

LIVEWORLD INC
Form 10QSB
November 09, 2007

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-QSB**

(Mark One)

Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2007

Transition Report Pursuant to Section 13 or 15(d) of the Exchange Act

**For the transition period from to
Commission File number 000-26657
LIVEWORLD, INC.**

(Exact name of small business 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
(Registrant's telephone number)

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

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

As of September 30, 2007, there were 30,862,811 shares of registrant's Common Stock, \$0.001 par value, outstanding.

Transitional Small Business Disclosure Format (Check one): Yes No

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

| | December 31, 2006 | September 30, 2007 |
|--|------------------------------|-------------------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 3,217 | \$ 2,322 |
| Accounts receivable, net | 1,222 | 1,158 |
| Accrued development and set up | 72 | |
| Prepaid expenses | 47 | 141 |
| Other current assets | 13 | 8 |
| Total current assets | 4,571 | 3,629 |
| Property and equipment, net | 1,110 | 995 |
| Investment in joint venture | 977 | 836 |
| Other assets | 4 | 5 |
| Total assets | \$ 6,662 | \$ 5,465 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 343 | \$ 611 |
| Accrued salaries | 91 | 29 |
| Accrued vacation | 278 | 389 |
| Due to officer | 34 | 1 |
| Other accrued liabilities | 73 | 131 |
| Current portion of capital lease obligations | 53 | 75 |
| Deferred revenue | 527 | 491 |
| Total current liabilities | 1,399 | 1,727 |
| Long-term capital lease obligation | 121 | 118 |
| Total liabilities | 1,520 | 1,845 |
| Stockholders' equity | | |
| Common stock: \$0.001 par value, 100,000,000 shares authorized and 30,682,811 and 30,862,811 shares issued and outstanding at December 31, 2006 and September 30, 2007, respectively | 31 | 31 |
| Additional paid-in-capital | 139,589 | 139,856 |
| Accumulated deficit | (134,478) | (136,267) |
| Total stockholders' equity | 5,142 | 3,620 |
| Total liabilities and stockholders' equity | \$ 6,662 | \$ 5,465 |

See accompanying notes to the unaudited financial statements.

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

| | Three Months Ended | | Nine Months Ended | |
|--------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2006 | 2007 | 2006 | 2007 |
| Total revenues | \$ 2,331 | \$ 2,809 | \$ 6,929 | \$ 7,885 |
| Cost of revenues | 891 | 1,110 | 2,741 | 3,026 |
| Gross margin | 1,440 | 1,699 | 4,188 | 4,859 |
| Operating expenses | | | | |

See accompanying notes to the unaudited financial statements.

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|------------|
| | 2006 | 2007 |
| Cash flows from operating activities | | |
| Net loss | \$ (227) | \$ (1,790) |
| Adjustments to reconcile net loss to cash flow provided by (used in) operating activities: | | |
| Stock based compensation expense | 66 | 217 |
| Depreciation | 354 | 455 |
| Equity in net loss of unconsolidated affiliate | | 141 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 89 | 64 |
| Other assets | 38 | (90) |
| Accounts payable | 202 | 268 |
| Accrued development and set-up | (262) | 72 |
| Accrued liabilities | 36 | 76 |
| Deferred revenue | 247 | (36) |
| Net cash provided by (used in) operating activities | 543 | (623) |
| Cash flows from investing activities | | |
| Purchase of property and equipment | (614) | (340) |
| Proceeds from repayment of note receivable from stockholder | 9 | |
| Net cash used in investing activities | (605) | (340) |
| Cash flows from financing activities: | | |
| Capital lease financing | | 18 |
| Proceeds from the issuance of common stock | 2,000 | |
| Proceeds from exercise of stock options | 7 | 50 |
| Net cash provided by financing activities | 2,007 | 68 |
| Change in cash and cash equivalent | 1,945 | (895) |
| Cash and cash equivalents, beginning of period | 1,426 | 3,217 |
| Cash and cash equivalents, end of period | \$ 3,371 | \$ 2,322 |
| Supplemental disclosure of cash flow activities: | | |
| Income taxes paid | \$ 46 | \$ 22 |
| Interest expense paid | \$ | \$ 10 |

See accompanying notes to the unaudited financial statements.

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LIVEWORLD, INC.
NOTES TO THE UNAUDITED CONDENSED FINANCIAL STATEMENTS
September 30, 2007

1. INTERIM FINANCIAL STATEMENTS

We prepared the unaudited condensed financial statements following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. 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 pursuant to SEC rules and regulations; nevertheless, we believe that the disclosures herein are adequate to make the information presented not misleading. Operating results for the three and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007 or future periods. The condensed balance sheet as of December 31, 2006 was derived from the audited financial statements as of that date. These unaudited condensed financial statements should be read in conjunction with our audited financial statements for the year ended December 31, 2006 contained in Amendment No. 2 to our Form10-SB filed with the SEC on July 13, 2007.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157 (FAS 157), Fair Value Measurements, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. FAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. FAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided we have not yet issued financial statements, including for interim periods, for that fiscal year. We are currently evaluating the impact of FAS 157, but do not expect the adoption of FAS 157 to have a material impact on our financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159 (FAS 159), The Fair Value Option for Financial Assets and Financial Liabilities including, an amendment to SFAS No. 115 which permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. FAS159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of FAS 159, but do not expect the adoption of FAS 159 to have a material impact on our financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Interpretation 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB No. 109 . FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return, including a decision on whether or not to file in a particular jurisdiction. The provisions of FIN 48 are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet a more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The cumulative effect of applying the provisions of FIN 48 is reported as an adjustment to the opening balance of retained earnings. FIN 48 is effective for years beginning after December 15, 2006; therefore, the Company has adopted FIN 48 as of January 1, 2007. The adoption of this accounting standard increases the level of disclosure that we provide regarding our tax positions. The adoption of FIN 48 does not have a material impact on our financial position and results of operations.

Other recent accounting pronouncements issued by the FASB (including it Emerging Issues Task Force ETIF), the American Institute of Certified Public Accountants (AICPA) and the SEC did not or are not believed by management to have a material impact on our present or future financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenues We recognize revenue in accordance with Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition in Financial Statements, 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.

We have 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

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consulting. Accordingly, these contracts are accounted for in accordance with EITF No. 00-21, Revenue Arrangements with Multiple Deliverables. EITF No. 00-21 requires that we assess whether the different elements qualify for separate accounting. Because we do 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 service portion of the contract. Revenues from on-line community hosting, on-line community management, moderation services, and consulting are recognized as the services are provided.

Deferred Revenue Deferred revenue is the amount associated with the initial service development and set-up of the community for our clients. These service development and set-up revenues are paid upfront but recognized ratably as the operational service contract is recognized.

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. The dilutive effect of outstanding stock options and warrants is computed using the treasury stock method. There were 23,590,277 and 23,604,277 outstanding options and warrants to purchase shares of our common stock for the periods ended September 30, 2006 and 2007, respectively. The outstanding options and warrants were excluded from the determination of diluted net loss per share for both the nine and three month period ended September 30, 2006 and 2007 as their effects are anti-dilutive.

Allowances for Doubtful Accounts We maintain an allowance for doubtful accounts for estimated losses that may arise if any of its customers are unable to make required payments. Management specifically analyzes the age of customer balances, historical bad debt experience, customer credit-worthiness, and changes in customer payments terms when making estimates of the uncollectibility of our accounts receivable balances. If we determine that the financial conditions of any of its customers deteriorated, whether due to customer specific or general economic issues, an increase in the allowance will be made. Accounts receivable are written off when all collection attempts have failed. Our allowance for doubtful accounts was \$0 as of December 31, 2006 and September 30, 2007.

4. STOCK-BASED COMPENSATION

Effective January 1, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R) (FAS No. 123 (R)), Share-Based Payment, which is a revision of SFAS No. 123. FAS No. 123(R) supersedes APB 25, Accounting for Compensation Arrangements and amends SFAS No. 95, Statement of Cash Flow. FAS No. 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 No. 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 We estimate 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 our 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 100% was used as an estimate of the expected future volatility of our stock price. Because trading of the stock is so thin, calculating the volatility based on daily market trades was not considered to be representative of future price movements when the stock is listed. We looked at the volatility of other companies which we judge to be similar based on industry. These companies had volatility ranging from 89 to 135. A factor of

1.0 was chosen based on historical data and on the similar companies.

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.

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Estimated Forfeitures When estimating forfeitures, we consider voluntary termination behavior as well as analysis of actual option forfeitures.

For the three months ended September 30, 2007 we issued a total of 245,000 options with an approximate fair value of \$80,000 for the option grants, and total expense for the period was approximately \$3,000.

We estimated the fair value of the stock options using the Black-Scholes option-pricing model, by using the following assumptions for the options granted for the three months ended September 30, 2007:

| | |
|-------------------------|--------------------------|
| | Stock Options |
| Dividend yield | 0% |
| Expected volatility | 100% |
| Risk-free interest rate | 4.40% |
| Expected term | 4 Years |
| Forfeiture rate | 13% |

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, 2006 | | 21,576,777 | \$ 0.12 | | |
| Granted | | | | | |
| Forfeited | | (175,000) | \$ 0.45 | | |
| Exercised | | | | | |
| Balance as of March 31, 2007 | 0 | 21,401,777 | \$ 0.12 | | |
| Additional shares reserved | 10,696,768 | | | | |
| Granted | (362,500) | 362,500 | \$ 0.57 | | |
| Forfeited | 40,000 | (40,000) | \$ 0.45 | | |
| Exercised | | (100,000) | \$ 0.38 | | |
| Balance as of June 30, 2007 | 10,374,268 | 21,624,277 | \$ 0.11 | | |
| Granted | (245,000) | 245,000 | \$ 0.46 | | |
| Forfeited | 185,000 | (185,000) | \$ 0.03 | | |
| Exercised | | (80,000) | \$ 0.03 | | |
| Balance as of September 30, 2007 | 10,314,268 | 21,604,277 | \$ 0.12 | 5.9 | \$ 9,104 |

The aggregate intrinsic value in the table above represents the difference between the exercise price of the underlying awards and the quoted price of our common stock for the options that were in-the-money as of September 30, 2007. During the three months ended September 30, 2006 and 2007, the aggregate intrinsic value of options exercised under our stock option plans was \$11,000 and \$41,000, respectively, determined as of the date of option exercise.

The 1996 Stock Option Plan (1996 Plan) provides for stock options to be granted to employees, independent contractors, officers, and directors. Prior to 2004, options were generally granted at an exercise price which approximates eighty-five percent (85%) to one hundred percent (100%) of the estimated fair market value per share at the date of grant, as determined by our Board of Directors. Since 2004, options have generally been granted at one hundred percent (100%) of their estimated fair market value per share at the date of grant, as determined by our Board of Directors. All options issued under the 1996 Plan and the 2007 Stock Option Plan (2007 Plan) have a term of ten (10) years, and generally have a vesting schedule such that they vest ratably over four (4) years, twenty-five percent (25%) one (1) year after the grant date and the remainder at a rate of 1/36 per month thereafter. As of December 31, 2005, all outstanding stock options were exercisable. The 1996 Plan expired in October of 2006 and was replaced by our 2007 Plan. Under the 2007 Plan, the number of shares authorized for grant is 10,696,768. As of September 30, 2007 there were a total of 21,604,277 outstanding options under the 1996 Plan and the 2007 Plan. As of September 30, 2007, there was approximately \$878,000 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.

Table of Contents**5. PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following items:

| (\$ in thousands) | December 31, 2006 | September 30, 2007 |
|--|-------------------------|--------------------------|
| Computer Equipment | \$ 1,978 | \$ 2,241 |
| Software | 1,034 | 1,077 |
| Furniture and fixtures | 22 | 24 |
| Leased Equipment | 174 | 208 |
| Accumulated depreciation | (2,098) | (2,555) |
| Property, furniture and equipment, net | \$ 1,110 | \$ 995 |

The depreciation expense was approximately \$62,000 and \$150,000 for the three months ended September 30, 2006 and 2007 respectively, and approximately \$354,000 and \$456,000 for the nine months ended September 30, 2006 and 2007 respectively.

Item 2. Management's Discussion and Analysis**Special Note Regarding Forward-Looking Statements**

This report on Form 10-QSB 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, 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 form 10-QSB. 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 Amendment No. 2 to our Form 10-SB filed with the SEC on July 13, 2007.

Overview

We are an interactive agency specializing in the provision of private label online social networks and community services for companies, many of which are in the Fortune 1000, to engage and build loyalty with, provide support to and gather intelligence from their customers. We develop and operate online social networks and communities for our clients. These communities are designed to build lasting relationships with and among our client's customers and other constituencies.

We create value by enabling and managing dialogue based relationships on the Internet. This in turn addresses the burgeoning market for Internet based relationship marketing, customer support and business intelligence services. Although online communities have existed for over 20 years, only in the past few years has the genre come into its own, and we believe it will become one of the dominant venues by which brands market to and manage relationships with their customers. We provide not only the technology and infrastructure to create an online community and the moderation services to oversee it, but also expertise to consult with our clients on the best way to integrate their community with their brand. Our community management and moderation services help to define the environment, provide leadership, and direct the content of the community to reflect that of the client's focus. Our features and tools enable members of the community to express themselves and interact with each other, and our client. In addition, our reporting tools reveal to the client what is happening and what it means, factors critical to community management, as well as to our clients to help them achieve their business objectives. Our services consist of the following products delivered on a complete end-to-end or modular basis:

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

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

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The LiveWorld Community Center, which is an integrated social network/online community that includes expressive profiles (user name, photo, interests, blog, user video, photo albums, guestbooks, and friends lists), message forums, polls, community galleries, and community calendars.

Stand-alone services such as blogs, user videos, message forums, groups, chats and live events (interactive webcasts).

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

Moderation Services: Moderation Services include standard policing, topical and editorial moderation. Moderators are trained personnel that read and view user content for adherence to web site guidelines, and take appropriate action when content violates those guidelines. Such action might include permitting, hiding (or deleting), or escalating such content to a supervisor. Moderation can also involve trained personnel leading topical discussions, or selecting or editing site content for featured display.

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

Backlog

We maintain a positive outlook for 2007, and our current backlog for the remainder of the fiscal year is approximately \$2.8 million.

Results From Operations

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

LIVEWORLD INC.
UNAUDITED STATEMENT OF OPERATIONS
(As a percentage of revenue)

| | Three Months Ended | | Nine Months Ended | |
|----------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2006 | 2007 | 2006 | 2007 |
| Total revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of revenues | 38.2 | 39.5 | 39.6 | 38.4 |
| Gross margin | 61.8 | 60.5 | 60.4 | 61.6 |
| Operating expenses | | | | |
| Product development | 20.4 | 25.4 | 17.7 | 25.0 |
| Sales and marketing | 17.1 | 22.6 | 18.9 | 23.2 |
| General and administrative | 32.0 | 28.4 | 27.2 | 33.0 |
| Stock based compensation | 2.2 | 2.6 | 1.0 | 2.8 |
| Total operating expenses | 71.7 | 79.0 | 64.8 | 84.0 |
| Operating loss | (9.9) | (18.5) | (4.4) | (22.4) |
| Other income | 0.9 | 2.0 | 1.8 | 1.7 |
| Loss before tax | (9.0)% | (16.5)% | (2.6)% | (20.7)% |

Nine and Three Months Ended September 30, 2006 and 2007**Total Revenues**

Our revenues increased from approximately \$6.9 million for the nine months ended September 30, 2006 to \$7.9 million for the nine months ended September 30, 2007, which represented an increase of 14% period-over-period. Revenues increased primarily as a result of increased sales of our community center services which include professional services, application hosting, and community management. We continue to develop relationships with new clients as we focus on marketing our community center services. Revenues for the nine months ended September 30, 2007 for non-AOL LLC clients increased 59%, which was offset in part by the decrease in AOL LLC (AOL US) revenues, AOL US revenues dropped 56% for the same period. AOL US represented approximately \$2.7 million for the nine months ended September 30, 2006 and \$1.2 million for the nine months ended September 30, 2007.

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For the nine months ended September 30, 2006, revenues from AOL US comprised approximately 39% of our total revenues and eBay Inc. (eBay) accounted for approximately 33% of our total revenues while all other clients represented approximately 28% of our total revenues. For the nine months ended September 30, 2007, revenues from AOL US comprised approximately 15% of our total revenues and eBay accounted for approximately 31% of our total revenues while all other clients represented 54% of our total revenues.

New clients in the nine months ended September 30, 2007 who we launched communities or provided moderation services for included the following:

AOL Europe

Jive as provider for Bank of America

The British Broadcasting Corporations

Digitas as agency for American Express

Hillary Clinton Presidential Campaign
Mattel

MindShare

MEC as agency for Sony Ericsson

Wildfire as agency for Procter and Gamble

Wildfire as agency for Glaxo-Smith Klein

Our revenues increased from approximately \$2.3 million in the three months ended September 30, 2006 to \$2.8 million for the three months ended September 30, 2007 representing an increase of 21% period-over-period. The growth of our revenues was driven by the increase in non AOL US revenues which grew 56% period-over-period, or approximately \$914,000, from \$1.6 million to \$2.5 million. This increase was offset in part by the decrease in AOL US revenues, which dropped 62% period-over-period. AOL US was approximately \$705,000, or 30% of total revenues for the three months ended September 30, 2006 and reduced to approximately \$270,000, or 10% of total revenues in the three months ended September 30, 2007. We expect our total revenues from AOL US to decline in both absolute dollars and as a percentage of revenues for fiscal 2007 and to be insignificant as a percentage of revenues for 2008. The changes in AOL US business have resulted in a continuous reduction in the volume of services AOL US purchases from us. We anticipate that the loss of this revenue will be offset in part or in full by additional revenues from new contracts and projects with our existing clients or new clients, and should not have a material impact on our operations.

For the three months ended September 30, 2007, revenues from AOL US accounted for approximately 10% and eBay represented approximately 28% of our total revenues, while all other clients represented 62% of our total revenues for the period.

No client other than eBay and AOL US represents more than 10% of our total revenues in a given period.

Operating Expenses

Product Development Product development costs were approximately \$1.2 million, or 18% of total revenues for the nine months ended September 30, 2006, and \$2.0 million, or 25% of total revenues for the nine months ended September 30, 2007, which represented an increase of 60%. For the three months ended September 30, 2006, product development costs were approximately \$476,000, or 20% of total revenues, and \$713,000, or 25% of total revenues for the three months ended September 30, 2007, which represented an increase of 50% period-over-period.

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The period-over-period spending increases were related to our continued development efforts and improvements to our service offerings. The majority of these costs were personnel related, including salary costs, as we hired employees in connection with the ongoing development and enhancement of our services. We are committed to our service development efforts and expect service development costs will continue to increase in future periods. Such efforts may not result in additional new services and any new services may not gener