Answers CORP
Form 10QSB
August 10, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NUMBER 001-32255

ANSWERS CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	98-0202855
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

Jerusalem Technology Park
The Tower
Jerusalem 91481 Israel
(ADDRESS INCLUDING ZIP CODE OF PRINCIPAL EXECUTIVE OFFICES)

+972-2-649-5000
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

Indicate by an (X) whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 x NO o

Indicate by check mark whether registrant is a shell company (as defined in rule 12b-2 of the Exchange Act): Yes o NO x

As of August 8, 2006, the registrant had outstanding 7,780,946 shares of Common Stock, $0.001 par value per share.

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PART I. FINANCIAL INFORMATION

Cautionary Note regarding Forward-Looking Statements

In addition to historical information, this Quarterly Report on Form 10-QSB contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Forward-looking statements are those that predict or describe future events. You can generally identify forward-looking statements as statements containing the words “believe,” “expect,” “will,” “anticipate,” “intend,” “estimate,” “project,” or other similar expre although not all forward-looking statements contain these identifying words. All statements in this report regarding our future strategy and operations, projected financial position, estimated future revenues, projected costs, future prospects are forward-looking statements. You should not place undue reliance on our forward-looking statements because the matters they describe are subject to known and unknown risks, many of which are beyond our control. Our forward-looking statements are based on the information currently available to us and speak only as of the date on which this report was filed with the SEC. We expressly disclaim any obligation to issue any updates or revisions to our forward-looking statements, even if subsequent events cause our expectations to change regarding the matters discussed in those statements. Over time, our actual results, performance or achievements will likely differ from the anticipated results, performance or achievements that are expressed or implied by our forward-looking statements, and such difference might be significant and materially adverse to our stockholders. Factors that may cause such differences include, but are not limited to, those discussed under "Risk Factors" set forth in our registration statement on Form S-3/A, as filed with the Securities and Exchange Commission in May 2006 and declared effective in June 2006, including among others the uncertainties associated with our ability to increase the number of users visiting our Website, our ability to increase the number of partners who will generate increased traffic to our Website, our ability to improve the monetization of our products, a decision by Google to stop directing user traffic to Answers.com through its definition link, a decision by Google, currently the provider of almost all of our search engine traffic, and other search engines, to change the algorithms responsible for directing search queries to the web pages that are most likely to contain the information being sought by Internet users or restrict the flow of users visiting our Website, our ability to renew current contracts with content providers on commercially acceptable terms or that our costs with respect to these contracts will not increase prohibitively following any renewal, the risks of litigation relating to our intellectual property, the risks associated with dependence upon key personnel and the need for additional financing. Please consider our forward-looking statements in light of those risks as you read this report.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Answers Corporation (formerly GuruNet Corporation) and Subsidiary

Consolidated Balance Sheets (in thousands except share data)

	June 30 2006 $	December 31 2005 $
Assets		
Current assets:		
Cash and cash equivalents	**4,528**	2,840
Investment securities	**7,435**	11,163
Accounts receivable	**791**	451
Other prepaid expenses and other current assets	**409**	349
Total current assets	**13,163**	14,803
Long-term deposits (restricted)	**214**	211
Deposits in respect of employee severance obligations	**705**	610
Property and equipment, net	**786**	597
Other assets:		
Intangible assets, net	**5,000**	5,384
Prepaid expenses, long-term	**362**	254
Deferred tax asset, long-term	**15**	13
Total other assets	**5,377**	5,651
Total assets	**20,245**	21,872
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	**339**	305
Accrued expenses	**666**	673
Accrued compensation	**526**	322
Deferred revenues, short-term	**33**	67
Total current liabilities	**1,564**	1,367
Long-term liabilities:		
Liability in respect of employee severance obligations	**707**	622
Deferred tax liability, long-term	**120**	98

Deferred revenues, long-term	**430**	442
Total long-term liabilities	**1,257**	1,162
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: $0.01 par value; 1,000,000 shares authorized and undesignated	**-**	-
Common stock; $0.001 par value; 30,000,000 shares authorized;7,780,946 and 7,664,969 shares issued and outstanding as of June 30, 2006 and December 31, 2005, respectively	**8**	8
Additional paid-in capital	**70,492**	69,492
Deferred compensation	**-**	(3,518)
Accumulated other comprehensive loss	**(28)**	(29)
Accumulated deficit	**(53,048)**	(46,610)
Total stockholders' equity	**17,424**	19,343
Total liabilities and stockholders' equity	**20,245**	21,872

See accompanying notes to the interim consolidated financial statements

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Answers Corporation (formerly GuruNet Corporation) and Subsidiary

Consolidated Statements of Operations (in thousands except share and per share data)

	Three months ended June 30		Six months ended June 30	
	2006	**2005**	**2006**	**2005**
	$	$	$	$
Revenues:				
Answers.com advertising revenue	**1,457**	357	**2,547**	463
Answers service licensing	**46**	28	**99**	12
Subscriptions	**8**	40	**19**	125
	1,511	425	**2,665**	600
Costs and expenses:				
Cost of revenue	**808**	286	**1,492**	528
Research and development	**1,951**	344	**4,588**	640
Sales and marketing	**678**	451	**1,320**	812
General and administrative	**965**	1,078	**1,765**	1,931
Total operating expenses	**4,402**	2,159	**9,165**	3,911
Operating loss	**(2,891)**	(1,734)	**(6,500)**	(3,311)
Interest income, net	**145**	145	**286**	231
Other expenses, net	**(201)**	(21)	**(204)**	(21)
Loss before income taxes	**(2,947)**	(1,610)	**(6,418)**	(3,101)
Income taxes	**(11)**	9	**(20)**	(6)
Net loss	**(2,958)**	(1,601)	**(6,438)**	(3,107)
Basic and diluted net loss per common share	**(0.39)**	(0.23)	**(0.85)**	(0.48)
Weighted average shares used in computing basic and diluted net loss per common share	**7,678,328**	6,986,768	**7,555,185**	6,512,508

See accompanying notes to the interim consolidated financial statements

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Answers Corporation (formerly GuruNet Corporation) and Subsidiary

Consolidated Statements of Cash Flows (in thousands)

	Six months ended June 30	
	2006	**2005**
	$	$
Cash flows from operating activities:		
Net loss	**(6,438)**	(3,107)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	**594**	115
Deposits in respect of employee severance obligations	**(95)**	(28)
Increase in liability in respect of employee severance obligations	**85**	46
Deferred income taxes	**20**	3
Stock-based compensation to non-employees for services rendered	**-**	809
Stock-based compensation to employees and directors	**856**	121
Stock-based compensation in connection with the Brainboost transaction (see Note 4)	**3,489**	-
Exchange rate losses	**(23)**	12
Changes in operating assets and liabilities:		
Increase in accounts receivable and other current assets	**(400)**	(174)
Increase (decrease) in long-term prepaid expenses and current assets	**(108)**	35
Increase in accounts payable	**34**	176
Increase in accrued expenses and other current liabilities	**197**	461
Decrease in short-term deferred revenues	**(34)**	(96)
Decrease in long-term deferred revenues	**(12)**	-
Net cash used in operating activities	**(1,835)**	(1,627)
Cash flows from investing activities:		
Capital expenditures	**(308)**	(161)
Capitalization of software development costs	**(36)**	-
Purchase of intangible assets	**(55)**	-
Increase in long-term deposits	**(3)**	(13)
Purchases of investment securities	**(8,816)**	(16,150)
Proceeds from sales of investment securities	**12,545**	5,200
Net cash provided by (used in) investing activities	**3,327**	(11,124)
Cash flows from financing activities:		
Exercise of common stock options and warrants	**173**	13,828
Net cash provided by financing activities	**173**	13,828
Effect of exchange rate changes on cash and cash equivalents	**23**	(12)
Net increase in cash and cash equivalents	**1,688**	1,065

Cash and cash equivalents at beginning of period	**2,840**	1,565
Cash and cash equivalents at end of period	**4,528**	2,630
Supplemental disclosures of cash flow information:		
Income taxes paid	**4**	3
Non-cash investing activities:		
Unrealized net loss from securities	**1**	-

See accompanying notes to the interim consolidated financial statements

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Note 1 - Business

Answers Corporation ("the Parent"), formerly GuruNet Corporation, was founded as a Texas corporation on December 22, 1998, and reorganized as a Delaware corporation in April 1999. On December 27, 1998 the Parent formed a subsidiary based in Israel ("the Subsidiary"), primarily for the purpose of providing research and development services to the Parent. On December 1, 2005, the Parent acquired all of the limited liability interests of Brainboost Technology, LLC for $4 million in cash and 439,000 shares of restricted stock ("Brainboost" - see Note 4). On April 20, 2006, Brainboost Technology, LLC filed a certificate of dissolution with the state of Delaware and all of its assets were absorbed into the Parent. Answers Corporation and its wholly owned Subsidiary are collectively referred to as "the Company". The Company operates an answer-based search service to users through its Web site, Answers.com, downloadable applications and co-brands.

The Company began trading on NASDAQ under the symbol ANSW on August 2, 2005. Prior to such date, the Company's shares were traded on the American Stock Exchange under the symbol GRU. On October 17, 2005, the Company changed its corporate name from GuruNet Corporation to Answers Corporation.

The accompanying unaudited interim consolidated financial statements were prepared in accordance with the instructions for Form 10-QSB and, therefore, do not include all disclosures necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with generally accepted accounting principles. All adjustments, which are, in the opinion of management, of a normal recurring nature and are necessary for a fair presentation of the interim financial statements, have been included. Nevertheless, these financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-KSB/A for the year ended December 31, 2005. The results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period.

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Note 2 - Revenue Recognition

The Company, through its website Answers.com and co-branded sub-domains of Answers.com, generates revenues via advertising in the form of sponsored links and image ads. This includes both pay-per-performance ads and paid-for-impression advertising. In the pay-for performance model, the Company earns revenue based on the number of clicks associated with such ads; in the paid-for-impression model, the Company's revenue is derived from the display of ads.

The Company incentivizes third-party sites for traffic they send to Answers.com or co-branded sub-domains of Answers.com. The fees paid to such partners are calculated based upon a percentage of the revenue the Company earns from such traffic and are included in cost of revenues.

Generally, the Company does not contract directly with advertisers, but rather, obtains those advertisers through the efforts of third parties. The third party is obligated to pay the Company a portion of the revenue it receives from advertisers, as compensation for the Company's sale of promotional space on its Internet properties. Amounts received from such third parties are reflected as revenue in the period in which such advertising services are provided.

The Company also provides its answers-based search services to third parties that include the service in their own websites. Revenues from the provision of such services are recognized in the period the services are provided.

The Company recognizes revenues from sales of subscriptions over the life of the subscription, which is generally one year, in accordance with Statement of Position (SOP) No. 97-2, "Software Revenue Recognition", issued by the American Institute of Certified Public Accountants (AICPA). Sales that do not yet meet the criteria for revenue recognition, are classified as "Deferred Revenues" on the balance sheet, and are amortized over the subscription period.

In 2003, the Company sold lifetime subscriptions to its consumer product, which had no defined termination date. Cash received from such lifetime subscriptions was recorded as deferred revenues. Beginning April 2004, certain users who purchased lifetime subscriptions in 2003, exchanged their lifetime subscriptions for free two-year subscriptions to a newer enhanced version of the GuruNet product. The cash previously received from such users is recognized over the new two-year subscription. Lifetime subscriptions, which were not exchanged for subscriptions with defined termination dates, continue to be deferred and amounted to $425,000 as of June 30, 2006.

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Note 3 - Accounting for Stock-Based Compensation

Adoption of Statement of Financial Accounting Standards No. 123 (revised 2004)

Prior to January 1, 2006, the Company accounted for stock-based awards to employees and directors under the intrinsic value method, which followed the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "*Accounting for Stock Issued to Employees*" (APB 25). The intrinsic value method of accounting resulted in compensation expense for stock options to the extent option exercise prices were set below the market value of the Company's stock on the date of grant. To the extent stock option awards were forfeited prior to vesting, the previously recognized expense was reversed and recorded as a reduction to operating expenses.

Additionally, prior to January 1, 2006, the Company adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, *"Accounting for Stock-based Compensation"* (SFAS 123) and SFAS No. 148, "*Accounting for Stock-Based Compensation—Transition and Disclosure"* (SFAS 148), for awards to its directors and employees. The fair value of options granted to employees and directors prior to May 12, 2004, the date of the Company's first filing with the U.S. Securities and Exchange Commission (SEC), in connection with its Initial Public Offering (IPO), was estimated on the date of grant using the minimum-value method. The fair value of options granted to employees and directors subsequent to May 12, 2004, was measured according to the Black-Scholes option-pricing model.

The fair value of options and warrants granted to non-employees prior to January 1, 2006, has been computed and accounted for in accordance with SFAS 123 and Emerging Issues Task Force (EITF) 96-18, *"Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services"*, and was measured according to the Black-Scholes option-pricing model.

As of January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), *"Share-Based Payments"* (SFAS 123R) using the modified prospective method, which requires measurement of compensation cost for all stock-based awards based upon the fair value on date of grant and recognition of such compensation cost over the service period for awards expected to vest. Under this method, the Company recognizes compensation cost for awards granted on or after January 1, 2006, based on the Black-Scholes option-pricing model. Furthermore, with the exception of stock options granted to employees prior to May 12, 2004, the date of the Company's first filing with the SEC in connection with its IPO, the Company will recognize cost for unvested share-based awards as of January 1, 2006 based on the grant date fair value of those awards, adjusted for estimated forfeitures, if any, as previously calculated and reported for pro-forma disclosure purposes. The Company will recognize cost for unvested share-based awards as of January 1, 2006 and that were granted prior to May 12, 2004, based on the intrinsic value of such grants on their grant date. The value of stock options, as noted, is recognized as compensation expense on a straight-line basis, over the requisite service period of the entire award, net of estimated forfeitures. Based on its decision to use the modified prospective method in adopting SFAS 123R, the Company did not need to adjust the corresponding 2005 amounts included in these financial statements.

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Note 3 - Accounting for Stock-Based Compensation (cont'd)

Valuation Assumptions for Stock Options

The fair value for each stock option granted to employees and directors during the six months ended June 30, 2006 and 2005, was estimated at the date of grant using the Black-Scholes option-pricing model, assuming no dividends and the following assumptions:

	Six months ended June 30	
	2006	**2005**
Weighted average risk-free interest rate	4.64%	3.84%
Expected life (in years)	4.08	3.97
Weighted average expected volatility	40.86%	53.06%

The fair value for each stock option granted to non-employees during the six months ended June 30, 2005, was estimated at the date of grant using the Black-Scholes option-pricing model, assuming no dividends and the following assumptions (no such options were granted during the six months ended June 30, 2006):

	Six months ended June 30	
	2006	**2005**
Weighted average risk-free interest rate	N/A	4.01%
Contractual term (in years)	N/A	9.87
Weighted average expected volatility	N/A	72.36%

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option.

The expected life represents the weighted average period of time that options granted are expected to be outstanding. The expected life of the options granted to employees and directors during the six months ended June 30, 2006, is calculated based on the Simplified Method as allowed under Staff Accounting Bulletin No. 107 (SAB 107), giving consideration to the contractual term of the options and their vesting schedules. The expected life of the options granted to non-employees equals their contractual term.

Due to the lack of sufficient history of the Company's own stock volatility, the Company estimates its own expected stock volatility based on the historical stock volatility of three other companies, which are similar to the Company.

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Note 3 - Accounting for Stock-Based Compensation (cont'd)

Fair Value Disclosures — Prior to SFAS 123(R) Adoption

Prior to January 1, 2006, as allowed by SFAS 123, the Company accounted for stock-based awards to employees and directors under the intrinsic value method, and adopted the disclosure requirements of SFAS 123 and SFAS 148, for awards to its directors and employees.

The following table illustrates the effect on net loss and net loss per share, as if the Company had applied the fair value methods of SFAS No. 123 for accounting purposes:

	Three months ended June 30, 2005 $ (in thousands, except for per share data) (Unaudited)	Six months ended June 30, 2005 $ (in thousands, except for per share data) (Unaudited)
Net loss, as reported	(1,601)	(3,107)
Add:		
Stock-based compensation expense to employees and directors included in reported net loss, net of related tax effects	111	121
Deduct:		
Stock-based compensation expense to employees and directors determined under fair value based method for all awards, net of related tax effects	(263)	(335)
Pro-forma net loss	(1,753)	(3,321)
Net loss per common share, basic and diluted:		
As reported	(0.23)	(0.48)
Pro-forma	(0.25)	(0.51)

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Note 4 - Acquisition of Brainboost

On December 1, 2005, (the “Acquisition Closing Date”) the Company entered into a purchase agreement (the “Purchase Agreement”) to acquire all of the limited liability interests of Brainboost Technology, LLC, (“Brainboost”), a Delaware limited liability company, from the Brainboost Partnership (the “Seller”). The Company, as a result of the acquisition, took title to, and possession of, all assets owned by Brainboost, primarily, all intellectual property rights associated with a functionality known as the Brainboost Answer Engine, an artificial intelligence technology targeting natural language search on the World-Wide-Web. The Company has integrated a beta version of the Brainboost Answer Engine into its website to enable natural language search through Answers.com. The Company intends to further develop the technology in the future.

Pursuant to the Purchase Agreement, the Company paid the Seller an aggregate of $4,000,000 in cash and 439,000 shares of restricted common stock (the “Stock Consideration”) in the Company. The number of shares issued was determined based upon the average share price of $10.2575 over a 20 consecutive day period that was designated by the Company and the Seller prior to the Acquisition Closing Date. The fair value of the Stock Consideration was determined to be approximately $5.6 million, or $12.716 per share, based upon an average share price within 2 days before and after the Acquisition Closing Date. The Stock Consideration is subject to certain lock-up agreements that limit its transferability during the year subsequent to the Acquisition Closing Date.

Furthermore, on the date of acquisition, the Company entered into an Employment Agreement with one of the principals of the Seller (the “Principal”), with an effective date of December 5, 2005 (the “Employment Agreement”). Pursuant to the Employment Agreement, the Principal joined the Company as Director of Natural Language Research and took charge of the integration and further development of the acquired technology within the Company’s systems and proprietary products.

In connection with the Purchase Agreement and the Employment Agreement, the Company entered into an escrow agreement on the acquisition date whereby 50%, 25%, and 25% of the Stock Consideration was scheduled to be released on March 1, June 1, and December 1, 2006, respectively, subject to certain performance and non-performance obligations. On March 1 and June 1, 2006, the Company released 50% and 25% of the Stock Consideration, respectively. Because the Stock Consideration released in March and June 2006, a total of 329,250 shares, was originally subject to forfeiture based on the Principal’s employment, the value of such escrowed shares, in the amount of $4,186,743 on the date of acquisition, has been recognized as research and development expense over the six-month requisite service period, beginning December 2005. The remaining 25% of shares that release from escrow on December 1, 2006, a total of 109,750 shares, are not subject to the Principal’s employment.

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Note 4 - Acquisition of Brainboost (cont'd)

In addition, the Seller received certain non-transferable price protection rights, whereby a decline in the Company's average stock price for the 20 consecutive trading days immediately preceding the one-year anniversary of the Acquisition Closing Date below $10.2575, would trigger the Seller's right to receive from the Company compensation for the reduction in the Stock Consideration's value (the "Price Protection"). In such an event, the Company would either pay the Seller cash for the difference between the $10.2575 and the average stock price, or repurchase the shares at $10.2575, for the remaining Stock Consideration held by the Seller on the one-year anniversary of the acquisition close (see Note 7 d). The Price Protection is also subject to cancellation at the cumulative occurrence of certain conditions relating to the market price of the Stock Consideration, the registration of the Stock Consideration, and other criteria including termination of the Principal from the Company prior to the one-year anniversary of the Acquisition Closing Date. Any cash consideration payable pursuant to the Price Protection will be accounted for upon settlement as an adjustment to the value of the shares issued at closing. Upon adoption of SFAS 123R, the value of the portion of the Price Protection that relates to the Stock Consideration that was deemed compensation expense (see above), has been charged as stock-based compensation over the requisite six-month employment service period ended May 31, 2006. As a result, the Company recorded additional stock-based compensation expense of $55,000 during the six months ending June 30, 2006.

The transaction was accounted for as an asset acquisition. The allocation of the purchase price to the assets acquired was as follows:

	$ (in thousands)
Acquired Technology - Brainboost Answer Engine	**5,355**
In-Process Research & Development	**97**
Total Assets Acquired	**5,452**
Value of escrowed shares being charged to compensation expense over the six months ending May 31, 2006	**4,187**
Total Purchase Price	**9,639**

The Acquired Technology is included on the accompanying balance sheets in intangible assets, net, and is being amortized on a straight-line basis over an estimated useful life of six years. During the six months ending June 30, 2006, $446,000 of the Acquired Technology has been amortized and recorded as cost of revenue.

The In-Process Research and Development relates to projects that were substantive, yet incomplete as of the acquisition date. Accordingly, it was not recorded as a separate asset on the balance sheet but as additional research and development expense as of the Acquisition Closing Date.

The value of escrowed shares relates to the Stock Consideration, associated with the March and June escrow release dates, and has been recorded as equity and charged to expenses on a straight-line basis over the six months ended May 31, 2006. During the six months ending June 30, 2006, $3,489,000 of such value has been amortized and recorded as research and development compensation expense.

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Note 5 - Stockholders' Equity

General

The following table summarizes the changes in the Company's stockholders' equity during the six-month period ending June 30, 2006:

	$ (in thousands)
December 31, 2005 (Audited)	**19,343**
Exercise of stock options	**173**
Stock-based compensation	**856**
Other comprehensive income	**1**
Stock-based compensation in connection with the Brainboost transaction (see Note 4)	**3,489**
Net loss for the period	**(6,438)**
June 30, 2006 (Unaudited)	**17,424**

Additionally, upon the adoption of SFAS 123R effective January 1, 2006, the balance of deferred compensation as of December 31, 2005, amounting to $3,517,844, was reversed against additional paid-in capital, and will be recorded based on the vesting terms of the stock-based awards for which this deferred compensation has been recorded in the past.

Common Stock

During the six months ended June 30, 2006, the Company issued a total of 115,977 shares of common stock due to the exercise of 115,977 of the Company's outstanding stock options, for a total consideration of approximately $173,000.

On March 21, 2006, and as a part of the Brainboost Purchase Agreement (see Note 4), the Company filed an amended Registration Statement, to register the Brainboost Shares (the "Registration Statement") with the SEC. The Registration Statement had been declared effective by the SEC on June 9, 2006.

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Note 5 - Stockholders' Equity (cont'd)

Stock Warrants

As of June 30, 2006, there were 1,157,763 outstanding stock warrants with a weighted average exercise price of $16.21. All warrants are exercisable immediately. No warrants were granted, exercised or forfeited during the six months ended June 30, 2006.

On February 4, 2005 the Company entered into an agreement (the "Warrants Agreement"), with certain holders of stock warrants, pursuant to which such holders exercised an aggregate of 1,871,783 stock warrants at the stated exercise price thereof. As a result, the Company issued an aggregate of 1,871,783 shares of its common stock, for aggregate gross consideration of $12,559,700. Under the terms of the Warrants Agreement, in order to provide incentive to the warrant holders to exercise their stock warrants , for every share of common stock purchased by the holders through the exercise of stock warrants, the Company issued to the warrant holders new warrants, dated February 4, 2005, to purchase such number of shares of common stock equal to 55% of the number of shares of common stock underlying their respective stock warrants (the "New Warrants"). As a result, the Company issued 1,029,488 of New Warrants at an exercise price of $17.27 per share. The New Warrants are immediately exercisable and expire on February 4, 2010.

Stock Compensation Plans

The Company provides for direct grants or sales of common stock, and common stock options to employees and non-employees through the following: the 1999 Stock Option Plan (the 1999 Plan), the 2000 Stock Option Plan (the 2000 Plan) and the 2003 Stock Option Plan (the 2003 Plan) (thereafter collectively "Prior Option Plans"), the 2004 Stock Option Plan (the 2004 Plan) and the 2005 Incentive Compensation Plan (the 2005 Plan). In addition, prior to 2006, the Company had granted stock options outside of its stock options plans, to certain individuals and entities. As of June 30, 2006, 35,651 options were issued and outstanding outside of the Company's stock option plans.

The 2005 Plan was approved by the Company's stockholders in July 2005, following the earlier adoption by the Company's board of directors. Under the 2005 Plan, the Company may grant stock options, stock appreciation rights, restricted stock, deferred stock, other stock-related awards and performance awards to officers, directors, employees, consultants and other persons who provide services to the Company. The total number of Company shares of common stock allowed for under the 2005 Plan was set at 850,000, upon its adoption, and was increased by 250,000 on June 21, 2006, following the approval of the Company's stockholders.

Under all of the Company's option plans, options generally vest 25%, with respect to the number granted, upon the first anniversary date of the option grant, and the remainder vest in equal monthly installments over the 36 months thereafter. Vested options are exercisable immediately. The Company issues new shares upon share option exercises.

The options generally expire between six to ten years after grant date. Except for grants to certain executives, employee options are generally forfeited, if not exercised, within three months of termination of employment.

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Note 5 - Stockholders' Equity (cont'd)

Stock Options

During the six months ended June 30, 2006, the Company granted a total of 527,350 stock options to its employees and officers, of which 516,350 stock options were granted under the Company's 2005 Compensation Plan, and 11,000 stock options under its 2004 Stock Option Plan.

The following table summarizes the Company's stock option activity during the six months ended June 30, 2006:

	Number of stock options		Weighted average exercise price
Outstanding as of December 31, 2005	**1,429,521**	$	8.27
Granted (2005 and 2004 Plans)	527,350		12.74
Exercised	(115,977)		1.49