200
Net cash provided by (used in) operating activities	28	(283)	(558)	(906)
Cash flows from investing activities:				
Purchase of property and equipment	(33)	(76)	(287)	(417)
Net cash provided by (used in) investing activities	(33)	(76)	(287)	(417)
Cash flows from financing activities:				
Capital lease financing	(45)	57	72	76
Proceeds from exercise of stock options	32	-	32	50
Note payable financing	(24)	-	74	-
Net cash provided by (used for) financing activities	(37)	57	180	126
Change in cash and cash equivalent	(32)	(302)	(657)	(1,197)
Cash and cash equivalents, beginning of period	1,395	2,322	2,020	3,217
Cash and cash equivalents, end of period	\$ 1,363	\$ 2,020	\$ 1,363	\$ 2,020

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.