

**ANNUAL REPORT FOR
THE YEAR ENDED
December 31, 2011**

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
33,157,634 Shares Issued and Outstanding

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

	December 31, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalent	\$ 1,323	\$ 750
Accounts receivable, net	857	692
Prepaid expenses	135	79
Total current assets	2,315	1,521
Property and equipment, net	132	95
Non-cash investment in joint venture	----	815
Other assets	17	17
Total assets	\$ 2,464	\$ 2,448
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 12	\$ 61
Accrued employee expenses	348	333
Other accrued liabilities	10	26
Current portion of capital lease obligations	----	23
Current portion of note payable	15	44
Deferred revenue	889	578
Total current liabilities	1,274	1,065
Long-term capital lease obligation	----	15
Total liabilities	1,274	1,080
Stockholders' equity		
Common stock: \$0.001 par value, 100,000,000 shares authorized 33,151,981 and 33,157,634 issued and outstanding as of December 31, 2010 and 2011 respectively	33	33
Additional paid-in capital	141,094	140,981
Accumulated deficit	(139,938)	(139,646)
Total stockholders' equity	1,190	1,368
Total liabilities and stockholders' equity	\$ 2,464	\$ 2,448

See accompanying notes to the unaudited financial statements

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

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2011	2010	2011	2010
Total revenues	\$ 2,491	\$ 1,708	\$ 8,271	\$ 7,321
Cost of revenues	832	643	2,840	2,706
Gross Margin	1,659	1,065	5,431	4,615
Operating Expense				
Product development	374	336	1,398	1,752
Sales and marketing	534	539	2,041	2,292
General and administrative	362	360	1,427	1,751
Stock based compensation	26	38	114	253
Total operating expense	1,297	1,273	4,979	6,049
Income/(loss) from operations	363	(208)	451	(1,433)
Interest expense, net	----	(1)	(2)	(7)
Other income	----	6	----	(76)
Income /(loss) before tax	363	(203)	449	(1,516)
Provision for income taxes	----	----	(5)	----
Non-cash equity in net loss of unconsolidated affiliate*	(719)	(4)	(736)	(52)
Net loss	(356)	(207)	(292)	(1,568)
Basic Loss per share	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.05)
Shares used in computing basic loss per share	33,157,634	33,151,981	33,157,634	33,151,981
Diluted net income (loss) per share	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.05)
Shares used in computing diluted income (loss) per share	33,157,634	33,151,981	33,157,634	33,151,981
Departmental allocation of stock-based compensation:				
Product development	\$ 11	\$ 20	\$ 56	\$ 127
Sales and marketing	10	10	37	60
General and administrative	5	8	21	66
Total stock-based compensation	\$ 26	\$ 38	\$ 114	\$ 253

*See note 6 for a detailed explanation.

See accompanying notes to the unaudited financial statements

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

	Three Months Ended		Twelve Months Ended	
	December 31,		December 31,	
	2011	2010	2011	2010
Cash flows from operating activities:				
Net income (loss)	\$ (356)	\$ (207)	\$ (292)	\$ (1,568)
Adjustments to reconcile net income (loss) provided by (used in) operating activities:				
Depreciation of long-lived assets	17	36	80	198
Stock-based compensation	26	38	114	253
Non-cash equity in net loss of unconsolidated affiliate	797	4	815	52
Changes in operating assets and liabilities:				
Accounts receivable	666	522	(165)	439
Other assets	(9)	42	(56)	78
Accounts payable	(189)	(113)	(49)	(50)
Accrued liabilities	(39)	(7)	(1)	(50)
Deferred revenue	(300)	16	311	(97)
Net cash provided by (used in) operating activities	<u>614</u>	<u>330</u>	<u>756</u>	<u>(745)</u>
Cash flows from investing activities:				
Purchase of property and equipment	<u>(60)</u>	<u>(7)</u>	<u>(117)</u>	<u>(30)</u>
Net cash provided by (used in) investing activities	<u>(60)</u>	<u>(7)</u>	<u>(117)</u>	<u>(30)</u>
Cash flows from financing activities:				
Capital lease financing	---	(24)	(38)	(119)
Note payable financing	<u>(6)</u>	<u>(15)</u>	<u>(29)</u>	<u>59</u>
Net cash provided by (used for) financing activities	(6)	(39)	(67)	(60)
Change in cash and cash equivalent	547	284	573	(835)
Cash and cash equivalents, beginning of period	<u>776</u>	<u>466</u>	<u>750</u>	<u>1,585</u>
Cash and cash equivalents, end of period	<u>\$ 1,323</u>	<u>\$ 750</u>	<u>\$ 1,323</u>	<u>\$ 750</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 to provide private-label social network services for global brands enabling them to scale their social media programs through human moderation and community programming services which are scalable when combined with our proprietary technology. Our services and products include: strategy & management, moderation services to protect brands, actionable insight services to reveal what customers are thinking and what to do about it, community programming services to engage and support customers and technology platforms to scale those services. The technology platforms include moderation, response, insight, engagement and curation tools for Facebook, other social networks and central community web sites. Our clients use these services for marketing, support and insight.

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 December 31, 2011 are not necessarily indicative of the results that may be expected for future periods. The balance sheet, operating results, and statements of cash flows for the periods ended December 31, 2011, and December 31, 2010 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 stand-alone 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 on-line community 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 on-line social network and community services to clients; the expenses 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 amounts associated with the initial service development and set-up of a 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 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. As of December 31, 2011 there were 23,083,057 outstanding options and warrants to purchase shares of the Company's common stock; and as of December 31, 2010 there were 21,988,681 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	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2011	2010	2011	2010
Numerator:				
Net income (loss) attributable to common Stockholders	\$ (356)	\$ (207)	\$ (292)	\$ (1,568)
Denominator:				
Weighted-average shares used to compute basic EPS	33,158	33,152	33,158	33,152
Effect of dilutive securities:				
Diluted common shares	----	----	----	----
Weighted-average shares used to compute diluted EPS	33,158	33,152	33,158	33,152
Net earnings per share:				
Basic	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.05)
Diluted	\$ (0.01)	\$ (0.01)	\$ (0.01)	\$ (0.05)

4. 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'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 twelve months ended December 31, 2011:

	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, 2010	11,278,631	18,350,744	\$ 0.13		
Granted	(1,745,000)	1,745,000	\$ 0.08		
Forfeited	644,971	(644,971)	\$ 0.13		
Exercised	(5,653)	(5,653)	\$ 0.04		
Balance as of December 31, 2011	<u>10,172,949</u>	<u>19,445,120</u>	<u>\$ 0.12</u>	<u>3.7</u>	<u>\$407</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, 2011.

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 approximated 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 10,172,949. As of December 31, 2011 there were a total of 19,445,120 outstanding options under the 1996 Plan and the 2007 Plan. As of December 31, 2011, there was approximately \$100,000 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 years.

5. PROPERTY AND EQUIPMENT

Property, furniture and equipment consisted of the following items:

(\$ in thousands)	December 31, 2011	December 31, 2010
Computer equipment	\$ 2,404	\$ 2,294
Software	1,198	1,198
Furniture and fixtures	44	37
Leasehold improvements	23	23
Leased equipment	418	418
Accumulated depreciation	(3,955)	(3,876)
Property, furniture and equipment, net	<u>\$ 132</u>	<u>\$ 95</u>

Depreciation expense was approximately \$80,000 and \$198,000 for the twelve months ended December 31, 2011 and 2010, respectively.

6. EXTRAORDINARY ITEM

In 2006, we established a joint venture and entered into a sales representative agreement with it. The joint venture was tasked with marketing and selling our products and services to specific channels and organizations. In addition to paying commissions to the joint venture on sales it made we also entered into an agreement that provided for the granting of warrants to purchase our common stock. The warrants were issued based on the performance of the joint venture during the term of these agreements. In 2006 we used a Black-Scholes calculation to determine the value of the initial warrants resulting in a total value of approximately \$762,000, and according to GAAP and SEC regulations we booked this as an asset on the balance sheet. The value of the warrants fluctuated with the income of the joint venture and as of the fourth quarter of 2011 the value was approximately \$719,000.

The term of the joint venture and sales representative agreement was for five year and expired in late 2011. As a result of the expiration of the joint venture all operations ended in the fourth quarter of 2011. It was determined the booked value of the warrants needed to be written off as an asset, since the joint venture was no longer in operation. Therefore we took the one-time non-cash charge of \$719,000 to our net earnings. This resulted in a GAAP accounting net loss of \$356,000 for the three months ended December 31, 2011 and a net loss of approximately \$292,000 for the full year. Our income, net of this one-time non-cash extraordinary item, was \$363,000, or 15% of total revenues for the three months ended December 31, 2011, and a loss of approximately \$203,000, or 12% of total revenues for the three months ended December 31, 2010. This represented an improvement of approximately \$565,000 period-over-period.

For the twelve months ended December 31, 2011 our income net of this extraordinary item was approximately \$444,000, or 5% of total revenues, as compared to the loss of approximately \$1.5 million for the twelve months ended December 31, 2010, or 21% of total revenues. The improvement of approximately \$2.0 million was a result of our increased revenues and decreased operating expenses.

In thousands, except per share amounts	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2011	2010	2011	2010
Net income (loss) attributable to common Stockholders	\$ (356)	\$ (207)	\$ (292)	\$ (1,568)
One-time extraordinary item	719	4	736	52
Income (loss), excluding the extraordinary non-cash item	<u>\$ 363</u>	<u>\$ (203)</u>	<u>\$ 444</u>	<u>\$ (1,516)</u>
Weighted-average shares used to compute basic EPS	33,158	33,152	33,158	33,152
Effect of dilutive securities:				
Diluted common shares	4,333	----	4,333	----
Weighted-average shares used to compute diluted EPS	<u>37,491</u>	<u>33,152</u>	<u>37,491</u>	<u>33,152</u>
Earnings per share:				
Basic	<u>\$ 0.01</u>	<u>\$ (0.01)</u>	<u>\$ 0.01</u>	<u>\$ (0.05)</u>
Diluted	<u>\$ 0.01</u>	<u>\$ (0.01)</u>	<u>\$ 0.01</u>	<u>\$ (0.05)</u>

For additional information regarding the warrants see the 2007 10-K.

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 quarterly 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 periods ended December 31, 2011 and 2010 were neither audited nor reviewed by an independent accounting firm and are subject to change upon such a review or audit being completed.

Backlog

We maintain a positive outlook for 2012, and our current backlog for the remainder of the fiscal year is approximately \$5.8 million, as compared to the \$5.7 million in backlog at the beginning of 2011. Additionally, bookings which were approximately \$1,000,000 in the fourth quarter of 2011, as compared to approximately \$1,000,000 for the fourth quarter of 2010. We anticipate seeing improved bookings for 2012, however it is possible on a quarter-to-quarter basis we may see some variability in our bookings number.

Overview

We enable our global brand clients to scale their social media programs through human moderation and community programming services which are scalable when combined with our proprietary technology. Our services and products include: strategy & management, moderation services to protect brands, actionable insight services to reveal what customers are thinking and what to do about it, community programming services to engage and support customers and technology platforms to scale those services. The technology platforms include moderation, response, insight, engagement and curation tools for Facebook, other social networks and central community web sites. Our clients use these services for marketing, support and insight. Our services consist of the following products delivered on a complete end-to-end or modular basis:

Moderation Services: We provide moderation services across multiple social channels including Facebook, Twitter, YouTube, and central branded communities enabling us to protect the brand across all channels. These services are human-based ensuring content is reviewed in context, and utilize our Advanced Power Moderation Tools. The tools enable us to moderate user content at rates that are usually 2x to 10x faster than moderation without our tools. Under optimal conditions we are able to moderate up to 1,000 posts/hour/moderator on the Facebook Wall and provide our clients with a scalable, flexible service which gives them meaningful insight to their customers. We use our Advanced Power Moderation Tools when we moderate the Facebook Wall, LiveWorld applications and platforms as well as integrate the tools with a client's custom websites or applications. We also provide moderation on 3rd party applications and platforms with any existing tools that come with those platforms.

Moderation Services include Content Moderation, Brand Interaction and Operational Support. Moderators are trained personnel that read and review user content for adherence to the brand's social media 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 posting and tuning brand content and responding to users in a conversational tone as well as escalating issues and monitoring social media channels. We have provided over 1.5 million hours of moderation in as many as 70 country/language combinations.

Insight Services: Insight Services includes standard page, site and moderation metrics reporting, web listening, Insight Tagging and qualitative Community Tone/Insight Reports. Insight Tagging is a LiveWorld solution that combines the human touch of our moderators with our advanced tools to individually tag user comments according to client designated criteria and then report on the results.

Community Programming Services: Community Programming focuses on the community cultural model, stimulating and managing deep consumer-to-consumer conversational interaction. Available services include Planning, Engagement, Analysis and Recommendations,

and Training. We also provide strategic services to help clients define their desired community and these services are implemented with a cross-social channel roadmap.

Technology Tools & Platforms: LiveWorld offers a series of tools, applications and platforms designed to stimulate more conversation and relationships among and with a brand's customers:

- **Advanced Power Moderation Tools & Content Review System:** Tools for reviewing and moderating user content at high speeds and optimal quality. The tools enable us to moderate user content at rates that are usually 2x to 10x faster than moderation without our tools. Under optimal conditions we are able to moderate up to 1,000 posts/ hour/moderator on the Facebook Wall and provide our clients with a scalable, flexible service which gives them meaningful insight to their customers. We use our Advanced Power Moderation Tools when we moderate the Facebook Wall, LiveWorld applications and platforms as well as integrate the tools with a client's custom websites or applications. These tools also enable us to provide high quality, flexible brand response and interaction on social network venues, insight tagging and the management and routing of content to and within a client company.
- **Curator:** A user content aggregation and curation application enables us to selectively aggregate user content from the social web, moderate it with our moderation and insight tools and selectively republish it on Facebook, other social networks and web sites.
- **Facebook Forums:** A message forum application for Facebook, LiveWorld Facebook Forums provides a rich conversational experience for consumers with features to allow the brand to focus and manage the conversation — resulting in more dialogue, deeper customer engagement, and, in turn, greater loyalty.
- **3rd Party Facebook CMS Platforms:** A Facebook CMS enables the brand to construct a Facebook tab with compelling interactive content to attract users and run engaging promotions. We partner with leading Facebook CMS vendors to provide a solution for our clients. LiveWorld provides the client with the CMS license, while also setting up and managing the Facebook CMS solution.
- **Community Center 5.0 –API:** A richly featured central branded community site platform with an API-centric model for digital agencies and in-house web development groups to create custom community sites.

Total Revenues

Our business is primarily based on building recurring revenue streams through the operation of private-label on-line social networks 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 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 a client requests after we have begun to provide services to the 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 client communities on our servers and these fees are generally based on page views per month; technology license fees are fees we charge for the licensed use and support of our technology on behalf of a client whether that technology is being utilized by our personnel or client personnel; moderation and community management revenues are fees derived from services provided to a client on a monthly basis to moderate and manage the social network or community and the community needs of the client, generally involving a monthly minimum fee for a specified minimum volume of hours with any additional time being charged at an hourly rate.. 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 on-line 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.

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 community management, which include 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 December 31,		Twelve Months Ended December 31,	
	2011	2010	2011	2010
Total revenues	100%	100%	100%	100%
Cost of revenues	33	38	34	37
Gross Margin	67	62	66	63
Operating Expense				
Product development	15	20	17	24
Sales and marketing	21	32	25	31
General and administrative	15	21	17	24
Stock based compensation	1	2	1	3
Total operating expense	52	75	60	83
Income (loss) from operations	15	(13)	6	(20)
Other income (expense)	---	---	---	(1)
Income (loss) before tax	15%	(13)%	6%	(21)%

Three and Twelve Months Ended December 31, 2011 and 2010

Total Revenues

Our revenues for the three months ended December 31, 2011 were approximately \$2.5 million, as compared to approximately \$1.7 million for the three months ended December 31, 2010. This was an increase of approximately \$783,000 or 46% period-over-period. Revenues increased primarily as a result of new client acquisitions and larger projects from our existing client base.

For the three months ended December 31, 2011, revenues from eBay comprised approximately 23% of our total revenues while Walmart made up approximately 20% of our total revenues and all other clients represented approximately 57% of our total revenues. This compares to the three months ended December 31, 2010 where revenues from eBay comprised approximately 34% of our total revenues and all other clients represented approximately 66% of total revenues.

Our revenues for the twelve months ended December 31, 2011 were approximately \$8.3 million, as compared to approximately \$7.3 million for the twelve months ended December 31, 2010. This was an increase of approximately \$950,000 or 13% year-over-year. Revenues increased primarily as a result of new client acquisitions.

For the twelve months ended December 31, 2011, revenues from eBay comprised approximately 23% of our total revenues while Walmart made up approximately 10% of our total revenues and all other clients represented approximately 67% of our total revenues. This compares to the twelve months ended December 31, 2010 where revenues from eBay comprised approximately 34% of our total revenues and all other clients represented approximately 66% of total revenues.

Cost of Revenues

Cost of revenues were approximately \$832,000, or 33% of total revenues for the three months ended December 31, 2011, and approximately \$643,000 or 38% of total revenues for the three months ended December 31, 2010. This represented an increase of approximately \$189,000 or 29% period-over-period. This increase was due primarily to a boost in demand for our moderation services.

Cost of revenues for the twelve months ended December 31, 2011 were approximately \$2.8 million as compared to approximately \$2.7 million for the twelve months ended December 31, 2010. This represented an increase of approximately \$134,000, or 5% period-over-period. This slight increase was a result of higher demand for our moderation services off-set by our reduced dependency of outside contractors.

Operating Expenses

Product Development. Expenditures for product development were approximately \$374,000, or 15% of total revenues for the three months ended December 31, 2011, and approximately \$336,000 or 20% of total revenues for the three months ended December 31, 2010. This represented an increase in absolute dollars of approximately \$38,000, or 11% period-over-period. The increase was driven by new product development.

For the twelve months ended December 31, 2011, expenditures for product development were approximately \$1.4 million or 17% of total revenues. This compares to approximately \$1.8 million in product development costs for the twelve months ended December 31, 2010 or 24% of total revenues. This represented a decrease in absolute dollars of approximately \$354,000 or 20% year-over-year. 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 believe product development expenditures will increase in absolute dollars in 2012. We are committed to our product development efforts and will continue to invest in product development programs. 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 \$534,000, or 21% of total revenues for the three months ended December 31, 2011, and approximately \$539,000, or 32% for the three months ended December 31, 2010 representing a decrease in absolute dollars of approximately \$6,000 or 1% period-over-period.

We anticipate increasing our sales and marketing expenditures as overall revenues increase.

For the twelve months ended December 31, 2011 costs related to sales and marketing were approximately \$2.0 million or 25% of total revenues. This compares to approximately \$2.3 million in sales and marketing costs for the twelve months ended December 31, 2010 or 31% of total revenues. This represented a decrease in absolute dollars of approximately \$251,000 or 11% year-over-year.

The substantial majority of our sales and marketing expenses are associated with our ongoing moderation and 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 increase as we expand our sales and marketing efforts to new clients. In addition, if our product development efforts are successful and new products or services are created, we will 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 \$362,000, or 15% of total revenues for the three months ended December 31, 2011, and approximately \$360,000, or 21% of total revenues for the three months ended December 31, 2010.

For the twelve months ended December 31, 2011 general and administrative expenses were approximately \$1.4 million or 17% of total revenues. This compares to the approximately \$1.8 million in general and administrative expenses for the twelve months ended December 31, 2010 or 24% of total revenues. This represented a decrease in absolute dollars of approximately \$324,000 or 19% period-over-period.

The vast majority of the cost savings was related to the reduction in outside advisory costs, reduced employee-related expenses and reductions in administrative expenses.

Financial Condition, Liquidity and Capital Resources

For the three months ended December 31, 2011 we had positive total cash flows of approximately \$547,000 while for the three months ended December 31, 2010 we had positive total cash flows of approximately \$284,000. This represented an increase in our total cash flows of approximately \$263,000 period-over-period. The primary reasons for the increase in total cash flows for the three months ended December 31, 2011 were the increased revenues and improved operating margins.

For the twelve months ended December 31, 2011 we had positive total cash flows of approximately \$573,000 while for the twelve months ended December 31, 2010 we had negative total cash flows of approximately \$835,000. This represented an increase in our total cash flows of approximately \$1.4 million year-over-year. The primary reasons for the increase in total cash flows for the twelve months ended December 31, 2011 were the increased revenues and improved operating margins.

We ended 2011 with approximately \$1.3 million in cash, as compared to the approximately \$750,000 in cash at the end of 2010.

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 the foreseeable future.

Our total assets were approximately \$2.5 million as of December 31, 2011, and approximately \$2.4 million as of December 31, 2010. This represented an increase of approximately \$16,000 of total assets. Our cash and cash equivalents were approximately \$1.3 million as of December 31, 2011 which was an increase of approximately \$573,000 or 76% from the cash and cash equivalents balances of approximately \$750,000 as of December 30, 2010.

Accounts receivable was approximately \$857,000 as of December 31, 2011 which was an increase of approximately \$165,000 or 24% from the accounts receivable balance of approximately \$692,000 as of December 30, 2010. Accounts receivable balances are expected to fluctuate with the levels of new client acquisition and enhancement activity and the timing of billings and collections.

Property and equipment increased approximately \$37,000 to approximately \$132,000 as of December 31, 2011 from approximately \$95,000 as of December 31, 2010. We anticipate our property and equipment to grow as we see increased revenues.

These increases were off-set by the one-time non-cash extraordinary write off of the warrants issued in combination with the joint venture which expired in the fourth quarter of 2011. This was a one-time, non-cash GAAP accounting event. For further details please see note six.

As of December 31, 2011, our current assets, which are made up of cash and cash equivalents, accounts receivable, and prepaid expenses were approximately \$2.3 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 million, which was an improvement of approximately \$585,000 from the period ended December 31, 2010.

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. Capital scenarios may include but are not limited to public stock issuance, private investment rounds, merger or acquisition and/or privatization. There can be no assurance that we will be able to raise additional capital on favorable terms or at all.

Our income before interest, taxes, depreciation and amortization, and non-cash stock-based compensation ("Adjusted EBITDA"), was approximately \$486,000, or 20% of total revenues for the three months ended December 31, 2011 as compared to Adjusted EBITDA loss of approximately \$131,000, or 8% of total revenues for the three months ended December 31, 2010. The increase in Adjusted EBITDA of approximately \$617,000 period-over-period was primarily due to the improved operating results of the company.

For the twelve months ended December 31, 2011 our Adjusted EBITDA was approximately \$723,000 or 9% of total revenues. This compares to Adjusted EBITDA loss of approximately \$1.1 million, or 15% of total revenues for the twelve months ended December 31, 2010. The increase in Adjusted EBITDA of approximately \$1.8 million year-over-year was primarily due to the improved operating results of the company.

We define Adjusted EBITDA as net income or (loss) excluding net interest income, income taxes, changes in the equity of the unconsolidated affiliate, 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 December 31,		Twelve Months Ended December 31,	
	2011	2010	2011	2010
Reported net (loss)	\$ (356)	\$ (207)	\$ (292)	\$ (1,568)
Depreciation and amortization	17	36	80	198
Stock-based compensation	26	38	114	253
Interest income, net	----	(1)	(2)	(7)
Equity of unconsolidated affiliate	797	4	815	52
Provisions for income taxes	----	----	5	----
Adjusted EBITDA	<u>\$ 486</u>	<u>\$ (131)</u>	<u>\$ 723</u>	<u>\$ (1,072)</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 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 December 31,		Twelve Months Ended December 31,	
	2011	2010	2011	2010
Net Cash Provided by (used in) operating activities	\$ 614	\$ 330	\$ 756	\$ (745)
Interest income, net	----	(1)	(2)	(7)
Taxes	----	----	5	----
Changes in accounts receivable	(666)	(522)	165	(439)
Changes in other assets	9	(42)	56	(78)
Changes in accounts payable	189	113	49	50
Changes in accrued liabilities	39	7	1	50
Changes in deferred revenues	300	(16)	(311)	97
Adjusted EBITDA	<u>\$ 486</u>	<u>\$ (131)</u>	<u>\$ 723</u>	<u>\$ (1,072)</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 December 31,		Twelve Months Ended December 31,	
	2011	2010	2011	2010
Cash flows from operating activities:				
Net income (loss)	\$ (356)	\$ (207)	\$ (292)	\$ (1,568)
Adjustments to reconcile net income (loss) provided by (used in) operating activities:				
Depreciation of long-lived assets	17	36	80	198
Stock-based compensation	26	38	114	253
Non-cash equity in net loss of unconsolidated affiliate	797	4	815	52
Changes in operating assets and liabilities:				
Accounts receivable	666	522	(165)	439
Other assets	(9)	42	(56)	78
Accounts payable	(189)	(113)	(49)	(50)
Accrued liabilities	(39)	(7)	(1)	(50)
Deferred revenue	(300)	16	311	(97)
Net cash provided by (used in) operating activities	<u>614</u>	<u>330</u>	<u>756</u>	<u>(745)</u>
Cash flows from investing activities:				
Purchase of property and equipment	<u>(60)</u>	<u>(7)</u>	<u>(117)</u>	<u>(30)</u>
Net cash provided by (used in) investing activities	<u>(60)</u>	<u>(7)</u>	<u>(117)</u>	<u>(30)</u>
Cash flows from financing activities:				
Capital lease financing	---	(24)	(38)	(119)
Note payable financing	<u>(6)</u>	<u>(15)</u>	<u>(29)</u>	<u>59</u>
Net cash provided by (used for) financing activities	(6)	(39)	(67)	(60)
Change in cash and cash equivalent	547	284	573	(835)
Cash and cash equivalents, beginning of period	<u>776</u>	<u>466</u>	<u>750</u>	<u>1,585</u>
Cash and cash equivalents, end of period	<u>\$ 1,323</u>	<u>\$ 750</u>	<u>\$ 1,323</u>	<u>\$ 750</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.