

**ANNUAL REPORT FOR  
THE TWELVE MONTHS ENDED  
December 31, 2013 and 2012**

**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**  
**33,321,634 Shares Issued and Outstanding as of June 5, 2014**

**Liveworld, Inc.**  
**Financial Statements**  
**December 31, 2013 and 2012**  
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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Audit Committee of the  
Board of Directors and Shareholders  
of Liveworld, Inc.

We have audited the accompanying balance sheets of Liveworld, Inc. (the “Company”) as of December 31, 2013 and 2012, and the related statements of operations, stockholders’ equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Liveworld, Inc. as of December 31, 2013 and 2012, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Marcum LLP

San Francisco, CA  
June 5, 2014

**LIVEWORLD, INC.**  
**BALANCE SHEETS**  
(In thousands)

	<b>December 31, 2013</b>	<b>December 31, 2012</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 4,413	\$ 3,382
Accounts receivable	488	517
Prepaid expenses	336	276
Total current assets	5,237	4,175
Property and equipment, net	257	234
Other assets	18	17
Total assets	\$ 5,512	\$ 4,426
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Accounts payable	\$ 159	\$ 235
Accrued employee expenses	576	509
Other accrued liabilities	6	12
Deferred revenue	665	581
Total current liabilities	1,406	1,337
Stockholders' equity		
Common stock: \$0.001 par value, 100,000,000 shares authorized 33,321,634 and 33,257,634 issued and outstanding as of December 31, 2013 and December 31, 2012, respectively	33	33
Additional paid-in capital	141,448	141,243
Accumulated deficit	(137,375)	(138,187)
Total stockholders' equity	4,106	3,089
Total liabilities and stockholders' equity	\$ 5,512	\$ 4,426

See accompanying notes to the financial statements

**LIVEWORLD, INC.**  
**STATEMENTS OF OPERATIONS**  
(In thousands, except per share data)

	<b>Twelve Months Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Total revenues	\$ 14,523	\$ 13,557
Cost of revenues	5,262	4,691
Gross Margin	9,261	8,866
Operating Expenses		
Product development	3,725	3,658
Sales and marketing	1,875	1,311
General and administrative	2,840	2,112
Total operating expenses	8,440	7,081
Income from operations	821	1,785
Other income	6	12
Income before tax	827	1,797
Provision for income taxes	15	32
Net income	812	1,765
Basic net income per share	\$ 0.02	\$ 0.05
Shares used in computing basic net income per share	33,259,634	33,207,634
Diluted net income per share	\$ 0.02	\$ 0.04
Shares used in computing diluted income per share	41,291,384	40,415,064
Departmental allocation of stock-based compensation:		
Cost of revenues	\$ 31	\$ 12
Product development	70	51
Sales and marketing	32	29
General and administrative	66	40
Total stock-based compensation	\$ 199	\$ 132

See accompanying notes to the financial statements

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

	<b>Twelve Months Ended</b>	
	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<u>          </u>	<u>          </u>
Cash flows from operating activities:		
Net income	\$ 812	\$ 1,765
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	134	87
Stock-based compensation	199	132
Changes in operating assets and liabilities:		
Accounts receivable	29	(558)
Prepaid expenses and other assets	(61)	(140)
Accounts payable	(76)	223
Accrued employee expenses and other liabilities	61	163
Deferred revenue	84	589
Net cash provided by operating activities	<u>1,182</u>	<u>2,261</u>
Cash flows from investing activities:		
Purchases of property and equipment	<u>(157)</u>	<u>(189)</u>
Net cash used in investing activities	<u>(157)</u>	<u>(189)</u>
Cash flows from financing activities:		
Proceeds from exercise of stock options	6	2
Payment of note payable	<u>----</u>	<u>(15)</u>
Net cash provided by (used in) financing activities	<u>6</u>	<u>(13)</u>
Change in cash and cash equivalents	1,031	2,059
Cash and cash equivalents, beginning of year	<u>3,382</u>	<u>1,323</u>
Cash and cash equivalents, end of year	<u>\$ 4,413</u>	<u>\$ 3,382</u>
Supplemental cash flow information:		
Income taxes paid	<u>\$ 4</u>	<u>\$ 7</u>

See accompanying notes to the financial statements

**LIVEWORLD, INC.**  
**STATEMENTS OF STOCKHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2013 and 2012**  
(In thousands, except share data)

	<u>Common Stock</u> <u>Shares</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 as January 1, 2012	33,157,634	\$ 33	\$ 141,109	\$ (139,952)	\$ 1,190
Common stock options exercised	100,000	----	2		2
Stock-based compensation			132		132
Net income				1,765	1,765
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Balance December 31, 2012	33,257,634	33	141,243	(138,187)	3,089
Common stock options exercised	64,000	----	6		6
Stock-based compensation			199		199
Net income				812	812
Balance December 31, 2013	<u>33,321,634</u>	<u>\$ 33</u>	<u>\$ 141,448</u>	<u>\$ (137,375)</u>	<u>\$ 4,106</u>

See accompanying notes to the financial statements

## 1. ORGANIZATION

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 headquarters are located in San Jose, California. The Company's principal business is social content marketing for global brands. Through a combination of software and services, the Company provides strategy, engagement, moderation, and insight to help brands deepen customer relationships and in turn improve marketing, support and market learning.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Basis of Presentation and Use of Estimates* – The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The preparation of the accompanying financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

*Cash and Cash Equivalents* – The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

*Fair Value Measurements* – Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value should maximize the use of observable inputs and minimize the use of unobservable inputs. The accounting guidance for fair value establishes a three-level hierarchy for disclosure of fair value measurements, as follows:

Level 1 – Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 – Inputs (other than quoted market prices included in Level 1) that are either directly or indirectly observable, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the instrument's anticipated life.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The carrying values of certain financial instruments of the Company, such as cash and cash equivalents, accounts receivable, prepaid expenses and other assets, accounts payable and accrued liabilities, and deferred revenue approximate fair value due to their relatively short maturities.

*Concentrations of Credit Risk* – Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of cash and cash equivalents. Bank deposits are held by two financial institutions having strong credit ratings and these deposits may at times be in excess of insured limits. The Company is exposed to credit risk in the event of a default by the financial institutions holding its cash and cash equivalents.

The Company's accounts receivable are derived primarily from customers who have signed contracts with the Company, for the Company to provide services to the customer. The Company performs ongoing credit evaluations of its customers, does not require collateral and maintains allowances for potential credit losses when deemed necessary. In 2013 eBay and Walmart accounted for 59% of total revenues respectively; in 2012 eBay and Walmart accounted for 56% of total revenues and no other client represented greater than 10% of total revenues for the Company in either year. As of December 31, 2013 eBay and Walmart represented 7% of total outstanding accounts receivable and 39% as of December 31, 2012, all of which was subsequently collected by the Company.

*Allowances for Doubtful Accounts* – The Company did not record an allowance for doubtful accounts as of December 31, 2013 and 2012. The Company maintains an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unlikely to make required payments. Management specifically analyzes the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payment terms when making estimates of the uncollectibility of the Company's accounts receivable balances. If the Company determines that the financial condition 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.

*Property and Equipment* – Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method over the estimated useful lives of the respective assets of three years for computer equipment,



software, and for furniture and office equipment. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful lives of the respective assets.

*Revenues* – The Company recognizes revenues 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.

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 our Strategy, Engagement, Moderation and Insight software and services to clients; the expenses associated with the development, set-up and operation of our services, including expenses associated with server costs for managing the software tools, license fees for our platform; and the cost of providing moderators and any strategic consulting services the client may request from us. These expenses consist primarily of salaries, payroll taxes, benefits and related expenditures for moderation and consulting services, as well as, software license fees, hardware costs.

*Deferred Revenues* – Deferred revenues are the amounts associated with the initial service development and set-up of a community for our clients and/or prepayments by customers. 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.

*General and Administrative* – General and administrative expenses are the combined 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* – The Company accounts for its stock-based compensation expense based on the fair value of the stock-based awards that are ultimately expected to vest. The fair value of an employee stock option grant is estimated on the date of grant using the Black-Scholes option pricing model, and is recognized as expense on a straight-line basis over the employee's requisite service period (generally the vesting period), net of estimated forfeitures. Forfeitures are estimated at the time of grant and revised in subsequent periods if actual forfeitures differ from the prior estimates.

The Company records the expense attributed to non-employee services paid with stock-based awards based on the estimated fair value of the awards determined using the Black-Scholes option pricing model. The measurement of stock-based compensation for non-employees is subject to re-measurement as the options vest, and the expense is recognized over the period during which services are received.

*Income Taxes* – The Company uses the liability method to account for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts of existing assets and liabilities and their tax bases. Deferred tax assets and liabilities are measured using enacted tax rates applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is established when necessary to reduce deferred tax assets to the amount expected to be realized. Financial statement effects of uncertain tax positions are recognized when it is more-likely-than-not, based on the technical merits of the position, that it will be sustained upon examination. Interest and penalties related to unrecognized tax benefits are included within the provision for income tax.

*Comprehensive Income (Loss)* – Comprehensive income (loss) is defined as a change in equity of a business enterprise during a period, resulting from transactions from non-owner sources. There have been no items qualifying as comprehensive income (loss) and, therefore, for all periods presented, the Company's comprehensive income (loss) was the same as its reported net income.

*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, 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. As of December 31, 2013 there were options and warrants outstanding to purchase 13,207,843 shares that had an anti-dilutive effect on earnings. As of December 31, 2012 there were options and warrants outstanding to purchase 16,469,248 shares that had 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, 2013 there were 21,239,594 outstanding options and warrants to purchase shares of the Company's common stock; and as of December 31, 2012 there were 23,676,678 outstanding options and warrants to purchase shares of the Company's common stock.

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

<u>In thousands, except per share amounts</u>	<b>Twelve Months Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Numerator:	\$ 812	\$ 1,765
Net income attributable to common Stockholders		
Denominator:		
Weighted-average shares used to compute basic EPS	33,259	33,208
Effect of dilutive securities:		
Diluted common shares	8,032	7,207
Weighted-average shares used to compute diluted EPS	41,291	40,415
Net earnings per share:		
Basic	\$ 0.02	\$ 0.05
Diluted	\$ 0.02	\$ 0.04

### 3. STOCK-BASED COMPENSATION

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 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. 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 8,141,199.

#### *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 of our stock options has been determined utilizing the "simplified" method for awards that qualify as "plain vanilla" options. The expected term of stock options granted to non-employees is equal to the contractual term of the option award.

*Expected Volatility* — A volatility rate was used as an estimate of the expected future volatility of the Company's common stock. The Company estimated the expected stock volatility based on the historical volatility of publicly traded peer companies for periods that are commensurate with the expected term (in years).

*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 years ended December 31, 2013 and 2012:

	<b>Stock Options</b>	
	<u>2013</u>	<u>2012</u>
Dividend yield	0%	0%
Expected volatility	79%	89%
Risk-free interest rate	1.25% - 1.90%	0.99% - 1.34%
Estimated term	7 Years	7 Years

A summary of the stock option activity is as follows:

	<b>Shares Available for Grant</b>	<b>Options Outstanding</b>	<b>Weighted Average Exercise Price Per Share</b>	<b>Weighted Average Remaining Contractual Life (in years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Balance as of January 1, 2012	10,172,949	19,445,120	\$0.14		
Granted	(6,731,167)	6,731,167	\$0.11		
Forfeited	6,243,791	(6,243,791)	\$0.02		
Exercised	-	(100,000)	\$0.02		
Balance as of December 31, 2012	<u>9,685,573</u>	<u>19,832,496</u>	<u>\$ 0.15</u>	<u>6.3</u>	<u>\$2,730</u>
Granted	(1,390,000)	1,390,000	\$ 0.27		
Forfeited	3,763,084	(3,763,084)	\$ 0.11		
Exercised	-	(64,000)	\$ 0.09		
Balance as of December 31, 2013	<u><u>12,058,657</u></u>	<u><u>17,395,412</u></u>	<u><u>\$ 0.17</u></u>	<u><u>6.4</u></u>	<u><u>\$2,262</u></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, 2013.

<u>Exercise Price</u>	<u>Options Outstanding and Exercisable</u>		
	<u>Number of Shares</u>	<u>Weighted- Average Remaining Contractual Life (in years)</u>	<u>Aggregate Intrinsic Value (in thousands)</u>
\$0.01 - \$0.17	300,000	4.94	
\$0.02 - \$0.04	1,727,813	6.40	
\$0.055 - \$0.17	5,071,213	7.58	
\$0.22 - \$0.48	4,801,625	5.13	
\$0.51 - \$0.57	557,500	2.80	
	<u>12,458,151</u>	<u>6.21</u>	<u>\$1,556</u>

As of December 31, 2013, there was approximately \$653,000 of total unrecognized compensation expense related to non-vested stock-based compensation arrangements granted under the 1996 Plan and the 2007 Plan. The cost is expected to be recognized over the next 7 years.

#### 4. Warrants

In July 2006, the Company entered into a joint venture with WPP, creating LiveWorld-WPP L.L.C. where upon each party contributed \$250,000 to fund the joint venture's operations. In addition, the Company entered into an agreement that provided for the granting of a substantial number of warrants to WPP to purchase the Company's 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. Subsequent grants were made in 2009 and 2010 for 1,809,324 shares of Common Stock at a per share exercise price of \$1.20 and 34,858 shares of Common Stock at a per share exercise price of \$1.30, respectively.

These warrants were issued as an incentive for WPP to enter into the joint venture with the Company, which was later dissolved in 2011. All of these warrants, which have a term of 10 years, were outstanding as of December 31, 2013.

## 5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following items:

(\$ in thousands)	December 31, 2013	December 31, 2012
Computer equipment	\$ 1,798	\$ 3,010
Software	1,211	1,198
Furniture and fixtures	31	44
Leasehold improvements	23	23
	3,063	4,275
Accumulated depreciation	(2,806)	(4,041)
Property and equipment, net	\$ 257	\$ 234

Depreciation expense was approximately \$134,000 and \$87,000 for the twelve months ended December 31, 2013 and December 31, 2012, respectively.

## 6. RELATED PARTY NOTE PAYABLE

The Company entered into a Note Payable agreement with the Chairman of the Board and Chief Executive Officer of the Company in September of 2010 where the Company borrowed \$50,000 for 24 months with an annualized interest rate of 8%. The approximately \$15,000 the Company paid in 2012 was to pay off the remaining amount owed to the Chief Executive Officer.

## 7. COMMITMENTS AND CONTINGENCIES

*Leases* – The Company leases its facilities under operating leases which expire in December 2014, January 2015, or are month-to-month payments. Rent expense related to operating leases is recognized ratably over the entire lease term. The Company is required to pay property tax, insurance and normal maintenance costs. As of December 31, 2013, future minimum lease payments required under the operating leases are approximately \$316,000 for 2014, and \$113,000 for 2015.

Rent expense of approximately \$151,000 and \$134,000 was recognized in 2013 and 2012 respectively.

*Contingencies* – The Company is not currently subject to any legal proceedings. The Company may from time to time, however become a party to various legal proceedings, arising in the ordinary course of business.

**8. TAX PROVISION**  
(all \$ in thousands)

The income tax expense for the years ended December 31, 2013 and 2012 are as follows:

	<b>December 31,</b>	
	<u>2013</u>	<u>2012</u>
<u>Current:</u>		
Federal	\$ 14	\$ 29
State	<u>1</u>	<u>3</u>
<u>Deferred:</u>		
Federal	----	----
State	<u>----</u>	<u>----</u>
Total provision for income taxes	<u>\$ 15</u>	<u>\$ 32</u>

A reconciliation of the effective income tax rate to the federal rate is as follows:

	<u>2013</u>	<u>2012</u>
Federal income tax	34.00%	34.00%
State income tax	5.85%	5.85%
Valuation allowance changes affecting the provision for income tax	-66.46%	-45.52%
Tentative minimum tax	1.65%	1.57%
Stock compensation expense	23.53%	4.37%
Other	<u>1.65%</u>	<u>1.57%</u>
	<u>1.65%</u>	<u>1.57%</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets as of December 31, 2013 and December 31, 2012 are as follows:

	<b>December 31,</b>	
	<u>2013</u>	<u>2012</u>
<u>Deferred Tax Assets</u>		
Net operating loss carryforwards	\$ 40,764	\$ 42,257
Accruals	161	124
Research and development credits	3,512	3,108
AMT credits	13	12
Others	<u>1</u>	<u>3</u>
Gross deferred tax assets	\$ 44,451	\$ 45,504

Deferred Tax Liabilities		
Depreciation and amortization	\$ (6)	\$ (46)
Research and development credit reserves	(702)	(622)
	<hr/>	<hr/>
Gross deferred tax liabilities	(708)	(668)
Valuation allowance	\$ (43,742)	\$ (44,835)
	<hr/>	<hr/>
Total net deferred income tax assets	\$ ----	\$ ----

As of December 31, 2013 and December 31, 2012, the Company had net deferred tax assets of approximately \$43,742,000 and \$44,835,000 respectively. Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance. There was a decrease in the valuation allowance of approximately \$1,094,000 in 2013 and a decrease of approximately \$257,000 in 2012.

As of December 31, 2013, the Company had net operating loss carryforwards for federal income tax purposes of approximately \$118,848,000 which expire beginning in the year 2018. The Company also has state net operating loss carryforward of approximately \$6,080,000 which expire beginning in 2014. As of December 31, 2013, the Company had research and development credits for federal income tax purposes of approximately \$1,775,000 which expire beginning in the year 2017. The Company also has state research and development credit carryforwards of approximately \$1,737,000 which never expire.

The Company accounts for income taxes in accordance with ASC 740-10 "Accounting for Income Taxes" which requires that the Company recognize deferred tax liabilities and assets based on the differences between financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all deferred tax assets will not be realized.

ASC 740-10 utilizes a two-step approach wherein a tax benefit is recognized if an income tax position is more-likely-than-not to be sustained. The amount of the benefit is then measured to be the highest tax benefit that is greater than 50% likely to be realized. The Company has elected to include interest and penalties related to its tax contingencies in income tax expense.

This accounting standard had no material impact on the Company's financial statements and there were no accruals for interest and penalties related to uncertain tax positions through December 31, 2013. The Company files a U.S. federal and various state income tax returns. The tax years 2010 through 2013 remain open and subject to audit by the United States and state taxing jurisdictions.

Section 382 of the Internal Revenue Code limits the use of net operating loss and income tax credit carry-forwards in certain situations where changes occur in the stock ownership of a company. If the Company should have an ownership change of more than 50% of the value of the Company's capital stock, utilization of the carryforwards could be restricted. The Company is currently assessing the impact of Section 382 on the future utilization of these carryforwards. The Company has established a full valuation allowance against its deferred tax assets.

The Company had approximately \$702,000 and \$622,000 of unrecognized tax benefits as of December 31, 2013 and December 31, 2012, respectively. The following table summarizes the activity related to our unrecognized tax benefits:

	<u>December 31,</u> <u>2013</u>	<u>December 31,</u> <u>2012</u>
Balance at the beginning of the year	\$ 621	\$ 534
Increases related to current year tax positions	<u>\$ 80</u>	<u>\$ 87</u>
Balance at the end of the year	<u>\$ 701</u>	<u>\$ 621</u>

Interest and penalties related to unrecognized tax benefits would be included as income tax expense in the Company's statement of operations. As of December 31, 2013, and December 31, 2012, the Company had not recognized any tax-related penalties or interest in its balance sheet or statement of operations. The Company does not anticipate a material change to its unrecognized tax benefits over the next twelve months. Unrecognized tax benefits may change during the next twelve months for items that arise in the ordinary course of business. If any of these benefits are recognized, none of them would affect the effective tax rate for the Company.

## **9. SUBSEQUENT EVENTS**

The Company evaluated subsequent events through June 5, 2014, the date these financial statements were available to be issued.

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

### 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.*

### Backlog

We maintain a positive outlook for 2014, our current backlog is approximately \$12.2 million.

### Overview

We provide our global brand clients with social content marketing solutions including strategy, engagement, moderation, and insight through a combination of software and human services. We bring a human touch scaled by technology that creates value out of user content and provides big cost savings. By providing software and services, LiveWorld delivers a full range of social media solutions. 1) Strategy to connect business goals to social media and deploy effective programs 2) Engagement for marketing, service & support. 3) Moderation to protect brands, and 4) Actionable insights to tell brands what their customers think and what to do about it. Our clients use these solutions to improve their relationship marketing, customer support and market learning.

**Social Strategy Solution:** LiveWorld strategic work enables brands to connect business goals to social media programs including providing social audits and market analysis, defining a social brand identity, and developing effective implementation programs. Our team of strategists range in experience from 10 to 30 years in the online community-social media space and have developed hundreds of programs for global brands.

**Social Engagement Solution:** The LiveWorld social engagement solutions stimulate the attention of a brand’s customers, guides their emotional experiences to care about the brand, remember it, come back for more, and bring their friends with them. The solution consists of conversation content programming plans, social media crisis plans, online events, creative concepts, content, community management, and day to day online engagement. Our Social Content Marketing Software (SCMS) enables human social specialists to respond to customers with an organic feel across social channels, while supporting brand content guidelines.

**Social Content Moderation Solution:** The LiveWorld content moderation solution protects the brand and creates a positive environment for customers. Our Social Content Marketing Software (SCMS) supports a trained team of human moderators to accept, reject, and escalate content in context, at an affordable cost. The LiveWorld moderation team creates an integrated workflow to cover thousands of pages simultaneously and at rates that are usually 2x to 10x faster than moderation without our tools. Under optimal conditions we are able to moderate up to 2,000 actions/ hour/moderator (800-1,200 typical) and provide our clients with a scalable, flexible service which gives them meaningful insight to their customers. We also provide moderation services on 3<sup>rd</sup> party applications and platforms with any existing tools that come with those platforms.

**Social Insight Solution:** The LiveWorld social insight solution enables brands to understand what their customers think and what to do about it. Our Active Listening solutions, monitor the social web and provide actionable insights based on conversational and metrics analysis. These services are available with popular 3<sup>rd</sup> party listening and analytics tools and/or with LiveWorld software. Our insight agents review and tag content at high speed, maintaining quality by considering the content in context. Using our culture-tone-engagement framework, social strategists evaluate content and conversational dynamics to produce deep insights and actionable recommendations. Our Social Content Marketing Software (SCMS), is designed to engage and scale human review and analysis at every level — helping brands to define what social media content to target to affect which business decisions.



## Total Revenues

The Company recognizes revenues 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.

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 our Strategy, Engagement, Moderation and Insight software and services to clients; the expenses associated with the development, set-up and operation of our services, including expenses associated with server costs for managing the software tools, license fees for our platform; and the cost of providing moderators and any strategic consulting services the client may request from us. These expenses consist primarily of salaries, payroll taxes, benefits and related expenditures for moderation and consulting services, as well as, software license fees, hardware costs.

## 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.

*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

	Twelve Months Ended December 31,	
	2013	2012
Total revenues	100%	100%
Cost of revenues	36	35
Gross Margin	64	65
Operating Expense		
Product development	26	27
Sales and marketing	13	10
General and administrative	20	16
Total operating expense	59	53
Income from operations	5%	12%

## **Twelve Months Ended December 31, 2013 and 2012**

### **Total Revenues**

Our revenues for the twelve months ended December 31, 2013 were approximately \$14.5 million, as compared to approximately \$13.6 million for the twelve months ended December 31, 2012. This was an increase of approximately \$966,000 or 7% period-over-period. Revenues increased primarily as a result of new projects with our existing clients and new client acquisitions.

For the twelve months ended December 31, 2013, revenues from eBay and Walmart together comprised approximately 59% of our total revenues while all other clients represented approximately 41% of our total revenues. This compares to the twelve months ended December 31, 2012 where revenues from eBay and Walmart together comprised approximately 56% of our total revenues and all other clients represented approximately 44% of total revenues.

### **Cost of Revenues**

Cost of revenues were approximately \$5.3 million, or 36% of total revenues for the twelve months ended December 31, 2013, and \$4.7 million or 35% of total revenues for the twelve months ended December 31, 2012. This represented an increase of approximately \$571,000 or 12% period-over-period. The increase in cost of revenues was driven primarily by the increase in new client acquisitions and new projects with our existing clients.

### **Operating Expenses**

*Product Development.* Expenditures for product development were approximately \$3.7 million, or 26% of total revenues for the twelve months ended December 31, 2013, and approximately \$3.7 million or 27% of total revenues for the twelve months ended December 31, 2012. This represented an increase in absolute dollars of approximately \$67,000, or 2% period-over-period. The increase was a result of increased hiring for our product development team.

The majority of product development costs are personnel related. 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 \$1.9 million, or 13% of total revenues for the twelve months ended December 31, 2013, and approximately \$1.3 million, or 10% for the twelve months ended December 31, 2012 representing an increase in absolute dollars of approximately \$564,000 or 30% period-over-period. The period-over-period increase in sales and marketing activities was as a result of increased headcount in our sales team, and an increase in our marketing efforts.

*General and Administrative.* General and administrative expenses were approximately \$2.8 million, or 20% of total revenues for the twelve months ended December 31, 2013, and approximately \$2.1 million, or 16% of total revenues for the twelve months ended December 31, 2012. This represented an increase in absolute dollars of approximately \$728,000, or 34% period-over-period. The increase in general and administrative expenses period-over-period was related to additional costs for outside advisory services and recruiting expenses.

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

Our total assets were approximately \$5.5 million as of December 31, 2013, and approximately \$4.4 million as of December 31, 2012. This represented an increase of approximately \$1.1 million, or a 25% increase of total assets. Our cash and cash equivalents were approximately \$4.4 million as of December 31, 2013 which was an increase of approximately \$1.0 million or 30% from the cash and cash equivalents balances of approximately \$3.4 million as of December 31, 2012. This increase in the cash and cash equivalents was due to the increased revenues and collections on deferred revenues.

Net accounts receivable was approximately \$488,000 as of December 31, 2013 which is a decrease of approximately \$29,000, or 6% from the net accounts receivable balance of approximately \$517,000 as of December 31, 2012. Accounts receivable balances are expected to fluctuate with the levels of new client acquisition and enhancement activity and the timing of billings and collections.

For the twelve months ended December 31, 2013 we had positive cash flows of approximately \$1.0 million while for the twelve months ended December 31, 2012 we had positive cash flows of approximately \$2.1 million.

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 foreseeable future.

As of December 31, 2013, our current assets, which are made up of cash and cash equivalents, accounts receivable, and prepaid expenses were approximately \$5.2 million while our current liabilities, which are made up of our accounts payable, deferred revenue, and accrued liabilities were approximately \$1.4 million. This represented a positive working capital position of approximately \$3.8 million, which was an increase of approximately \$993,000 from the period ended December 31, 2012.

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.

### **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.