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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2009

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-25075

**ARTIFICIAL LIFE, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State of incorporation)

**04-3253298**  
(I.R.S. Employer Identification No.)

**520 Broadway, Suite 350  
Santa Monica, CA 90401  
U.S.A.**  
(Address of principal executive offices)

**(310) 496-4288**  
(Issuer's telephone number, including area code)

**Not Applicable**  
(Former name, former address and former fiscal year,  
if changed since last report)

Indicate by check mark 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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of July 31,

2009 there were 50,244,132 shares of Common Stock, \$.01 par value per share, outstanding.

**ARTIFICIAL LIFE, INC.**

**INDEX OF INFORMATION CONTAINED IN FORM 10-Q FOR THE  
QUARTER ENDED JUNE 30, 2009**

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**PART I FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**ARTIFICIAL LIFE, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS**

**ASSETS**

	<u>June 30, 2009</u>	<u>December 31, 2008</u>
	(unaudited)	
Current assets:		
Cash	\$ 1,439,093	\$ 1,430,578
Accounts receivable, net	18,773,831	13,859,315
Prepaid expenses and other	471,661	914,372
Deferred tax asset	—	500,000
Total current assets	<u>20,684,585</u>	<u>16,704,265</u>
Fixed assets, net	<u>3,069,557</u>	<u>3,140,067</u>
License rights, net	14,968,150	9,617,198
Prepaid expenses, deposits and other assets	<u>1,497,828</u>	<u>828,943</u>
	16,465,978	10,446,141
<b>TOTAL ASSETS</b>	<u><b>\$ 40,220,120</b></u>	<u><b>\$ 30,290,473</b></u>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Accounts payable	\$ 2,498,716	\$ 669,745
Accrued expenses and other	620,903	472,813
Income tax payable	218,000	60,000
Note payable — officer/stockholder	938,704	737,771
Notes payable	<u>1,000,000</u>	<u>1,000,000</u>
Total liabilities (all current)	<u>5,276,323</u>	<u>2,940,329</u>
Stockholders' equity:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized, no shares issued and outstanding		
Common stock, \$.01 par value; 130,000,000 shares authorized, 50,244,132 shares issued and outstanding as of June 30, 2009 and 47,724,132 shares issued and outstanding as of December 31, 2008	502,441	477,241
Additional paid-in capital	53,654,712	51,708,712
Notes receivable from stockholders	(19,577)	(19,577)
Accumulated deficit	(19,202,709)	(24,686,144)
Accumulated other comprehensive income (loss)	8,930	(130,088)
Total stockholders' equity	<u>34,943,797</u>	<u>27,350,144</u>
	<u><b>\$ 40,220,120</b></u>	<u><b>\$ 30,290,473</b></u>

See accompanying notes to unaudited condensed consolidated financial statements.

**ARTIFICIAL LIFE, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE INCOME**  
**(UNAUDITED)**

	Three-month Period Ended June 30,		Six-month Period Ended June 30,	
	2009	2008	2009	2008
<b>Revenues:</b>				
Software license revenue	\$7,577,225	\$5,475,924	\$14,629,598	\$9,594,301
Application services and other revenue	744	5,546	11,571	12,173
	<u>7,577,969</u>	<u>5,481,470</u>	<u>14,641,169</u>	<u>9,606,474</u>
<b>Cost of revenues:</b>				
Cost of software license revenue	1,090,980	634,047	1,817,250	812,126
Cost of application services and other revenue	6,627	34,999	21,769	57,720
	<u>1,097,607</u>	<u>669,046</u>	<u>1,839,019</u>	<u>869,846</u>
<b>Gross Profit</b>	<u>6,480,362</u>	<u>4,812,424</u>	<u>12,802,150</u>	<u>8,736,628</u>
<b>Operating expenses:</b>				
General and administrative	1,391,040	581,860	2,976,213	1,028,792
Research and development	924,311	826,756	1,782,637	1,350,673
Sales and marketing	1,040,908	513,621	1,532,528	936,256
Total operating expenses	<u>3,356,259</u>	<u>1,922,237</u>	<u>6,291,378</u>	<u>3,315,721</u>
<b>Income from operations</b>	<u>3,124,103</u>	<u>2,890,187</u>	<u>6,510,772</u>	<u>5,420,907</u>
<b>Other income (expenses):</b>				
Interest income and other	109,483	1,026	109,503	3,958
Interest expense	(36,228)	(15,556)	(66,480)	(98,061)
Foreign currency transaction (losses) gains	(283,154)	190,412	(412,360)	358,405
	<u>(209,899)</u>	<u>175,882</u>	<u>(369,337)</u>	<u>264,302</u>
<b>Income before income taxes</b>	<u>2,914,204</u>	<u>3,066,069</u>	<u>6,141,435</u>	<u>5,685,209</u>
Income tax expense	(143,000)	(375,755)	(658,000)	(501,310)
<b>Net income</b>	<u>2,771,204</u>	<u>2,690,314</u>	<u>5,483,435</u>	<u>5,183,899</u>
Foreign currency translation adjustment	231,696	15,753	139,018	53,300
<b>Comprehensive income</b>	<u>\$3,002,900</u>	<u>\$2,706,067</u>	<u>\$ 5,622,453</u>	<u>\$5,237,199</u>

Net income per share				
Basic	<u>\$ 0.06</u>	<u>\$ 0.06</u>	<u>\$ 0.11</u>	<u>\$ 0.11</u>
Diluted	<u>\$ 0.06</u>	<u>\$ 0.05</u>	<u>\$ 0.11</u>	<u>\$ 0.11</u>
Weighted average shares outstanding				
Basic	<u>48,397,539</u>	<u>46,249,746</u>	<u>48,062,696</u>	<u>45,158,361</u>
Diluted	<u>48,421,914</u>	<u>49,195,815</u>	<u>48,220,370</u>	<u>47,672,154</u>

See accompanying notes to unaudited condensed consolidated financial statements.

**ARTIFICIAL LIFE, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	Six-month Period Ended June 30,	
	2009	2008
Cash flows from operating activities:		
Net income	\$5,483,435	\$5,183,899
Adjustments to reconcile net income to net (cash used) provided by in operating activities:		
Depreciation and amortization	1,935,938	986,686
Deferred income tax expense	500,000	60,355
Amortization of discount on notes payable	—	33,000
Provision for losses on doubtful accounts receivable	2,623,162	2,469
Foreign currency transaction (gain) loss	412,360	(358,405)
Interest expense accrued on notes payable officer / stockholder	14,285	7,727
Salary accrued to officer / stockholder	175,395	20,361
Changes in operating assets and liabilities:		
Increase in restricted cash	—	(165,000)
Increase in accounts receivable	(13,981,178)	(1,015,072)
Increase in prepaid expenses, deposits, and other assets	(226,174)	(1,026,802)
Increase (decrease) in accounts payable, accrued expenses and other	1,573,791	(815,576)
Increase in income tax payable	158,000	441,675
Net cash (used in) provided by operating activities	<u>(1,330,986)</u>	<u>3,355,317</u>
Cash flows from investing activities:		
Purchase of fixed assets	(45,879)	(1,810,404)
Purchase of license rights	(254,180)	(4,647,761)
Deposits on fixed assets	—	(2,871,800)
Net cash used in investing activities	<u>(300,059)</u>	<u>(9,329,965)</u>
Cash flows from financing activities:		
Net proceeds from issuance of common stock	1,905,200	5,241,002
Advances under note payable to officer / stockholder	202,257	—
Repayment of note payable to officer / stockholder	(191,004)	(288,808)
Net cash provided by financing activities	<u>1,916,453</u>	<u>4,952,194</u>
Net increase (decrease) in cash	285,408	(1,022,454)
Cash, beginning of period	1,430,578	6,210,435
Effect of exchange rate changes on cash	(276,893)	(812)
Cash, end of period	<u>\$ 1,439,093</u>	<u>\$ 5,187,169</u>
Supplemental disclosure of non-cash investing activity:		
Purchase of license rights and related increase in accounts payable	<u>\$ 6,443,500</u>	<u>\$ —</u>
Issuance of common stock and warrants in satisfaction of accounts payable	<u>\$ 66,000</u>	<u>\$ —</u>

See accompanying notes to unaudited condensed consolidated financial statements.

**ARTIFICIAL LIFE, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**1. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements of Artificial Life, Inc. (the “Company”) have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and in accordance with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all information and footnotes required by generally accepted accounting principles for a complete financial statement presentation. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, as follows:

*Artificial Life Asia Limited*, located in Hong Kong, supports Artificial Life in its customer service and game development.

*Artificial Life Europe GmbH*, located in Berlin, Germany; formed in January 2007 to concentrate on customer service and support activities of sales and marketing expansion in European, Middle Eastern and African (EMEA) markets.

*Artificial Life Japan Ltd.*, located in Tokyo, Japan; acquired by the Company in July 2007 for support activities of sales and marketing expansion in Japanese markets.

*Artificial Life America, Inc.*, located in Los Angeles, California; formed in August 2008 to support U.S. customers and focus on design and creative direction for game development.

*Artificial Life Ventures, Inc.*, *Artificial Life USA, Inc.*, and *Artificial Life Mobile Computing, Inc.*, all non-operating, inactive subsidiaries in 2009 and 2008.

All significant inter-company balances and transactions have been eliminated in consolidation.

Operating results for the six months ended June 30, 2009, are not necessarily indicative of results that may be expected for the year ending December 31, 2009. Amounts at December 31, 2008, are derived from the Company’s audited consolidated financial statements. For further information, refer to the audited consolidated financial statements and notes thereto included in the Company’s annual Report on Form 10-K for the year ended December 31, 2008.

The financial information included in this report has been prepared in conformity with the accounting policies reflected in the financial statements included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

**Recently issued and adopted accounting standards**

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements*. SFAS No. 157 established a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS No. 157 also expands financial statement disclosure requirements about a company’s use of fair value measurements, including the effect of such measures on earnings. In February 2008, the FASB issued Staff Position FAS 157-2, which delayed the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted Staff Position FAS 157-2 on January 1, 2009. At June 30, 2009, the Company had no financial assets or liabilities subject to recurring fair value measurements.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option). The fair value option may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, SFAS No. 159 specifies that unrealized gains and losses for that instrument be reported in earnings at each subsequent reporting date. The Company did not elect to apply the fair value option to any outstanding instruments.

In April 2009, the FASB issued FSP SFAS No. 107-1 and Accounting Principles Board Opinion (“APB”) 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, (FSP 107-1), which requires that the fair value disclosures required for all financial instruments within the scope of SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, be included in interim financial statements. This FSP also requires entities to disclose the method and significant assumptions used to estimate the fair value of financial instruments on an interim and annual basis and to highlight any changes from prior periods. FSP 107-1 is effective for interim period ending after June 15, 2009. The adoption of FSP 107-1 did not have a material impact on the Company’s consolidated financial statements.

In June 2009, the FASB approved its Accounting Standards Codification (“Codification”) as the single source of authoritative United States accounting and reporting standards applicable for all non-governmental entities, with the exception of the SEC and its staff. The Codification, which changes the referencing of financial standards, is effective for interim or annual financial periods ending after September 15, 2009. Therefore, in the third quarter of fiscal year 2009, all references made to US GAAP will use the new Codification numbering system prescribed by the FASB. As the Codification is not intended to change or alter existing US GAAP, it is not expected to have any impact on the Company’s consolidated financial position or results of operations.

On January 1, 2009, the Company adopted SFAS No. 141(Revised 2007), *Business Combinations*, (SFAS No. 141R). SFAS No. 141R provides revised guidance on how acquirers recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. SFAS No. 141R also expands required disclosures surrounding the nature and financial effects of business combinations. Management believes that the adoption of SFAS 141R will have an impact on the accounting for any future acquisition, if one were to occur. The Company is required to apply the guidance in SFAS 141R for any future business combinations.

On January 1, 2009, the Company adopted SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS No. 160 establishes accounting and reporting standards for a noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Because all of the Company’s subsidiaries are wholly-owned by the Company, there are no noncontrolling interests, and as a result, the adoption of this standard had no effect on the Company’s consolidated financial statements.

On January 1, 2009, the Company adopted SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133*. SFAS No. 161 requires enhanced disclosures about the Company’s derivative and hedging activities. The adoption of SFAS 161 did not have an impact on the Company’s financial statements.

On January 1, 2009, the Company adopted the provisions of Emerging Issues Task Force (“EITF”) 07-05, *Determining whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock*, which provides guidance on determining what types of instruments or embedded features in an instrument held by a reporting entity can be considered indexed to its own stock for the purpose of evaluating the first criteria of the scope exception in paragraph 11(a) of SFAS 133. The adoption of this EITF required the Company to perform additional analysis on its free standing equity instruments; however, it did not have an impact on the Company’s consolidated financial statements.

#### **Reclassifications:**

Certain amounts reported in the 2008 interim financial statements have been reclassified to conform to the 2009 presentation.

## 2. STOCK BASED COMPENSATION

At January 1, 2009, all outstanding options and warrants issued to employees were fully vested and exercisable. There were no stock options granted during the six-month periods ended June 30, 2009 and 2008. At June 30, 2009, the Company had outstanding options to purchase 2,065,000 shares of common stock under its stock option plan, issued to employees as follows:

Weighted average exercise price	\$0.88
Aggregate intrinsic value	\$139,350
Weighted average remaining contractual term	0.49 year

At June 30, 2009, the Company had outstanding warrants to purchase 700,000 shares of common stock issued to employees as follows:

Weighted average exercise price	\$0.83
Aggregate intrinsic value	\$42,000
Weighted average remaining contractual term	0.43 year

## 3. CUSTOMER CONCENTRATION

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable. The Company extends credit to its customers in the normal course of business and generally does not require collateral. Due to the global financial crisis and general market conditions, in 2009 the Company has granted extended payment terms (up to 180 days) to certain customers. The Company assesses the probability of collection from each customer at the outset of the arrangement based on a number of factors, including the customer's payment history and its current creditworthiness. If in management's judgment collection is not probable, the Company does not record revenue until the uncertainty is removed.

Management performs ongoing credit evaluations, and the Company maintains an allowance for potential credit losses based upon its loss history and its aging analysis. The allowance for doubtful accounts of \$3,354,450 at June 30, 2009, and \$731,500 at December 31, 2008, is the Company's best estimate of the amount of probable credit losses in existing accounts receivable. Management reviews the allowance for doubtful accounts each reporting period based on a detailed analysis of accounts receivable. In the analysis, management primarily considers the age of the customer's receivable and also considers the creditworthiness of the customer, the economic conditions of the customer's industry, the general economic conditions and trends and the business relationship and history with its clients among other factors. If any of these factors change, the Company may also change its original estimates, which could impact the level of the Company's future allowance for doubtful accounts. If judgments regarding the collectability of accounts receivable were incorrect, adjustments to the allowance may be required, which would reduce profitability. Since the Company's accounts receivable are often concentrated in a relatively few number of customers, a significant change in the liquidity or financial position of any one of these customers could have a material adverse effect on the Company's financial statements. During the six months ended June 30, 2009, the Company entered into agreements with certain of its customers to offset accounts receivable of approximately \$6.4 million from these customers with accounts payable for the same amount to these customers. The offset of these receivables and payables represents a legal right of setoff and has been accounted for in accordance with the provisions of FASB Interpretation No. ("FIN") 39.

At June 30, 2009, the Company had 95 telecom carriers, resellers, distributors and general corporate customers compared to 70 such customers at December 31, 2008 and 52 such customers at June 30, 2008. For the three-month and six-month periods ended June 30, 2009, resellers and distributors represented approximately 62% of the Company's revenues.

For the three-month period ended June 30, 2009, the Company had two customers that represented approximately 60% and 37% of the Company's revenues, respectively. For the three-month period ended June 30, 2008, the Company had two customers that represented approximately 55% and 42% of the Company's revenues, respectively. For the six-month period ended June 30, 2009, the Company had three customers that represented approximately 61%, 19% and 17% of the Company's revenues, respectively. For the six-month period ended June 30, 2008, the Company had three customers that represented approximately 61%, 24% and 11% of the Company's revenues, respectively.

At June 30, 2009, accounts receivable were due from 56 customers. Of these, three customers accounted for approximately 72%, 13% and 9% of the accounts receivable, respectively. At June 30, 2009, 34% and 55% of accounts receivable were aged within 30 days and 60 days, respectively. At June 30, 2009, the average age of accounts receivable from all customers was 104 days as compared to 83 days at December 31, 2008. The average age of receivables from the Company's three largest customers at June 30, 2009 was 135 days.

#### 4. NET INCOME PER SHARE

Basic net income per share is calculated based on the weighted average number of common shares outstanding for the three and six month periods ended June 30, 2009 and 2008. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and warrants, and are determined using the treasury stock method. The following table sets forth the computation of fully diluted shares for the three months and six months ended June 30, 2009 and 2008.

	Three-month Period Ended June 30		Six-month Period Ended June 30	
	2009	2008	2009	2008
Shares used in basic per share calculation	48,397,539	46,249,746	48,062,696	45,158,361
Effect of dilutive securities:				
Options	24,375	1,381,581	93,488	1,251,495
Warrants	—	1,564,488	64,186	1,262,298
Shares used in dilutive per share calculation	<u>48,421,914</u>	<u>49,195,815</u>	<u>48,220,370</u>	<u>47,672,154</u>

#### 5. INCOME TAXES

The difference between the expected and effective income tax expense recorded for the six-month periods ended June 30, 2009 and 2008, is due primarily to changes in the valuation allowance on net deferred tax assets.

At June 30, 2009, the Company's deferred tax asset which has been fully allowed for, primarily consists of net operating loss carryforwards. The recognition of this net deferred tax asset is based on the Company's analysis of past, current and projected financial results of the Company's operations. Based on this analysis, management does not believe that as of June 30, 2009, it is more likely than not that the asset can be realized. If future taxable income exceeds the level that has been assumed in calculating the deferred tax asset, the valuation allowance could be reduced with a corresponding credit to income.

At June 30, 2009, the Company has recorded a current income tax payable of \$218,000, which consists of estimated state income taxes and U.S. federal alternative minimum tax.

#### 6. CONTINGENCIES

From time to time, legal proceedings or disputes arise in the normal course of business. The Company monitors and reviews these matters and maintains accruals where appropriate.

In September 2008, an action was brought against Artificial Life Europe GmbH in Germany in a contractual dispute, in which a claim of approximately \$375,000 was made against the Company. A court hearing is scheduled for September 2009 before the State Court in Berlin. The Company intends to contest this claim and defend itself vigorously, including the filing of available counterclaims. While the Company cannot predict the outcome of the matter, the Company believes that the final outcome of this matter will not have a material adverse impact on its financial position or results of operation.

## 7. NOTES PAYABLE

### Related party note payable:

The Company has a revolving note payable to its chief executive officer for advances made by him to the Company, as well as deferred salary and bonus. The note bears interest at 5%, and is repayable upon demand. On August 10 2009, the Board of Directors of the Company approved a loan agreement that was executed by the Company and the chief executive officer under which the note payable is secured by the assets of the Company. Activity on the note payable to the chief executive officer during the six months ended June 30, 2009 and 2008, was as follows:

	2009	2008
Beginning balance, January 1	\$ 737,771	\$ 751,860
Advances	202,257	—
Repayments	(191,004)	(288,808)
Accrued salary and bonus	175,395	20,361
Accrued interest	14,285	7,727
Ending balance, June 30	<u>\$ 938,704</u>	<u>\$ 491,140</u>

### Other notes:

The Company has promissory notes payable to two non-related party stockholders for an aggregate principal amount of \$1,000,000. These notes are unsecured, bear an annual interest rate of 10%, and matured on December 31, 2008. The notes are due on demand, and the holders may convert the notes and any unpaid interest accumulated thereon into shares of common stock at a conversion price of \$2.50 per share. The Company determined that the notes did not have any beneficial conversion feature, as the conversion exercise price exceeded the market price of the Company's common stock.

## 8. STOCKHOLDERS' EQUITY

During the quarter ended June 30, 2009, the Company issued 2,520,000 shares of common stock along with warrants to purchase an additional 1,545,000 shares of common stock for cash of \$1,905,200. As part of this placement, one party received 100,000 shares and warrants to purchase 100,000 shares in satisfaction of \$66,000 of accounts payable. The private placement offering was made to seven institutional and two individual accredited investors. In connection with the private placement offering, the Company retained a selling agent to whom it paid a commission of \$33,000. The issuance of the common stock and warrants are exempt from the registration requirements of the Securities Act of 1933, as amended. The warrants have a two-year term with exercise prices ranging from \$0.80 to \$1.25 per share and are immediately exercisable.

## 9. FAIR VALUE MEASUREMENTS

SFAS No. 157 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact, and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of non performance.

SFAS No. 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SFAS No. 157 establishes three levels of inputs that may be used to measure fair value:

*Level 1* – Quoted prices in active markets for identical assets or liabilities.

*Level 2* – Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3* – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (supported by little or no market activity).

At June 30, 2009, the Company has no financial assets or liabilities subject to recurring fair value measurements.

The Company's financial instruments include cash, accounts receivable, accounts payable, and notes payable. Management estimates that the carrying amounts of the non-related party financial instruments approximate their fair values due to their short-term nature. The fair value of the related party notes payable is not practical to estimate due to the related party nature of the underlying transactions.



## 10. SUBSEQUENT EVENTS

The Company evaluated events through August 11, 2009 for consideration as a subsequent event to be included in its June 30, 2009 Financial Statements issued August 12, 2009.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### *General*

The following Management's Discussion and Analysis is intended to help the reader understand our results of operations and financial condition and is provided as a supplement to, and should be read in conjunction with our financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains, in addition to historical statements, forward-looking statements that involve risks and uncertainties. Our actual future results could differ significantly from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, the factors discussed in the section titled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008. Any forward-looking statement speaks only as of the date on which such statement is made and we do not intend to update any such forward-looking statements.

### *Overview*

In the second quarter of 2009, we sold over 4,593,000 of our mobile 3G and Java games globally, primarily to resellers, aggregators and hand set manufacturers. The sales include one time downloads, end user subscriptions via operator decks, off-deck sales, bulk reseller packages and pre-installation licenses for cell phones.

However, the focus of the Company since the end of 2008 has been on the development, sales and launch of iPhone and iPod Touch games (referred to collectively as "iPhone games"). From December 2008 through July 2009, the Company has successfully developed and released the following nine iPhone games:

Amateur Surgeon (with Cartoon Networks),  
SHOOTER (with Paramount),  
BMW Expression of Joy Z4 LITE,  
BMW Experience Z4,  
RED BULL Air Race LITE,  
RED BULL Air Race World Championship,  
iDroids™,  
iSoccer Backstreet and  
VERMINATOR

These iPhone games have been downloaded an aggregate of more than 1.7 million times, and four games have been at one time within the top 10 most downloaded games in the United States and/or in many other countries around the globe on the Apple App Store platform.

In April 2009, we signed a license agreement with the renowned German soccer club, VfB Stuttgart to launch a soccer title "VfB – The Official Mobile Game" for mobile devices. The game is tentatively scheduled for release in the third quarter of 2009, around the start of the new 2009/2010 soccer season.

In April 2009, we signed an agreement with Starz Media to launch an iPhone game inspired by the upcoming horror movie Pandorum, from Overture Films. The game is tentatively scheduled for release in the third quarter of 2009 just prior to the film's debut in theaters globally.

In April and May 2009, we launched the RED BULL Air Race World Championship Lite and Full Versions, the first official air race motor sport games for the iPhone and iPod touch platform.

In April 2009, we signed a three-year license agreement with multi-platinum two-time, Grammy-winning rock band Linkin Park and Warner Brothers Records to launch a social community based music game featuring Linkin Park's music on the iPhone and iPod touch platform. The first launch is tentatively scheduled for the fourth quarter of 2009.

In May 2009, we launched the iDroidsMania™, our first branded game offered in the Apple App Store. The game has been launched as a full version and a free lite version containing the first two levels as a trial.

In May 2009, we started working as a subcontractor for China Telecom, one of the three Chinese telecom operators that have recently been awarded a 3G license from the Chinese government. We are working with China Telecom in Hunan to set up the 3G WAP content and sales platform. After the successful launch in Hunan, we intend to expand our service coverage and product sales with a wide variety of premium 3G mobile entertainment products and services to more provinces and cities in China and other telecommunication companies.

In May 2009, we launched the BMW Z4 Experience iPhone game for the new BMW Z4 Roadster.

In June 2009, we launched iSoccer Backstreet™, our first 3D soccer game.

In June 2009, we launched the VERMINATOR™, our own branded iPhone game.

During the six months ended June 30, 2009, we continued to market and expand the distribution of our products in Europe, Asia and the United States by entering into various strategic relationships. Our products are now sold in over 100 countries through resellers and telecom partners and in over 65 countries through Apple's App Store/iTunes distribution platform.

In addition to marketing our current products, we continue to focus on developing more new iPhone/iPod Touch and Smart Phone products, such as real time 3D/3G games and massive multi-player mobile games. We are also in ongoing talks with global media and major global brands to license additional appealing content and intellectual property.

Even though several of our new products and services have successfully been launched in several countries, there can be no guarantee that these new products and services will contribute substantially to our future revenues or will continue to be successful.

As of June 30, 2009, we had total assets of \$40,220,120 and total liabilities of \$5,276,323. As of June 30, 2009, current assets were \$20,684,585 as compared to \$16,704,265 at December 31, 2008, and current liabilities were \$5,276,323 as compared to \$2,940,329 at December 31, 2008.

We had 59 full time employees as of June 30, 2009. We also hire temporary staff, external consultants and interns to support our operations.

As we are still in the early phase of the global roll out of our key mobile products in several countries around the world, results of operations to date may not be indicative of our future results of operations. Moreover, we expect to experience significant fluctuations in our future operating results due to a variety of factors including the speed of the expansion of the 3G mobile markets, the general market acceptance of our products, our ability to sell and license our third party intellectual property, the increasing diversity and number of mobile phone handset types, the amount of software consulting we undertake in the future, our success in creating and entering into strategic alliances, our mix of product and service sales, our response to competitive pressure, our ability to attract and retain qualified personnel, and our ability to execute our business strategy in the Asian, European and American markets. Gross profit margins will vary from product to product between products and services and among the countries in which our products are sold. In addition, our sales mix may vary from period to period and our gross margins will fluctuate accordingly.

In addition, the stability of our earnings is also heavily influenced by macroeconomic factors. As the economy improves or worsens, our business may be similarly impacted. Macroeconomic factors, such as the current conditions in the debt markets, have impacted and will continue to impact our business. At this time, we view the direction of the economy to be uncertain, which does not allow us a high degree of certainty in predicting our earnings.

## Results of Operations

### Three months ended June 30, 2009 Compared to three months ended June 30, 2008

**REVENUES:** Revenues for the quarter ended June 30, 2009 were \$7,577,969 as compared to \$5,481,470 for the quarter ended June 30, 2008. The increase in revenues of \$2,096,499 or 38% was mainly due to increased (a) product license revenue from mobile games, one-time downloads, (b) monthly subscription revenues for 3G games derived from mobile operators, bulk resellers and hand set distributors and (c) license revenues from the sale of our technology platform Mobile Booster™.

**COST OF REVENUES:** Cost of revenues mainly consisted of amortization of intangible assets. Cost of revenues for the quarter ended June 30, 2009 was \$1,097,607 as compared to \$669,046 for the quarter ended June 30, 2008. The increase of \$428,561, or 64%, was primarily due to the amortization of license rights.

**GROSS MARGIN:** Gross margin for the quarter ended June 30, 2009 was \$6,480,362 as compared to \$4,812,424 for the quarter ended June 30, 2008. The increase of \$1,667,938, or 35%, was mainly due to increased product license income from mobile games, one-time downloads and monthly subscription revenues for 3G games derived from mobile operators, bulk resellers and hand set distributors and a global license deal for the sale of our technology platform offset by amortization of license rights acquired in earlier periods.

**GENERAL AND ADMINISTRATIVE:** General and administrative expenses consisted of salaries of administrative personnel, rent, professional fees and costs associated with employee benefits, supplies, communications, travel and the provision for doubtful accounts receivable. General and administrative expenses for the quarter ended June 30, 2009 were \$1,391,040 as compared to \$581,860 for the quarter ended June 30, 2008. The increase of \$809,180 was mainly due to a 2009 provision for doubtful accounts receivable, off-set by a decrease in expenses related to public relations and professional services.

**SALES AND MARKETING:** Sales and marketing expenses consisted of salaries of sales and marketing personnel and costs relating to marketing materials, advertising, trade shows, traveling and public relations activities. Sales and marketing expenses for the quarter ended June 30, 2009 were \$1,040,908 as compared to \$513,621 for the quarter ended June 30, 2008. The increase of \$527,287 was primarily due to an increased allowance for doubtful accounts, partially offset by a decrease in expenses related to marketing and sub-contracting expenses.

**RESEARCH & DEVELOPMENT:** Research and development expenses consisted of salary, training, consulting, subcontracting and other expenses incurred to develop and fulfill the design specifications and production of the products and services from which we derive our revenues. Research and development expenses for the quarter ended June 30, 2009 were \$924,311 as compared to \$826,756 for the quarter ended June 30, 2008. The increase of \$97,555 was mainly due to the increase in consulting expenses.

**OTHER EXPENSE/INCOME:** Other expenses for the quarter ended June 30, 2009 totaled \$209,899, as compared to other income of \$175,882 for the quarter ended June 30, 2008. The other expenses of \$209,899 were mainly due to income of \$109,483, interest expense of \$36,228 and foreign currency transaction losses of approximately \$283,154 in this quarter compared to a gain of approximately \$190,000 (primarily resulting from foreign currency transaction gains) in the second quarter of 2008.

**INCOME FROM OPERATIONS AND NET INCOME:** Income from operations for the quarter ended June 30, 2009 was \$3,124,103 as compared to income from operations of \$2,890,187 for the quarter ended June 30, 2008. Income from operations was mainly due to revenue of \$7,577,969 from the sale of product licenses for our mobile games and technology licenses, which was offset by costs of revenue of \$1,097,607 and operational costs of \$3,356,259. Net income for the quarter ended June 30, 2009 was \$2,771,204, compared to net income of \$2,690,314 for the quarter ended June 30, 2008. Basic and diluted net income per share for the second quarter of 2009 was \$0.06, as compared to \$0.06 and \$0.05, respectively, for the quarter ended June 30, 2008.

*Six Months Ended June 30, 2009 Compared with Six Months Ended June 30, 2008*

**REVENUES:** Revenues for the six months ended June 30, 2009 were \$14,641,169 as compared to \$9,606,474 for the six months ended June 30, 2008. The increase of revenues of \$5,034,695 or 52% was mainly due to increased (a) product license revenue from mobile game one-time downloads, (b) monthly subscription revenues for 3G games derived from mobile operators, bulk resellers and hand set distributors and (c) license revenues from the sale of our technology platform Mobile Booster™.

**COST OF REVENUES:** Cost of revenues mainly consist of amortization of intangible assets. Cost of revenues for the six month ended June 30, 2009 was \$1,839,019 as compared to \$869,846 for the six months ended June 30, 2008. The increase of \$969,173, or 111%, was primarily due to the amortization of license rights.

**GROSS MARGIN:** Gross margin for the six month ended June 30, 2009 was \$12,802,150 as compared to \$8,736,628 for the six months ended June 30, 2008. The increase of \$4,065,522, or 47%, was mainly due to increased product license income from mobile games, one-time downloads and monthly subscription revenues for 3G games derived from mobile operators, bulk resellers and hand set distributors and a global license deal for the sale of our technology platform, offset by amortization of license rights acquired in earlier periods.

**GENERAL AND ADMINISTRATIVE:** General and administrative expenses consisted of salaries of administrative personnel, rent, professional fees and costs associated with employee benefits, supplies, communications, travel and the provision for doubtful accounts receivable. General and administrative expenses for the six months ended June 30, 2009 were \$2,976,213 as compared to \$1,028,792 for the six months ended June 30, 2008. The increase of \$1,947,421 was mainly due to a 2009 provision for doubtful accounts receivable of approximately \$2.1 million, offset by a decrease in expenses related to public relations and professional services.

**SALES AND MARKETING:** Sales and marketing expenses consisted of salary expenses for sales and marketing personnel and costs relating to marketing materials, advertising, trade shows, traveling and public relations activities. Sales and marketing expenses for the six months ended June 30, 2009 were \$1,532,528 as compared to \$936,256 for the six months ended June 30, 2008. The increase of \$596,272 was primarily due to increased allowances for doubtful accounts.

**RESEARCH & DEVELOPMENT:** Research and development expenses consisted of salary, training, consulting, subcontracting and other expenses incurred to develop and fulfill the design specifications and production of the products and services from which we derive our revenues. Research and development expenses for the six months ended June 30, 2009 were \$1,782,637 as compared to \$1,350,673 for the six months ended June 30, 2008. The increase of \$431,964 was mainly due to increased consulting and telecommunication expenses.

**OTHER EXPENSE/INCOME:** Other expenses for the six months ended June 30, 2009 totaled \$369,337, as compared to other income of \$264,302 for the six months ended June 30, 2008. The other expenses of \$369,337 were mainly due to interest income of \$109,503, interest expense of \$66,480 and foreign currency transaction losses of approximately \$412,360 for the six months ended June 30, 2009 comparing to a gain of approximately \$358,000 (primarily resulting from foreign currency transaction gains) for the six months ended June 30, 2008.

**INCOME FROM OPERATIONS AND NET INCOME:** Income from operations for the six months ended June 30, 2009 was \$6,510,772 as compared to income from operations of \$5,420,907 for the six months ended June 30, 2008. Income from operations is mainly due to revenue of \$14,641,169 from the sale of product licenses for our mobile games, one-time downloads and monthly subscription revenues for 3G games and technology licenses, offset by costs of revenue of \$1,839,019 and operational costs of \$6,291,378. Net income for the six months ended June 30, 2009 was \$5,483,435 as compared to net income of \$5,183,899 for the six months ended June 30, 2008. Basic and diluted net income per share for the six months ended June 30, 2009 was \$0.11, as compared to \$0.11 for the six months ended June 30, 2008.

The difference between the expected and effective income tax expense recorded for the six-month periods ended June 30, 2009 and 2008, is due primarily to changes in the valuation allowance on net deferred tax assets.

At June 30, 2009, the Company's deferred tax asset, which has been fully allowed for, primarily consisted of net operating loss carryforwards. The recognition of this net deferred tax asset is based on the Company's analysis of past, current and projected financial results of the Company's operations. Based on this analysis, management does not believe that as of June 30, 2009, the net deferred tax asset will more likely than not be realized. If future taxable income exceeds the level that has been assumed in calculating the deferred tax asset, the valuation allowance could be reduced with a corresponding credit to income.

At June 30, 2009, the Company has recorded a current income tax payable of \$218,000, which consists of estimated state income taxes and U.S. federal alternative minimum tax.

## CASH FLOW SUMMARY

Our cash flows from operating, investing and financing activities, as reflected in the consolidated statements of cash flows for the six month periods ended June 30, 2009 and 2008, are summarized as follows:

	<u>2009</u>	<u>2008</u>
Cash provided by (used in):		
Operating activities	\$(1,330,986)	\$ 3,355,317
Investing activities	(300,059)	(9,329,965)
Financing activities	1,916,453	4,952,194
Effect of exchange rate changes on cash	<u>(276,893)</u>	<u>(812)</u>
Net increase (decrease) in cash, considering effect of exchange rate changes on cash	<u>\$ 8,515</u>	<u>\$(1,023,266)</u>

Cash used in operating activities was \$1,330,986 for the six months ended June 30, 2009, which was an increase of \$4,686,303 compared to the six months ended June 30, 2008. This increase in cash used is due to growth in the accounts receivable balance compared to the prior period and granting certain customers extended payment terms (up to 180 days), offset by an increase of net income, non-cash depreciation and amortization charges, deferred income tax expense and foreign currency transaction loss.

Cash used in investing activities was \$300,059 for the six months ended June 30, 2009, which was a decrease of \$9,029,906 compared to the six months ended June 30, 2008. This decrease was primarily due to decreased expenditures relating to license rights and fixed assets, which were comprised primarily of software.

Cash provided by financing activities was \$1,916,453 for the six months ended June 30, 2009, which was a decrease of \$3,035,741 compared to the six months ended June 30, 2008. This decrease was due to the issuance of common stock and warrants at a comparably lower price during the six months ended June 30, 2009 compared to the prior period.

### *Liquidity and Capital Resources*

As of June 30, 2009, we had a working capital surplus of \$15,408,262 and stockholders' equity of \$34,943,797.

On July 7, 2009, we completed a private placement raising (through June 30, 2009) total cash proceeds of \$1,905,200 through the issuance of 2,420,000 shares of common stock to several investors. As part of this placement, one party received 100,000 shares and warrants to purchase 100,000 shares in satisfaction of \$66,000 of accounts payable. We expect that we will raise additional capital to support our operations, to finance receivables and to accommodate planned future growth. We are currently also in discussions with additional investors about further investments for the third or fourth quarters of 2009. However, there can be no guarantees that such funds will be available on commercially reasonable terms, if at all. If such financing is not available on satisfactory terms, we may be unable to expand or continue our business as desired and operating results may be adversely affected. Debt financing will increase expenses and must be repaid regardless of operating results. Equity financing could result in a substantial dilution to existing stockholders.

We have borrowed funds from time to time in the past from our chief executive officer, Eberhard Schoneburg. As of June 30, 2009, we owed Mr. Schoneburg an aggregate amount of \$938,704, as compared to \$737,771 at December 31, 2008. During the three months ended June 30, 2009, Mr. Schoneburg advanced an additional \$354,600 including deferred salary of \$152,343 to the Company. The advanced funds bear interest at a rate of 5% per year and are secured by the assets of the Company.

The Company continued to generate income in the second quarter of 2009, and we expect that cash flow generated from 2009 operations and additional financing through various sources will be sufficient to fund the Company's operations, working capital and commitment needs for the next 12 months.

Economic conditions in the United States and in foreign markets in which we operate could substantially affect our sales and profitability and our cash position and collection of accounts receivable. Economic activity in the United States and throughout much of the world has undergone a sudden, sharp economic downturn in 2008 and 2009 following the housing downturn and subprime lending collapse in the United States and globally. Global credit and capital markets have experienced unprecedented volatility and disruption. Business credit and liquidity have tightened in much of the world. Some of our suppliers and customers may face credit issues and could experience cash flow problems and other financial hardships. These factors have had a substantial impact on the timeliness of receivable collections from our customers. The Company cannot predict at this point in time how this situation will develop and whether accounts receivable may need to be written off in the coming quarters.



Changes in governmental banking, monetary and fiscal policies to restore liquidity and increase credit availability may not be effective in alleviating the global economic declines. It is difficult to determine the breadth and duration of the economic and financial market problems and the many ways in which they may affect our suppliers, customers and our business in general. Nonetheless, continuation or further worsening of these difficult financial and macroeconomic conditions could have a significant adverse effect on our sales, collectability of our accounts receivables, profitability and results of operations.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable. The Company extends credit to its customers in the normal course of business and generally does not require collateral.

The Company's standard payment terms are normally within 90 days. In 2009, the Company has provided extended payment terms (up to 180 days) to certain customers. The Company assesses the probability of collection from each customer at the outset of the arrangement based on a number of factors, including the customer's payment history and its current creditworthiness. If in management's judgment collection of a fee is not probable, the Company does not record revenue until the uncertainty is removed.

Management performs ongoing credit evaluations, and the Company maintains an allowance for potential credit losses based upon its loss history and its aging analysis. The allowance for doubtful accounts of \$3,354,450 at June 30, 2009, and \$731,500 at December 31, 2008, is the Company's best estimate of the amount of probable credit losses in existing accounts receivable. Management reviews the allowance for doubtful accounts each reporting period based on a detailed analysis of accounts receivable. In the analysis, management primarily considers the age of the customer's receivable and also considers the creditworthiness of the customer, the economic conditions of the customer's industry, the general economic conditions and trends and the business relationship and history with its clients among other factors. If any of these factors change, the Company may also change its original estimates, which could impact the level of the Company's future allowance for doubtful accounts. If judgments regarding the collectability of accounts receivable were incorrect, adjustments to the allowance may be required, which would reduce profitability. Since the Company's accounts receivable are often concentrated in a relatively few number of customers, a significant change in the liquidity or financial position of any one of these customers could have a material adverse effect on the Company's financial statements. During the six months ended June 30, 2009, the Company entered into agreements with certain of its customers to offset accounts receivable of approximately \$6.4 million from these customers with accounts payable for the same amount to these customers. The offset of these receivables and payables represents a legal right of setoff and has been accounted for in accordance with the provisions of FASB Interpretation No. ("FIN") 39.

### *Recently Issued and Adopted Accounting Pronouncements*

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements*. SFAS No. 157 establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS No. 157 also expands financial statement disclosure requirements about a company’s use of fair value measurements, including the effect of such measures on earnings. In February 2008, the FASB issued Staff Position FAS 157-2, which delayed the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company adopted Staff Position FAS 157-2 on January 1, 2009. At June 30, 2009, the Company has no financial assets or liabilities subject to recurring fair value measurements.

SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option). The fair value option may be elected on an instrument-by-instrument basis and is irrevocable, unless a new election date occurs. If the fair value option is elected for an instrument, SFAS No. 159 specifies that unrealized gains and losses for that instrument be reported in earnings at each subsequent reporting date. The Company did not elect to apply the fair value option to any outstanding instruments.

In April 2009, the FASB issued FSP SFAS No. 107-1 and Accounting Principles Board Opinion (“APB”) 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, (FSP 107-1), which requires that the fair value disclosures required for all financial instruments within the scope of SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, be included in interim financial statements. This FSP also requires entities to disclose the method and significant assumptions used to estimate the fair value of financial instruments on an interim and annual basis and to highlight any changes from prior periods. FSP 107-1 is effective for interim periods ending after June 15, 2009. The adoption of FSP 107-1 is not expected to have a material impact on the Company’s consolidated financial statements.

In June 2009, the FASB approved its Accounting Standards Codification (“Codification”) as the single source of authoritative United States accounting and reporting standards applicable for all non-governmental entities, with the exception of the SEC and its staff. The Codification, which changes the referencing of financial standards, is effective for interim or annual financial periods ending after September 15, 2009. Therefore, in the third quarter of fiscal year 2009, all references made to US GAAP will use the new Codification numbering system prescribed by the FASB. As the Codification is not intended to change or alter existing US GAAP, it is not expected to have any impact on the Company’s consolidated financial position or results of operations.

On January 1, 2009, the Company adopted SFAS No. 141(Revised 2007), *Business Combinations*, (SFAS No. 141R). SFAS No. 141R provides revised guidance on how acquirers recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. SFAS No. 141R also expands required disclosures surrounding the nature and financial effects of business combinations. Management believes that the adoption of SFAS 141R will have an impact on the accounting for any future acquisition, if one were to occur. The Company is required to apply the guidance in SFAS 141R for any future business combinations.

On January 1, 2009, the Company adopted SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS No. 160 establishes accounting and reporting standards for a noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Because all of the Company’s subsidiaries are wholly-owned by the Company, there are no noncontrolling interests, and as a result, the adoption of this standard had no effect on the Company’s consolidated financial statements.

On January 1, 2009, the Company adopted SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities — an amendment of FASB Statement No. 133*. SFAS No. 161 requires enhanced disclosures about the Company’s derivative and hedging activities. The adoption of SFAS 161 did not have an impact on the Company’s financial statements.

On January 1, 2009, the Company adopted the provisions of Emerging Issues Task Force (“EITF”) 07-05, *Determining whether an Instrument (or Embedded Feature) Is Indexed to an Entity’s Own Stock*, which provides guidance on determining what types of instruments or embedded features in an instrument held by a reporting entity can be considered indexed to its own stock for the purpose of evaluating the first criteria of the scope exception in paragraph 11(a) of SFAS 133. The adoption of this EITF did not have an impact on the Company’s consolidated financial statements.

#### ***Off-Balance Sheet Arrangements***

At June 30, 2009, we did not have any material off-balance sheet arrangements.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

Not applicable.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### ***Evaluation of Disclosure Controls and Procedures***

(a) *Evaluation of Disclosure Controls.* Our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, as appropriate to allow timely decisions regarding required disclosure. Based on his evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2009.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

(b) *Changes in internal control over financial reporting.* There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Our management team will continue to evaluate our internal control over financial reporting throughout 2009 as we implement our Sarbanes Oxley testing methodologies.

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## PART II - OTHER INFORMATION

### ITEM 1 - LEGAL PROCEEDINGS

From time to time, legal proceedings or disputes arise in the normal course of business. The Company monitors and reviews these matters and maintains accruals where appropriate.

In September 2008, an action was brought against Artificial Life Europe GmbH in Germany in a contractual dispute, in which a claim of approximately \$375,000 was made against the Company. A court hearing is scheduled for September 2009 before the State Court in Berlin. The Company intends to contest this claim and defend itself vigorously, including the filing of available counterclaims. While the Company cannot predict the outcome of the matter, the Company does not believe that the final outcome will have a material adverse impact on its financial position or results of operations.

### ITEM 1A – RISK FACTORS

There have been no material changes to the Company's risk factors as previously disclosed in Item 1A "Risk Factors" in the Company's Form 10-K for the fiscal year ended December 31, 2008.

### ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

### ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

Not applicable.

### ITEM 4 – SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

### ITEM 5 – OTHER INFORMATION

Not applicable.

### ITEM 6 - EXHIBITS

- 10\* Loan Agreement, dated August 10, 2009 between the Registrant and Eberhard Schoneburg.
- 31.1\* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32\* Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Filed herewith

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**ARTIFICIAL LIFE, INC.**

Date: August 12, 2009

By: /s/ Eberhard Schoneburg  
Name: Eberhard Schoneburg  
Title: Chief Executive Officer and  
Chief Financial Officer

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## SECURITY AGREEMENT

This Security Agreement (“Agreement”) is between Eberhard Schonburg (“Secured Party”) and Artificial Life, Inc. (“Debtor”).

### SECTION 1. DEFINITIONS

**1.1 Capitalized Terms.** Unless defined elsewhere in this Agreement, capitalized terms used in this Agreement will have the meanings ascribed to them in the attached Appendix A.

**1.2 UCC Terms.** Unless the context clearly indicates otherwise, terms used in this Agreement that are defined in the Uniform Commercial Code will have the meanings ascribed to them in the Uniform Commercial Code.

### SECTION 2. SECURITY INTEREST

**2.1 Grant.** As security for the full and prompt payment and performance of the Obligations, Debtor grants Secured Party a security interest in the Collateral.

#### 2.2 Perfection.

2.2.1. Debtor authorizes Secured Party to file all financing statements and other documents evidencing the security interests granted hereby under applicable law at the location of the Collateral that Secured Party deems reasonably necessary to perfect and continue Secured Party’s security interest in the Collateral. Debtor authorizes Secured Party to indicate on each financing statement that the financing statement covers all assets or all personal property of Debtor.

2.2.2. If any Collateral other than certificated securities and goods covered by a document is in the possession of a person other than Debtor, Secured Party, or a lessee of the Collateral from Debtor in the ordinary course of Debtor’s business, Debtor will assist Secured Party in obtaining from the person a bailee acknowledgment of security interest, in form and substance reasonably satisfactory to Secured Party.

2.2.3. Upon Secured Party’s request, Debtor will take any other actions that Secured Party deems reasonably necessary to perfect and continue Secured Party’s security interest in the Collateral.

**2.3 Termination.** Upon Debtor’s request after the full payment and performance of the Obligations, Secured Party will take all actions that Debtor deems reasonably necessary to terminate Secured Party’s security interest in the Collateral.

### SECTION 3. REPRESENTATIONS AND WARRANTIES OF DEBTOR

Debtor represents and warrants to Secured Party as follows:

**3.1 Authority.** Debtor has full power and authority to sign and deliver this Agreement and to perform all of Debtor's obligations under this Agreement.

**3.2 Binding Obligation.** This Agreement is the legal, valid, and binding obligation of Debtor, enforceable against Debtor in accordance with its terms, except as enforceability may be limited by bankruptcy, insolvency, or other similar laws of general application or by general principles of equity.

**3.3 No Conflicts.** The signing and delivery of this Agreement by Debtor and the performance by Debtor of all of Debtor's obligations under this Agreement will not:

- 3.3.1. breach any agreement to which Debtor is a party, or give any person the right to accelerate any obligation of Debtor;
- 3.3.2. violate any law, judgment, or order to which Debtor is subject; or
- 3.3.3. require the consent, authorization, or approval of any person, including but not limited to any governmental body.

**3.4 Ownership.** Debtor has good title to the Collateral, free from all Encumbrances except Permitted Encumbrances. Debtor has the right and power to transfer and assign the Collateral to Secured Party, free from any restriction or condition.

**3.5 Names of Debtor.** The exact full legal name of Debtor is Artificial Life, Inc.

**3.6 Location of Debtor.** Debtor is a corporation duly organized and validly existing under the laws of the state of Delaware. Debtor presently maintains offices in Los Angeles, California, USA; Hong Kong, PRC; Berlin, Germany; and Tokyo, Japan.

#### **SECTION 4. COVENANTS OF DEBTOR**

Debtor covenants to Secured Party that Debtor will perform the following obligations and observe the following conditions until the Obligations are fully paid and performed:

**4.1 Ownership.** Debtor will keep the Collateral free from all Encumbrances except Permitted Encumbrances. Debtor will not permit any person to restrict or condition Debtor's right and power to transfer and assign the Collateral to Secured Party.

**4.2 Name of Debtor.** Debtor will not change Debtor's legal name.

**4.3 Location of Debtor.** Debtor will maintain its existence as a corporation and will not change the State of its organization.

**4.4 No Disposition of Collateral.** Debtor will not sell, lease, license, distribute, or otherwise dispose of any Collateral, except in connection with:

- 4.4.1. the disposition of inventory in the ordinary course of Debtor's business; and
- 4.4.2. the replacement of equipment in the ordinary course of Debtor's business.

**4.5 Condition of Collateral.** Debtor will keep the tangible Collateral in good repair and operating condition, reasonable wear and tear excepted.

**4.6 Personal Property.** Debtor will not attach any Collateral to any real property in a manner that would cause the Collateral to become real property or a fixture.

**4.7 Notification.** Debtor will promptly notify Secured Party if any of the following occurs:

- 4.7.1. any material change in the business of Debtor;
- 4.7.2. any material loss or damage with respect to any Collateral, whether or not the loss or damage is covered by insurance;
- 4.7.3. any material adverse change in the financial condition of Debtor; or
- 4.7.4. an Event of Default.

**4.8 Future Commercial Tort Claims.** Debtor will promptly notify Secured Party if Debtor obtains any rights to any commercial tort claim. Debtor will ensure that the notice includes the adverse parties to the claim and the specific facts out of which the claim arose.

**4.9 Future Copyrights.**

4.9.1. Debtor will promptly notify Secured Party if:

(a) the United States Copyright Office issues a registration for any work of Debtor for which an application for copyright registration was made; or

(b) Debtor acquires a work that has been registered with the United States Copyright Office.

4.9.2. Debtor will ensure that the notice includes the title, registration number, and effective date of registration of the work.

4.9.3. Debtor will enter into a copyright security agreement in form and substance reasonably satisfactory to Secured Party, and will take any other actions that Secured Party deems reasonably necessary to perfect and continue Secured Party's security interest in Debtor's works that have been registered with United States Copyright Office.

#### **4.10 Future Patents.**

4.10.1. Debtor will promptly notify Secured Party if:

(a) the United States Patent and Trademark Office issues a patent for any invention of Debtor for which an application for patent was made; or

(b) Debtor acquires an invention for which a patent has been issued by the United States Patent and Trademarks Office.

4.10.2. Debtor will ensure that the notice includes the title, patent number, and effective date of issuance of the patent.

4.10.3. Debtor will enter into a patent security agreement in form and substance reasonably satisfactory to Secured Party, and will take any other actions that Secured Party deems reasonably necessary to perfect and continue Secured Party's security interest in Debtor's inventions for which a patent has been issued by the United States Patent and Trademark Office.

#### **SECTION 5. PAYMENT OF TAXES AND OTHER CHARGES BY SECURED PARTY**

Whenever Debtor fails to pay when due any taxes, assessments, or other charges necessary to be paid for the protection of Secured Party's rights under this Agreement, Secured Party may pay the same. Such payments will be added to the Obligations, and will bear interest at an annual rate of 5%.

#### **SECTION 6. SECURED PARTY'S WARNING TO DEBTOR**

**6.1** Unless you, Debtor, provide me, Secured Party, with evidence of the insurance coverage as required by our contract or loan agreement, we may purchase insurance at your expense to protect our interest. This insurance may, but need not, also protect your interest. If the collateral becomes damaged, the coverage we purchase may not pay any claim you make or any claim made against you. You may later cancel this coverage by providing evidence that you have obtained property coverage elsewhere.

**6.2** You are responsible for the cost of any insurance purchased by the Secured Party. The cost of this insurance may be added to your contract or loan balance. If the cost is added to your contract or loan balance, the interest rate on the underlying contract or loan will apply to this added amount. The effective date of coverage may be the date your prior coverage lapsed or the date you failed to provide proof of coverage.

**6.3** The coverage the Secured Party purchases may be considerably more expensive than insurance you can obtain on your own and may not satisfy any need for property damage coverage or any mandatory liability insurance requirements imposed by applicable law.

## **SECTION 7. RIGHTS AND OBLIGATIONS CONCERNING COLLATERAL**

### **7.1 Inspection.**

7.1.1. Upon Secured Party's request, Debtor will:

- (a) permit Secured Party to inspect any Collateral in the possession of Debtor;
- (b) assist Secured Party in inspecting any Collateral in the possession of a person other than Debtor or Secured Party;
- (c) permit Secured Party to inspect and copy Debtor's books of account and records related to the Collateral.

7.1.2. Upon Debtor's request, Secured Party will permit Debtor to inspect any Collateral in the possession of Secured Party.

**7.2 Verification.** Upon 5 days' notice by Secured Party to Debtor, Secured Party may contact appropriate third parties, including account debtors of Debtor, to verify the completeness and accuracy of any information provided by Debtor to Secured Party regarding the Collateral.

**7.3 Purchase Money Security Interests.** To the extent Debtor uses funds borrowed from Secured Party to buy Collateral, Debtor's repayment of the funds will apply on a first-in first-out basis so that the portion of the funds used to buy a particular item of Collateral will be paid in the order Debtor bought the Collateral.

**7.4 Collection, Enforcement, and Assembly.** Before an Event of Default has occurred, Secured Party may, upon notice to Debtor:

7.4.1. notify an account debtor or other person obligated on Collateral to make payment or otherwise render performance to or for the benefit of Secured Party;

7.4.2. take any proceeds to which Secured Party is entitled under the Uniform Commercial Code; and

7.4.3. enforce the obligations of account debtors or other persons obligated on Collateral and exercise the rights of Debtor with respect to the obligations of the account debtors or other persons obligated on Collateral to make payment or otherwise render performance to Debtor, and with respect to any property that secures the obligations of the account debtors or other persons obligated on the Collateral.

## SECTION 8. DEFAULTS AND REMEDIES

**8.1 Events of Default.** Each of the following events is an Event of Default:

8.1.1. Debtor fails to make any payment Obligation when due;

8.1.2. Debtor fails to perform any non-payment Obligation within 20 days after Secured Party notifies Debtor of the failure to perform the Obligation when due;

8.1.3. any representation or warranty made by Debtor in this Agreement is found to have been untrue or misleading in any material respect as of the date of this Agreement;

8.1.4. an Encumbrance other than a Permitted Encumbrance attaches to any Collateral;

8.1.5. any material loss or damage with respect to the Collateral occurs that is not covered by insurance;

8.1.6. Debtor voluntarily dissolves or ceases to exist, or any final and nonappealable order or judgment is entered against Debtor decreeing its dissolution;

8.1.7. Debtor fails to pay, becomes insolvent or unable to pay, or admits in writing an inability to pay Debtor's debts as they become due, or makes a general assignment for the benefit of creditors;

8.1.8. a proceeding with respect to Debtor is commenced under any applicable law for the benefit of creditors, including but not limited to any bankruptcy or insolvency law, or an order for the appointment of a receiver, liquidator, trustee, custodian, or other officer having similar powers over Debtor or the Collateral is entered; and

8.1.9. an event of default occurs under:

(a) any agreement evidencing, guaranteeing, or securing the payment or performance of any of the Obligations; or

(b) any agreement securing the payment or performance of any of the obligations of any guarantor of the Obligations.

**8.2 Remedies.** On and after an Event of Default, Secured Party may exercise the following remedies, which are cumulative and which may be exercised singularly or concurrently:

8.2.1. upon notice to Debtor, the right to accelerate the due dates of the Obligations so that the Obligations are immediately due, payable, and performable in their entirety;

8.2.2. the right to pay and perform any of the Obligations;

8.2.3. any remedy available to Secured Party under any agreement evidencing, guaranteeing, or securing the payment or performance of any of the Obligations or any of the obligations of any guarantor of the Obligations;

8.2.4. any remedy available to Secured Party under the Uniform Commercial Code; and

8.2.5. any other remedy available to Secured Party at law or in equity.

**8.3 Additional Rights and Obligations.** After an Event of Default:

8.3.1. upon Secured Party's request, Debtor will assemble the Collateral and make it available to Secured Party at a place designated by Secured Party which is reasonably convenient to both parties;

8.3.2. upon Secured Party's request, Debtor will otherwise assist Secured Party in exercising any remedy available to Secured Party under this Agreement;

8.3.3. Secured Party may use Debtor's copyrights, patents, tradenames, trademarks, trade secrets, and other similar property to prepare, process, and advertise the Collateral for sale, lease, license, or other disposition; and

8.3.4. Secured Party will have no obligation to resort to any Collateral in any particular order or marshal any Collateral in favor of Debtor or any other person.

**8.4 Application of Cash Proceeds.** After an Event of Default, Secured Party will apply or pay over for application the cash proceeds of collection, enforcement, or disposition of Collateral in the following order to:

8.4.1. the reasonable expenses of collection, enforcement, retaking, holding, preparing for disposition, processing, disposing, and reasonable attorney's fees and legal expenses incurred by Secured Party;

8.4.2. the satisfaction of the Obligations, in such order as Secured Party may determine, to the extent such order is not inconsistent with any agreement evidencing the payment or performance of the Obligations; and

8.4.3. other persons, including but not limited to Debtor, in accordance with the Uniform Commercial Code.

**SECTION 9. RELEASE, INDEMNIFICATION, AND WAIVERS**

**9.1 Release and Indemnification.** Debtor releases and will defend and indemnify Secured Party for, from, and against any and all claims, actions, proceedings, damages, liabilities, and expenses of every kind, whether known or unknown, including but not limited to reasonable attorney's fees, resulting from or arising out of:

9.1.1. any action that Secured Party takes to perfect or continue Secured Party's security interest in the Collateral; or

9.1.2. the exercise of any remedy available to Secured Party under this Agreement, without regard to cause or the negligence of Secured Party or any other person.

**9.2 Waiver by Debtor.** Debtor waives demand, presentment for payment, notice of dishonor or nonpayment, protest, notice of protest, and lack of diligence in collection, and agrees that Secured Party may amend any agreement evidencing, guaranteeing, or securing any of the Obligations or extend or postpone the due dates of the Obligations without affecting Debtor's liability.

**9.3 No Waiver by Secured Party.** No waiver will be binding on Secured Party unless it is in writing and signed by Secured Party. Secured Party's waiver of a breach of a provision of this Agreement or any agreement evidencing, guaranteeing, or securing any of the Obligations will not be a waiver of any other provision or a waiver of a subsequent breach of the same provision. Secured Party's failure to exercise any remedy under this Agreement or any agreement evidencing, guaranteeing, or securing any of the Obligations will not be considered a waiver by Secured Party of Secured Party's right to exercise the remedy.

## SECTION 10. GENERAL

**10.1 Time of Essence.** Time is of the essence with respect to all dates and time periods in this Agreement.

**10.2 No Assignment.** Debtor may not assign or delegate any of Debtor's rights or obligations under this Agreement to any person without the prior written consent of Secured Party, which Secured Party may withhold in Secured Party's sole discretion.

**10.3 Binding Effect.** This Agreement will be binding on the parties and their respective heirs, personal representatives, successors, and permitted assigns, and will inure to their benefit.

### 10.4 Amendment.

10.4.1. Except as otherwise provided in Section 10.4.2, this Agreement may be amended only by a written document signed by the party against whom enforcement is sought.

10.4.2. Secured Party may amend and restate the definition of "Collateral" in Appendix A without the consent of Debtor to account for any commercial tort claims for which notice is or should have been given under Section 4.8. Upon an amendment, Secured Party will promptly deliver to Debtor a copy of the amended and restated Appendix A.

**10.5 Notices.** All notices or other communications required or permitted by this Agreement:

10.5.1. must be in writing;

10.5.2. must be delivered to the parties at the addresses set forth below, or any other address that a party may designate by notice to the other parties; and

10.5.3. are considered delivered:

(a) upon actual receipt if delivered personally or by fax or an overnight delivery service; and

(b) at the end of the third business day after the date of deposit in the United States mail, postage pre-paid, certified, return receipt requested.

To Secured Party:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Fax: \_\_\_\_\_

Attn: \_\_\_\_\_

To Debtor:

Artificial Life, Inc.  
520 Broadway, Suite 350  
Santa Monica, CA 90401  
USA

Fax: \_\_\_\_\_

Attn: \_\_\_\_\_

**10.6 Severability.** If a provision of this Agreement is determined to be unenforceable in any respect, the enforceability of the provision in any other respect and of the remaining provisions of this Agreement will not be impaired.

**10.7 Further Assurances.** The parties will sign other documents and take other actions reasonably necessary to further effect and evidence this Agreement.

**10.8 Attachments.** Any exhibits, schedules, and other attachments referenced in this agreement are part of this Agreement.

**10.9 Remedies.** The parties will have all remedies available to them at law or in equity. All available remedies are cumulative and may be exercised singularly or concurrently.

**10.10 Governing Law.** This Agreement is governed by the laws of the State of Delaware, without giving effect to any conflict-of-law principle that would result in the laws of any other jurisdiction governing this Agreement.

**10.11 Venue.** Any action or proceeding arising out of this Agreement will be litigated in courts located in Delaware. Each party consents and submits to the jurisdiction of any local, state, or federal court located in Delaware.

**10.12 Attorney's Fees.** If any arbitration or litigation is instituted to interpret, enforce, or rescind this Agreement, including but not limited to any proceeding brought under the United States Bankruptcy Code, the prevailing party on a claim will be entitled to recover with respect to the claim, in addition to any other relief awarded, the prevailing party's reasonable attorney's fees and other fees, costs, and expenses of every kind, including but not limited to the costs and disbursements specified under the laws of the state of Delaware, incurred in connection with the arbitration, the litigation, any appeal or petition for review, the collection of any award, or the enforcement of any order, as determined by the arbitrator or court.

**10.13 Entire Agreement.** This Agreement contains the entire understanding of the parties regarding the subject matter of this Agreement and supersedes all prior and contemporaneous negotiations and agreements, whether written or oral, between the parties with respect to the subject matter of this Agreement.

**10.14 Signatures.** This Agreement may be signed in counterparts. A fax transmission of a signature page will be considered an original signature page. At the request of a party, a party will confirm a fax-transmitted signature page by delivering an original signature page to the requesting party.

[signature page to follow]

Dated effective: August 10, 2009

Secured Party:

/s/ Eberhard Schöneburg  
EBERHARD SCHÖNEBURG

Debtor:

ARTIFICIAL LIFE, INC.

\_\_\_\_\_  
By: \_\_\_\_\_

Its: \_\_\_\_\_

**APPENDIX A**  
**Definitions**

“Collateral” means all of Debtor’s personal property, wherever located, whether presently owned or subsequently acquired, including but not limited to: accounts receivable, chattel paper, deposit accounts, documents, equipment, general intangibles, instruments, inventory, investment property, letter-of-credit rights, and money; all intellectual property, including but not limited to patents, copyrights, trademarks, licenses, service marks, trade secrets, inventions, designs, and know-how; all commercial tort claims; and books of account and records related to the property.

“Encumbrance” means any lien, mortgage, pledge, security interest, or other encumbrance.

“Event of Default” means any event specified in Section 8.1.

“Obligations” means all present and future obligations of any kind owed by Debtor to Secured Party, including but not limited to all of Debtor’s obligations arising out of:

- Loan Agreement dated September 29, 2005 between Debtor and Secured Party;
- Loan Agreement dated April 3, 2009 between Debtor and Secured Party;
- Loan Agreement dated May 6, 2009 between Debtor and Secured Party;
- this Agreement.

“Permitted Encumbrances” means:

Encumbrances in favor of Secured Party;

Encumbrances arising by operation of law for taxes, assessments, or government charges not yet due;

statutory Encumbrances for services or materials arising in the ordinary course of Debtor’s business for which payment is not yet due; and

nonconsensual Encumbrances incurred or deposits made in the ordinary course of Debtor’s business for workers’ compensation and unemployment insurance and other types of social security.

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**Exhibit 31.1**

**CERTIFICATIONS**

I, Eberhard Schoneburg, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Artificial Life, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2009

/s/ Eberhard Schoneburg  
Eberhard Schoneburg  
Chief Executive Officer

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**Exhibit 31.2**

**CERTIFICATIONS**

I, Eberhard Schoneburg, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Artificial Life, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting

Date: August 12, 2009

/s/ Eberhard Schoneburg  
Eberhard Schoneburg  
Chief Financial Officer

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**Exhibit 32**

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Artificial Life, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Eberhard Schoneburg, Chief Executive Officer and Principal Financial Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Eberhard Schoneburg  
Eberhard Schoneburg  
Chief Executive Officer and  
Chief Financial Officer

August 12, 2009