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

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2009

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period _____ to _____

Commission file number: 0-25075

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

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act:
None

Securities registered pursuant to Section 12(g) of the Exchange Act:
Common Stock, \$.01 Par Value
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition 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 Smaller reporting company
(Do not check if 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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant on June 30, 2009, based on the closing price on that date of \$0.89 on the Over-The-Counter Bulletin Board, was approximately \$38 million. For the purposes of calculating this amount only, all directors and executive officers of the Registrant have been treated as affiliates.

As of February 28, 2010, the Registrant had 57,882,337 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

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We own or have rights to certain trademarks that we use in connection with the sale of our products, including, but not limited to, the following: *Smart Engine*[™], *OPUS-M*[™], *MoPA-TV*[™], *SmartBot*[™], *V-Girl*[™], *V-boy*[™], *ToonMates*[™], *V-disco*[™], *V-penguins*[™], *Poli-the Bear*[™], *iDroidsMania*[™], *iSoccer Backstreet*[™], and *Verminator*[™]. This Form 10-K may also contain trademarks, trade names, and service marks that are owned by other persons or entities.

References in this annual report on Form 10-K to the “Company,” “we,” “us,” and “our” is to Artificial Life, Inc., a Delaware corporation.

CAUTIONARY STATEMENT REGARDING FUTURE RESULTS, FORWARD-LOOKING INFORMATION AND CERTAIN IMPORTANT FACTORS

In this report we make, and from time to time we otherwise make, written and oral statements regarding our business and prospects, such as projections of future performance, statements of management’s plans and objectives, forecasts of market trends, and other matters that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements containing the words or phrases “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimates,” “projects,” “believes,” “expects,” “anticipates,” “intends,” “target,” “goal,” “plans,” “objective,” “should,” or similar expressions identify forward-looking statements, which may appear in documents, reports, filings with the Securities and Exchange Commission, news releases, written or oral presentations made by officers or other representatives made by us to analysts, stockholders, investors, news organizations, and others, and discussions with management and our other representatives. For such statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Our future results, including results related to forward-looking statements, involve a number of risks and uncertainties. No assurance can be given that the results reflected in any forward-looking statement will be achieved. Any forward-looking statement speaks only as of the date on which such statement is made. Our forward-looking statements are based upon assumptions that are sometimes based upon estimates, data, communications, and other information from suppliers, government agencies, and other sources that may be subject to revision. Except as required by law, we do not undertake any obligation to update or keep current either (i) any forward-looking statement to reflect events or circumstances arising after the date of such statement or (ii) the important factors that could cause our future results to differ materially from historical results or trends, results anticipated or planned by us, or which are reflected from time to time in any forward-looking statement.

PART I

ITEM 1. BUSINESS

General and History

Artificial Life, Inc., a Delaware corporation with global headquarters in Los Angeles, California, a production center in Hong Kong and office in Berlin and Tokyo, is a full-service mobile phone application software provider and a pioneer in broadband mobile technology, mobile games, interactive mobile TV, mobile business applications, and m-commerce platforms. In 2008, Deloitte Touche Tohmatsu recognized us as one of the fastest growing companies in Asia.

Artificial Life, Inc. was founded in 1994 by Eberhard Schoneburg, our current president, chief executive officer, chief financial officer, and chairman. In December 1998, we had an initial public offering, and our shares were listed on the Nasdaq Small Cap Market. From 1998 until the end of 2001, we developed so-called smart agent driven Internet software. In 2002, we changed our business model and started developing mobile phone applications and have since become one of the leading developers and publishers of content for smartphones. From 2002 until the middle of 2008, our main office and headquarters were located in Hong Kong. In 2008, we relocated our headquarters to Los Angeles, CA, USA. Our shares currently trade on the Over-The-Counter Bulletin Board market (OTCBB) under the ticker symbol ALIF. In addition, our common stock has also traded on the German over-the-counter market.

Our current core business is to develop, market, distribute, and sell leading-edge mobile applications and technologies for the latest 3rd and 4th generation (3G and 4G) wireless telecommunications devices and mobile (smart-) phones. Among many other industry awards, we won the global Best Mobile Game Award by Ericsson and the Hong Kong Digital Entertainment Excellence Award for the Best Mobile Entertainment Product. For further details please visit our website www.artificial-life.com.

Background

We originally developed Internet technology and ALife SmartBot™ Internet products in the areas of general information retrieval, web navigation, customer self-help, self-service applications, and direct marketing on the Internet as well as wealth building and investment portfolio management for major international banks and financial institutions.

Today, however most of our products are based on a newly developed m-commerce platform called OPUS-M™ and our own proprietary ALife-SmartEngine™ technology and our SmartEngine Mobile Platform (“SEMP™”), which is a server-side middle ware used to develop and deploy our mobile applications. Please see our website www.artificial-life.com for more details about our core technology.

We are also pioneers in the field of animated human-like intelligent user interfaces for online and mobile devices. Many of our applications can communicate with the user via a life-like, three-dimensional graphical interface, which are now commonly known as “avatars.” These avatars may also be customized for specific client and branding purposes.

Since 2002, we have focused on mobile software development and have become a global, full-service mobile software provider and mobile application publisher, developing and distributing m-commerce applications, mobile games, mobile TV formats, mobile business applications, and mobile software technology in general.

PRODUCTS

Our main revenue source (approximately 51% of revenues) for 2009 was generated from the sales of mobile games, especially for 3G devices such as the iPhone and other smartphones. Our mobile games are sold primarily through reseller channels or under contract with major mobile carriers and operators worldwide. Certain of our games are sold via retailers to handset manufacturers who pre-install the games on their handsets before they are shipped to end users. In addition, we sell directly to end users via our own web portal, www.botme.com.

In addition to mobile games, we currently offer and sell three distinct mobile software packages:

- OPUS-M™ (an m-commerce platform developed in 2008 and 2009 and released in early 2010)
- Mobile controlled TV (MoPA-TV™ since mid 2007)
- Mobile business applications (Mobile Diab™ and Mobile Property since 2008)

OPUS-M™ is a newly released, m-commerce platform and an extension and improvement of our former MobileBooster product, which now is a component of OPUS-M™.

Our interactive TV technology platform MoPA-TV™ and special interactive TV show formats are sold to TV stations and TV format and content producers. For more details see www.mopa-tv.com.

Our mobile business applications are sold either directly to clients or through resellers and distributors. We currently sell two mobile business applications: (1) Mobile Diab™, a mobile blood sugar monitoring system for diabetes patients and (2) Mobile Property, a mobile service for property agents. Further business applications are in development and are scheduled for release later in 2010.

OPUS-M™

Artificial Life has OPUS-M™ worked for several years on the development and distribution of cutting-edge mobile games and applications for many mobile operating systems and platforms, having developed a vast catalogue of proprietary tools, technology, and mobile products. OPUS-M™ is a culmination of Artificial Life's experience, expertise, and insight regarding customers' needs for an m-commerce platform that will drive sales and facilitate mobile integration. Some of Artificial Life's previous mobile products, such as the MobileBooster and the powerful Smart Engine ("SEMP™") technology, and various core mobile modules to support carriers and operators, have been expanded upon, integrated, and brought together to create the new, powerful OPUS-M™ mobile commerce platform.

OPUS-M™ allows clients to build their own m-commerce shop or application. OPUS-M™'s architecture enforces and supports a modular and very flexible format made up of client selectable components catered to the specific needs of each customer, whether that be increased security, massive transaction support, enhanced mobile features, or enhanced application browsing. OPUS-M™'s components are separated into the three layers outlined below: the Core, the Service Layer, and the Application Layer.

Core

The Core of OPUS-M™ provides a framework upon which modules and applications are built. The Core is part of OPUS-M™ for all clients. Some of the more notable components belonging to the Core include the following:

- Messaging Framework
- Security
- Device Recognition
- Image Re-sampling



- Transaction History
- Billing

Service Layer

The Service Layer of OPUS-M™ addresses and offers several selectable components to cater to the business needs of customers setting up their m-commerce storefronts with such components as:

- Sales and Marketing Support
- Customer Relationship Management
- Content Management
- Business Intelligence and Reports
- Augmented Reality and New Media Applications
- Location-based Systems
- Application Migration
- Interface Adapter for 3rd Party Tools and Applications

Application Layer

The Application Layer of OPUS-M™ is comprised of Artificial Life business modules as well as third-party contributions to the platform. By launching applications on the OPUS-M™ platform, content providers may leverage the existing customer base and exposure provided by service operators in areas such as:

- Business Applications
- Games
- New Media
- Social Networking

With so much to offer, OPUS-M™ appeals to a wide customer base in the mobile market: business customers, content providers, and end-consumers. Clients can select their individual set of modules needed, providing support for social networking and even the latest augmented reality technology.

The pricing of the components is based on a monthly rental and usage fee and can be adjusted according to the transaction numbers executed via the platform.

Artificial Life also provides hosting services for the platform and applications and cloud computing and data distribution support for its clients.

MOBILE GAMES

We produce and sell mobile games, especially for broadband networks and high-level mobile phones. These games usually have advanced features such as live streaming video, multiplayer functions, real time 3D animations, and live social network connections.

Currently, we sell 32 mobile Java games and 24 iPhone games. Even though most of our games are designed for 3G phones, we also build versions of our games to cater to lower-grade phones such as 2G and 2.5G phones and networks. A full catalog of our game titles may be found at www.botme.com, www.artificial-life.com, and www.m-botme.com on the iPhone WAP portal.

Since the launch of the iPhone and iPod Touch by Apple, Inc., we have focused on developing games for these powerful wireless devices. As of December 31, 2009, we had produced and released 24 games for the iPhone and iPod Touch. So far, our most popular title was downloaded approximately 2.1 million times, our second most popular title approximately 1.5 million times, and the third most popular title, which was launched in early December, 2009, achieved over 1 million downloads in just one month. The average number of downloads per game was approximately 280,000. Paid iPhone games were sold for \$ 0.99 to \$ 4.99 with an average price per game of \$ 2.14.

As of February 2010, our total number of iPhone game downloads was approximately 10 million worldwide compared to approximately 12.3 million worldwide downloads of our mobile Java games. Our Java games are sold via our own web portal, www.botme.com, or through reseller channels and operators/carriers worldwide.

Besides the iPhone/iPod Touch platforms, we also support Android, Google's new open source platform for mobile devices.

MOPA-TV™: MOBILE CONTROLLED INTERACTIVE TV SHOWS AND FORMATS

In early 2007, we acquired an innovative mobile interface technology for live TV shows called SMS Galaxy. We renamed the technology "Mobile Participation TV" or MoPA-TV™. During 2008 and 2009, we substantially improved on the original technology and added a series of new product features. See our website www.mopa-tv.com for more details.

MoPA-TV™ is an interface technology for live TV shows. It allows TV viewers to participate in live TV shows from their home and to see themselves represented as an interactive 2D or 3D avatar on their TV screen in real time interacting with other MoPA-TV™ players or the TV show host.

The latest addition to the MoPA-TV™ system is a face rendering tool. This feature allows participants to create an avatar with a face that looks like their very own face. For this, participants simply take a photo of their own face with the built-in camera of their phones and send this picture to our servers. Our system then maps this photo on a pre-set 3D head of a chosen avatar.

With the acquisition and improvement of MoPA-TV™, we have become a pioneer and instant market leader in the space of interactive mobile interfaces to live TV shows. In early 2008, we launched a very successful live TV show in Japan with TV Asahi. In collaboration with RDF Digital USA, we are currently developing an interactive animated TV show entitled Sleuths, which is expected to be the first interactive television show in the United States. We are further improving this technology and are currently rolling out MoPA-TV™ globally.

We are providing the core technology of MoPA-TV™ to TV stations as well as full custom interactive TV game show formats. MoPA-TV™ game show formats can easily be customized to create a new game show or it can be integrated as a new feature into already existing popular game show formats.

MoPA-TV™ can also be used at large live events using oversized indoor or outdoor digital screens. In December 2008, we successfully launched the first such live quiz show with the German Soccer club FC Bayern Munich at their famous Allianz Arena, which seats approximately 70,000 participants. In July 2009, we also successfully implemented MoPA-TV™ at the 12th IAAF World Championships in Athletics Berlin 2009™ to entertain the audience in the Olympiastadion Berlin and at event sites in Berlin.

MOBILE BUSINESS APPLICATIONS SINCE 2008 (MOBILE DIAB™ and MOBILE PROPERTY)

Artificial Life currently offers two major non-game business applications:

- Mobile Diab™
- Mobile Property

Mobile Diab™

Mobile Diab™ is an innovative and interactive mobile diabetes monitoring and patient coaching system. It consists of an interactive mobile phone client component for patients to monitor their levels of blood sugar, blood pressure, bread unit intake, weight, and physical activities. The monitoring data from the user's phone is automatically transferred via secure wireless networks to a centralized telematic platform and is then made accessible to doctors for analysis through a secure and specialized interface on the Internet. Doctors can then set up automated alerts, advice messages, and schedules to send to patients when certain data points are exceeded. We intend to launch our first healthcare application based on Mobile Diab™ for the iPhone in 2010.

Mobile Property

Mobile Property delivers real estate property descriptions along with multimedia assets (like graphical floor plans, images, and videos) in real time to the mobile phone in an easy to use format. The system simplifies the property search process for the customer, while at the same time projecting a wider marketing campaign for the real estate agent. The mobile software uses a unique combination of mobile technology, internet property portal, and content search engine. It increases the efficiency and productivity and raises the profile of the real estate agent in the marketplace by providing a real time reporting and analysis module for user interests.

AUGMENTED REALITY

In 2009, we announced and launched a new line of products using augmented reality technology. This technology allows the inclusion of realistic and interactive 2D or 3D animations and renderings as well as information to appear seamlessly in video footage or live video streams to enhance game play or user experience in a diverse range of applications. Various supporting technologies will be leveraged in the creation of the augmented reality application lineup including image recognition, face detection, and object tracking. By combining mobile device cameras with location information, map data, and compass readings, virtual items can become part of the real world view through devices with cameras.

The new product line will include new mobile games as well as new mobile business and lifestyle applications. We intend to release these products in 2010. We will develop these new products in-house and also co-operate with other third parties and major research institutions in this field. Some products will be jointly developed with major global brands.

MOBILEBOOSTER™

MobileBooster™ is a development and productivity tool and platform for mobile broadband 3G applications and games. It facilitates and supports the mobile products roll-out process. It targets and supports mobile operators and carriers, production studios, software developing companies, media companies, and mobile aggregators and resellers in their roll-out and distribution process of mobile applications. This web-based platform organizes and automates the creation of program builds and the roll-out management of mobile products by providing and managing and keeping concise records of handset types, operators, aggregators, products, and project information and data.

MobileBooster™ comes populated with over 1,500 unique handset type data and associated attributes. It allows centralized and distributed storage management for mobile application builds.

MobileBooster™ supports the whole production life cycle including the design phase, development phase, testing phase, porting phase, and roll-out phase. We intend to release a new version and major extension of our MobileBooster™ platform. The new platform will serve as a full and flexible m-commerce platform for business clients that can be configured to suit customer needs by the clients themselves. For further information please visit www.artificial-life.com.

MobileBooster™ has now become an integrated part of OPUS-M™, our new m-commerce platform, and beginning 2010, is no longer sold as a stand-alone product.

MOBILE MUSIC

In 2009, we signed an agreement with Robbie Williams, the award-winning British music artist, to launch an iPhone game application featuring Robbie Williams' new music from the album "Reality Killed the Video Star", which incorporates cutting-edge 3D game play of the rally driving game genre. The game was released in the fourth quarter of 2009, in parallel with the new album, featuring the music and key visual themes of the record.

In 2009, we signed a three-year license agreement with multi-platinum, two-time-Grammy-winning rock band Linkin Park and Warner Bros. Records to launch a social community based music game featuring Linkin Park's music on iPhone. We intend to launch the product in the early second quarter of 2010.

MOBILE AGGREGATION AND DISTRIBUTION: DIRECT TO CONSUMER SALES BOTME.COM AND M-BOTME.COM

We have further expanded our global reach through the establishment of an off-deck web portal with which we are selling our products directly to end users. Our mobile and mobile WAP portal sites are www.botme.com and www.m-botme.com.

CONSULTING AND PRODUCT SERVICES

We occasionally provide consulting and custom specific project and product development services either directly or by utilizing the resources of partners, resellers, and consultants. In addition, we provide support for the creation and maintenance of our mobile products and, upon request, customer-specific, back-office tools for analyzing client profiles gathered by our bots, ourselves, or through our partners and resellers.

Business Strategy

Our current business strategy and goal is to establish the Company as the leading full-service broadband mobile content and m-commerce provider. We are focusing on four key markets: mobile games, mobile TV, mobile business applications, and our mobile commerce platform, OPUS-M™. In addition, we offer consulting services, customization services, custom product development for clients, and product placements and mobile marketing as well as mobile distribution and aggregation.

In addition to the mobile game business, in 2010 we will focus on mobile business and lifestyle applications. We are currently preparing and developing new mobile business and lifestyle products in the following fields:

- Mobile health care and health monitoring for diabetes
- Mobile security, digital watermarking, and virtual reconstruction of objects
- Augmented reality and mobile image recognition
- Mobile green technology, environmental protection monitoring, and control applications

By covering the whole range of broadband mobile software since the middle of 2007, we have successfully established multiple and independent revenue streams for the Company. We believe that this mix of revenue streams is the basis for our current success and profitability, and we intend to continue to expand our business on this basis.

We support all major mobile platforms, including Java, Brew, Symbian, iPhone/iPod Touch, iPad, and Android and have the technical tools and capabilities to launch mobile products on over 1,500 handset types globally.

Our target markets so far have primarily been Asia and Europe. With the re-location of our headquarters to Los Angeles, we expect more business in the Americas in 2010.

We are also considering strategic acquisitions of other companies with businesses that are complimentary to ours.

Marketing and Sales

In 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 70 countries through Apple's App Store/iTunes distribution platform.

In addition to marketing our current products, we continue to focus on developing new iPhone/iPod Touch, iPad, 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.

We are currently selling and marketing our products through a variety of methods and a vast number of channels, including, but not limited to, direct sales, distribution and channel agreements, hand-set manufacturers, and strategic relationships with third-party providers and resellers, and plan to continue to do so going forward. We believe that partner networks and strategic relationships, such as our co-operation with 3M, Paramount, Warner Bros. Records, Turner, Cartoon Networks, Red Bull, BMW, Linkin Park, and other key alliances around the world, provide an effective means of entering targeted vertical markets while targeted direct sales are instrumental for obtaining large, must-have clients. It is our belief that this strategy will provide a cost effective means of

achieving maximum exposure for our products and services.

Key Strategic Alliances

Relationship with 3M

In October 2009, we signed an alliance agreement with 3M Company to collaborate on projects related to the research and development of new mobile device products and technology. In addition, the Company and 3M plan to cooperate in connection with the marketing of certain of the Company's existing and new products in the following areas:

- General mobile and broadband applications and technologies
- Digital Watermarking
- Virtual reconstruction of 2D and 3D objects
- Augmented Reality
- 3D Image processing
- Object recognition
- Mobile Healthcare and Diabetes Solutions
- Mobile Marketing and M-Commerce Platform

We believe that cooperation will allow us to create innovative business and lifestyle applications for one of the leading innovators in the business world and the general public. 3M has also become a major shareholder in our Company in the fourth quarter of 2009.

Relationship with Apple Inc.

We are an accredited and registered developer for the iPhone and iPod Touch platforms from Apple. We have launched 24 iPhone and iPod Touch games and applications since December 2008 and intend to release several new games and applications in 2010. These games and applications are sold directly to consumers through the online Apple shop and iTunes platform. In 2010 we also intend to support and develop applications for the new iPad.

Relationship with Cartoon Network

We signed a development agreement with the Cartoon Network, Inc. Cartoon Network (CartoonNetwork.com) is currently watched by an estimated 200 million households in over 120 countries around the world. Cartoon Network is Turner Broadcasting System, Inc.'s ad-supported cable service that offers animated entertainment for kids and families.

The contract relates to the development of game applications for wireless platforms based on games published by Adult Swim, Cartoon Network's late night programming block showcasing original and acquired animation for young adults aged 18-34. In December 2008, we released the first successful joint product, *Amateur Surgeon*, for the iPhone and iPod Touch platform. The game has been in the top-100 ranking since launch under the "Adventure" and "Strategies" categories in most of the countries where the game is available. Since then, we have released several other successful iPhone games for Cartoon Networks. We have plans to launch additional titles in association with Cartoon Network in 2010.

Relationship with Red Bull

In 2008, we signed a license and game contract with Red Bull to bring the exciting Red Bull Air Race World Championship series to the iPhone/iPod Touch platform. This game was our first advertisement-based game and was released in the first quarter of 2009. In early 2010, we launched Red Bull Racing Challenge, the Formula One racing game for Red Bull.

Relationship with BMW

In November 2008, we reached an agreement with the German luxury car maker BMW to develop and launch an iPod/iPhone Touch game that features and promotes the new upcoming BMW Z4. Part of the agreement is also a license relating to the development of a racing game featuring the BMW Formula 1 car. In 2009, we launched *BMW Expression of Joy Z4 Lite*, *BMW Z4 Experience* and *BMW Sauber F1 Team Racing 09*.

Relationship with soccer club FC Bayern Munich

In mid 2008, we signed a two-year exclusive license agreement with the famous German soccer club FC Bayern Munich to develop and launch at least two interactive 3D soccer games based on the players of the club for the 2008/09 and 2009/10 seasons. We entered into a second agreement to develop and show interactive mobile quizzes based on MoPA-TV™ featured on the outdoor digital screens in the Allianz soccer arena.

Relationship with Linkin Park and Warner Bros. Records

In April 2009, we signed a three-year license agreement with multi-platinum, two-time-Grammy-winning rock band Linkin Park and Warner Bros. Records to launch a social community based massive multiplayer music game featuring Linkin Park's music on iPhone. We intend to launch this product in the first quarter of 2010.

Relationship with Starz Digital Media

In April 2009, we signed a license agreement with Starz Digital Media to launch an iPhone game inspired by the horror movie "Pandorum" for Overture Films, which game was released in the third quarter of 2009. In addition to that, we jointly developed the official "Spartacus: Blood and Sand" mobile game designed for iPhone and iPod Touch with the Company. The game was released in January 2010.

Relationship with Berlin Organising Committee 2009 GmbH

In July 2009, we implemented the MoPA-TV™ at the 12th IAAF World Championships in Athletics Berlin 2009™ to entertain the audience in the Olympiastadion Berlin and at event sites in Berlin.

Relationship with Robbie Williams

In September 2009, we signed an agreement with Robbie Williams, the multi-BRIT-Award-winning music artist, to launch an iPhone game application featuring Robbie Williams' new music from the album "Reality Killed the Video Star" and incorporating cutting-edge 3D game play of the rally driving game genre. The game was released in the fourth quarter of 2009.

Agreements with Mobile Operators and Resellers

In 2009, we further expanded our global reach to end users by signing up many new mobile operators and carriers as distributors for our products. As of today, we have entered into agreements with telecom carriers to make our products available in over 100 countries and all key markets worldwide, including Australia, Austria, Brunei, Canada, China, Croatia, Denmark, Finland, Germany, Greece, Holland, Hong Kong, Hungary, India, Israel, Italy, Japan, Latvia, Lithuania, Luxemburg, Malaysia, Mauritius, New Zealand, Poland, Spain, Sweden, Switzerland, South Africa, Taiwan, the United Kingdom, the USA, and many other markets.

We have also entered into agreements with more resellers of mobile devices to pre-install our games on mobile phones. We are continually evaluating additional strategic potential alliances globally for marketing and re-selling of our products and applications.

We established over 1,000 active direct and indirect sales channels for our products.

Significant Agreements and Events of the Past Year

- In January 2009, we signed a license agreement with the German car maker BMW to launch a promotional iPhone game for the new BMW Z4 car model. In March 2009, we signed an additional license agreement with BMW for the BMW F1 Sauber Formula One racing team.
- In February 2009, we launched the *Shooter* iPhone game with Paramount. The game reached the second highest level of downloads in Apple App Store for over 2 months.
- In March 2009, we launched the *BMW Expression of Joy Z4 Lite* iPhone game. Also in March 2009, we signed a license agreement with the German soccer club BVB Borussia Dortmund to develop a Java soccer game for the club.
- 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, which was released in September 2009, around the start of the new 2009/2010 soccer season. The game is already available on designated channels in Germany, Switzerland, and Austria.
- In April and May 2009, we launched *Red Bull Air Race World Championship* and *Red Bull Air Race World Championship Lite*, 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 Bros. 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 first quarter of 2010.
- In May 2009, we launched *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 *Verminator™*, our own branded iPhone game.
- In July 2009, we signed a technology licensing and production agreement with the Berlin Organizing Committee 2009 GmbH (BOC 2009 GmbH) to implement MoPA-TV™, the Company's innovative cross platform technology, at the 12th IAAF World Championships in Athletics Berlin 2009™ to entertain the audience in the Olympiastadion Berlin and at event sites in Berlin.
- In July 2009, Starz Digital Media revealed plans to jointly develop the official "Spartacus: Blood and Sand" mobile game designed for iPhone and iPod Touch with the Company. The game will utilize the touch screen and motion sensitive features of the popular mobile devices and bring to life the action, violence, and sex seen in the series. The game was released in January 2010.
- In August 2009, we signed a two-year exclusive development and distribution agreement with Red Bull Racing to produce an official racing game on the iPhone and iPod Touch platform featuring Red Bull Racing's Formula One cars and drivers. The game was released in January 2010.
- In August 2009, we announced a collaboration with RDF Digital USA to produce an interactive animated TV show entitled "Sleuths". Implementing our innovative MoPA-TV™ system, Sleuths will be the first television show in the United States to let audiences become part of the storyline.
- In August 2009, we launched the *iSink U* iPhone game.
- In August 2009, we announced our strategic decision to expand our business activities in China. All of the Company's iPhone and iPod Touch games and applications will be translated into simplified Chinese and launched in China as soon as possible. In addition, the Company will create new and specially tailored iPhone and iPod applications for the Chinese market.
- In September 2009, we launched *Pandorum*, the official movie game for the horror film of the same name from Overture Films, on the iPhone and iPod Touch platform.
- In September 2009, we launched *BMW Sauber F1 Team Racing 09*, featuring the BMW Sauber F1 Team for the 2009 season, on the iPhone and iPod Touch platform. This is the second collaboration between BMW and Artificial Life to develop iPhone applications.
- In September 2009, we signed an agreement with Robbie Williams, the multi-BRIT-Award-winning music artist, to launch the first official iPhone game application featuring Robbie Williams' new music from the album "Reality Killed the Video Star" and incorporate cutting-edge 3D game play of the rally driving game genre. The artist is releasing the application in parallel to the new album, which features the music and key visual themes of the record.

The game was released in November 2009 and is currently retailing on the Apple App Store.

- In September 2009, we announced our strategic decision to expand our non-gaming related mobile activities through the launch of our first healthcare application for the iPhone, an intelligent mobile diabetes monitoring system. The application is tentatively scheduled for release in the first quarter of 2010.
- In October 2009, we launched the first official mobile game with Borussia Dortmund, one of the most outstanding teams in the Bundesliga, the German first division soccer league. The game is already available on various portals of well-known mobile content providers in Germany, Switzerland, and Austria.
- In October 2009, we signed a securities purchase agreement with 3M Company in accordance with which 3M purchased 6,447,491 shares of our common stock at a price of \$1.00 per share. The shares purchased by 3M Company represent a 10% interest of our equity, calculated on a fully diluted basis.
- In October 2009, we signed an alliance agreement with 3M Company in accordance with which we will collaborate in the coming years in projects related to the research and development of new mobile device products and technology, as well as marketing of certain of our existing and new products.
- In November 2009, we announced our successful collaboration with Cartoon Network's Adult Swim Games in bringing *Five Minutes to Kill (Yourself)* to the Apple App Store for the iPhone and iPod Touch. Both companies have plans to launch more mobile titles in 2010.
- In November 2009, we announced a new line of mobile products using augmented reality technology. This technology allows the inclusion of realistic and interactive 2D or 3D animations and renderings as well as information to appear seamlessly in video footage or live video streams to enhance game play or user experience.

Competition

The market for most of our products and services is still emerging and constantly evolving. Competition may intensify as the markets mature and more established software companies may become increasingly involved. Barriers to market entry may be considered as relatively insubstantial. However, we believe that we have a strong market position and a technical lead especially in the 3G area due to the use of our SEMP™ and OPUS-M™ which allow us the effective production of high quality mobile games and applications.

In the mobile area, the following companies may be considered potential competitors even though none of them has yet, to our knowledge, produced any direct competing product to us: Bandai Networks Co., Ltd.; BANPRESTO Co., Ltd.; Capcom Co., Ltd.; Chillingo, Ltd.; Com2uS Corp.; CYBIRD Co., Ltd.; Digby; Digital Chocolate, Inc.; Eidos Interactive Ltd. (under SCi Entertainment Group); Electronic Arts, Inc.; Entaz Co., Ltd.; Gameloft GAMEVIL, Inc.; Glu Mobile; G-mode Co., Ltd.; Hands-On Mobile, iFone Ltd.; Hudson Entertainment, Inc.; InfoSpace, Inc.; I-Play (under Digital Bridges Limited); Jaleco Ltd.; JAMDAT Mobile Inc.; Konami Digital Entertainment, Inc.; KongZhong Corp.; Kuju Mobile; M DREAM Co., Ltd.; MFORMA Group, Inc.; Namco Networks America Inc.; Netbiscuits; Pearl-in-Palm Information Technology Ltd.; Player One Ltd.; Reakosys, Inc.; PopCap Games, Inc.; SEGA Mobile, division of SEGA Corporation; Square Enix Co., Ltd.; Square Enix, Inc.; Taito Corp.; Tapulous Inc.;

THQ Wireless Inc.; Tianjin Mammoth Technology Co., Ltd.; and Ubisoft Entertainment.

This list may not be complete and may change and substantially increase over time. Some of our existing and potential competitors have longer operating histories, greater name recognition, larger customer bases, and significantly greater financial, technical, and marketing resources than us. Such competitors are able to commit operating resources to product development and enhancement, engage in more thorough marketing campaigns for their products and services, be more aggressive from a pricing standpoint, and make more attractive offers to potential employees and partners.

To the extent one or more of our competitors introduce products that more fully address customer requirements, our business could be materially adversely affected. There can be no assurance that we will be successful in customizing contracted enhancements to our existing products incorporating new technology on a timely basis, or that our products will adequately address the changing needs of the marketplace. If we are unable to customize existing products in a timely manner in response to changing market conditions or customer requirements, our business, prospects, financial condition, and results of operations may be materially adversely affected.

Intellectual Property and Other Proprietary Rights

We rely upon trade secrets, know-how, copyrights, and certain continuing technological innovations to develop and maintain our competitive position. We seek to protect such information, in part, by entering into confidentiality agreements with our corporate partners, collaborators, employees, and consultants. These agreements provide that all confidential information developed or made known during the course of the individual's or entity's relationship with us is to be kept confidential and not be disclosed to third parties except in specific circumstances. We have endeavored to cause our employees to execute forms of Confidentiality and Inventions Agreements, which provide that, to the extent permitted by applicable law, all inventions conceived by an individual during the individual's employment will remain our exclusive property. There can be no assurance that these agreements will not be breached, that we would have adequate remedies for any breach or that our trade secrets will not otherwise become known or be independently discovered by competitors. Further, there can be no assurance that we will be able to protect our copyrights and trade secrets or that other parties will not independently develop substantially equivalent proprietary information and techniques.

Employees

As of December 31, 2009, we, together with our subsidiaries, had 65 full-time employed staff, of whom 57 are engaged in research, engineering, product development, sales, marketing, and technical support and the balance in management and administrative positions. None of our employees are represented by a labor union or covered by a collective bargaining agreement. We have not experienced any work stoppages and consider relations with our employees to be good.

We also work with a varying and growing number of long-term and short-term contractors to support our operations.

General Market Conditions

Economic conditions in the United States and in foreign markets in which we operate have substantially affected our sales and profitability in 2009. Economic activity in the United States and throughout much of the world has undergone a sudden, sharp economic downturn following the 2008 and 2009 housing downturn and subprime lending crisis and the following banking crisis in 2008 and 2009 in both the United States and Europe. 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 have faced credit issues and experienced cash flow problems and other financial hardships. These have affected timeliness of payments to us. Consumer confidence and spending are down significantly.

Changes in governmental banking, monetary, and fiscal policies aimed at restoring liquidity and increasing 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, receipts, profitability, and results of operations.

ITEM 1A. RISK FACTORS

Not Applicable.

ITEM 1B. UNRESOLVED STAFF COMMENTS

The Company is in receipt of a comment letter from the staff of the Securities and Exchange Commission, or the SEC, dated December 18, 2009. This letter contained two comments. One comment relates to a request for further information with regard to the Company's Liquidity and Capital Resources disclosure in its form 10-Q for the quarter ended September 30, 2009. The second comment relates to extinguishments of certain liabilities recorded by the Company in its 2008 and 2007 consolidated financial statements, which are included in its Forms 10-K for those years. The liabilities extinguished (derecognized) by the Company represented liabilities incurred prior to 2003 by an inactive subsidiary and were derecognized upon the expiration of the applicable State statute of limitations for which a creditor could bring a claim or action against the Company. The Company determined that these liabilities could be extinguished in 2007 and 2008 based on its interpretation of applicable accounting standards and consultations with its legal counsel. Although the Company has determined that it has a legal defense against any such claims, and the possibility of any such claims is remote, the Staff has stated in its December 18, 2009 comment letter that it appears the conditions for derecognition of these liabilities have not been met, and therefore, the financial statements should be revised to reflect such liabilities. The Staff stated that the Company should amend its 2008 Form 10-K or tell the Staff why revision is not required pursuant to applicable accounting standards. Any revision would be accomplished through a restatement of the Company's financial statements for 2007 and 2008 and disclosed in amendments to its 10-K filings.

The liabilities amounted to approximately \$685,000 in 2007 and \$48,000 in 2008. The Company has submitted a response letter to the SEC with regard to these comments providing additional information and reasserting the position that such extinguishments were appropriate, and irrespective of such, that the extinguishments given management's analysis of qualitative and quantitative information available, would not be material to the Company or to an investor.

The Company can make no assurance that it will not receive an additional comment letter from the SEC or whether it will in the future make a determination to restate its financial statements as initially proposed by the SEC. If such a restatement were undertaken, the above described amounts would be recorded to the Company's financial statements as non-current liabilities and appropriate adjustments to the 2008 and 2007 statements of income would be required. This would be effected through amendments to the Company's 10-K for the year ended December 31, 2008 and through an amendment to this 2009 Form 10-K filing.

ITEM 2. PROPERTIES

In June 2009, we renewed a short-term lease for our U.S. temporary service office of 153 square feet in Los Angeles, which serves as our global corporate headquarters, requiring a monthly rent payment of approximately \$1,320 and which is on a month-to-month basis.

In October 2009, we renewed a two-year lease for our Hong Kong office that consists of approximately 8,400 square feet of office space, requiring a monthly rent payment of approximately \$18,000. The lease expires in December 2011.

Our Berlin office consists of 7,632 square feet of office space that we lease for \$11,000 per month. The lease expires in February 2012. The lease is in German and contains additional provisions that are typical of a Berlin commercial real-estate lease.

In June 2009, we entered into a one-year lease of a residential apartment in Hong Kong that expires in June 2010. The lease requires a monthly rent payment of approximately \$4,500.

In April 2009, we entered into a one-year lease of a residential apartment in Los Angeles, California for our Creative Director. The lease requires a monthly rent payment of approximately \$3,100 and expires in April 2010.

ITEM 3. LEGAL PROCEEDINGS

In September 2008, an action stemming from a contract dispute was brought against Artificial Life Europe GmbH in Germany in which a claim of approximately \$375,000 was made against the Company. A court hearing was held in September 2009 before the State Court in Berlin. In February 2010, the Court ordered the Company to pay the plaintiff a settlement claim of approximately \$350,000 and all court and attorney fees incurred by the plaintiff. The settlement amount and the estimated court and attorney fees have been accrued as of December 31, 2009. In March 2010, the Company filed an appeal with the State Court in Berlin, and no payment will be made until a final judgment is issued by the Court. We believe we have adequately reserved for our current litigation and that the ultimate outcome of pending appeal will not have a material adverse impact on our consolidated financial position or results of operations taken as a whole.

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

Our common stock currently trades on the Nasdaq Over-The-Counter Bulletin Board ("OTCBB") under the symbol "ALIF." In addition, our common stock has traded on the German over-the-counter market. The following table sets forth for the periods indicated, the range of the high and low bid quotations for our common stock on the OTCBB. Such quotations reflect inter-dealer prices, without retail mark-up, mark-down or commissions and may not represent actual transactions.

	2009	Low	High
First Quarter		\$0.58	\$1.49
Second Quarter		\$0.63	\$1.05
Third Quarter		\$0.71	\$0.94
Fourth Quarter		\$0.85	\$1.37
	2008	Low	High
First Quarter		\$1.55	\$2.00
Second Quarter		\$1.65	\$2.60
Third Quarter		\$1.18	\$1.90
Fourth Quarter		\$0.80	\$1.15

In February 2010, we announced our planned listing in the Entry Standard market segment of the Frankfurt Stock Exchange. The Company's current trading on the OTCBB is not anticipated to be affected by such listing.

Shareholders

As of February 28, 2010, we had outstanding 57,882,337 shares of common stock, held by approximately 188 stockholders of record.

Dividend Policy

To date, we have neither declared nor paid any cash dividends on shares of our common stock. We presently intend to retain earnings to finance the operation and expansion of our business and do not anticipate declaring cash dividends in the foreseeable future.

Recent Sales of Unregistered Securities

During 2009, the Company closed a private placement offering with twelve institutional and five individual accredited investors for 9,585,726 shares of common stock and warrants to purchase an additional 2,594,631 shares of common stock. The shares of common stock and warrants were sold for an aggregate purchase price of \$9,009,440. In connection with the private placement offering, the Company retained a selling agent to whom it paid a commission of approximately \$829,000. The issuance of the common stock and warrants are exempt from the registration requirements of the Securities Act of 1933, as amended, or the Securities Act, in accordance with Section 4(2) of the Securities Act and Regulations D and S under the Securities Act. The warrants have a two- to three-year term with exercise prices ranging from \$0.80 to \$1.50 and are immediately exercisable. In addition, the Company issued 101,345 shares of common stock to one director and one employee upon cashless exercises of stock options previously issued in 2006 with exercise price of \$0.83.

Equity Compensation Plan Information

The information required by this Item 5 regarding securities authorized for issuance under equity compensation plans is included in Item 11 of this report.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

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 accompanying notes to the financial statements.

During the course of 2009, Artificial Life, Inc. strengthened its position as a leading full service global mobile software provider by offering a wide variety of mobile products such as: mobile games and entertainment, mobile TV, mobile advertisement, mobile distribution and aggregation, mobile business applications, and mobile productivity tools and technology.

In 2009, we sold over 12.3 million licenses for our mobile Java games worldwide, a significant increase over the approximate 10 million licenses sold in 2008.

We are a registered developer for Apple's iPhone and iPod Touch platforms and develop games and applications for these platforms and we are a leading publisher of iPhone/iPod games. Since December 2008, we have released 24 iPhone and iPod Touch games. We achieved a total number of downloads of approximately 8.4 million games for the iPhone and iPod Touch in 2009.

Below is a summary of our current iPhone sales and download numbers and key ranking statistics through 2009:

Titles Released in 2008 and 2009:	24
Number of Countries Selling:	72
Rankings for 2009 on Apple charts:	
Top 100:	96% (23 titles)
Top 50:	88% (21 titles)
Top 10:	77% (17 titles)
Top 5:	46% (11 titles)
Rank 1:	33% (8 titles)
Number of Countries Reached (Top 10 of Apple charts):	56 countries (77% of all countries in which the games are offered)
Duration Staying on Apple charts in 2009:	
Top 100 for more than 30 days:	15 titles
Top 100 for more than 90 days:	9 titles
Top 100 for more than 180 days:	6 titles
Longest Continuous Top 100:	More than 1 year
Licensed Games: Own Branded Games:	16:8
Best Performing Game Categories:	Adventure and Racing

Approximately 51% of our revenues in 2009 were derived from mobile games, while approximately 21%, 22%, 6%, and 1% of our revenues were derived from the sales of MobileBooster™ productivity tool (now OPUS-M™) and our mobile business applications Mobile Diab™, Mobile Property, and MoPA-TV™, respectively. We expect revenues from non-gaming sources to increase percentage-wise in 2010.

We have experienced a 22% growth in overall revenues and remained profitable in 2009 despite the global financial crisis. We have won several major new clients and won follow up contracts from partners such as the German soccer club FC Bayern Munich, German car manufacturer BMW, Paramount, Red Bull, Turner (Cartoon Networks), VfB Stuttgart, Starz Digital Media, Warner Bros. Records, Linkin Park, and Robbie Williams.

Prior to 2008, our revenues were relatively small and we experienced operating losses and negative cash flow from operations. To support our global growth and expansion, we have financed our operations in recent years mostly by raising capital through equity financings and through loans provided by our founder and chief executive officer. In 2009, we completed private placements of common stock and warrants to several investors, raising gross proceeds of approximately \$9 million. This financing provided us with greater financial flexibility to pursue new business opportunities, invest in new technology licenses as the basis for new products and allowed us to develop new key products such as our OPUS-M™ platform. We intend to expand further in 2010 and continue to create and deliver innovative mobile technologies and products.

Even though we have seen a major improvement in sales and revenues in 2008 and 2009, we still may experience significant fluctuations in our future operating results due to a variety of factors. Factors that may affect our operating results include the development of the global mobile broadband markets, the general market acceptance of our products, the growth of the 3G handset markets, the future growth of sales of iPhone/iPod/iPad products and Android products, our ability to sell or license our intellectual property at reasonable price levels, success in creating and entering into strategic alliances, our mix of product and service sales, our response to competitive pressure, and our ability to attract and retain qualified personnel. In addition to the foregoing industry related factors, the aftermath of the downturn in the global economy over the past year could have an undesirable effect on our operations and revenue in 2010.

Gross profit margins vary from product to product and between products and services. Although we may have some ability to affect our products and services mix, our sales mix may vary from period to period and our gross margins will fluctuate accordingly.

Results of Operations —Year Ended December 31, 2009 compared to Year Ended December 31, 2008

Revenues. Revenues for the year ended December 31, 2009 were \$27,454,474 as compared to \$22,454,414 for the year ended December 31, 2008. The increase of \$5,000,060, or 22%, was primarily due to increased licensing revenue generated from the sales of our 3G mobile java and iPhone/iPod Touch products and our m-commerce platform as well as license income from the sales of our Mobile Diab™ and Mobile Property applications.

Cost of Revenues. Cost of revenues mainly consisted of amortization of intangible assets (license rights). Cost of revenues for the year ended December 31, 2009 was \$5,309,072 as compared to \$3,204,590 for the year ended December 31, 2008. The increase of \$2,104,482, or 66%, was primarily due to the increased amortization of license rights.

Gross Margin. Gross margin for the year ended December 31, 2009 was \$22,145,402 as compared to \$19,249,824 for the year ended December 31, 2008. The increase of \$2,895,578, or 15%, 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 number of license deals for the sale of our Mobile Diab™ and Mobile Property applications offset by amortization of license rights acquired.

General and Administrative Expenses. General and administrative expenses consisted of salary and payroll tax expenses of administrative personnel, rent, professional fees and costs associated with employee benefits, supplies, communications, and travel. Total general and administrative expenses for the year ended December 31, 2009 were \$6,426,674 as compared to \$3,268,260 for the year ended December 31, 2008. The increase of \$3,158,414, or 97%, was primarily due to the stock-based compensation expense of approximately \$0.6 million, depreciation of computer software of approximately \$1.4 million, and bad debt expense of approximately \$2 million partially offset by reduced legal and professional fees.

Research and Development Expenses. 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. Total research and development expenses for the year ended December 31, 2009 were \$4,930,495 as compared to \$3,250,289 in the year ended December 31, 2008. The increase of \$1,680,206, or 52%, was primarily due to the stock-based compensation expense of approximately \$0.5 million and an increase of approximately \$0.8 million in staff bonus and approximately \$0.5 million in internet expenses partially offset by reduced consulting fees.

Sales and Marketing Expenses. Sales and marketing expenses consisted of salary and payroll tax expenses of marketing personnel and costs relating to marketing materials, promotional videos, advertising, tradeshow-related expense and public relation activities. Total marketing expenses for the year ended December 31, 2009 were \$4,663,183 as compared to \$2,272,516 for the year ended December 31, 2008. The increase of \$2,390,667, or 105%, was primarily due to the stock-based compensation expense of approximately \$1.2 million and an increase of approximately \$0.3 million in staff bonus and salaries and approximately of \$0.9 million in consulting expenses.

Other Income/Expenses. Other income for the year ended December 31, 2009 totaled \$383,669 as compared to \$9,656 for the year ended December 31, 2008. The other income of \$383,669 was mainly due to net late payment charge income of approximately \$189,000, and foreign currency transaction gains of \$332,251 in this year compared to gains of \$161,574 in 2008.

Net Income. Net income for the year ended December 31, 2009 was \$7,568,719 as compared to \$10,575,285 for the year ended December 31, 2008. The decrease of \$3,006,566 was primarily due to stock-based compensation expense of \$2,385,500, bad debt expense of \$2,636,979, and income tax benefit of \$1,060,000 in this year compared to income tax benefit of \$106,870 in 2008. The basic and diluted net income per share for the year ended December 31, 2009 was \$0.15 compared to the basic and diluted net income per share for the year ended December 31, 2008 of \$0.23 and \$0.22, respectively.

Income from Operations and Net Income Excluding Stock-Based Compensation Expense and Debt Discounts on Detached Warrants Issued with Convertible Promissory Note. For the years ended December 31, 2009 and 2008, our income from operations was \$6,125,050 and \$10,458,759, respectively, and our net income was \$7,568,719 and \$10,575,285, respectively, which includes the effects of stock-based compensation expense for stock options, and the effects of interest expense arising from the accretion of discount on convertible notes. Excluding the income statement effects of stock-based compensation expense and interest expense arising from the accretion of discount on convertible notes, our non-GAAP income from operations would have been \$8,510,550 in 2009 and \$10,458,759 in 2008 and our non-GAAP net income would have been \$9,954,219 in 2009 and \$10,626,158 in 2008.

The difference between the expected and effective income tax benefit recorded for the years ended December 31, 2009 and 2008 is due primarily to changes in the valuation allowance on net deferred tax assets and the expected utilization of available net operating loss carry forwards.

At December 31, 2009, the Company has recorded a net current income tax payable of \$17,394, which consists of estimated state income taxes, U.S. federal alternative minimum tax, and foreign income taxes.

Non-GAAP income from operations and net income exclude stock-based compensation expense and interest expenses or accretion of debt discount expense that are driven primarily by discrete events that management does not consider to be directly related to our core operating performance. These non-GAAP financial measures should not be considered a substitute for income from operations and net income calculated in accordance with US GAAP, and the financial results calculated in accordance with US GAAP and reconciliations to those financial statements should be carefully evaluated. The non-GAAP income from operations and net income used by us may be calculated differently from and therefore may not be comparable to similarly titled measures used by other companies.

We believe that the presentation of non-GAAP income from operations and non-GAAP net income, especially as it relates to 2008 figures, provides important supplemental information to management and investors regarding financial and business trends relating to our financial condition and results of operations.

Reconciliation of GAAP to Non-GAAP Results

The table below sets forth the items included in income from operations and net income that management excludes in computing the non-GAAP income from operations and non-GAAP net income and provides a reconciliation of GAAP to Non-GAAP results:

	2009	2008
GAAP income from operations	\$6,125,050	\$10,458,759
Adjustment for stock-based compensation expense within:		
General and administrative	632,600	—
Research and development	506,100	—
Sales and marketing	1,246,800	—
Income from operations excluding stock-based compensation expense	<u>\$8,510,550</u>	<u>\$10,458,759</u>
GAAP net income	\$7,568,719	\$10,575,285
Adjustment for stock-based compensation expense within:		
General and administrative	632,600	—
Research and development	506,100	—
Sales and marketing	1,246,800	—
Extinguishment of liabilities	—	(48,127)
Debt discount on promissory notes within:		
Interest expense	—	99,000
Net income excluding stock-based compensation expense and interest expense from debt discount	<u>\$9,954,219</u>	<u>\$10,626,158</u>

Liquidity and Capital Resources

Cash Flow Summary

Our cash flows from operating, investing and financing activities, as reflected in the consolidated statements of cash flows for the years ended December 31, 2009 and 2008, are summarized as follows:

	<u>2009</u>	<u>2008</u>
Cash (used in) provided by:		
Operating activities	\$(2,213,329)	\$ 3,271,599
Investing activities	(5,024,156)	(13,073,391)
Financing activities	8,295,372	4,936,326
Effect of exchange rate changes on cash	(132,129)	85,609
Net increase (decrease) in cash, considering effect of exchange rate changes on cash	<u>\$ 925,758</u>	<u>\$ (4,779,857)</u>

Net cash used in operating activities was \$2,213,329 for year ended December 31, 2009, which was an increase of \$5,484,928 compared to the year ended December 31, 2008. This increase in cash used was due primarily to the increase in trade accounts and installment receivable balances compared to the prior period and granting certain customers extended payment terms (up to 180 days), offset by an increase of non-cash depreciation and amortization, write downs of certain fixed assets and license rights, bad and doubtful debt expense, stock-based compensation expense and accounts payable, accrued expenses, and other.

Net cash used in investing activities was \$5,024,156 for the year ended December 31, 2009, which was a decrease of \$8,049,235 compared to the year ended December 31, 2008. This decrease was primarily due to decreased cash expenditures for license rights and fixed assets.

Net cash provided by financing activities was \$8,295,372 for the year ended December 31, 2009, which was an increase of \$3,359,046 compared to the year ended December 31, 2008. This increase was due to the private placements completed during the year, raising cash proceeds of \$8,600,590, as compared to \$5,278,502 during the year ended December 31, 2008.

As of December 31, 2009, we had a working capital surplus of \$16,476,297 and stockholders' equity of \$46,508,635.

During the year ended December 31, 2009, we completed a private placement raising total cash proceeds of \$8,600,590 through the issuance of 9,241,071 shares of common stock, including through the exercise of stock options, to a number of investors. As part of this placement, three parties received 446,000 shares and warrants to purchase 1,110,500 shares in satisfaction of \$408,850 of accounts payable.

We have borrowed funds from time to time in the past from our chief executive officer, Eberhard Schoneburg, in the form of deferred bonuses payable to Mr. Schoneburg. As of December 31, 2009, we owed Mr. Schoneburg an aggregate amount of \$1,606,328, as compared to \$737,771 at December 31, 2008. During the year ended December 31, 2009, Mr. Schoneburg advanced funds of \$202,257 to the Company. The advanced funds bear interest at a rate of 5% per year and are secured by the assets of the Company.

We expect that cash flow to be generated from 2010 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 trade receivables. Economic activity in the United States and throughout much of the world has undergone a sudden, sharp 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 trade receivables may need to be written off in the next year.

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 trade receivables, profitability, and results of operations.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade receivables. 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 90 to 180 days. In 2009, the Company provided extended payment terms (up to 180 days) to certain long-term customers. Due in part to the global financial crisis at December 31, 2009, the average age of accounts and installment receivable from all customers was 128 days as compared to 83 days at December 31, 2008. The average age of receivables from the Company's four largest customers at December 31, 2009 was 138 days. The Company assesses the probability of collection from each customer at the outset of the arrangement and during the contract terms based on a number of factors, including the customer's business relationship with the Company, its 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 or it defers revenues until payments are received. On December 31, 2009, trade accounts and installment receivable were \$17,972,166 as compared to approximately \$27.5 million in revenues for 2009. Between December 31, 2009 and March 15, 2010, approximately \$3 million of this amount had been collected. Management estimates that on average an amount comparable to two full quaters of revenues will remain as receivables on its books going forward due to 180 days of general payment terms with major clients. This may be the case until the effects of the global financial crisis diminish and payment terms can be shortened again. 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 is approximately \$348,000 at December 31, 2009, compared to \$731,500 at December 31, 2008.

Management reviews the allowance for doubtful accounts for each reporting period based on a detailed analysis of trade receivables. In the analysis, management primarily considers the history with the client, 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 receivables were incorrect, adjustments to the allowance may be required, which would reduce profitability.

Since the Company's trade receivables 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 year ended December 31, 2009, the Company entered into agreements with certain of its customers to offset trade receivables of \$6,443,500 from these customers with accounts payable to these same parties. The offset of these receivables and payables represents a legal right of setoff pursuant to applicable accounting standards. The Company also entered into two agreements with one reseller customer and one licensor for assignment of trade

receivables of \$4,179,643 and \$4,160,315 (a total of \$8,339,958), respectively. The trade receivables were assigned in exchange for certain technology license rights. As a result, even though the Company invested in several license rights purchase agreements for a total consideration of approximately \$22,048,000 during all of 2009, the cash used in investing activities was not increased substantially during the year. Instead, these transactions lead to a decrease in cash used in operating activities, which management deemed appropriate and advantageous for the Company to minimize cash expenditures and credit risk exposure.

Inflation and Changing Prices

Because we anticipate that a significant portion of our future revenues will be based upon a percentage of sales of licensed mobile games, we do not anticipate inflation will have a material impact on future operations.

Critical Accounting Policies

Revenue Recognition, Concentrations and Credit Risk

Revenue recognition rules for software businesses are very complex. We follow specific and detailed guidelines in determining the proper amount of revenue to be recorded. However, certain judgments affect the application of our revenue recognition policy. Revenue results are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from year to year.

The Company generates revenues from the following sources:

- (a) Software agreements from the licensing of the Company's software;
- (b) Fees from mobile products sold to end users via telecommunications operators and carriers and
- (c) Application, consulting and implementation services.

Revenues from the licensing of the Company's software are accounted for in accordance with ASC 985-605, "Software-Revenue Recognition" (formerly Statement of Position ("SOP") 97-2, "Software Revenue Recognition" ("SOP 97-2")). The Company determines whether product revenue recognition is appropriate based upon the evaluation of whether the following four criteria have been met:

Persuasive evidence of an arrangement - Generally, the Company uses either a customer-signed contract or qualified customer purchase order as evidence of an arrangement. These contracts are typically non-cancelable by the customer.

Delivery of product - The Company considers delivery to have occurred when the product has been delivered to the customer, the customer has formally accepted the product, and no-post delivery obligations exist.

Fee is fixed or determinable - The Company assesses whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. If the fee is not deemed to be fixed or determinable, the Company recognizes revenue as payments become due and payable.

Collection of fee is reasonably assured - The Company assesses the probability of collecting from each customer at the outset of the arrangement based on a number of factors, including the customer's payment history, its current

creditworthiness, economic conditions in the customer's industry and geographic location, and general economic conditions. If in management's judgment, collection of a fee is not probable, the Company will defer revenue but recognize related costs.

The Company's management uses judgment and the business history with its clients concerning the satisfaction of these criteria, particularly the criteria relating to the determination of whether the arrangement fees are fixed and determinable and the criteria relating to the collectibility of the receivables in management's evaluation of each revenue transaction, including those with extended payment terms.

Software agreements may include multiple elements. Fees are allocated to the various elements based on vendor-specific objective evidence ("VSOE") of fair value and the portion of the fees allocated to each element is recognized as revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectability is probable.

If VSOE does not exist for the allocation of revenues to the various elements of the arrangement, all revenues from the arrangement are deferred until the earlier of (1) when VSOE exists, or (2) when all elements of the arrangement have been delivered. Historically, the majority of our software agreements have not included multiple elements nor has the Company had any continuing obligations or involvement under the agreements. In accordance with ASC 985-605, revenues from such licensing agreements have been recognized at the time the licenses were granted.

Revenues from entertainment products, games, and technologies used in mobile phones are recognized net in accordance with ASC 605-45 (formerly Emerging Issues Task Force ("EITF") No. 99-19 ("EITF 99-19")). Recognition is net as (1) the Company is not the primary obligor in the arrangements, (2) the amount the Company earns is fixed (the download rate), and (3) the telecommunications carrier and the Company both have credit risk. Revenues are recognized only after the applications have been downloaded by mobile users from the carriers and such downloads have been charged by carriers to end users and these charges are supported by statements received from the carriers.

Revenues from application, consulting, and implementation services are recognized as services are performed.

Revenue is deferred for transactions in which there are any significant future costs associated with that transaction. Development costs which are not required to be capitalized, primarily marketing and installation costs, are charged to earnings as incurred.

Allowance for Doubtful Accounts Receivable

The Company extends credit to its customers in the normal course of business when considered appropriate. The Company performs ongoing credit evaluations and generally does not require collateral. The Company maintains reserves for potential credit losses based upon its loss history and its aging analysis. The allowance for doubtful accounts is our best estimate of the amount of

probable credit losses in our existing accounts receivable. We review the allowance for doubtful accounts each reporting period based on a detailed analysis of our accounts receivable. In the analysis, we primarily consider the age of the customer's receivable and also consider the creditworthiness of the customer, the economic conditions of the customer's industry, and general economic conditions, among other factors. If any of these factors change, we may also change our original estimates, which could impact the level of our future allowance for doubtful accounts.

If payment is not made timely, we will contact the customer to try to obtain payment. Once all collection efforts are exhausted, the receivable is written off against the allowance for doubtful accounts.

Impairment of Long Lived Assets, including Intangible Assets

We review our long-lived assets, including intangible assets subject to amortization, whenever events or changes in circumstances indicate that the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such assets are considered impaired, the impairment to be recognized is equal to the amount by which the carrying value of the assets exceeds their fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. In assessing recoverability, we must make assumptions regarding estimated future cash flows and discount factors. If these estimates or related assumptions change in the future, we may be required to record impairment charges. Intangible assets with determinable lives are amortized over their estimated useful lives, based upon the pattern in which the expected benefits will be realized, or on a straight-line basis, whichever is greater.

Stock-Based Compensation Expense

Effective January 1, 2006, the Company adopted ASC 718, "Share-Based Payment" (formerly Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R")), using the modified prospective method. ASC 718 requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and is measured based on the grant date fair value of the award. ASC 718 also requires the stock option compensation expense to be recognized over the period during which an employee is required to provide service in exchange for the award (the vesting period).

Income Taxes

Deferred tax assets and liabilities are recorded for temporary differences between the financial statement and tax basis of assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. A deferred tax asset is recorded for any net operating loss, capital loss, and tax credit carry forward for income tax purposes, to the extent its realization is more likely than not. As changes in tax laws or rates are enacted, deferred tax assets, and liabilities will be adjusted through the provision for income taxes.

Derivatives

We follow the provisions of ASC 815, "Accounting for Derivative Instruments and Hedging Activities" (formerly Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133")), along with related interpretations EITF No. 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock" ("EITF 00-19") and EITF No. 05-2 "The Meaning of 'Conventional Convertible Debt Instrument' in Issue No. 00-19" ("EITF 05-2"). ASC 815 requires every derivative instrument (including certain derivative

instruments embedded in other contracts) to be recorded in the Balance Sheet as either an asset or liability measured at its fair value, with changes in the derivative's fair value recognized currently in earnings unless specific hedge accounting criteria are met. We value these derivative securities under the fair value method at the end of each reporting period (quarter), and their value is marked to market at the end of each reporting period with the gain or loss recognition recorded against earnings. We continue to revalue these instruments each quarter to reflect their current value in light of the current market price of our common stock. We utilize the Black-Scholes option-pricing model to determine fair value. Key assumptions of the Black-Scholes option-pricing model include applicable volatility rates, risk-free interest rates, and the instruments' expected remaining life. These assumptions require significant management judgment.

Recent Accounting Pronouncements

In June 2009, the FASB approved the FASB Accounting Standards Codification (the "Codification") ASC 105, "Generally Accepted Accounting Principles" (formerly Statement of Financial Accounting Standards ("SFAS") No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162" ("SFAS 168")) as the single source of authoritative nongovernmental generally accepted accounting principles (GAAP). All existing accounting standard documents, such as FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force and other related literature, excluding guidance from the Securities and Exchange Commission ("SEC"), have been superseded by the Codification. All other non-grandfathered, non-SEC accounting literature not included in the Codification has become nonauthoritative. The Codification did not change GAAP, but instead introduced a new structure that combines all authoritative standards into a comprehensive, topically organized online database. The Codification impacts the Company's consolidated financial statements, as all future references to authoritative accounting literature will be referenced in accordance with the Codification. As a result of the Company's implementation of the Codification during the quarter ended September 30, 2009, previous references to new accounting standards and literature are no longer applicable.

In October 2009, the FASB issued Accounting Standards Updates ("ASU") 2009-13, which amends ASC 605, "Revenue Recognition", to require companies to allocate the overall consideration in multiple-element arrangements to each deliverable by using a best estimate of the selling price of individual deliverables in the arrangement in the absence of vendor-specific objective evidence or other third-party evidence of the selling price. ASU 2009-13 will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, and early adoption will be permitted. The Company does not expect the adoption of this statement to have a material impact on its consolidated financial statements.

In October 2009, the FASB issued ASU 2009-14, which amends ASC 985-605, "Software-Revenue Recognition", to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. ASU 2009-14 will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and early adoption will be permitted. The Company does not expect the adoption of this statement to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued new accounting guidance ASC 825, "Financial Instruments" (formerly FASB Staff Position ("SOP") No. 107-1, "Interim Disclosures about Fair Value of Financial Instruments" ("SOP 107-1")) related to interim disclosures about the fair values of financial instruments. This guidance requires disclosures about the fair value of financial instruments whenever a public company issues financial information for interim reporting periods. This guidance is effective for interim

reporting periods ending after June 15, 2009. The Company adopted this guidance upon its issuance, and it had no material impact on the Company's consolidated financial statements.

On January 1, 2009, the Company adopted new guidance ASC 805-10-65-1 (formerly Statement of Financial Accounting Standards ("SFAS") No. 141(R), "Business Combinations" ("SFAS 141R")) issued by the FASB related to the accounting for business combinations and related disclosures. This new guidance addresses the recognition and accounting for identifiable assets acquired, liabilities assumed, and noncontrolling interests in business combinations. The guidance also establishes expanded disclosure requirements for business combinations. The Company will apply this new guidance to all business combinations subsequent to January 1, 2009.

On January 1, 2009, the Company adopted new guidance ASC 810, "Consolidation", regarding noncontrolling interests (formerly Statement of Financial Accounting Standards ("SFAS") No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS 160")) issued by the FASB related to the accounting for noncontrolling interests in consolidated financial statements. This guidance establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This guidance requires that noncontrolling interests in subsidiaries be reported in the equity section of the controlling company's balance sheet. It also changes the manner in which the net income of the subsidiary is reported and disclosed in the controlling company's income statement. The adoption of this guidance had no impact on the Company's consolidated financial statements.

Off-Balance Sheet Arrangements

At December 31, 2009, we did not have any material off-balance sheet arrangements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See the index included at Item 15. Exhibits, Financial Statement Schedules.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A(T). CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

(a) *Evaluation of Disclosure Controls.* Our chief executive officer/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 Securities Exchange Act of 1934, or 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/chief financial officer concluded that our disclosure controls and procedures were effective as of December 31, 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 change in our internal control over financial reporting that occurred during the year ended December 31, 2009 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 in 2010 as we implement our Sarbanes Oxley testing methodologies.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) and has assessed its effectiveness using the components established in the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Our internal control over financial reporting has been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Our internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of our assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures are being made only in accordance with authorization of our management and directors; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements. Our Chief Executive Officer/Chief Financial Officer concluded that we maintained effective internal control over financial reporting as of December 31, 2009.

This Annual Report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to temporary rules of the SEC that permit the Company to provide only management's report in this Annual Report.

ITEM 9B. OTHER INFORMATION

None.

PART III**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Set forth below are the names of our directors and executive officers, their ages, their offices with us, if any, their principal occupations or employment for the past five years, the length of their tenure as directors, and the names of other public companies in which they hold directorships.

Name	Age	Position
Eberhard Schoneburg	53	Chairman of the Board, Chief Executive Officer, President and Chief Financial Officer
Ernest Axelbank	31	Chief Technology Officer
Claudia Alsdorf	43	Director
Dr. Gert Hensel	55	Director
Rene Jaeggi	61	Director

Eberhard Schoneburg has been our founder and chairman of our board of directors since November 1994. He served as chief executive officer from November 1994 to May 1996 and from October 1997 to the present. He has served as chief financial officer from September 2002 to the present. We were founded in November 1994 as Neurotec International Corp., a wholly owned subsidiary of Neurotec GmbH, a German multimedia and Internet solutions company owned by Mr. Schoneburg and two corporate investors: a major German retailer, and an industrial conglomerate. Neurotec GmbH was part of the Neurotec Group, a group of high tech companies founded in Germany by Mr. Schoneburg in 1993. In 1997, Mr. Schoneburg sold all of his shares in Neurotec GmbH to the remaining stockholders and contemporaneously purchased 100% of the shares of Neurotec International Corp. from Neurotec GmbH. From 1989 to 1994, Mr. Schoneburg was a professor for industrial applications of artificial intelligence at Fachhochschule Furtwangen, Germany. From 1988 to 1993, he was the chairman of the BIT Group, a group of five German high-tech companies which he founded in 1988. Mr. Schoneburg was awarded the First Prize of the Berlin Innovation Award in 1990 for the development of the first European Neural Compiler and again in 1992 for the development of an expert system for detecting chemical hazards for Procter and Gamble. He has published five course books on a wide variety of topics such as computer viruses, neural networks, evolution strategies, and genetic programming. Mr. Schoneburg has successfully launched over 20 high tech companies on three continents over the last 20 years. Mr. Schoneburg was selected to be a director of the Company based in part on his experience as the founder of the Company, his position at the Company, his knowledge of the business sectors in which the Company operates, and his technical background.

Ernest Axelbank is our chief technology officer and has been with our company since March 1999. His duties include covering technical details regarding software architecture, software development, network infrastructure, and security. He also performs pre-sales and business development activities and liaises with partners and clients with requirements specification and deployment details.

Claudia Alsdorf joined our Board in August 2001. In 1999, Ms. Alsdorf co-founded echtzeit AG where she was principally responsible for the preparation of an initial public offering of echtzeit AG securities on the German Neuer Market exchange, as well as initiating a joint venture with a German retailer for three-dimensional product presentations and online catalogues. In 1996, Ms. Alsdorf founded echtzeit USA in San Francisco, and was mainly responsible for the initiation of operations with United States based companies. In 1995, Ms. Alsdorf co-founded echtzeit Gesellschaft fur mediales Gestalten mbH, a developer of computing environments for e-commerce and communications, both on the desktop and for large-scale multi-user Internet environments, with subsidiaries in Berlin, Cologne, and Zurich. Ms. Alsdorf is currently a corporate executive at SAP AG, Germany. Ms. Alsdorf was selected to be a director of the Company based in part on her experience with international business, including experience in high-tech sectors.

Dr. Gert Hensel joined our Board in July 2001. Since January 2000, Dr. Hensel has been the chief operating officer and founder of VICUS Grundstuecksservice GmbH, a real estate management company. From January 1998 to January 2000, Dr. Hensel was the founder and a shareholder of Weiss-Grundstuecksverwaltungs-und Entwicklungsgesellschaft GmbH Erkner, a real estate management company. Since January 1995, Dr. Hensel has been a corporate fiduciary for BIT GmbH, Berlin and a manager of DABU Accounting services. Dr. Hensel was selected to be a director of the Company based in part on his business experience and financial reporting expertise and Dr. Hensel qualifies as an “audit committee financial expert” under SEC regulations.

Rene Jaeggi joined our Board in May 2007. He was the chief executive officer of Adidas AG from 1986 to 1993. After 1993, he was (among other positions) co-owner of Romika GmbH in Germany, Chairman of H.T.M. in Vienna, Chairman of StairMaster in Seattle, Washington, and a member of the board of Rutledge Capital based in Greenwich, Connecticut. He is currently on the board of several international companies and Chairman of Flora Eco Power AG in Munich, a public bio energy company. Mr. Jaeggi was selected to be a director of the Company based in part on his international business experience and his experience as a director on other boards.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our executive officers, directors and beneficial owners of more than ten percent (10%) of our registered stock to file initial reports of ownership and reports of changes in ownership of our shares with the SEC, and to provide copies of such reports to the company.

In the fiscal year ended December 31, 2009, reports on Form 4 were not timely filed for Rene Taeggi, Gert Hensel, Claudia Alsdorf, and Eberhard Schoneburg.

Code of Ethics

We have adopted a Code of Ethics that applies to our principal executive, financial and, accounting officers. Artificial Life, Inc. will provide a copy of its code of ethics, without charge, to any person who requests it. Requests should be addressed in writing to Ms. Celine Hadaya, Investor Relations, Artificial Life, Inc., 26/F., 88 Hing Fat Street, Causeway Bay, Hong Kong.

Director Nominees Recommended by Stockholders

We have not implemented any changes to the procedures by which stockholders may recommend nominees to our board of directors since we last disclosed those procedures in our most recent proxy statement.

Audit Committee and Audit Committee Financial Expert

We have a separately designated a standing audit committee established in accordance with the Exchange Act, as amended. Dr. Hensel and Ms. Alsdorf are members of the audit committee. The Board has determined that at least one person on the Audit Committee, Dr. Gert Hensel, qualifies as a “financial expert” as defined by SEC rules implementing Section 407 of the Sarbanes-Oxley Act. Dr. Hensel also meets the definition of an “independent” director set forth in Rule 5605(a)(2) of the Corporate Governance Requirements of the Nasdaq Stock Market.

ITEM 11. EXECUTIVE COMPENSATION

The following table provides summary information concerning the compensation earned by our executive officers for the fiscal years ended December 31, 2009 and 2008. No other executive officers received compensation from us in excess of \$100,000 during those years.

Summary Compensation Table

Name & Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option and Warrant Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Nonqualified deferred compensation earnings (\$)	All other Compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Eberhard Schoneburg	2009	\$619,920	\$837,257	\$0	\$1,770,000	\$0	\$0	\$87,750(1)	\$3,314,927
Chief Executive	2008	\$393,436	\$320,361	\$0	\$0	\$0	\$0	\$78,000(1)	\$ 791,797
Officer and Chief Financial Officer									
Ernest Axelbank	2009	\$121,861	\$ 29,743	\$0	\$ 531,000	\$0	\$0	\$0	\$ 682,604
Chief Technology Officer	2008	\$110,897	\$0	\$0	\$0	\$0	\$0	\$0	\$ 110,897

(1) Represents housing allowance.

Mr. Schoneburg’s employment agreement provides for a cash bonus equal to 3% of net profits and a bonus payable in cash or stock equal to 3% of the total price of any merger of the Company with a third party or the acquisition of a majority of the Company’s shares in which Mr. Schoneburg is instrumental. The agreement further provides for a bonus payable in cash or stock equal to 3% of the overall increase in the Company’s market capitalization for each fiscal year payable. For 2007 and subsequent years, this amount cannot exceed the Company’s cash requirement, as defined in the employment agreement. Mr. Schoneburg’s employment agreement also includes severance payments (under certain conditions) of one and a half to three years salary as well as a non-compete provision for a period of six months following termination of his employment.

The following table provides information concerning unexercised options and warrants, stock that has not vested, and equity incentive plan awards outstanding as of December 31, 2009.

Outstanding Equity Awards At Fiscal Year-End

Name	Option Awards					Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
Eberhard Schoneburg	300,000	-0-	-0-	\$0.83	12/4/12	-0-	\$0	-0-	\$0
Chief Executive	300,000	-0-	-0-	\$0.94	12/4/12	-0-	\$0	-0-	\$0
Officer and Chief	700,000	-0-	-0-	\$0.83	12/4/12	-0-	\$0	-0-	\$0
Financial Officer	700,000	-0-	-0-	\$0.94	12/4/12	-0-	\$0	-0-	\$0

Ernest Axelbank	300,000	-0-	-0-	\$0.83	12/4/12	-0-	\$0	-0-	\$0
Chief Technology Officer	300,000	-0-	-0-	\$0.94	12/4/12	-0-	\$0	-0-	\$0

The following table provides information concerning compensation paid by us to our directors during the fiscal year ended December 31, 2009.

Director Compensation

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Nonqualified Deferred Compensation Earnings	All Other Compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
Gert Hensel	\$30,000	\$0	\$448,000	\$0	\$0	\$0	\$478,000
Claudia Alsdorf	\$30,000	\$0	\$282,000	\$0	\$0	\$0	\$312,000
Rene Jaeggi	\$60,000	\$0	\$282,000	\$0	\$0	\$0	\$342,000

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information as of February 28, 2010 regarding the beneficial ownership of our common stock by (i) each person that we believe beneficially owns 5% or more of our common stock; (ii) each named executive officer; (iii) each of our directors and each director nominee; and (iv) all of our current directors and executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Information regarding ownership of our common stock by our security holders is based, in part, upon our review of Forms 3, 4, and 5 and Schedules 13G filed with the Securities and Exchange Commission by such persons and information from the agent of our security holders. Unless otherwise noted, each of the security holders listed in the table possesses sole voting and investment power with respect to the shares indicated, and the address of our directors and executive officers is the address of our corporate offices. Shares not outstanding but deemed beneficially owned by virtue of the right of a person or member of a group to acquire them within 60 days are treated as outstanding only when determining the amount and percent owned by such person or group. As of February 28, 2010, there were 57,882,337 shares of common stock outstanding.

Name of Beneficial Owner	Shares Beneficially Owned	
	Amount	Percent of Class
Eberhard Schoneburg (1)	8,594,516	14.4%
Claudia Alsdorf (2)	557,570	1.0%
Dr. Gert Hensel (3)	734,797	1.3%
Rene Jaeggi (4)	400,000	*
Ernest Axelbank (5)	907,095	1.6%
3M Company	6,447,491	11.1%
All current directors and executive officers as a group 5 persons (6)	11,193,978	18.3%

* Less than 1%

- (1) Includes 2,000,000 shares subject to stock options and warrants that are exercisable within 60 days.
- (2) Includes 300,000 shares subject to stock options that are exercisable within 60 days.
- (3) Includes 500,000 shares subject to stock options that are exercisable within 60 days.
- (4) Includes 400,000 shares subject to stock options that are exercisable within 60 days.

- (5) Includes 600,000 shares subject to stock options that are exercisable within 60 days.
- (6) Includes 3,800,000 shares subject to stock options and warrants that are exercisable within 60 days.

Equity Compensation Plan Information

The following table sets forth certain information as of December 31, 2009 about our equity compensation plans under which our equity securities are authorized for issuance.

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	4,165,000	\$ 0.93	27,475,852
Equity compensation plans not approved by security holders	—	—	—
Total	4,165,000	\$ 0.93	27,475,852

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Since January 1, 2009, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or are to be a party in which the amount involved exceeded or exceeds the lesser of \$120,000 or 1% of the average total assets at year-end for the last three completed fiscal years and in which any director, executive officer or any member of the immediate family of any of the foregoing individuals has or will have a direct or indirect material interest other than the transactions described below.

Employment Agreements

Under an executive employment Agreement dated July 1, 2006, we agreed to employ Eberhard Schoneburg as President, chief executive officer and chairman of the Board. On June 1, 2008, we amended Mr. Schoneburg's employment contract ("Amendment"). The Amendment became effective on June 1, 2008 and has extended the current employment agreement through December 31, 2011. In accordance with the terms of the Amendment, Mr. Schoneburg will continue to serve as the current and acting Chairman, chief executive officer, president and chief financial officer of the Company. In addition, Mr. Schoneburg will continue to receive the benefits under the current employment agreement with a base salary of \$46,875 per month plus performance based bonuses.

Other Transactions

As of December 31, 2009, we owed Mr. Schoneburg an aggregate of \$1,606,328, including accrued bonus of \$837,257. The indebtedness bears interest at a rate of five percent (5%) per year and is secured by the assets of the Company.

Director Independence

Of our four directors, we believe that Claudia Alsdorf, Dr. Gert Hensel, and Rene Jaeggi are “independent directors” as defined in 5605(a)(2) of the Corporate Governance Requirements of the Nasdaq Stock Market. Ms. Alsdorf and Dr. Hensel are the only members of our audit committee and our compensation committee. We do not have a standing nominating committee or any committees performing similar functions. The entire Board performs the functions of a nominating committee.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

GHP Horwath, P.C. has served as our independent registered public accounting firm since May 1, 2002. All of the services described below were approved by our audit committee prior to performance. The audit committee has determined that the payments made to its independent registered public accounting firm for these services are compatible with maintaining such auditors’ independence.

Audit Fees

The aggregate fees for professional services rendered by GHP Horwath, P.C. in connection with its audit of our annual consolidated financial statements in our Form 10-K and the reviews of our quarterly consolidated financial statements included in our Forms 10-Q for the fiscal years ended December 31, 2009 and 2008 totaled approximately \$115,000 and \$134,800, respectively.

Audit-Related Fees

No fees were paid by us for audit-related services rendered by GHP Horwath, P.C. for the fiscal years ended December 31, 2009 and 2008.

Tax Fees

Fees of approximately \$8,200 and \$2,300 were paid by us for professional services rendered by GHP Horwath, P.C. for tax compliance matters for the fiscal years ended December 31, 2009 and 2008.

All Other Fees

There were no other fees for other services rendered by GHP Horwath for the fiscal years ended December 31, 2009 and 2008.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) List of documents filed as part of this report

1. Financial Statements

The following consolidated financial statements are included in this report on Form 10-K beginning on page F-1.

- Consolidated Balance Sheets as of December 31, 2009 and 2008;
- Consolidated Statements of Income and Comprehensive Income for the Years ended December 31, 2009 and 2008;
- Consolidated Statements of Changes in Stockholders' Equity for the Years ended December 31, 2009 and 2008;
- Consolidated Statements of Cash Flows for the Years ended December 31, 2009 and 2008; and
- Notes to Consolidated Financial Statements

Our consolidated financial statements and the notes thereto, together with the report of the independent registered public accounting firm on those consolidated financial statements are hereby filed as part of this report, beginning on page F-1.

2. Financial Statement Schedules

There are no schedules filed because of the absence of conditions under which they are required or because the required information is presented in the consolidated financial statements or the notes thereto.

3. Exhibits

The exhibits to this report on Form 10-K are listed in the Exhibit Index contained at the end of this report. The Exhibit Index indicates each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report on Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ Eberhard Schoneburg
Eberhard Schoneburg
President and Chief Executive Officer

Dated: March 15, 2010

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
<u>/s/ Eberhard Schoneburg</u> Eberhard Schoneburg	President, Chief Executive Officer and Director (Principal Executive Officer and Principal Financial Officer)	March 15, 2010
<u>/s/ Frank Namyslik</u> Frank Namyslik	Global Controller	March 15, 2010
<u>/s/ Claudia Alsdorf</u> Claudia Alsdorf	Director	March 15, 2010
<u>/s/ Dr. Gert Hensel</u> Dr. Gert Hensel	Director	March 15, 2010
<u>/s/ Rene Jaeggi</u> Rene Jaeggi	Director	March 15, 2010

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm	F-1
Consolidated Balance Sheets as of December 31, 2009 and 2008	F-2
Consolidated Statements of Income and Comprehensive Income for the Years Ended December 31, 2009 and 2008	F-3
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2009 and 2008	F-4
Consolidated Statements of Cash Flows for the Years Ended December 31, 2009 and 2008	F-5
Notes to Consolidated Financial Statements	F-6

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Artificial Life, Inc.

We have audited the accompanying consolidated balance sheets of Artificial Life, Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity and cash flows for each of the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Artificial Life, Inc. and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ GHP HORWATH, P.C.

GHP HORWATH, P.C.

Denver, Colorado

March 15, 2010

ARTIFICIAL LIFE, INC.
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2009 AND 2008

	December 31, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash	\$ 2,356,336	\$ 1,430,578
Trade accounts receivable, net	9,498,896	13,859,315
Trade installment receivable, net	8,473,270	—
Prepaid expenses and other	473,166	914,372
Deferred tax asset	1,000,000	500,000
Total current assets	<u>21,801,668</u>	<u>16,704,265</u>
Fixed assets, net	<u>1,575,531</u>	<u>3,140,067</u>
License rights, net	26,421,105	9,617,198
Prepaid expenses, deposits and other assets	1,325,702	828,943
Deferred tax asset	<u>710,000</u>	<u>-</u>
	<u>28,456,807</u>	<u>10,446,141</u>
TOTAL ASSETS	<u>\$ 51,834,006</u>	<u>\$ 30,290,473</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,297,854	\$ 669,745
Accrued expenses and other	737,128	472,813
Income tax payable	17,394	60,000
Note payable – officer/stockholder	1,606,328	737,771
Notes payable – stockholders	<u>666,667</u>	<u>1,000,000</u>
Total liabilities (all current)	<u>5,325,371</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, 57,411,203 (2009) and 47,724,132 (2008) shares issued and outstanding	574,111	477,241
Additional paid-in capital	63,006,782	51,708,712
Notes receivable from stockholders	(19,577)	(19,577)
Accumulated deficit	(17,117,425)	(24,686,144)
Accumulated other comprehensive income (loss)	<u>64,744</u>	<u>(130,088)</u>
Total stockholders' equity	<u>46,508,635</u>	<u>27,350,144</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 51,834,006</u>	<u>\$ 30,290,473</u>

See accompanying notes to consolidated financial statements.

ARTIFICIAL LIFE, INC.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
Revenues:		
Software license agreements	\$27,427,016	\$21,659,786
Reseller license agreement	—	778,800
Application services and other	27,458	15,828
	<u>27,454,474</u>	<u>22,454,414</u>
Cost of revenues:		
Cost of software license agreements	5,177,417	3,076,181
Cost of application services and other	131,655	128,409
	<u>5,309,072</u>	<u>3,204,590</u>
Gross profit	<u>22,145,402</u>	<u>19,249,824</u>
Operating expenses:		
General and administrative	6,426,674	3,268,260
Research and development	4,930,495	3,250,289
Sales and marketing	4,663,183	2,272,516
Total operating expenses	<u>16,020,352</u>	<u>8,791,065</u>
Income from operations	<u>6,125,050</u>	<u>10,458,759</u>
Other income (expenses):		
Interest income and other	189,832	25,152
Interest expense	(138,414)	(225,197)
Gain on extinguishment of liabilities	—	48,127
Foreign currency transaction gains	332,251	161,574
	<u>383,669</u>	<u>9,656</u>
Income before income tax	6,508,719	10,468,415
Income tax benefit	<u>1,060,000</u>	<u>106,870</u>
Net income	7,568,719	10,575,285
Foreign currency translation adjustment	<u>194,832</u>	<u>(95,974)</u>
Comprehensive income	<u>\$ 7,763,551</u>	<u>\$10,479,311</u>
Net income per share:		
Basic	<u>\$ 0.15</u>	<u>\$ 0.23</u>
Diluted	<u>\$ 0.15</u>	<u>\$ 0.22</u>
Weighted average shares outstanding:		
Basic	<u>50,554,592</u>	<u>46,420,825</u>
Diluted	<u>50,745,210</u>	<u>47,879,856</u>

See accompanying notes to consolidated financial statements.

ARTIFICIAL LIFE, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2009 AND 2008

	Common Stock		Additional paid-in capital	Notes receivable from stockholders	Accumulated deficit	Accumulated other comprehensive income (loss)	Total stockholders' equity
	Shares	Amount					
Balances at January 1, 2008	43,905,509	\$439,055	\$46,315,296	\$(19,577)	\$(35,261,429)	\$ (34,114)	\$11,439,231
Issuance of common stock and warrants in private placements, net	2,022,734	20,227	4,706,275	—	—	—	4,726,502
Common stock issued upon exercise of options and warrants	1,575,889	15,759	311,741	—	—	—	327,500
Common stock issued for prepaid consulting services	220,000	2,200	375,400	—	—	—	377,600
Net income	—	—	—	—	10,575,285	—	10,575,285
Other comprehensive loss - foreign currency translation adjustment	—	—	—	—	—	(95,974)	(95,974)
Balances at December 31, 2008	47,724,132	477,241	51,708,712	(19,577)	(24,686,144)	(130,088)	27,350,144
Issuance of common stock and warrants in private placements, net	9,139,726	91,397	8,509,193	—	—	—	8,600,590
Common stock issued upon exercise of options	101,345	1,013	(1,013)	—	—	—	—
Common stock issued for consulting services	446,000	4,460	404,390	—	—	—	408,850
Stock-based compensation expense	—	—	2,385,500	—	—	—	2,385,500
Net income	—	—	—	—	7,568,719	—	7,568,719
Other comprehensive income - foreign currency translation adjustment	—	—	—	—	—	194,832	194,832
Balances at December 31, 2009	<u>57,411,203</u>	<u>\$574,111</u>	<u>\$63,006,782</u>	<u>\$(19,577)</u>	<u>\$(17,117,425)</u>	<u>\$ 64,744</u>	<u>\$46,508,635</u>

See accompanying notes to consolidated financial statements.

ARTIFICIAL LIFE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
Cash flows from operating activities:		
Net income	\$ 7,568,719	\$ 10,575,285
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	6,016,049	2,182,652
Write down of fixed assets and license rights	826,053	263,566
Amortization of discount on notes payable	—	99,000
Bad and doubtful debt expense	2,636,979	731,500
Foreign currency exchange gains	(332,251)	(161,574)
Deferred income tax benefit	(1,210,000)	(166,870)
Interest expense accrued on advances from officer / stockholder	3,185	7,727
Stock-based compensation expense	2,385,500	—
Gain on extinguishment of liabilities	—	(48,127)
Salary / bonus accrued to officer / stockholder	837,257	320,361
Discount on trade receivable	347,961	—
Changes in operating assets and liabilities:		
Increase in trade accounts and installment receivables	(21,834,921)	(9,245,652)
Increase in prepaid expenses, deposits and other assets	(53,228)	(649,420)
Increase (decrease) in accounts payable	375,470	(57,245)
Increase (decrease) in accrued expenses and other	262,504	(639,604)
(Decrease) increase in income tax payable	(42,606)	60,000
Net cash (used in) provided by operating activities	(2,213,329)	3,271,599
Cash flows from investing activities:		
Purchase of fixed assets	(30,127)	(3,060,783)
Purchase of license rights	(4,994,029)	(10,012,608)
Net cash used in investing activities	(5,024,156)	(13,073,391)
Cash flows from financing activities:		
Net proceeds from issuance of common stock and warrants	8,600,590	5,278,502
Advances under note payable to officer/stockholder	202,257	—
Repayment of note payable to officer/stockholder	(174,142)	(342,176)
Repayment of note payable to stockholders	(333,333)	—
Net cash provided by financing activities	8,295,372	4,936,326
Net increase (decrease) in cash	1,057,887	(4,865,466)
Cash at beginning of period	1,430,578	6,210,435
Effect of exchange rate changes on cash	(132,129)	85,609
Cash at end of period	\$ 2,356,336	\$ 1,430,578
Supplemental cash flow disclosure:		
Cash paid for interest	\$ 166,000	\$ 64,700
Cash paid for income taxes	\$ 191,000	\$ —
Supplemental disclosure of non-cash investing and financing activities:		

Issuance of common stock and warrants in satisfaction of accounts payable	<u>\$ 408,850</u>	<u>\$ 377,600</u>
Purchase of license rights and related increase in accounts payable	<u>\$ 8,123,500</u>	<u>\$ —</u>
Purchase of license rights in exchange for assignment of trade accounts receivable	<u>\$ 8,339,958</u>	<u>\$ —</u>

See accompanying notes to consolidated financial statements.

ARTIFICIAL LIFE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

1. Organization and Nature of Operations:

Artificial Life, Inc. (“Artificial Life”), a Delaware Corporation (with its executive offices located in Los Angeles, California) and its wholly-owned subsidiaries (collectively referred to as the “Company”) develop, market, distribute and sell software applications and technologies for wireless telecommunications and devices and mobile phones. Artificial Life’s wholly-owned subsidiaries include the following:

Artificial Life Asia Limited, located in Hong Kong, develops products and 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 intercompany accounts and transactions have been eliminated in consolidation.

2. Summary of Significant Accounting Policies:

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Management evaluates the Company’s estimates and assumptions on an ongoing basis using historical experience and various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Management adjusts such estimates and assumptions when facts and circumstances dictate. The Company’s significant accounts with reported amounts based on estimates and judgments include revenue, trade accounts and installment receivables, the allowance for doubtful accounts, valuation of long-lived assets, deferred income taxes, and stock-based compensation expense. As future events and their effects cannot be determined with precision, actual results could differ from these estimates.

Long Lived Assets

Fixed assets are stated at cost. Depreciation and amortization is provided on the straight-line basis over the estimated useful lives of the respective assets (two to three years). Expenditures for maintenance, repairs and minor renewals are charged to expense as incurred. Betterments and major renewals are added to the fixed asset accounts at cost.

Amortizable license rights are amortized on a straight-line basis over their estimated useful lives of one to five years.



ARTIFICIAL LIFE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is measured by comparison of their carrying amounts to future net cash flows expected to be generated from the operation and sale of the long-lived assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount in which the carrying amount of the long-lived assets exceeds their fair values (Note 3).

Of the Company's total long-lived assets at December 31, 2009, approximately \$27,861,000, \$66,000 and \$70,000 are located in the United States, Hong Kong and Germany, respectively. Of the Company's total long-lived assets at December 31, 2008, approximately \$12,286,000, \$151,000, \$313,000, and \$7,000 are located in the United States, Hong Kong, Germany and Japan, respectively.

Revenue Recognition

The Company generates revenues from the following sources;

- (a) Software agreements from the licensing of the Company's software
- (b) Fees from mobile products sold to end users via telecommunications operators and carriers
- (c) Application, consulting and implementation services

Due to the strong expansion of the Company and the constant release of new products, the composition and source of revenues is continuously changing.

Revenues from the licensing of the Company's software are accounted for in accordance with ASC 985-605, "Software-Revenue Recognition" (formerly Statement of Position ("SOP") 97-2, "Software Revenue Recognition" ("SOP 97-2")). The Company determines whether product revenue recognition is appropriate based upon the evaluation of whether the following four criteria have been met:

Persuasive evidence of an arrangement - Generally, the Company uses either a customer-signed contract or qualified customer purchase order as evidence of an arrangement. These contracts are typically non-cancelable by the customer.

Delivery of product - The Company considers delivery to have occurred when the product has been delivered to the customer, the customer has formally accepted the product, and no post-delivery obligations exist.

Fee is fixed or determinable - The Company assesses whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. If the fee is not deemed to be fixed or determinable, the Company will defer revenue and recognize revenue as payments become due and payable (assuming all other revenue recognition criteria are met).

Collection of fee is reasonably assured - The Company assesses the probability of collecting from each customer at the outset of the arrangement based on a number of factors, including the customer's payment history, its current creditworthiness, economic conditions in the customer's industry and geographic location, and general economic conditions. If in management's judgment, collection of a fee is not probable, the Company will defer revenue but recognize related costs.

The Company's management uses significant judgment concerning the satisfaction of these criteria, particularly the criteria relating to the determination of whether the arrangement fees are fixed and determinable and the criteria relating to the collectibility of the receivables in management's evaluation of each revenue transaction, including those with extended payment terms.



ARTIFICIAL LIFE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

Software agreements may include multiple elements. Fees are allocated to the various elements based on vendor-specific objective evidence (“VSOE”) of fair value and the portion of the fees allocated to each element is recognized as revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectability is probable. If VSOE does not exist for the allocation of revenues to the various elements of the arrangement, all revenues from the arrangement are deferred until the earlier of (1) when VSOE exists, or (2) when all elements of the arrangement have been delivered. Historically, the majority of the Company’s software agreements have not included multiple elements, nor has the Company had any continuing obligations or involvement under the agreements. In accordance with ASC 985-605, revenues from such licensing agreements have been recognized at the time the licenses were granted.

Revenues from entertainment products, games and technologies used in mobile phones are recognized net in accordance with ASC 605-45, “Revenue Recognition – Principal Agent Consideration” (formerly Emerging Issues Task Force (“EITF”) No. 99-19 (“EITF 99-19”). Recognition is net as (1) the Company is not the primary obligor in the arrangements (2) the amount the Company earns is fixed (the download rate), and (3) the telecommunications carrier and the Company both have credit risk. Revenues are recognized only after the applications have been downloaded by mobile users from the carriers and such downloads have been charged by carriers to end users and these charges are supported by statements received from the carriers.

Revenues from application, consulting and implementation services are recognized as services are performed.

Revenue is also deferred for any transactions in which there are significant future costs associated with that transaction. At December 31, 2009, the Company has recorded approximately \$6,000 of deferred revenue in connection with these transactions (\$99,000 at December 31, 2008), which is presented in accrued expenses and other at December 31, 2009 and 2008).

Uncollected Deferred Revenue

Because of the Company’s revenue recognition policies, there are circumstances for which the Company is unable to recognize revenue relating to certain sales transactions that have been billed, but the related receivable has not been collected. While the receivable represents a legally enforceable obligation of the customer, for balance sheet presentation purposes, deferred revenue has been offset with the related receivable, and no amounts appear in the consolidated balance sheets for such transactions. The aggregate amount of unrecognized accounts receivable and deferred revenue was approximately \$4.8 million at December 31, 2009.

ARTIFICIAL LIFE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

Computation of Net Income Per Share

Net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted average number of common shares outstanding during the period and the weighted average dilutive common equivalent shares outstanding during the period. Common equivalent shares consist of the incremental common shares issuable upon the exercise of stock options and warrants and upon the conversion of convertible promissory notes (using the Treasury Stock method); common equivalent shares are excluded from the calculation if their effect is anti-dilutive.

For the years ended December 31, 2009 and 2008, the calculation of basic and diluted net income per share is as follows:

	<u>2009</u>	<u>2008</u>
Weighted average shares outstanding—basic	50,554,592	46,420,825
Dilutive securities:		
Stock options	95,899	1,014,270
Warrants	<u>94,719</u>	<u>444,761</u>
Shares used in dilutive net income per share calculation	<u>50,745,210</u>	<u>47,879,856</u>

Derivatives

The Company follows the provisions of ASC 815, “Accounting for Derivative Instruments and Hedging Activities” (formerly Statement of Financial Accounting Standards (“SFAS”) No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”), along with related interpretations, EITF No. 00-19 “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock” (“EITF 00-19”) and EITF No. 05-2 “The Meaning of ‘Conventional Convertible Debt Instrument’ in Issue No. 00-19” (“EITF 05-2”). ASC 815 requires every derivative instrument (including certain derivative instruments embedded in other contracts) to be recorded in the balance sheet as either an asset or liability measured at its fair value, with changes in the derivative’s fair value recognized currently in earnings unless specific hedge accounting criteria are met. The Company values these derivative securities under the fair value method at the end of each reporting period, and their value is marked to market at the end of each reporting period with the gain or loss recognition recorded against earnings. The Company continues to revalue these instruments each quarter to reflect their current value in light of the current market price of the Company common stock. The Company utilizes the Black-Scholes option-pricing model to determine fair value. Key assumptions of the Black-Scholes option-pricing model include applicable volatility rates, risk-free interest rates and the instruments’ expected remaining life. These assumptions require significant management judgment.

Software Development Costs

The Company accounts for software development costs in accordance with ASC 985-20, “Costs of Software to Be Sold, Leased, or Marketed” (formerly Statement of Financial Accounting Standards (“SFAS”) No. 86, “Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed” (“SFAS 86”)) under which certain software development costs incurred subsequent to the establishment of technological feasibility are capitalized and amortized over the estimated lives of the related products. Technological feasibility is established upon completion of a working model. Development costs incurred subsequent to the establishment of technological feasibility have not been significant, and all software development costs have been charged to

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research and development expenses in the accompanying consolidated statements of income.

Legal Defense Costs

The Company does not accrue for estimated future legal and related defense costs, if any, to be incurred in connection with outstanding or threatened litigation and other disputed matters (Note 10), but rather records such as period costs when the services are rendered.

Research and Development

Research and development costs are charged to operations as incurred. The Company includes in research and development expense: payroll, facility rent, supplies and other expense items directly attributable to research and development. The Company does not contract its research and development work, nor does it, at this time, perform research and development work for others.

Foreign Currency Translation

The functional currency of Artificial Life Europe GmbH is the Euro, the functional currency of Artificial Life Asia Ltd. is the Hong Kong Dollar, and the functional currency of Artificial Life Japan Ltd. is the Yen. These entities' assets and liabilities have been translated at exchange rates at the balance sheet date, and revenues and expenses have been translated at average exchange rates during the reporting periods, while stockholders' equity is translated at historical exchange rates. Any resulting translation adjustments are included in other comprehensive income (loss), a component of stockholders' equity. Foreign currency transaction gains and losses are included in determining net income.

Recent Accounting Pronouncements

In June 2009, the FASB approved the FASB Accounting Standards Codification (the "Codification") ASC 105, "Generally Accepted Accounting Principles" (formerly Statement of Financial Accounting Standards ("SFAS") No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 16" ("SFAS 168")) as the single source of authoritative nongovernmental generally accepted accounting principles (GAAP). All existing accounting standard documents, such as FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force and other related literature, excluding guidance from the Securities and Exchange Commission ("SEC"), have been superseded by the Codification. All other non-grandfathered, non-SEC accounting literature not included in the Codification has become nonauthoritative. The Codification did not change GAAP, but instead introduced a new structure that combines all authoritative standards into a comprehensive, topically organized online database. The Company adopted the Codification during the quarter-ended September 30, 2009. As a result, all references to authoritative accounting literature are now referenced in accordance with the Codification.

In October 2009, the FASB issued Accounting Standards Updates ("ASU") 2009-13, which amends ASC 605, "Revenue Recognition", to require companies to allocate the overall consideration in multiple-element arrangements to each deliverable by using a best estimate of the selling price of individual deliverables in the arrangement in the absence of vendor-specific objective evidence or other third-party evidence of the selling price. ASU 2009-13 will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, and early adoption will be permitted. The

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Company does not expect the adoption of this statement to have a material impact on its consolidated financial statements.

In October 2009, the FASB issued ASU 2009-14, which amends ASC 985-605, "Software-Revenue Recognition", to exclude from its requirements (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product's essential functionality. ASU 2009-14 will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, and early adoption will be permitted. The Company does not expect the adoption of this statement to have a material impact on its consolidated financial statements.

In April 2009, the FASB issued new accounting guidance ASC 825, "Financial Instruments" (formerly FASB Staff Position ("SOP") No. 107-1, "Interim Disclosures about Fair Value of Financial Instruments" ("SOP 107-1")) related to interim disclosures about the fair values of financial instruments. This guidance requires disclosures about the fair value of financial instruments whenever a public company issues financial information for interim reporting periods. The Company adopted this guidance upon its issuance, and it had no material impact on the Company's consolidated financial statements.

On January 1, 2009, the Company adopted new guidance adopted new guidance ASC 805-10-65-1 (formerly Statement of Financial Accounting Standards ("SFAS") No. 141(R), "Business Combinations" ("SFAS 141R")) issued by the FASB related to the accounting for business combinations and related disclosures. This new guidance addresses the recognition and accounting for identifiable assets acquired, liabilities assumed, and noncontrolling interests in business combinations. The guidance also establishes expanded disclosure requirements for business combinations. The Company will apply this new guidance to any future business combinations.

On January 1, 2009, the Company adopted new guidance ASC 810, "Consolidation", regarding noncontrolling interests (formerly Statement of Financial Accounting Standards ("SFAS") No. 160, "Noncontrolling Interests in Consolidated Financial Statements" ("SFAS 160")) issued by the FASB related to the accounting for noncontrolling interests in consolidated financial statements. This guidance establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This guidance requires that noncontrolling interests in subsidiaries be reported in the equity section of the controlling company's balance sheet. It also changes the manner in which the net income of the subsidiary is reported and disclosed in the controlling company's income statement. The adoption of this guidance had no impact on the Company's consolidated financial statements.

Reclassifications:

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

3. Trade Accounts and Installment Receivables, and Concentration of Credit Risk:

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts and installment receivables. 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 granted extended payment terms (up to 180 days) to certain customers. The Company assesses the probability of collection from each customer at

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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 approximately \$348,000 at December 31, 2009, and \$731,500 at December 31, 2008, is the Company's best estimate of the amount of credit losses in existing trade receivables. Management reviews the allowance for doubtful accounts each reporting period based on a detailed analysis of trade receivables. 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, general economic conditions and trends, and the business relationship and history with its customers, 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 receivables were incorrect, adjustments to the allowance may be required, which would reduce profitability. Since the Company's trade receivables 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.

The Company has one customer with whom it has a long-standing business relationship, and to whom it has been selling software since 2007. At December 31, 2009, the Company entered into an installment receivable agreement with this customer, which is due in various installments through December 31, 2010. This receivable has been discounted using a 3.5% discount rate to reflect the interest component of the transaction, which is to be amortized using the effective interest method over the period in which payments are made and the balance is outstanding. The discount rate is reset periodically, if necessary, considering prevailing interest rates. The discount on this receivable is approximately \$140,000 at December 31, 2009.

To minimize cash expenditures in the fourth quarter of 2009, the Company exchanged approximately \$8.3 million of receivables from this customer for license rights purchased from an unrelated vendor, from whom the Company has a history of purchasing other licenses in cash transactions (Note 4).

To further reduce cash expenditures during the year ended December 31, 2009, the Company entered into agreements with certain of its customers to offset trade receivables of approximately \$6.4 million from these customers with accounts payable to these same parties. The offset of these receivables and payables represents a legal right of setoff pursuant to applicable accounting standards.

At December 31, 2009, the Company had 92 telecom carriers, resellers, distributors and general corporate customers compared to 70 such customers at December 31, 2008. For the years ended December 31, 2009 and 2008, resellers and distributors represented approximately 49% and 56% of the Company's revenues, respectively.

For the year ended December 31, 2009, 97% of total revenues were generated from forty-five European companies (of which one customer accounted for approximately 48%, and one customer accounted for approximately 22% of total revenues), and 3% from twenty-eight U.S., Asian, Australian and South American companies. For the year ended December 31, 2008, 83% of

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total Company's revenues were generated from thirty-nine European companies and 17% from twenty-five U.S. and Asian companies.

At December 31, 2009, trade receivables were due from 54 customers. Of these, three customers accounted for approximately 47%, 27% and 15% of the trade receivables, respectively. At December 31, 2009, 19% and 45% of trade receivables were aged within 30 days and 120 days, respectively. At December 31, 2009, the average age of trade receivables from all customers was 128 days as compared to 83 days at December 31, 2008. The average age of receivables from the Company's four largest customers at December 31, 2009, was 138 days.

4. License Rights:

License rights consist of the following at December 31, 2009 and 2008:

	December 31, 2009	December 31, 2008
License rights	\$32,738,165	\$11,900,861
Less accumulated amortization	(6,317,060)	(2,283,663)
	<u>\$26,421,105</u>	<u>\$ 9,617,198</u>

Amortization expense for the years ended December 31, 2009 and 2008 was approximately \$4,420,000 and \$2,040,000, respectively.

During the years ended December 31, 2009 and 2008, the Company wrote down the carrying value of certain license rights by approximately \$826,000 and \$264,000, respectively. The charges were based on management's analysis of the license's expected future cash flows, and the charges are included in cost of revenues in the Company's 2009 and 2008, statements of income.

The following table summarizes the expected remaining amortization of license rights over the next five years as of December 31, 2009:

Year ending December 31,	Amount
2010	\$ 6,786,163
2011	6,341,629
2012	5,389,979
2013	4,907,770
2014	2,995,564
	<u>\$ 26,421,105</u>

Beginning in 2007 and continuing through 2009, the Company has acquired from one vendor, several license rights to the reselling, sublicensing and localization and marketing of certain technologies in specified geographic regions throughout the world. In January 2010, the Company entered into a new license rights agreement with this vendor, which combines all previous licenses into one unified worldwide license. This new license term expires on December 31, 2014. The Company acquired this worldwide license right in January 2010, for approximately \$2.8 million.

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5. Fixed Assets:

Fixed assets consist of the following at December 31, 2009 and 2008:

	December 31, 2009	December 31, 2008
Office equipment	\$ 127,567	\$ 119,462
Office furniture	195,264	194,873
Computer equipment	313,584	297,344
Computer software	2,871,800	2,871,800
	3,508,215	3,483,479
Less accumulated depreciation	(1,932,684)	(343,412)
	<u>\$ 1,575,531</u>	<u>\$3,140,067</u>

Depreciation expense for the years ended December 31, 2009 and 2008, was approximately \$1,596,000 and \$143,000, respectively.

6. Notes Payable and Extinguishment of Liabilities:

Notes Payable

Prior to January 1, 2008, the Company issued promissory notes 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 originally matured on December 31, 2007, but were extended until December 31, 2008 (The "Maturity Date"). The holders could convert the notes and any unpaid interest accumulated thereon only after the Maturity Date into shares of common stock at a conversion price of \$2.50 per share. Because these notes were convertible only if the Company did not pay the debt, these notes were determined to have a contingent beneficial conversion feature valued at approximately \$520,000, which would only have been recorded had the Company not paid the notes. In the fourth quarter of 2009, the Company paid one of the notes in full (\$333,333). The remaining note with a balance of \$666,667 was fully paid in January 2010.

These notes were issued along with warrants to purchase 300,000 shares of the Company's common stock at \$3.00 per share. These warrants have a three-year term, and the relative fair value of the warrants was \$198,000, based on a Black-Scholes analysis and an evaluation of market rates of interest for similar debt instruments. As a result, a discount of \$198,000 was applied against the principal balances of the notes, which has been amortized to interest expense over the term of the debt. The effective interest rate on these notes was approximately 30%.

Extinguishment of liabilities

In 2008, the Company determined (pursuant to management's interpretation of applicable accounting standards and based on consultations with the Company's legal counsel) that certain payables incurred in 2002 by Artificial Life USA, Inc. (a non-operating, inactive subsidiary since 2002, with no assets) could be extinguished (derecognized). Accordingly, the Company recorded a gain on the extinguishment of liabilities of approximately \$48,000 in 2008. The Company made a similar determination in 2007 for liabilities incurred prior to 2002, and derecognized \$685,000 in that year.

Management's determination that such liabilities could be extinguished was based primarily on the Company's interpretation of the applicable State statutes which support management's belief that any actions or claims for such amounts are barred after a statutorily-determined period of time. Management believes that the possibility of any future claims or actions against the Company is remote, and even if such claims were made, the Company has a legal defense against any such claims.

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7. Related Party Transactions:

The Company has a revolving note payable to its chief executive officer for advances made by him to the Company, as well as accrued salary and bonus. The note bears interest at 5%, secured by the assets of the Company and repayable when sufficient funds are determined by the board of directors to be available.

Activity on the note payable during the years ended December 31, 2009 and 2008, is as follows:

	<u>2009</u>	<u>2008</u>
Beginning balance	\$ 737,771	\$ 751,859
Advance	202,257	—
Repayments	(174,142)	(342,176)
Accrued salary/bonus	837,257	320,361
Accrued interest	3,185	7,727
Ending balance	<u>\$1,606,328</u>	<u>\$ 737,771</u>

At December 31, 2009 and 2008, notes receivable from stockholders of \$19,577 are due in connection with the exercise of options prior to 2008, and therefore have been presented as a reduction to stockholders' equity.

8. Stockholders' Equity:

Common Stock

2009 transactions

In 2009, the Company sold 9,139,726 shares of its common stock in private placements for net proceeds of \$8,600,590, which were net of placement costs of approximately \$829,000, of which 6,447,491 shares were sold pursuant to terms of a Securities Purchase Agreement (the "SPA") with 3M Company ("3M"). The SPA was entered into in conjunction with the execution of a collaboration agreement (the "Alliance Agreement"), in which the Company and 3M have agreed to collaborate on various technological projects, as defined. Proceeds from the sale of shares are to be used for general business purposes, including those business purposes outlined and defined in the Alliance Agreement. The SPA provides for certain pre-emptive rights in contemplation of a future issuance of the Company's common stock, in which under certain circumstances, as defined, 3M has the right to purchase a proportionate number of shares necessary to maintain its defined percentage ownership.

As part of these placements, three parties received 446,000 common shares and warrants to purchase 1,110,500 shares of common stock in satisfaction of \$408,850 of accounts payable.

In 2009, the Company also issued 101,345 shares of common stock upon the cashless exercise of options.

2008 transactions

In 2008, the Company sold 2,022,734 shares of common stock in private placements for net proceeds of \$4,726,502, which were net of placement cost of approximately \$27,000. The Company also issued 1,575,889 shares of common stock upon the exercise of

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options and warrants for \$327,500.

In 2008, the Company also issued 100,000 and 120,000 shares of non-forfeitable, fully vested common stock to two consultants at \$1.70 and \$1.73 per share (the market price of the common stock at the date of the transactions), respectively, for prepaid consulting services. These services are to be provided through their respective terms which expire in December 2011 and December 2012. The Company is amortizing these amounts on a straight-line basis, as services are provided, over the respective terms of the agreements. The Company recognized approximately \$96,000 and \$44,000 of expense in 2009 and 2008, respectively.

Stock Option Plan

The Company maintains a 1998 Equity Incentive Plan (the “Plan”), as amended, which provides for the issuance of both non-statutory and incentive stock options to employees, officers, directors and consultants of the Company. The Company has reserved 40 million shares of common stock for issuance under the Plan.

The Company accounts for stock-based compensation expense under ASC 718, “Share-Based Payment” (formerly Statement of Financial Accounting Standards (“SFAS”) No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”). ASC 718 requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and is measured based on the grant date fair value of the award. ASC 718 also requires the stock option compensation expense to be recognized over the period during which an employee is required to provide service in exchange for the award (the vesting period).

In December 2009, the Company granted options to four directors and eleven employees to purchase 3,000,000 shares of common stock at an exercise price of \$0.94 per share (the market price of the Company’s common stock on the grant date). These options have a three-year term and vested immediately. In December 2009, the Company also authorized a three-year extension of 1,000,000 options which were due to expire in December 2009. These options were originally granted in 2006 to two directors and two employees at an exercise price of \$0.83 per share.

Total stock-based compensation expense recognized during the year ended December 31, 2009 was \$1,759,000. No options were granted in 2008.

The Company used a Black-Scholes option pricing method to determine the fair value of options granted during 2009 as of each grant date using the following assumptions:

Risk free interest rate	0.75%
Dividend yield	None
Expected term of options, in years	2
Expected volatility	86%

The expected volatility was based on the historical price volatility of the Company’s common stock. The dividend yield represents the Company’s anticipated cash dividend on common stock over the expected term of the stock options. The Company utilized the U.S. Treasury bill rate for the expected term of the stock options to determine the risk-free interest rate. The expected term of stock options represents the period of time that the stock options granted are expected to be outstanding based on management’s estimation. Option forfeitures are estimated at the time of grant and revised if necessary in subsequent periods if actually

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forfeitures differ from these estimates.

During 2009, Plan options to acquire 400,000 shares of common stock, with an intrinsic value of approximately \$128,000, were exercised on a cashless basis, for no consideration. During 2008, Plan options to acquire 1,100,000 shares of common stock, with an intrinsic value of approximately \$1,643,000, were exercised, primarily on a cashless basis, for \$20,000.

A summary of the status of the Company's stock options under the Plan as of December 31, 2009 and 2008, and the changes during the years then ended is presented below:

	2009		2008	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	2,165,000	\$0.87	3,365,000	\$0.68
Granted	3,000,000	\$0.94	—	\$ —
Exercised	(400,000)	\$0.83	(1,100,000)	\$0.40
Cancelled or expired	(600,000)	\$0.83	(100,000)	\$0.83
Outstanding at end of year	4,165,000	\$0.93	2,165,000	\$0.87
Options exercisable at end of year	4,165,000		2,165,000	

There are 4,165,000 options outstanding and exercisable under the plan at December 31, 2009; they have an intrinsic value of approximately \$179,000. The exercise prices of these options range from \$0.50 to \$2.00 per share, they have a weighted average remaining contractual term of approximately 2.8 years, and a weighted average exercise price of \$0.93 per share.

Other Stock Options

A summary of the status of the Company's other options issued as of December 31, 2009 and 2008, and the changes during the years then ended is presented below:

	2009		2008	
	Other Options	Weighted Average exercise price	Other Options	Weighted Average exercise price
Outstanding at beginning of year	7,500	\$ 1.50	562,045	\$ 0.71
Exercised	—	—	(554,545)	\$ 0.70
Cancelled or expired	(7,500)	\$ 1.50	—	—
Outstanding at end of year	—	—	7,500	\$ 1.50

During 2008, options to purchase 554,545 shares of common stock were exercised, in part on a cashless basis for \$70,000.

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Warrants

2009 transactions

In connection with the sale of common stock in 2009, the Company issued warrants to purchase 2,594,631 shares of common stock at an exercise price range from \$0.80 to \$1.50 per share. These warrants expire on various dates through December 2012, and vested immediately.

In December 2009, the Company authorized a three-year extension of 700,000 warrants granted to its chief executive officer which were due to expire in December 2009. The warrants were issued in 2006 with an exercise price of \$0.83 per share and vested immediately. In December 2009, the Company also granted its chief executive officer warrants to purchase 700,000 shares of common stock with an exercise price of \$0.94 per share. These warrants have a three-year term and vested immediately.

Total stock-based compensation expense related to warrants recognized during the year ended December 31, 2009 was \$626,500. No warrants were granted in 2008.

The Company used a Black-Scholes option pricing method to determine fair value of warrants granted during 2009 as of each grant date using the following assumptions:

Risk free interest rate	0.75%
Dividend yield	None
Expected term of warrants in years	2
Expected volatility	86%

The expected volatility was based on the historical price volatility of the Company's common stock. The dividend yield represents the Company's anticipated cash dividend on common stock over the expected term of the warrants. The Company utilized the U.S. Treasury bill rate for the expected term of the stock options to determine the risk-free interest rate. The expected term of warrants represents the period of time that the warrants granted are expected to be outstanding based on management's estimation.

2008 transactions

In connection with the sale of common stock in 2008, the Company issued warrants to purchase 1,011,366 shares of common stock at an exercise price of \$3.00 per share. These warrants expire on various dates through December 2011 and vested immediately. In connection with this transaction, the Company also issued warrants to purchase 265,517 shares of common stock at an exercise price of \$2.00 per share, with a three-year term, and which vested in July 2008.

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A summary of the status of the Company's warrants as of December 31, 2009 and 2008, and the changes during the years then ended is presented below:

	2009		2008	
	Warrants	Weighted Average exercise price	Warrants	Weighted Average exercise price
Outstanding at beginning of year	3,955,422	\$ 1.96	4,584,056	\$ 1.43
Issued	2,594,631	\$ 1.20	1,276,883	2.79
Granted	700,000	\$ 0.94	—	—
Exercised	—	—	(331,250)	0.72
Cancelled or expired	(373,296)	\$ 2.03	(1,574,267)	1.33
Outstanding at end of year	<u>6,876,757</u>	<u>\$ 1.57</u>	<u>3,955,422</u>	<u>\$ 1.96</u>

At December 31, 2009, 6,876,757 warrants are outstanding and exercisable, and have a weighted average remaining contractual term of approximately 1.79 years. At December 31, 2009 and 2008, outstanding compensatory warrants had an intrinsic value of approximately \$161,500 and \$59,500, respectively.

9. Income Taxes:

Deferred tax assets and liabilities are recorded for temporary differences between the financial statement and tax basis of assets and liabilities. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. A deferred tax asset is recorded for any net operating loss, capital loss and tax credit carry forward for income tax purposes, to the extent their realization is more likely than not. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company's policy is to recognize interest and penalties accrued on unrecognized tax benefits, if any, as a component of income tax expense. As of December 31, 2009, the Company has accrued no interest and penalties relating to unrecognized tax benefits.

The Company files income tax returns in the US federal jurisdiction and various State and foreign jurisdictions. The Company is no longer subject to US Federal tax examinations for years before 2005, and State and foreign jurisdictions that remain subject to examination range from 2002 to 2008. Management does not believe there will be any material changes in unrecognized tax positions over the next year. Interest and penalties of approximately \$5,000 related to income taxes were classified as income tax expense for the year ended December 31, 2009.

At December 31, 2009, the Company has U.S. federal net operating loss carryforwards ("NOL's") of approximately \$3,247,000, expiring through 2028. At December 31, 2009, the Company also has Hong Kong NOL's of approximately \$2,275,000 that may be carried forward indefinitely, German NOL's of approximately \$1,510,000 that may be carried forward indefinitely, and Japan NOL's of approximately \$781,000 expiring through 2016. The general income tax rates applicable to the Company in its foreign jurisdictions are approximately 16%, 30%, and 42%, in Hong Kong, Germany, and Japan, respectively.

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The reconciliation between actual income tax benefit and expected income tax expense computed by applying the U.S. federal income tax rate of 34% to income before income taxes is as follows:

	2009	2008
Expected income tax expense	\$ 2,213,000	\$ 3,559,300
Effect of foreign income tax rate and other differences	(45,000)	(159,200)
Effect of U.S. State tax and U.S. Alternative Minimum Tax	138,000	60,000
Change in valuation allowance and other	(3,366,000)	(3,566,970)
Income tax benefit	<u>\$(1,060,000)</u>	<u>\$ (106,870)</u>

The tax effects of temporary differences that give rise to the deferred tax assets at December 31, 2009 and 2008, are presented below:

	2009	2008
Deferred tax assets		
Net operating loss carryforwards:		
United States	\$ 1,104,000	\$ 4,073,000
Germany	456,000	535,000
Japan	328,000	238,000
Hong Kong	375,000	155,000
Receivables	118,000	248,000
Accrued expenses	41,000	32,000
Long-lived assets	285,000	22,000
	<u>2,707,000</u>	<u>5,303,000</u>
Valuation allowance	(997,000)	(4,803,000)
Net deferred tax asset	<u>\$ 1,710,000</u>	<u>\$ 500,000</u>
Current net deferred tax asset	\$ 1,000,000	\$ 500,000
Non-current net deferred tax asset	710,000	—
	<u>\$1,710,000</u>	<u>\$ 500,000</u>

The recognition of the net deferred tax assets at December 31, 2009, is based on the Company's analysis of past, current and projected financial results of the Company's operations. Based on this analysis, management concluded that the net deferred tax asset represents that amount which has been determined to be more likely than not of being realized. If future taxable income is less than the amount that has been assumed in determining the deferred tax asset at December 31, 2009, an increase in the valuation allowance may be required with a corresponding charge against income. If future taxable income exceeds the level that has been assumed in calculating the deferred tax asset (including taxable income in foreign jurisdictions), the valuation allowance could be reduced with a corresponding credit to income.

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10. Commitments and Contingencies:

Leases

In October 2009, the Company renewed a two-year lease for office space in Hong Kong that now expires in December 2011, with a monthly rental payment of approximately \$18,000. In June 2009, the Company also entered into a one-year lease of a residential apartment in Hong Kong that expires in June 2010. The lease requires a monthly rental payment of approximately \$4,500.

In February 2007, the Company began leasing an office in Berlin, Germany, which serves as the Company’s headquarters for European operations. The lease requires a monthly rental payment of approximately \$11,000, and it expires in February 2012. In August 2009, the Company entered into a two-year lease of an automobile in Berlin, Germany. The lease requires a monthly rental payment of approximately \$1,000. The lease expires in September 2011.

In June 2009, the Company renewed a short-term lease of its U.S. office in Los Angeles, California, which serves as the Company’s global corporate headquarters. The lease requires a monthly rental payment of \$1,320 and is renewable on a month-to-month basis. In April 2009, the Company entered into a one-year lease of a residential apartment in Los Angeles, California. The lease requires a monthly rental payment of approximately \$3,100 and expires in April 2010.

Total rent expense for the years ended December 31, 2009 and 2008, was approximately \$462,000 and \$408,000, respectively. Future minimum lease payments are as follows:

<u>Year ending December 31,</u>	<u>Amount</u>
2010	\$ 396,000
2011	354,700
2012	22,100
	<u>\$ 772,800</u>

Employment Contract

In July 2006, the Company entered into an executive employment agreement with its President and Chief Executive Officer/Chairman (the “CEO”) of the Board (the “Employment Contract”). This agreement expired in December 2009, and provides for an initial annual base salary of \$120,000, which is to increase annually as determined by the Board of Directors in increments of at least 25% per year. This agreement also provides for a cash bonus equal to 3% of net profits and a bonus payable in cash or stock equal to 3% of the total price of any merger of the Company with a third party or the acquisition of a majority of the Company’s shares in which the CEO is instrumental. The agreement further provides for a bonus payable in cash or stock equal to 3% of the overall increase in the Company’s market capitalization for each fiscal year payable, and for 2007 and subsequent years, cannot exceed the Company’s cash requirement, as defined. The agreement also includes severance payments (under certain conditions) of one and a half to three years salary as well as a non-compete provision for a period of six months following termination of the CEO’s employment. Effective June 1, 2008, the Employment Contract was amended, in that the Employment Contract was extended through December 31, 2011, the CEO is to continue to serve as the current and acting Chairman, CEO, president of the Company, and the CEO is to continue to receive the benefits under the current Employment Contract and his base salary was increased to \$46,875 per month.



ARTIFICIAL LIFE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

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 was held in September 2009, before the State Court in Berlin. In February 2010, the Court ordered the Company to pay the plaintiff a settlement claim of approximately \$350,000, and all court and attorney fees incurred by the plaintiff. The settlement amount and the estimated court and attorney fees have been accrued as of December 31, 2009. The Company filed an appeal with the State Court in Berlin in March 2010, and no payment will be made until a final judgment is issued by the Court. Management believes the Company has adequately reserved for litigation and that the ultimate outcome of pending appeal will not have a material adverse impact on the Company's consolidated financial position or results of operations taken as a whole.

11. Fair value measurements:

Accounting standards define 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.

Accounting standards have established 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. Accounting standards have established 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 December 31, 2009 and 2008, the Company has no financial assets or liabilities subject to recurring fair value measurements.

The Company's financial instruments include cash, trade and installment receivables, 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 practicable to estimate due to the related party nature of the underlying transactions.

ARTIFICIAL LIFE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)
FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

12. Subsequent Events:

In January 2010, the Company completed a private placement offering with one institutional and one individual accredited investor for 471,134 shares of common stock and warrants to purchase an additional 145,516 shares of common stock. The shares of common stock and warrants were sold for an aggregate purchase price of \$608,598. The warrants have a two to three-year term with exercise prices ranging from \$1.30 to \$1.80 and are immediately exercisable.

EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Exhibit Description</u>
3.1	Amended and Restated Certificate of Incorporation filed with the Delaware Secretary of State on December 22, 1998 (Incorporated by reference to Exhibit 3.2 to Pre-Effective Amendment No. 1 to the Registrant's Registration Statement on Form S-1 filed on November 4, 1998)
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation filed with the Secretary of State of Delaware on September 28, 2006 (Incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-QSB filed on November 14, 2006)
3.2	Restated Bylaws (Incorporated by reference to Exhibit 3.4 to Pre-Effective Amendment No. 1 to the Registrant's Registration Statement on Form S-1 filed on November 4, 1998)
10.1*	Employment Agreement, dated July 1, 2006, between the Registrant and Eberhard Schoneburg (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-QSB filed on November 14, 2006)
10.2*	Amended and Restated 1998 Equity Incentive Plan (Incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement on Schedule 14A filed on August 21, 2006)
10.3*	Amendment to Employment Agreement, dated March 29, 2007, between the Registrant and Eberhard Schoneburg (Incorporated by reference to Exhibit 10.6 to the Registrant's Annual Report on Form 10-KSB filed on April 2, 2007)
10.4*	Amendment to Employment Agreement, dated June 1, 2008 between the Registrant and Eberhard Schoneburg (Incorporated by reference to Exhibit 10.5 to the Registrant's Annual Report on Form 10-K filed on February 10, 2009)
10.5*	Security Agreement, dated August 10, 2009, between the Registrant and Eberhard Schoneberg (Incorporated by reference to Exhibit 10 to the Registrant's Quarterly Report on Form 10-Q filed on August 12, 2009)
10.6**	Hong Kong Tenancy Agreement I, dated October 30, 2009
10.7**	Hong Kong Tenancy Agreement II, dated October 30, 2009
14.1	Code of Ethics (Incorporated by reference to Exhibit 14.1 to the Registrant's Annual Report on Form 10-KSB filed on April 2, 2007)
21.1**	List of Subsidiaries
23.1**	Consent of GHP Horwath, P.C.
31.1**	Certification of Principal Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2**	Certification of Principal Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certifications Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

* Denotes management contract or compensatory plan, contract, or arrangement.

** Filed herewith.

Filename:	d26229ex10-6.htm
Type:	EX-10.6
Comment/Description:	(this header is not part of the document)

Exhibit 10.6

Dated the 30th day of October 2009

MUTUAL PROPERTY MANAGEMENT COMPANY LIMITED as agent for The Chung Shun Land Investment Company Limited
And
ARTIFICIAL LIFE ASIA LIMITED

TENANCY AGREEMENT

ROBERTSONS
Solicitors & Notaries
57th Floor, The Center
No.99 Queen's Road Central
Hong Kong

Parties BETWEEN the party named and described as the Landlord in **Part 1 of the First Schedule** (hereinafter called "the Landlord") of the one part and the party or parties named and described as the Tenant in **Part 2 of the First Schedule** (hereinafter called "the Tenant") of the other part.

Agreement to rent the Premises WHEREBY IT IS MUTUALLY AGREED as follows :-

1. The Landlord shall let and the Tenant shall take ALL THOSE premises set out in Part 3 of the First Schedule (hereinafter called "the said Premises") TOGETHER WITH the use in common with the Landlord and all others having the like right and subject to the right of the Landlord, its managing agents or the manager of the said building (hereinafter defined) to restrict such use to use go pass and repass up down over and upon the common parts including inter alia entrances, staircases, passages and lavatories (if any) in the building (of which the said premises form part) more particularly described in **Part 3 of the First Schedule** (hereinafter called "the said building") in so far as the same is necessary for the proper use and enjoyment of the said premises AND TOGETHER with the use in common as aforesaid of the lifts (if any are installed in the said building and during such hours as the same shall be operating) EXCEPTING AND RESERVING to the Landlord and all persons authorized by the Landlord the free and uninterrupted passage of water and soil through the water pipes and drains and of electricity through the electric wires and meters which now are or may at any time hereafter be in or passing through the said premises with power for the Landlord and the Landlord's agents at all reasonable times to enter the said premises for the purpose of inspecting repairing cleansing replacing or altering the said pipes drains wires and meters the Landlord making good all damages done to the said premises in exercising such power for the term particularized in **Part 4 of the First Schedule** (hereinafter called "the said term") YIELDING AND PAYING therefore during the said term the clear calendar monthly rent (hereinafter called "the said rent") as set out in **Part 5(i) of the First Schedule** which sum shall be payable exclusive of rates management fees air-conditioning charges and other outgoings in advance in each and every calendar month without any deduction or right to set off (whether legal or equitable) and the first of such payments to be made on the signing of this Agreement and all subsequent payments to be made on the 1st day of each and every succeeding calendar month and when the term of tenancy does not commence on the 1st day of the month, the Landlord may at any time during the said term require the Tenant to pay rent for a particular month on a pro-rata basis, namely, from the commencement day to the end of the month, and thereafter the Tenant shall pay rent for each calendar month (including the last month of the said term also on a pro-rata basis) on the 1st day of each such calendar month subject to and with the benefit of the Deed of Mutual Covenant and Management Agreement (hereinafter called "the Deed of Mutual Covenant") (if any) of the said building and the rules regulations and directions made by the manager for the time being of the said building.

Agreement by Tenant To pay rent 2. The Tenant to the intent that the obligations may continue throughout the said term hereby agrees with Landlord as follows :-

- (a) To pay unto the Landlord the said rent and other charges at the time and in the manner aforesaid.
- (b) To pay or discharge all Maintenance and Management Charges currently at HK\$9,660.00 per month and Air-Conditioning Charges currently at HK\$12,180.00 per month in respect of the said Premises or as provided in accordance with the provisions of the Deed of Mutual

Covenants and Management Agreement (if any) of the said Building. The Maintenance and Management Charges and Air-Conditioning Charges shall be subject to increase by the Landlord during the continuance of the term hereby created on giving one month's notice in writing of any increase to the Tenant. Upon the expiration of the said period of one month the Maintenance and Management Charges shall be increased by the amount specified in the Landlord's notice. There shall be no restriction on the number of occasion upon which the Landlord may call for an increase of such Maintenance and Management Charges and Air-Conditioning Charges.

To pay rates

- (c) To pay rates charged on the said Premises as assessed by the Government quarterly in advance within the months of January, April, July and October provided that the first payment thereof shall be paid on the commencement of the tenancy and in the event of the said premises not having been assessed to rates by the Government to pay such sum
-

as shall be required by the Landlord as a deposit by way of security for the due payment of rates subject to adjustment on actual rating assessment being received from the Government and also to pay and discharge all taxes assessments duties charges impositions and outgoings whatsoever now or hereafter to be imposed or charged on the said premises or upon the owner or occupier in respect thereof by the Government of Hong Kong other lawful authority (Government Rent, Property Tax and expenses of a capital and non-recurring nature alone excepted).

- To pay electricity charges (d) To pay and discharge all charges for electricity and telephone rental and other outgoings now or at any time hereafter consumed by the Tenant and chargeable in respect of the said Premises and to make all necessary deposits therefore (if any).
- To keep interior etc. in repair (e) To keep the interior of the said Premises including the flooring and interior plaster or other finishing material or rendering to walls, floors and ceilings and the Landlord's fixtures therein including all doors, windows, electrical installations and wiring and fire fighting installation in good, clean tenable, substantial and proper repair and condition and properly preserved and painted as may be appropriate when from time to time required and to so maintain the same at the expense of the Tenant. The Tenant shall in the last year of the said term paint and decorate in a proper and workmanlike manner all parts of the said premises usually painted and decorated and all such internal parts of the said premises that have been or ought properly to be so treated and deliver up the same to the Landlord at the expiration or sooner determination of the term in like condition replacing and reinstating any part of the said premises damaged or destroyed by or through or in consequence directly or indirectly of any negligent act or omission of the Tenant may be released by the Landlord if the Landlord shall be satisfied with the condition of the said premises in the last year of the said term. The Tenant particularly agrees:-
- To repair and replace electrical wirings within the said Premises (i) To repair or replace, if so required by the appropriate supply company, statutory undertaking or authority as the case may be under the terms of any Electricity Supply or similar Ordinance for the time being in force or any Orders in Council or Regulations made thereunder, all electrical wiring installations and fittings within the said Premises from the Tenant's meter or meters to and within the same.
- To keep sanitary and water apparatus used exclusively in good repair (ii) To keep the sanitary and water apparatus used exclusively by the Tenant and his servants, agents and licensees in good, clean and tenable repair and condition to the satisfaction of the Landlord and in accordance with the Regulations or by-laws of all Public Health and other Government Authorities concerned and repair or replace any drains pipes or sanitary or plumbing apparatus if required by the Landlord or any government authority.
- To be responsible for loss or damage caused by interior defects (iii) To be wholly responsible for any loss, damage or injury caused to any other person whomsoever directly or indirectly through the defective or damaged condition of any part of the interior of the said Premises and to make good the same by payment or otherwise and to indemnify the Landlord against all actions, proceedings, claims and demands made upon the Landlord in respect of any such loss, damage or injury and all costs and expenses incidental thereto.
- To be responsible for maintenance of windows (iv) to reimburse to the Landlord the cost of replacing all broken and damaged windows whether the same be broken or damaged by the negligence of the Tenant or any of its servants, agents or licensees or by circumstances beyond the control of the Tenant.
- To be responsible for maintenance of shop front plate glass (v) to reimburse to the Landlord the cost of repairing or replacing the shop front plate glass or any part thereof in the event of the same being broken or damaged by the Tenant or by any servant, agent or licensee of the Tenant.
- Installation of additional air-conditioners (vi) upon prior consent of the Landlord is given, to install additional air-conditioning units at such places and in such positions of the said Premises as shall be approved by the Landlord and not to cut the window or bar or projecting out of the said Premises and to make good all damage done to all windows, doors and window panes and to replace or reinstate the same in strict accordance with any direction which shall or may be given by the Landlord and to be responsible for their maintenance and repair at the expenses of the Tenant.
- To permit Landlord to enter and view the state of repair and to carry out necessary repairs (f) To permit the Landlord and all persons authorised by him at all reasonable times to enter and view the state of repair of the said Premises, to take inventories of the fixtures therein, to carry out any works or repairs which may be required to be done and, during the last three months of the said term, to show the said Premises to prospective tenants or purchasers.
- To permit Landlord to repair other premises (g) To permit the Landlord and all persons authorised by him at all reasonable times to enter and carry out any works or repairs in respect of other premises in the said building PROVIDED that in this connection the Landlord shall be responsible to make good all damage done to the said Premises.
- To execute repairs on receipt of notice (h) On receipt of any notice from the Landlord or his authorised representatives specifying any works or repairs which they require to be done and which are the responsibility of the Tenant hereunder, forthwith to put in hand and execute the same with all possible dispatch and without any delay.



- Not to erect install or alter fixtures etc without Landlord's consent (i) Not without the previous written consent of the Landlord to erect, install or alter any fixtures partitioning or other partitioning erection or installation in the said Premises or shop front or any part thereof.
- Not to cut or maim or deface any doors, walls, beams or any structural part of the Premises (j) Not to cut, maim, injure, drill into, mark or deface or permit or suffer to be cut, maimed, injured, drilled into, marked or defaced any doors, windows, walls, beams, structural members or any part of the fabric of the said Premises nor any of the plumbing or sanitary apparatus or installations included therein.
- Not to remove any fixtures, erections on any part of the Premises (k) Not without the previous written consent of the Landlord to put up or remove any fixtures partitions or other erections on any part of the said Premises without the like consent and to reinstate or restore the said Premises to their original condition at the expiration or sooner determination of the said term of tenancy.
- Not to install any plant apparatus or machinery without consent (l) Not to install or use in the said Premises any plant, apparatus or machinery which consumes electricity without the prior consent of the Landlord. In the event of such installation or use being approved the Tenant shall pay the charges for all electricity thereby consumed.
- Not to erect aerial (m) Not to erect any aerial on the roof or walls of the said building nor the ceiling or walls of the said Premises.
- Not to deliver bulky items (n) Not to take delivery of furniture or fixtures or bulky items of goods in and out of the building without the permission of the Landlord.
- Not to prepare food (o) Not to prepare or permit to be prepared any food or to allow delivery of food from the said Premises.
- Not to keep pressurized items (p) Not to permit to be brought into the said Premises any gas whether bottled or in pressurized containers or otherwise for any purpose whatsoever.
- Not to display sign etc. (q) Not without the prior written consent of the Landlord to affix erect attach or display or permit or suffer so to be upon any part of the exterior of the said Premises or to ***or through any windows thereof any placard, poster, decoration, flag, notice, advertisement, signboard, sign, name or other device whatsoever whether illuminated or not*** PROVIDED that the Landlord shall have the right to remove at the cost and expense of the Tenant any signboard or other things which shall have been affixed displayed or exhibited as aforesaid without the prior consent of the Landlord AND PROVIDED FURTHER that which said cost and expenses shall be recoverable by the Landlord from the Tenant as a debt.
- Not to drive nails etc. into ceilings, walls or floors (r) Not to drive or insert or permit or suffer to be driven or inserted any nails, screws, hooks brackets or similar articles into the ceilings, walls or floors of the said Premises without the previous written consent of the Landlord, nor without the like consent to lay or use any floor covering which may damage the existing flooring.
- Usage of the said Premises (s) Not to use the said Premises for any purpose other than for the purpose and under the name as described and set out in the Third Schedule hereto. For the avoidance of doubt, *not to use the said Premises for any of the following purposes, namely : domestic premises, factory or industrial premises, undertakers or business or activities in connection therewith, dance hall, club, billiard saloon, massage establishment as defined in Miscellaneous Licences Ordinance, automatic machines establishment as defined in the Miscellaneous Licences Ordinance, premises licenced under the Gambling Ordinance for playing therein or games in which mahjong or Tin Kau tiles are used, offensive trades as in the Public Health and Urban Services Ordinance, top-less bar or any business the operation of which may directly or indirectly involve the provision of female companionship to the customers thereof. Not to operate around-the-clock business and use the said Premises for any kinds of school including training center, teaching institute and tutorial workshop without Landlord's prior consent. No over night work is allowed unless prior consent is obtained from the Landlord.*
- Not to use the said Premises as sleeping quarters or domestic premises (t) Not to use or permit to suffer the said Premises or any part thereof to be used as sleeping quarters or as domestic premises within the meaning of the Landlord and Tenant (Consolidation) Ordinance or similar legislation for the time being in force.
- Not to produce noise audible outside (u) Not to produce or permit or suffer to be produced any noise (including sound produced by broadcasting or any apparatus or equipment capable of producing, reproducing, receiving or recording sound) **so as to cause a nuisance** to other users of the Building, and where music is to be regularly played, to install at the Tenant's cost or expense and to the satisfaction of the Landlord adequate sound proofing or insulation devices in the said Premises.
- Not to permit any nuisance or annoyance (v) Not to do or permit or suffer to be done any act or thing which may be or become a nuisance or annoyance to the Landlord or to the tenant or occupiers of other premises in the said building or in any adjoining or neighboring building.
- Not to breach Government Lease or cause insurance policies to be voided or premium to be increased (w) Not to do or permit or suffer to be done any act, deed, matter or thing whatsoever which amounts to a breach of any of the terms and conditions under which the land on which the said building stands is held from the Government or whereby any insurance on the Building against loss or damage by fire and/or claims by third parties for the time being in force may be rendered void or voidable or whereby the premium thereon may be increased Provided that if as the result of any act, deed, matter or thing done permitted or suffered by the Tenant, the premium on any such policy of insurance shall be increased, the Landlord shall be entitled at his option either to terminate this Agreement or to continue the same upon payment by the Tenant of the additional premium and upon such other terms and conditions

as the Landlord may, at his discretion, think fit to impose.

- Not to keep items of combustible or hazardous goods on the said Premises (x) Not to keep or store or permit or suffer to be kept or stored in the said Premises any arms, ammunition, gun-powder, saltpetre, kerosene or other explosive or combustible substance or hazardous goods which may contravene any ordinance regulation by-law or Management Rules of the Building or constitute a nuisance or annoyance to the tenants or occupants of any part of the Building or injurious or detrimental to the reputation of the Building of which the said Premises form part.
- Not to permit illegal or immoral use (y) Not to use or permit or suffer the said Premises to be used for any illegal or immoral purpose or for any purpose which is in contravention of the terms and conditions contained in the Government Lease or Conditions under which the said Premises are held from the Government and not to carry on any trade or business thereon which is now or may hereafter be declared to be an offensive trade under the Public Health & Urban Services Ordinance or any other Ordinance or Regulations and any enactment amending or substituting the same.
- Not to encumber, leave rubbish or obstruct passage and common areas (z) Not to encumber or obstruct or permit to be encumbered or obstructed with any box, packaging or other obstruction of any kind or nature any of the entrances, passages, lifts (if any) lobbies or other parts of the Building in common use and not to leave rubbish or any other article or thing in any part of the Building not in the exclusive occupation of the Tenant.
- Not to lay wiring or cables etc. in the public areas (aa) Not to lay install affix or attach any wiring, cables or other article or thing in or upon any of the entrances, staircases, landings, passage-ways, **lobbies** or, public areas.
- No to employ any Security Contractors except from the Landlord (bb) Not to employ any security contractors for the rendering of any services for or in connection with said Premises without the consent of the Landlord, but to permit the Landlord's servants or security guards to enter the said Premises at all reasonable times for security purposes, and to connect and keep the said Premises connected to any communal alarm or security system, the fees for any connection of burglary alarm from the said Premises to the communal alarm or security system and any subsequent repair and maintenance fees thereof shall be solely borne by the Tenant.
- Not to install any gate or rolling shutter without consent. (cc) Not to install any gate, additional lock, fixture, rolling shutter or additional door to the entrances of the said Premises without prior consent from the Landlord. If the door lock is changed, a key should be deposited with the Landlord for custody.
- Deposit a spare key of the said Premises with the Landlord in case of emergency (dd) To deposit with the Landlord a key to the said Premises and to grant the Landlord access to the said Premises in the event of any apparent emergency by the use of the key deposited or otherwise.
- No pets (ee) Not to keep in the building or any part thereof any dog or other pet or animal.
- Not to alter or install additional locks etc. (ff) Not without the previous written consent of the Landlord to alter the existing locks, bolts or fittings on the entrance doors to the said Premises nor to install any additional locks, bolts or fittings thereon.
- Not to change the colour of doors and glasses of the said Premises or any part thereof (gg) Not to change the colour of the doors or the wooden door(s) to the glass door(s) (if applicable) of the said Premises without prior approval from the Landlord.
- No overloading of electricity (hh) Not to use electricity in excess of the supply from the electricity meter at any one time in the said Premises and the Landlord shall not be responsible for supply of any additional electricity.
- Tenant shall at its own cost to apply for transferal of the electric meter (ii) Upon signing of this Agreement, the Tenant shall at its own cost apply for transferal of the electric meter to its own and pay the related electric meter deposit directly to the Electric Company. Tenant shall undertake to immediately and unconditionally transfer back the electric meter to the Landlord with settlement of the outstanding electric charges (if any) at the termination or early termination of this Agreement. If the Tenant fails to transfer the electric meter to its own name within 7 days from the date of taking over the said Premises, the Landlord is entitled to disconnect the electric meter and shut down the air conditioners without prior notice and the Tenant shall not make any claims against the Landlord.
- Not to carry out business during Rent-free Period (jj) Not to carry out any business or start working during the Rent-free Period for decoration in the said Premises, failing which the Landlord shall be entitled to charge the Tenant for the rental payment and other fees without prior notice. **Tenant shall pay the Management Fee, Air-Conditional Charges and all outgoing payments during the Rent Free Period. The Tenant shall submit full details of decoration plan(s) to the Landlord for approval before commencement of works, failing which the whole amount of decoration deposit shall be forfeited without prior notice.**
- Garbage (kk) To be fully responsible for the disposal of any bulky refuse which is not included in the Maintenance and Management Charges. Any bulky garbage must not be placed at the common area or any part of the Building and be removed away daily by Tenants themselves or by the nominated cleaning contractor at Tenant's own cost.
- Burglary Alarm (ll) To appoint the Landlord's nominated contractor for repairing and maintenance of the Burglary Alarm installed at the main door and to pay the related fees annually in advance (if any) as shall be charged by the contractor.
- Electrical installations or wiring (mm) Any alternation in electrical installations or wirings of the said Premises shall be done by the nominated electrical contractor of the Landlord but at the Tenant's own expenses. Tenant shall obtain consent from the Landlord before commencement of work and not to cause the

electrical loading exceeding the loading of the existing meter.

- To appoint contractors designated by the Landlord
- (nn) To appoint either registered electrical contractors under HKSAR or electrical contractor nominated by Landlord to rectify and testify the electrical installation in the said Premises and make sure that the electrical installation complies with relevant regulations and Ordinance in Hong Kong but at the Tenant's sole expenses if it is required by the Government.
- * (oo) To appoint contractor nominated by Landlord if any work of fire services and air conditioning (Air Ducts) or alteration is required.
- (pp) **The Tenant shall submit details of decoration plans including room partitions, electrical installation, air conditionings or other decoration (if any) to Landlord for approval before commencing of work. The Tenant shall not commence any work for decoration before approval to the work is obtained from the Landlord.**
- (qq) Landlord shall have right to cut off or shut down the electrical supply at any part of the Building without prior notice to Tenant in the event that maintenance, repairing or emergency work is to be carried out. Tenant shall not object the cut-off or shut-down of the electrical power supply and shall not make any claim against the Landlord for any consequences arising therefrom.
- Insurance (rr) The Tenant shall effect an valid insurance policy covering public liability of the said Premises for the **insured amount not less than HK\$5 million** to indemnify the Landlord by any person in respect of any loss or damage or injury caused by the overflow of water or the escape of fumes, smoke, fire or any other substance or thing from the said Premises owing to the neglect or default of the Tenant, his licensees, servants or agents during the term of the tenancy agreement including the period of decoration.
- Not to assign underlet etc (ss) Without the prior written approval of the Landlord not to assign, underlet or otherwise part with the possession of the said Premises or any part thereof in any way whether by way of sub-letting, lending, sharing or other means whereby any person or persons not a party to this Agreement obtains the use, possession, occupation or enjoyment of the said Premises or any part thereof regardless of whether any rental or other consideration is given therefor. **The tenancy shall be personal to the Tenant named in this Agreement and without in any way limiting the generality of the foregoing**, the following acts and events shall, unless previously approved in writing by the Landlord (which approval the Landlord may give or withhold at its discretion without assigning any reason therefor) be deemed to be breaches of this Clause :-
- (i) any take-over, reconstruction, amalgamation, merger, voluntary liquidation or change in the person or persons who own a majority of the Tenant's voting shares or who otherwise has or have effective control thereof.
- (ii) the giving by the Tenant of a Power of Attorney or similar authority whereby the donee of the Power obtains the right to use, possess, occupy or enjoy the said Premises or any part thereof or does in fact use, possess, occupy or enjoy the same.
- (iii) the change of the Tenant's business name without the previous written consent of the Landlord, such consent shall not be unreasonably withheld.
- “Subject always to the following:
- (1) In the event that the Tenant desires to undertake any of the activities described at paragraphs (i), (ii) or (iii) directly above, it shall provide written notice to the Landlord of its desire to do so.
- (2) The Landlord shall have 10 days from the date of receipt of the Tenant's written notice within which approve or reject the Tenant's proposed activity.
- (3) If the Landlord does not reject the Tenant's proposed activity by way of a written notice to the Tenant within 10 days of receipt the Tenant's written notice, the Tenancy Agreement shall continue in force without interruption or variation for the remainder of the Term.
- (4) If the Landlord rejects the Tenant's proposed activity, the Landlord shall provide the Tenant with written notice of the termination of the Tenant's tenancy of the Premises under the Tenancy Agreement, such notice expiring 3 months after the date of the receipt of the Landlord's notice rejecting the Tenant's proposed activity”
- (iv) Notwithstanding any provisions to the contrary herein the Tenant shall be entitled to enter into consignment arrangements or such other business arrangements which the Landlord shall consider and approve in writing provided that the Tenant shall ensure that the right of such consignees and occupiers shall be that of licensees only and there shall be no tenancy or sub-tenancy created by such consignment or other arrangements and shall ensure that such consignees and occupiers shall deliver up vacant possession of such parts of the said Premises as shall be occupied by them to the Landlord at the expiration or sooner determination of this Agreement in accordance with the terms hereof.
- To comply with the Deed of Mutual Covenants and all ordinances etc (tt) To obey and comply with and to indemnify the Landlord against the breach of the Deed of Mutual Covenants and Management Agreement (if any) of the said building and all ordinances, regulations, by-laws, rules and requirements of any Governmental or other

competent authority relating to the conduct and carrying on of the Tenant's business on the said Premises or to any other act, deed, matter or thing done, permitted suffered or omitted therein or thereon by the Tenant or any employee, agent or licensee of the Tenant.

- To pay cost of clearing or drains etc. (uu) To pay to the Landlord on demand all costs incurred by the Landlord in cleansing or clearing any of the drains pipes sanitary or plumbing apparatus choked or stopped up owing to the careless or improper use or neglect by the Tenant or any employee agent or licensee of the Tenant.
- To protect interior from approaching typhoon (vv) To take all precautions to protect the interior of the said Premises against damage by storm or typhoon or the like and to replace all broken and damaged windows and window-frames whether the same be broken or damaged by the negligence of the Tenant or owing to circumstances (including typhoon) beyond the control of the Tenant.
- To be responsible for contractors, servants, agents and licensees (ww) To be responsible to the Landlord for the acts, neglects and defaults of all contractors, servants, agents and licensees of the Tenant as if they were the acts, neglects and defaults of Tenant himself and for the purpose of this Agreement "licensee" shall include any person present in, using or visiting the said Premises with the consent of the Tenant express or implied.
- Re-instate premises (xx) Unless the Landlord otherwise agrees in writing, to re-instate and restore the said Premises to their original condition and to make good all damage caused or occasioned by the erection and removal of alterations partitions or other erections. The Tenant shall also restore to the Landlord all keys of the said Premises and toilets used by the Tenant upon yielding up of the said Premises.
- To yield up to end of term (yy) Quietly to yield up the said Premises together with all fixtures, fittings and additions therein and thereto at the expiration or sooner determination of this tenancy in its original state and condition.
- To apply for consent for the type of business (zz) To apply to the Government and other relevant authorities for consent and/or permission to operate and carry on the type of business intended to be carried on by the Tenant at the said Premises and to pay all fees and/or premium and to observe and perform all conditions and stipulations that may be imposed for the grant of such consent and/or permission.
- Sprinkler System (aaa) Not to do or permit or suffer to be done any act or thing which will damage or interfere with or attest the operating of the sprinkler system or any other fire protection or fire fighting systems equipment or apparatus or any security system, equipment or apparatus or any part or parts thereof and to keep the Landlord fully indemnified against all loss, damages, claims and demands as a result of any act or thing done or permitted or suffered to be done by the Tenant aforesaid. Provided that the existing all sprinklers and fire fighting system are in align with current Fire Regulations within the premises. Should there be any alteration regarding the sprinkler systems, the tenant shall be fully responsible for all reinstatement works and subject to the Landlord's satisfaction and be complied with regulations of Fire Services Department.
- Tenant is responsible for discharging all utility charges (bbb) To pay and discharge all charges in respect of electricity, gas, water and telephones as may be shown by the separate meter or meters installed upon the said Premises or by accounts rendered to the Tenant.
- Landlord's covenant 3. The Landlord hereby agrees with the Tenant as follows :-
- Structural maintenance (a) To pay the Government Rent payable in respect of the said Premises and the Property Tax and expenses of a capital nature (if any) attributable to or payable in respect of the said Premises.
- (b) To keep the outside main walls of the said Premises in good and proper repair.
- (c) At the expense of the Tenant to repaint, repair and maintain the outer shop front(s) and outer door(s) of the said Premises whenever reasonably required by the Tenant so to do or whenever, in the opinion of the Landlord, such work shall be deemed by the Landlord to be necessary provided that the Tenant shall not be liable to reimburse the Landlord the cost of repairing or replacing the shop front plate glass except as provided in Clause 2(e)(v).
- Other provisions, Landlord's right of re-entry 4. It is hereby further expressly agreed and declared as follows :-
- (a) If the rent and/or Management and Maintenance Charge and/or rates and/or Air-Conditioning Charges hereby agreed to be paid or any part thereof shall be unpaid for fifteen (15) days after the same shall become payable (whether legally or formally demanded or not) or if the Tenant shall fail or neglect to observe or perform any of the agreement, stipulations or conditions herein contained and on the Tenant's part to be observed and performed or if the Tenant shall become bankrupt, or being a corporation shall go into liquidation or if any petition shall be filed for the winding up of the Tenant, or if the Tenant otherwise becomes insolvent or makes any composition or arrangement with creditors or shall suffer any execution to be levied on the said Premises or otherwise on the Tenant's goods, then and in any such case it shall be lawful for the Landlord at any

time thereafter to re-enter on the said Premises or any part thereof in the name of the whole whereupon this Agreement shall absolutely cease and determine but without prejudice to any right of action by the Landlord in respect of any outstanding breach or non-observance or non-performance of any of the agreements, stipulations and conditions herein contained and on the Tenant's part to be observed and performed and to the Landlord's right to deduct all loss and damage thereby incurred from the deposit paid by the Tenant in accordance with the Clause 5 hereof.

- (b) If the rent or any part thereof shall be unpaid for ten days after the same shall become payable (whether legally or formally demanded or not) the Tenant shall further pay to the Landlord interest calculated at the rate of two percent (2%) above the Hong Kong and Shanghai Bank's best lending rate for the time being per annum on the amount unpaid as aforesaid from the date upon which the same shall have become payable until the date of payment.
 - (c) A written notice served by the Landlord on the Tenant in manner hereinafter mentioned to the effect that the Landlord thereby exercises the power of re-entry herein contained shall be a full sufficient exercise of such power without actual entry on the part of the Landlord.
 - (d) Acceptance of rent by the Landlord shall not be deemed to operate as a waiver by the Landlord of any right to proceed against the Tenant in respect of any breach non-observance or non-performance by the Tenant of any of the agreements, stipulations and conditions herein contained and on the Tenant's part to be observed and performed.
 - (e) The Landlord shall not be under any liability to the Tenant or to any other person whomsoever in respect of any loss or damage to person or property sustained by the Tenant or any such other person caused by or through or in any way owing to the overflow of water from anywhere within the said building. The Tenant shall fully and effectually indemnify the Landlord from and against all claims and demands made against the Landlord by any person in respect of any loss, damage or injury caused by or through or in any way owing to the overflow of water from the said Premises or to the neglect or default of the Tenant, his servants, agents or licensees or to the defective or damaged condition of the interior of the said Premises or any fixtures or fittings for the repair of which the Tenant is responsible hereunder and against all costs and expenses incurred by the Landlord in respect of any such claim or demand.
 - (f) If the said Premises or any part thereof shall be destroyed or so damaged (not attributable to the act or default of the Tenant) by fire, typhoon, Act of God, Force Majeure of other cause beyond the control of the Landlord as to be rendered unfit for use and occupation, the rent hereby agreed to be paid or a part thereof proportionate to the damage sustained shall cease to be payable until the said Premises shall have been restored or reinstated and the Landlord shall not be liable to pay any damage or compensation to the Tenant in these circumstances AND Provided Always that the Landlord shall be under no obligation to repair or reinstate the said Premises if, in their opinion, it is not reasonably economical or practicable so to do And Provided Further that if the whole or substantially the whole of the said Premises shall have been destroyed or rendered unfit for use and occupation and shall not have been repaired and reinstated within three months of the occurrence of the destruction or damage either party shall be entitled at any time before the same are so repaired and reinstated to terminate this Agreement by notice in writing to the other but such determination shall not prejudice the Landlord's rights and remedies in respect of rent and outstanding breaches of covenant.
 - (g) For the purposes of these presents any act, default, neglect or omission of any servant, agent or licensee (as hereinbefore defined) of the Tenant shall be deemed to be the act, default, neglect or omission of the Tenant and the Tenant shall compensate the Landlord for any damages suffered by the Landlord whether or not due to the negligence of the Tenant or all of its contractors, servants, agents, licensees and any person present in, using or visiting the said Premises with the consent of the Tenant express or implied.
 - (h) For the purposes of Part III of the Landlord and Tenant (Consolidation) Ordinance (Chapter 7) and of these presents, the rent payable in respect of the said Premises shall be and be deemed to be in arrear if not paid in advance at the times and in manner hereinbefore provided for payment thereof. All costs and expenses for and incidental to any distraint and legal charges shall be paid by the Tenant and is covertable from him as a debt on a full indemnity basis.
 - (i) To the extent that the Tenant can lawfully do so, the Tenant hereby expressly agrees to deprive himself of all rights (if any) to protection against eviction or ejection afforded by any existing or future legislation from time to time in force and applicable to the said Premises or to this tenancy and the Tenant agrees to deliver up vacant possession of the said Premises to the Landlord on the expiration or sooner determination of the tenancy hereby created.
 - (j) No condoning, excusing or waiving by the Landlord of any default, breach or non-observance or non-performance, by the Tenant at any time or times of any of the Tenant's obligations herein contained shall operate as a waiver of the Landlord's rights hereunder in respect of any continuing or subsequent default, breach or non-observance or non-
- Written notice sufficient exercise of right
- Acceptance of rent not waiver or breach of covenant
- Landlord not liable for overflow of water
- Tenant to indemnify Landlord against all claims in respect of any loss or damage due to overflow of water
- Abatement of rent if the said Premises damaged by fire etc
- Tenant responsible for acts of servants visitors etc.
- For the purposes of distraint rent in arrear if not paid in advance on due date
- Tenant waives rights to protection under Landlord and Tenant Ordinances
- No waiver by Landlord

performance or so as to defeat or affect in any way the rights and remedies of the Landlord hereunder in respect of any such continuing or subsequent default, or affect in any way the rights and remedies of the

- Landlord hereunder in respect of any such continuing or subsequent default or breach and no waiver by the Landlord shall be inferred from or implied by anything done or omitted by the Landlord unless expressed in writing and signed by the Landlord. Any consent given by the Landlord shall operate as a consent only for the particular matter to which it relates and in no way shall be considered as a waiver or release of any of the provisions hereof nor shall it be construed as dispensing with the necessity of obtaining the specific written consent of the Landlord in the future, unless expressly so provided.
- Landlord can exhibit letting notices during last three months of term (k) During the three months immediately preceding the expiration of the term hereby created, the Landlord shall be a liberty to affix and maintain without interference upon any external part of the said Premises a notice stating that the said Premises are to be let and such other information in connection therewith as the Landlord shall reasonably require.
- Service of notice (l) Any notice required to be served hereunder shall, if to be served on the Tenant, be sufficiently served if addressed to the Tenant and sent by prepaid post to or delivered at the said Premises or the Tenant's last known place of business or residence in Hong Kong and if to be served on the Landlord, shall be sufficiently served if addressed to the Landlord and sent by prepaid post to or delivered to the Landlord's residence or registered office as shown in the Agreement.
- Stamp duty and costs (m) The stamp duty and other disbursements on this Agreement and its counterpart shall be borne by the Landlord and Tenant in equal shares.
- Definitions (n) Unless the context otherwise requires, words herein importing the masculine gender shall include the feminine and neuter and words herein in the singular shall include the plural and vice versa.
- No key money etc. (o) No key or construction money or other premium of a similar nature have been paid or agreed to be paid by the Tenant to the Landlord and no advance payment of rent has been paid to the Landlord except in pursuance of Clause 1 hereof.
- Landlord's right to name the Building (p) The Landlord reserves the right to name the said Building with any such names or styles as in its sole discretion may determine and at any time and from time to time to change, alter, substitute or abandon any such names provided that the Landlord shall give the Tenant and to the Postal and other relevant Government Authorities not less than three months' notice of its intention so to do.
- Lift and Air-conditioning plant (q) The Landlord shall not be liable to pay compensation to the Tenant in respect of any period during which due to circumstances beyond the control of the Landlord the proper operation of the lifts and air-conditioning plant shall be interrupted as a result of mechanical failure or need for repair or overhaul nor shall the Landlord be liable thereby to grant an abatement of rent in respect of such interruption.
- Full agreement (r) This Agreement sets out the full agreement reached between the parties and the Tenant hereby expressly declares that no other representations have been made or warranties given relating to the Landlord or the Tenant or the Building or the said Premises has been made given or implied the same is hereby waived.
- Additional terms (s) The additional terms (if any) as set out in the Part 8 of the First Schedule hereto shall also apply but in the event that any contradiction between such additional terms and the foregoing conditions, the provisions of such additional terms shall prevail.
- No warrant for user (t) It is hereby further agreed between the parties hereto that there is no warranty and/or representation on the part of the Landlord that the said Premises are suitable for the purposes stipulated in paragraph 2(s) hereinabove mentioned.
- No warrant for air-conditioning (u) The Landlord shall at its own cost be responsible for the repairing and maintenance of the air-conditioners by its nominated contractors but the Tenant shall not make any claims against the Landlord in case of any damages caused by malfunction and any leaking of water from the air-conditioners.
- Tenant's deposit 5. (a) The Tenant shall on the signing hereof deposit and maintain with the Landlord a deposit of the amount as set out in the Part 6 of the First Schedule hereto to secure the due observance and performance by the Tenant of the agreements, stipulations and conditions herein contained and on the Tenant's part to be observed and performed. The said deposit shall be retained by the Landlord throughout the said term free of any interest to the Tenant and in the event of any breach or non-observance or non-performance by the Tenant or any of the said agreements, stipulations or conditions aforesaid, the Landlord shall be entitled to terminate this Agreement and to forfeit the said deposit by way of liquidated damages. Notwithstanding the foregoing, the Landlord may in any such event at this option elect not to terminate this Agreement and forfeit the deposit but to deduct therefrom the amount of any monetary loss incurred by the Landlord in consequence of the breach, non-observance or non-performance by the Tenant in which event the Tenant shall as a condition precedent to the continuation of the Tenancy deposit with the Landlord the amount so deducted and if the Tenant shall fail so to do, the Landlord shall forthwith be entitled to re-enter on the said Premises and to determine this Agreement and forfeit the deposit as hereinbefore provided.
- Repayment of deposit (b) Subject as aforesaid, the said deposit shall be refunded to the Tenant by the Landlord



without interest within thirty days after the expiration or sooner determination of this Agreement and the delivery of vacant possession to the Landlord within thirty days of the settlement of the last outstanding claim by the Landlord against the Tenant in respect of any unsettled reinstatement charge, any breach, non-observance or non-performance of any of the agreements, stipulations or conditions herein contained and on the part of the Tenant to be observed and performed, whichever is the later.

Assignment of ownership

- (c) Unless the Landlord consents in writing, the deposit shall not be used to set off the rent and/or Management and Maintenance Charges and/or Air-Conditioning payable by the Tenant to the Landlord at any time during the Term of this Tenancy.
- (d) If the said Premises shall be assigned by the Landlord during the said term, the Landlord shall have the right but is not obliged to transfer the said deposit or any part thereof after deduction (if any) to the assignee by giving notice in writing to the Tenant notifying the Tenant of such transfer. Upon completion of such transfer and subject to (i) the Landlord having informed the Tenant in writing of any deduction which the Landlord has made from the said deposit and (ii) the assignee having given a written undertaking to the Tenant undertaking to hold the said deposit or such part hereof transferred to the assignee and to refund the same to the Tenant in accordance with the terms and conditions hereof, the Landlord shall notwithstanding anything contained herein to the contrary be released from any further liability and all obligations to return the said deposit or any part thereof to the Tenant. In addition and without prejudice to the generality of the foregoing, the Landlord may but is not obliged to request the Tenant and Tenant shall upon request by the Landlord at the Tenant's costs and expenses sign and execute such document as may be reasonably required by the Landlord to release the Landlord from all claims liabilities demands and proceedings in respect of the refund of the said deposit or any part thereof.

Re-development

- (e) The Landlord shall enter into a contract for the sale of the said building or any part thereof or the said Premises or any part thereof or shall resolve to redevelop the said building or any part thereof whether wholly by demolition and rebuilding or otherwise or partially by renovation, refurbishment or otherwise which shall include or affect the said Premises or any part thereof (a copy of a Resolution of the Landlord's Board of Directors certified true and correct by the Landlord's Secretary) shall be conclusive evidence of the aforesaid contract or resolution, as the case may be and be binding on the Tenant, then in any of such events the Landlord shall be entitled to terminate this Agreement by giving six calendar months' notice in writing to the Tenant and immediately upon the expiration of such notice this Agreement shall cease and determine but without prejudice to the rights and remedies of either party against the other in respect of any antecedent claim or breach of any of the agreements stipulations terms and conditions herein set out. Save as hereinbefore expressly provided the Tenant shall have no claim against the Landlord or any other party(ies) for any loss, compensation, damages, costs or expenses arising out of or in connection with the aforesaid or the Landlord's exercising its rights under this clauses.

Claim for all expenses and legal charges in regard to any payment in arrears

- (f) The Tenant shall reimburse or pay to the Landlord all expenses and charges (including legal costs on a solicitor and client basis) incurred by the Landlord in connection with the demand of payment of the arrears of the said rent, the maintenance and management fees, the rates, air-conditioning charges and all other outgoings payable by the Tenant hereunder and enforcement of any other provisions and terms herein in Court of otherwise.

Condition and state of the said Premises

- (g) The said Premises shall be handed over to the Tenant with the standard fitting-out supplied by the Landlord. No warranty whatsoever is given by the Landlord on the physical state and condition of the said Premises or any part thereof or the installation, additions, alterations, fittings and fixtures therein. The Tenant expressly acknowledges and confirms that he has inspected the said Premises and the installation, additions, alterations, fittings and fixtures therein prior to entering into this Agreement and had satisfied himself in all respects as to the area size suitability and condition in relation to the aforementioned or any other matter pertaining to the tenancy or relating to the installation, additions, alterations, fittings and fixtures in the said Premises. The Tenant shall take up the said Premises on an "as is" basis including all fixtures, fittings, additions, erections and alteration made or installed upon or in the said Premises prior to the commencement of the said term.

House Rules and Regulations

- (j) Such Rules and Regulations shall be in addition to and not in substitution of the terms and conditions in this Agreement. In the event of conflict between the terms and conditions set out in such Rules and Regulations and the terms and conditions of this Agreement, the Landlord or the Manager of the Building shall have the absolute discretion to elect as to which set of terms and conditions are applicable.

Takeover of Fixtures and Fittings

- 6. The Tenant agrees to (if applicable) takeover the fixtures and fittings including the glass or wooden door (s) left by the previous tenant and shall at its own cost be solely responsible for their repairing and maintenance and to comply with the regulations and ordinance of the concerned government authority including replacement of the existing glass door to a wooden door. The Tenant shall be fully responsible for reinstating the said Premises to its original states and making good any damages to the satisfaction of the Landlord (if required by the Landlord) upon the expiration or sooner determination of this Tenancy Agreement.



- Applicable Law : 7. This Agreement shall be construed and take effect in accordance with the Laws of The Hong Kong Special Administrative Region.
- Marginal Notes : 8. The marginal notes are intended for guidance only and do not form part of this Agreement nor shall any of the provisions in this Agreement be construed or interpreted by reference thereto or in any way affected or limited thereby.

THE FIRST SCHEDULE ABOVE REFERRED TO

Part 1- The Landlord

LANDLORD : **THE CHUNG SHUN LAND INVESTMENT COMPANY LIMITED** whose registered office is situate at Unit 2203, 22nd Floor, 88 Hing Fat Street, Causeway Bay, Hong Kong acting by their agent **MUTUAL PROPERTY MANAGEMENT COMPANY LIMITED** whose registered office is situate at Unit 2103, 21st Floor, 88 Hing Fat Street, Causeway Bay, Hong Kong

Part 2 – The Tenant

TENANT : Artificial Life Asia Limited whose registered address is situate at 26th Floor, 88 Hing Fat Street, Causeway Bay, Hong Kong (Business Registration Certificate No. 31171834-000-07-09-9)

Part 3 – The said Premises

PREMISES : ALL THAT the of 26th FLOOR of No. 88 HING FAT STREET, HONG KONG (“the Building”) erected on ALL THAT piece of parcel of ground registered in the Land Registry as THE REMAINING PORTION OF INLAND LOT NO.2234

Part 4 – The said Term

TERM : Two-Year Fixed Term commencing on 1st January 2010

Part 5 – The said Rent

RENT : HONG KONG DOLLARS ONLY (HK\$69,300.00) per month (exclusive of government rates, management fee, and air-conditioner fee) payable in advance on the 1st day of each successive calendar month.

MANAGEMENT FEE : HONG KONG DOLLARS ONLY (HK\$9,660.00) per month

AIR-CONDITIONING: CHARGES : HONG KONG DOLLARS ONLY (HK\$12,180.00) per month

Part 6 – The said Deposit

RENTAL DEPOSIT: HONG KONG DOLLARS TWO HUNDRED SEVENTY THREE THOUSAND AND FORTY TWO HUNDRED ONLY (HK\$273,420.00)

Part 7 – The said User

USER : For commercial use only

Part 8 – The Special Conditions

- 1 Subject to the provisions of Clause 2ss herein, the Tenant shall only trade his business at the said Premises in which he is sole proprietor or major partner and he shall notify the Landlord in writing the said business name within one month from the date hereof.
- 2 Should the tenant be found repeated breach of the material terms and conditions as stipulated in this tenancy agreement, the Landlord is entitled to terminate this agreement at any time without any compensation to the tenant during the tenancy
- 3 The said Premises is let on an “as is” condition together with the Landlord’s fixtures. No additional work shall be provided by the Landlord.
- 4 The Landlord shall have no objection to any lawful business purpose for which the said Premises shall be used by the Tenant but the Landlord does not warrant that the said Premises are fit for any particular purpose. The Tenant shall be responsible for obtaining all necessary permits or licences from the appropriate Government authorities for the user of the said Premises and shall at all times comply with all rules and regulations laid down by such authorities for giving such permits and the Tenant shall indemnify the Landlord from and against all proceedings action fines damages claims and demands whatsoever which may arise as a result of the non-compliance by the Tenant of such rules and regulations or any of them.
- 5 At the expiration or sooner determination of the tenancy at the Tenant’s own cost reinstate and restore the same to the plan and design as if such addition or alteration (or such of them as may be specified by the Landlord) has not been made and make good all damages thereto to the satisfaction of the Landlord.

- 6 In the event of the said Premises hereby resumed by the Government or if the said Premises shall be required by the Government for any other purpose whatsoever, then upon the issue of any notice of resumption by the Government or upon any notice being published in the Government Gazette that (1) the said Premises shall be resumed or (2) that the said Premises shall be so required by the Government, then this Agreement shall forthwith be terminated and the Tenant shall vacate the said Premises forthwith whereupon the deposit payable hereunto shall be returned to the Tenant but without compensation interest or costs and the Tenant shall not have any claim against the Landlord for such early determination of this Agreement BUT without prejudice to the right of action of the Landlord in respect of any breach of the Tenant's terms and conditions herein contained and on the Tenant's part to be observed and performed.
- 7 Should the said Premises be declared or condemned dangerous by the Building Authority or any other competent Government Authority during the continuance of the term hereby created, the Tenant shall forthwith vacate the said Premises and waive all his rights and privilege to any claim or demand for damages or compensation which may be afforded to the Tenant by any Ordinance in force and in particular the Demolished Building (Re-development of Sites) Ordinance Cap.337.
- 8 Tenant shall comply with the Fitting Out and House Rules of the Building.
- 9 So far as permitted by law, the Landlord and its servants, agents, visitors, invitees and/or licensees shall not in any circumstances be liable or responsible to the Tenant, its servants, agents, visitors, invitees and or licensees or any of them and/or any other person whomsoever for any loss, injury, damage, nuisance, annoyance and/or inconvenience which may be sustained by the Tenant, its servants, agents, visitors, invitees and licensees or any of them and/or any other person whomsoever (whether personally or to their respective properties) notwithstanding any provision to the contrary.
- 10 The Tenant acknowledge that Mutual Property Management Co. Ltd. ("Mutual") is the Landlord's agent in respect of this tenancy and the Tenant agrees and for the avoidance of doubt, hereby confirms that Mutual shall be entitled to the benefit of all provisions for the benefit of the Landlord and Mutual shall be entitled to enforce all provisions enforceable by the Landlord under this Tenancy Agreement.
- 11 For any decoration regarding the captioned premises, Tenant is required to submit the Application Form for decoration to the Building Manger for Landlord's approval before any commencement of works, such approval not to be unreasonably withheld.
- 12 The Tenant shall be entitled to put up a signboard at its own cost bearing the name(s) "Artificial Life Asia Limited" which name(s) shall also be displayed at the directory board(s) on the main lobby and the 26th Floor of the Building. Provided that the Tenant shall procure the company namely "Artificial Life Asia Limited" to observe and comply with the terms of this Agreement. The Tenant shall indemnify the Landlord for any costs expenses or damages which maybe incurred or suffered by the Landlord in the event that the said company contravenes any provision of this Agreement.

AS WITNESS the hands of the parties hereto the day and year first above written.

SIGNED by /s/ Timothy Lam Jr.

for and on behalf of the Landload
Mutual Property Management Co., Ltd.

SIGNED by /s/ Eberhard Schoneburg

for and on behalf of the Tenant
Artificial Life Asia Ltd.

Filename: d26229ex10-7.htm
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Comment/Description:
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Exhibit 10.7

Dated the 30th day of October 2009

MUTUAL PROPERTY MANAGEMENT COMPANY LIMITED as agent for The Chung Shun Land Investment Company Limited
 And
ARTIFICIAL LIFE ASIA LIMITED

TENANCY AGREEMENT

ROBERTSONS
 Solicitors & Notaries
 57th Floor, The Center
 No.99 Queen's Road Central
 Hong Kong

Parties BETWEEN the party named and described as the Landlord in **Part 1 of the First Schedule** (hereinafter called "the Landlord") of the one part and the party or parties named and described as the Tenant in **Part 2 of the First Schedule** (hereinafter called "the Tenant") of the other part.

WHEREBY IT IS MUTUALLY AGREED as follows :-

Agreement to rent the Premises 1. The Landlord shall let and the Tenant shall take ALL THOSE premises set out in Part 3 of the First Schedule (hereinafter called "the said Premises") TOGETHER WITH the use in common with the Landlord and all others having the like right and subject to the right of the Landlord, its managing agents or the manager of the said building (hereinafter defined) to restrict such use to use go pass and repass up down over and upon the common parts including inter alia entrances, staircases, passages and lavatories (if any) in the building (of which the said premises form part) more particularly described in **Part 3 of the First Schedule** (hereinafter called "the said building") in so far as the same is necessary for the proper use and enjoyment of the said premises AND TOGETHER with the use in common as aforesaid of the lifts (if any are installed in the said building and during such hours as the same shall be operating) EXCEPTING AND RESERVING to the Landlord and all persons authorized by the Landlord the free and uninterrupted passage of water and soil through the water pipes and drains and of electricity through the electric wires and meters which now are or may at any time hereafter be in or passing through the said premises with power for the Landlord and the Landlord's agents at all reasonable times to enter the said premises for the purpose of inspecting repairing cleansing replacing or altering the said pipes drains wires and meters the Landlord making good all damages done to the said premises in exercising such power for the term particularized in **Part 4 of the First Schedule** (hereinafter called "the said term") YIELDING AND PAYING therefore during the said term the clear calendar monthly rent (hereinafter called "the said rent") as set out in **Part 5(i) of the First Schedule** which sum shall be payable exclusive of rates management fees air-conditioning charges and other outgoings in advance in each and every calendar month without any deduction or right to set off (whether legal or equitable) and the first of such payments to be made on the signing of this Agreement and all subsequent payments to be made on the 1st day of each and every succeeding calendar month and when the term of tenancy does not commence on the 1st day of the month, the Landlord may at any time during the said term require the Tenant to pay rent for a particular month on a pro-rata basis, namely, from the commencement day to the end of the month, and thereafter the Tenant shall pay rent for each calendar month (including the last month of the said term also on a pro-rata basis) on the 1st day of each such calendar month subject to and with the benefit of the Deed of Mutual Covenant and Management Agreement (hereinafter called "the Deed of Mutual Covenant") (if any) of the said building and the rules regulations and directions made by the manager for the time being of the said building.

Agreement by Tenant To pay rent 2. The Tenant to the intent that the obligations may continue throughout the said term hereby agrees with Landlord as follows :-

- (a) To pay unto the Landlord the said rent and other charges at the time and in the manner aforesaid.
- (b) To pay or discharge all Maintenance and Management Charges currently at HK\$9,660.00 per month and Air-Conditioning Charges currently at HK\$12,180.00 per month in respect of the said Premises or as provided in accordance with the provisions of the Deed of Mutual Covenants and Management Agreement (if any) of the said Building. The Maintenance and Management Charges and Air-Conditioning Charges shall be subject to increase by the Landlord during the continuance of the term hereby created on giving one month's notice in writing of any increase to the Tenant. Upon the expiration of the said period of one month the

To pay Maintenance and Management Charges

Maintenance and Management Charges shall be increased by the amount specified in the Landlord's notice. There shall be no restriction on the number of occasion upon which the Landlord may call for an increase of such Maintenance and Management Charges and Air-Conditioning Charges.

To pay rates

- (c) To pay rates charged on the said Premises as assessed by the Government quarterly in advance within the months of January, April, July and October provided that the first payment thereof shall be paid on the commencement of the tenancy and in the event of the said premises not having been assessed to rates by the Government to pay such sum as shall be required by the Landlord as a deposit by way of security for the due payment of rates subject to adjustment on actual rating assessment being received from the Government and also to pay and discharge all taxes assessments duties charges impositions and outgoings whatsoever now or hereafter to be imposed or charged on the said premises or upon the owner or occupier in respect thereof by the
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- Government of Hong Kong other lawful authority (Government Rent, Property Tax and expenses of a capital and non-recurring nature alone excepted).
- To pay electricity charges (d) To pay and discharge all charges for electricity and telephone rental and other outgoings now or at any time hereafter consumed by the Tenant and chargeable in respect of the said Premises and to make all necessary deposits therefore (if any).
- To keep interior etc. in repair (e) To keep the interior of the said Premises including the flooring and interior plaster or other finishing material or rendering to walls, floors and ceilings and the Landlord's fixtures therein including all doors, windows, electrical installations and wiring and fire fighting installation in good, clean tenable, substantial and proper repair and condition and properly preserved and painted as may be appropriate when from time to time required and to so maintain the same at the expense of the Tenant. The Tenant shall in the last year of the said term paint and decorate in a proper and workmanlike manner all parts of the said premises usually painted and decorated and all such internal parts of the said premises that have been or ought properly to be so treated and deliver up the same to the Landlord at the expiration or sooner determination of the term in like condition replacing and reinstating any part of the said premises damaged or destroyed by or through or in consequence directly or indirectly of any negligent act or omission of the Tenant may be released by the Landlord if the Landlord shall be satisfied with the condition of the said premises in the last year of the said term. The Tenant particularly agrees:-
- To repair and replace electrical wirings within the said Premises (i) To repair or replace, if so required by the appropriate supply company, statutory undertaking or authority as the case may be under the terms of any Electricity Supply or similar Ordinance for the time being in force or any Orders in Council or Regulations made thereunder, all electrical wiring installations and fittings within the said Premises from the Tenant's meter or meters to and within the same.
- To keep sanitary and water apparatus used exclusively in good repair (ii) To keep the sanitary and water apparatus used exclusively by the Tenant and his servants, agents and licensees in good, clean and tenable repair and condition to the satisfaction of the Landlord and in accordance with the Regulations or by-laws of all Public Health and other Government Authorities concerned and repair or replace any drains pipes or sanitary or plumbing apparatus if required by the Landlord or any government authority.
- To be responsible for loss or damage caused by interior defects (iii) To be wholly responsible for any loss, damage or injury caused to any other person whomsoever directly or indirectly through the defective or damaged condition of any part of the interior of the said Premises and to make good the same by payment or otherwise and to indemnify the Landlord against all actions, proceedings, claims and demands made upon the Landlord in respect of any such loss, damage or injury and all costs and expenses incidental thereto.
- To be responsible for maintenance of windows (iv) to reimburse to the Landlord the cost of replacing all broken and damaged windows whether the same be broken or damaged by the negligence of the Tenant or any of its servants, agents or licensees or by circumstances beyond the control of the Tenant.
- To be responsible for maintenance of shop front plate glass (v) to reimburse to the Landlord the cost of repairing or replacing the shop front plate glass or any part thereof in the event of the same being broken or damaged by the Tenant or by any servant, agent or licensee of the Tenant.
- Installation of additional air-conditioners (vi) upon prior consent of the Landlord is given, to install additional air-conditioning units at such places and in such positions of the said Premises as shall be approved by the Landlord and not to cut the window or bar or projecting out of the said Premises and to make good all damage done to all windows, doors and window panes and to replace or reinstate the same in strict accordance with any direction which shall or may be given by the Landlord and to be responsible for their maintenance and repair at the expenses of the Tenant.
- To permit Landlord to enter and view the state of repair and to carry out necessary repairs (f) To permit the Landlord and all persons authorised by him at all reasonable times to enter and view the state of repair of the said Premises, to take inventories of the fixtures therein, to carry out any works or repairs which may be required to be done and, during the last three months of the said term, to show the said Premises to prospective tenants or purchasers.
- To permit Landlord to repair other premises (g) To permit the Landlord and all persons authorised by him at all reasonable times to enter and carry out any works or repairs in respect of other premises in the said building PROVIDED that in this connection the Landlord shall be responsible to make good all damage done to the said Premises.
- To execute repairs on receipt of notice (h) On receipt of any notice from the Landlord or his authorised representatives specifying any works or repairs which they require to be done and which are the responsibility of the Tenant hereunder, forthwith to put in hand and execute the same with all possible dispatch and without any delay.
- Not to erect install or alter fixtures etc without Landlord's consent (i) Not without the previous written consent of the Landlord to erect, install or alter any fixtures partitioning or other partitioning erection or installation in the said Premises or shop front or any part thereof.
- Not to cut or maim or deface any doors, walls, beams or any structural part of the Premises (j) Not to cut, maim, injure, drill into, mark or deface or permit or suffer to be cut, maimed, injured, drilled into, marked or defaced any doors, windows, walls, beams, structural members or any part of the fabric of the said Premises nor any of the plumbing or sanitary apparatus or installations included therein.
- Not to remove any fixtures, erections on any part of the Premises (k) Not without the previous written consent of the Landlord to put up or remove any fixtures partitions or other erections on any part of the said Premises without the like consent and to reinstate or restore the said Premises to their original condition at the expiration or sooner determination of the said term of tenancy.
- Not to install any plant (l) Not to install or use in the said Premises any plant, apparatus or machinery which consumes

apparatus or machinery without
consent

electricity without the prior consent of the Landlord. In the event of such installation or use being
approved the Tenant shall pay the charges for all electricity thereby consumed.

- Not to erect aerial (m) Not to erect any aerial on the roof or walls of the said building nor the ceiling or walls of the said Premises.
- Not to deliver bulky items (n) Not to take delivery of furniture or fixtures or bulky items of goods in and out of the building without the permission of the Landlord.
- Not to prepare food (o) Not to prepare or permit to be prepared any food or to allow delivery of food from the said Premises.
- Not to keep pressurized items (p) Not to permit to be brought into the said Premises any gas whether bottled or in pressurized containers or otherwise for any purpose whatsoever.
- Not to display sign etc. (q) Not without the prior written consent of the Landlord to affix erect attach or display or permit or suffer so to be upon any part of the exterior of the said Premises or to **or through any windows thereof any placard, poster, decoration, flag, notice, advertisement, signboard, sign, name or other device whatsoever whether illuminated or not** PROVIDED that the Landlord shall have the right to remove at the cost and expense of the Tenant any signboard or other things which shall have been affixed displayed or exhibited as aforesaid without the prior consent of the Landlord AND PROVIDED FURTHER that which said cost and expenses shall be recoverable by the Landlord from the Tenant as a debt.
- Not to drive nails etc. into ceilings, walls or floors (r) Not to drive or insert or permit or suffer to be driven or inserted any nails, screws, hooks brackets or similar articles into the ceilings, walls or floors of the said Premises without the previous written consent of the Landlord, nor without the like consent to lay or use any floor covering which may damage the existing flooring.
- Usage of the said Premises (s) Not to use the said Premises for any purpose other than for the purpose and under the name as described and set out in the Third Schedule hereto. For the avoidance of doubt, *not to use the said Premises for any of the following purposes, namely : domestic premises, factory or industrial premises, undertakers or business or activities in connection therewith, dance hall, club, billiard saloon, massage establishment as defined in Miscellaneous Licences Ordinance, automatic machines establishment as defined in the Miscellaneous Licences Ordinance, premises licenced under the Gambling Ordinance for playing therein or games in which mahjong or Tin Kau tiles are used, offensive trades as in the Public Health and Urban Services Ordinance, top-less bar or any business the operation of which may directly or indirectly involve the provision of female companionship to the customers thereof. Not to operate around-the-clock business and use the said Premises for any kinds of school including training center, teaching institute and tutorial workshop without Landlord's prior consent. No over night work is allowed unless prior consent is obtained from the Landlord.*
- Not to use the said Premises as sleeping quarters or domestic premises (t) Not to use or permit to suffer the said Premises or any part thereof to be used as sleeping quarters or as domestic premises within the meaning of the Landlord and Tenant (Consolidation) Ordinance or similar legislation for the time being in force.
- Not to produce noise audible outside (u) Not to produce or permit or suffer to be produced any noise (including sound produced by broadcasting or any apparatus or equipment capable of producing, reproducing, receiving or recording sound) **so as to cause a nuisance** to other users of the Building, and where music is to be regularly played, to install at the Tenant's cost or expense and to the satisfaction of the Landlord adequate sound proofing or insulation devices in the said Premises.
- Not to permit any nuisance or annoyance (v) Not to do or permit or suffer to be done any act or thing which may be or become a nuisance or annoyance to the Landlord or to the tenant or occupiers of other premises in the said building or in any adjoining or neighboring building.
- Not to breach Government Lease or cause insurance policies to be voided or premium to be increased (w) Not to do or permit or suffer to be done any act, deed, matter or thing whatsoever which amounts to a breach of any of the terms and conditions under which the land on which the said building stands is held from the Government or whereby any insurance on the Building against loss or damage by fire and/or claims by third parties for the time being in force may be rendered void or voidable or whereby the premium thereon may be increased Provided that if as the result of any act, deed, matter or thing done permitted or suffered by the Tenant, the premium on any such policy of insurance shall be increased, the Landlord shall be entitled at his option either to terminate this Agreement or to continue the same upon payment by the Tenant of the additional premium and upon such other terms and conditions as the Landlord may, at his discretion, think fit to impose.
- Not to keep items of combustible or hazardous goods on the said Premises (x) Not to keep or store or permit or suffer to be kept or stored in the said Premises any arms, ammunition, gun-powder, saltpetre, kerosene or other explosive or combustible substance or hazardous goods which may contravene any ordinance regulation by-law or Management Rules of the Building or constitute a nuisance or annoyance to the tenants or occupants of any part of the Building or injurious or detrimental to the reputation of the Building of which the said Premises form part.
- Not to permit illegal or immoral use (y) Not to use or permit or suffer the said Premises to be used for any illegal or immoral purpose or for any purpose which is in contravention of the terms and conditions contained in the Government Lease or Conditions under which the said Premises are held from the Government and not to carry on any trade or business thereon which is now or may hereafter be declared to be an offensive trade under the Public Health & Urban Services Ordinance or any other Ordinance or Regulations and any enactment amending or substituting the same.
- Not to encumber, leave rubbish or obstruct passage and common areas (z) Not to encumber or obstruct or permit to be encumbered or obstructed with any box, packaging or other obstruction of any kind or nature any of the entrances, passages, lifts (if any) lobbies or other

parts of the Building in common use and not to leave rubbish or any other article or thing in any part of the Building not in the exclusive occupation of the Tenant.

- Not to lay wiring or cables etc. in the public areas
- No to employ any Security Contractors except from the Landlord
- Not to install any gate or rolling shutter without consent.
- Deposit a spare key of the said Premises with the Landlord in case of emergency
- No pets
- Not to alter or install additional locks etc.
- Not to change the colour of doors and glasses of the said Premises or any part thereof
- No overloading of electricity
- Tenant shall at its own cost to apply for transferal of the electric meter
- Not to carry out business during Rent-free Period
- Garbage
- Burglary Alarm
- Electrical installations or wiring
- To appoint contractors designated by the Landlord
- Insurance
- (aa) Not to lay install affix or attach any wiring, cables or other article or thing in or upon any of the entrances, staircases, landings, passage-ways, **lobbies** or, public areas.
- (bb) Not to employ any security contractors for the rendering of any services for or in connection with said Premises without the consent of the Landlord, but to permit the Landlord's servants or security guards to enter the said Premises at all reasonable times for security purposes, and to connect and keep the said Premises connected to any communal alarm or security system, the fees for any connection of burglary alarm from the said Premises to the communal alarm or security system and any subsequent repair and maintenance fees thereof shall be solely borne by the Tenant.
- (cc) Not to install any gate, additional lock, fixture, rolling shutter or additional door to the entrances of the said Premises without prior consent from the Landlord. If the door lock is changed, a key should be deposited with the Landlord for custody.
- (dd) To deposit with the Landlord a key to the said Premises and to grant the Landlord access to the said Premises in the event of any apparent emergency by the use of the key deposited or otherwise.
- (ee) Not to keep in the building or any part thereof any dog or other pet or animal.
- (ff) Not without the previous written consent of the Landlord to alter the existing locks, bolts or fittings on the entrance doors to the said Premises nor to install any additional locks, bolts or fittings thereon.
- (gg) Not to change the colour of the doors or the wooden door(s) to the glass door(s) (if applicable) of the said Premises without prior approval from the Landlord.
- (hh) Not to use electricity in excess of the supply from the electricity meter at any one time in the said Premises and the Landlord shall not be responsible for supply of any additional electricity.
- (ii) Upon signing of this Agreement, the Tenant shall at its own cost apply for transferal of the electric meter to its own and pay the related electric meter deposit directly to the Electric Company. Tenant shall undertake to immediately and unconditionally transfer back the electric meter to the Landlord with settlement of the outstanding electric charges (if any) at the termination or early termination of this Agreement. If the Tenant fails to transfer the electric meter to its own name within 7 days from the date of taking over the said Premises, the Landlord is entitled to disconnect the electric meter and shut down the air conditioners without prior notice and the Tenant shall not make any claims against the Landlord.
- (jj) Not to carry out any business or start working during the Rent-free Period for decoration in the said Premises, failing which the Landlord shall be entitled to charge the Tenant for the rental payment and other fees without prior notice. **Tenant shall pay the Management Fee, Air-Conditional Charges and all outgoing payments during the Rent Free Period. The Tenant shall submit full details of decoration plan(s) to the Landlord for approval before commencement of works, failing which the whole amount of decoration deposit shall be forfeited without prior notice.**
- (kk) To be fully responsible for the disposal of any bulky refuse which is not included in the Maintenance and Management Charges. Any bulky garbage must not be placed at the common area or any part of the Building and be removed away daily by Tenants themselves or by the nominated cleaning contractor at Tenant's own cost.
- (ll) To appoint the Landlord's nominated contractor for repairing and maintenance of the Burglary Alarm installed at the main door and to pay the related fees annually in advance (if any) as shall be charged by the contractor.
- (mm) Any alternation in electrical installations or wirings of the said Premises shall be done by the nominated electrical contractor of the Landlord but at the Tenant's own expenses. Tenant shall obtain consent from the Landlord before commencement of work and not to cause the electrical loading exceeding the loading of the existing meter.
- (nn) To appoint either registered electrical contractors under HKSAR or electrical contractor nominated by Landlord to rectify and testify the electrical installation in the said Premises and make sure that the electrical installation complies with relevant regulations and Ordinance in Hong Kong but at the Tenant's sole expenses if it is required by the Government.
- * (oo) To appoint contractor nominated by Landlord if any work of fire services and air conditioning (Air Ducts) or alteration is required.
- (pp) **The Tenant shall submit details of decoration plans including room partitions, electrical installation, air conditionings or other decoration (if any) to Landlord for approval before commencing of work. The Tenant shall not commence any work for decoration before approval to the work is obtained from the Landlord.**
- (qq) Landlord shall have right to cut off or shut down the electrical supply at any part of the Building without prior notice to Tenant in the event that maintenance, repairing or emergency work is to be carried out. Tenant shall not object the cut-off or shut-down of the electrical power supply and shall not make any claim against the Landlord for any consequences arising therefrom.
- (rr) The Tenant shall effect an valid insurance policy covering public liability of the said Premises for the **insured amount not less than HK\$5 million** to indemnify the Landlord by any person in respect of any loss or damage or injury caused by the overflow of water or the escape of



- fumes, smoke, fire or any other substance or thing from the said Premises owing to the neglect or default of the Tenant, his licensees, servants or agents during the term of the tenancy agreement including the period of decoration.
- Not to assign underlet etc (ss) Without the prior written approval of the Landlord not to assign, underlet or otherwise part with the possession of the said Premises or any part thereof in any way whether by way of sub-letting, lending, sharing or other means whereby any person or persons not a party to this Agreement obtains the use, possession, occupation or enjoyment of the said Premises or any part thereof regardless of whether any rental or other consideration is given therefor. **The tenancy shall be personal to the Tenant named in this Agreement and without in any way limiting the generality of the foregoing**, the following acts and events shall, unless previously approved in writing by the Landlord (which approval the Landlord may give or withhold at its discretion without assigning any reason therefor) be deemed to be breaches of this Clause :-
- (i) any take-over, reconstruction, amalgamation, merger, voluntary liquidation or change in the person or persons who own a majority of the Tenant's voting shares or who otherwise has or have effective control thereof.
 - (ii) the giving by the Tenant of a Power of Attorney or similar authority whereby the donee of the Power obtains the right to use, possess, occupy or enjoy the said Premises or any part thereof or does in fact use, possess, occupy or enjoy the same.
 - (iii) the change of the Tenant's business name without the previous written consent of the Landlord, such consent shall not be unreasonably withheld.
"Subject always to the following:
 - (1) In the event that the Tenant desires to undertake any of the activities described at paragraphs (i), (ii) or (iii) directly above, it shall provide written notice to the Landlord of its desire to do so.
 - (2) The Landlord shall have 10 days from the date of receipt of the Tenant's written notice within which approve or reject the Tenant's proposed activity.
 - (3) If the Landlord does not reject the Tenant's proposed activity by way of a written notice to the Tenant within 10 days of receipt the Tenant's written notice, the Tenancy Agreement shall continue in force without interruption or variation for the remainder of the Term.
 - (4) If the Landlord rejects the Tenant's proposed activity, the Landlord shall provide the Tenant with written notice of the termination of the Tenant's tenancy of the Premises under the Tenancy Agreement, such notice expiring 3 months after the date of the receipt of the Landlord's notice rejecting the Tenant's proposed activity"
 - (iv) Notwithstanding any provisions to the contrary herein the Tenant shall be entitled to enter into consignment arrangements or such other business arrangements which the Landlord shall consider and approve in writing provided that the Tenant shall ensure that the right of such consignees and occupiers shall be that of licensees only and there shall be no tenancy or sub-tenancy created by such consignment or other arrangements and shall ensure that such consignees and occupiers shall deliver up vacant possession of such parts of the said Premises as shall be occupied by them to the Landlord at the expiration or sooner determination of this Agreement in accordance with the terms hereof.
- To comply with the Deed of Mutual Covenants and all ordinances etc (tt) To obey and comply with and to indemnify the Landlord against the breach of the Deed of Mutual Covenants and Management Agreement (if any) of the said building and all ordinances, regulations, by-laws, rules and requirements of any Governmental or other competent authority relating to the conduct and carrying on of the Tenant's business on the said Premises or to any other act, deed, matter or thing done, permitted suffered or omitted therein or thereon by the Tenant or any employee, agent or licensee of the Tenant.
- To pay cost of clearing or drains etc. (uu) To pay to the Landlord on demand all costs incurred by the Landlord in cleansing or clearing any of the drains pipes sanitary or plumbing apparatus choked or stopped up owing to the careless or improper use or neglect by the Tenant or any employee agent or licensee of the Tenant.
- To protect interior from approaching typhoon (vv) To take all precautions to protect the interior of the said Premises against damage by storm or typhoon or the like and to replace all broken and damaged windows and window-frames whether the same be broken or damaged by the negligence of the Tenant or owing to circumstances (including typhoon) beyond the control of the Tenant.
- To be responsible for contractors, servants, agents and licensees (ww) To be responsible to the Landlord for the acts, neglects and defaults of all contractors, servants, agents and licensees of the Tenant as if they were the acts, neglects and defaults of Tenant himself and for the purpose of this Agreement "licensee" shall include any person present in, using or visiting the said Premises with the consent of the Tenant express or implied.
- Re-instate premises (xx) Unless the Landlord otherwise agrees in writing, to re-instate and restore the said Premises to their original condition and to make good all damage caused or occasioned by the erection and removal of alterations partitions or other erections. The Tenant shall also restore to the Landlord all keys of the said Premises and toilets used by the Tenant upon yielding up of the said Premises.
- To yield up to end of term (yy) Quietly to yield up the said Premises together with all fixtures, fittings and additions therein and thereto at the expiration or sooner determination of this tenancy in its original state and condition.



- To apply for consent for the type of business
- (zz) To apply to the Government and other relevant authorities for consent and/or permission to operate and carry on the type of business intended to be carried on by the Tenant at the said Premises and to pay all fees and/or premium and to observe and perform all conditions and stipulations that may be imposed for the grant of such consent and/or permission.
- Sprinkler System
- (aaa) Not to do or permit or suffer to be done any act or thing which will damage or interfere with or attest the operating of the sprinkler system or any other fire protection or fire fighting systems equipment or apparatus or any security system, equipment or apparatus or any part or parts thereof and to keep the Landlord fully indemnified against all loss, damages, claims and demands as a result of any act or thing done or permitted or suffered to be done by the Tenant aforesaid. Provided that the existing all sprinklers and fire fighting system are in align with current Fire Regulations within the premises. Should there be any alteration regarding the sprinkler systems, the tenant shall be fully responsible for all reinstatement works and subject to the Landlord's satisfaction and be complied with regulations of Fire Services Department.
- Tenant is responsible for discharging all utility charges
- (bbb) To pay and discharge all charges in respect of electricity, gas, water and telephones as may be shown by the separate meter or meters installed upon the said Premises or by accounts rendered to the Tenant.
- Landlord's covenant
3. The Landlord hereby agrees with the Tenant as follows :-
- (a) To pay the Government Rent payable in respect of the said Premises and the Property Tax and expenses of a capital nature (if any) attributable to or payable in respect of the said Premises.
- (b) To keep the outside main walls of the said Premises in good and proper repair.
- (c) At the expense of the Tenant to repaint, repair and maintain the outer shop front(s) and outer door(s) of the said Premises whenever reasonably required by the Tenant so to do or whenever, in the opinion of the Landlord, such work shall be deemed by the Landlord to be necessary provided that the Tenant shall not be liable to reimburse the Landlord the cost of repairing or replacing the shop front plate glass except as provided in Clause 2(e)(v).
- Structural maintenance
4. It is hereby further expressly agreed and declared as follows :-
- (a) If the rent and/or Management and Maintenance Charge and/or rates and/or Air-Conditioning Charges hereby agreed to be paid or any part thereof shall be unpaid for fifteen (15) days after the same shall become payable (whether legally or formally demanded or not) or if the Tenant shall fail or neglect to observe or perform any of the agreement, stipulations or conditions herein contained and on the Tenant's part to be observed and performed or if the Tenant shall become bankrupt, or being a corporation shall go into liquidation or if any petition shall be filed for the winding up of the Tenant, or if the Tenant otherwise becomes insolvent or makes any composition or arrangement with creditors or shall suffer any execution to be levied on the said Premises or otherwise on the Tenant's goods, then and in any such case it shall be lawful for the Landlord at any time thereafter to re-enter on the said Premises or any part thereof in the name of the whole whereupon this Agreement shall absolutely cease and determine but without prejudice to any right of action by the Landlord in respect of any outstanding breach or non-observance or non-performance of any of the agreements, stipulations and conditions herein contained and on the Tenant's part to be observed and performed and to the Landlord's right to deduct all loss and damage thereby incurred from the deposit paid by the Tenant in accordance with the Clause 5 hereof.
- (b) If the rent or any part thereof of shall be unpaid for ten days after the same shall become payable (whether legally or formally demanded or not) the Tenant shall further pay to the Landlord interest calculated at the rate of two percent (2%) above the Hong Kong and Shanghai Bank's best lending rate for the time being per annum on the amount unpaid as aforesaid from the date upon which the same shall have become payable until the date of payment.
- (c) A written notice served by the Landlord on the Tenant in manner hereinafter mentioned to the effect that the Landlord thereby exercises the power of re-entry herein contained shall be a full sufficient exercise of such power without actual entry on the part of the Landlord.
- (d) Acceptance of rent by the Landlord shall not be deemed to operate as a waiver by the Landlord of any right to proceed against the Tenant in respect of any breach non-observance or non-performance by the Tenant of any of the agreements, stipulations and conditions herein contained and on the Tenant's part to be observed and performed.
- (e) The Landlord shall not be under any liability to the Tenant or to any other person whomsoever in respect of any loss or damage to person or property sustained by the Tenant or any such other person caused by or through or in any way owing to the overflow of water from anywhere within the said building. The Tenant shall fully and effectually indemnify the Landlord from and against all claims and demands made against the Landlord by any person in respect of any loss, damage or injury caused by or through or in any way owing to the overflow of water from the said Premises or to the neglect or default of the Tenant, his servants, agents or licensees or to the defective or damaged condition of the interior of the said Premises or any fixtures or fittings for the repair of which the Tenant is responsible hereunder and against all costs and expenses incurred by the Landlord in respect of any such claim or demand.
- (f) If the said Premises or any part thereof shall be destroyed or so damaged (not attributable to the act
- Other provisions, Landlord's right of re-entry
- Written notice sufficient exercise of right
- Acceptance of rent not waiver or breach of covenant
- Landlord not liable for overflow of water
- Tenant to indemnify Landlord against all claims in respect of any loss or damage due to overflow of water
- Abatement of rent if the said

Premises damaged by fire etc

or default of the Tenant) by fire, typhoon, Act of God, Force Majeure of other cause beyond the control of the Landlord as to be rendered unfit for use and occupation, the rent hereby agreed to be paid or a part thereof proportionate to the damage sustained shall cease to be payable until

the said Premises shall have been restored or reinstated and the Landlord shall not be liable to pay any damage or compensation to the Tenant in these circumstances AND Provided Always that the Landlord shall be under no obligation to repair or reinstate the said Premises if, in their opinion, it is not reasonably economical or practicable so to do And Provided Further that if the whole or substantially the whole of the said Premises shall have been destroyed or rendered unfit for use and occupation and shall not have been repaired and reinstated within three months of the occurrence of the destruction or damage either party shall be entitled at any time before the same are so repaired and reinstated to terminate this Agreement by notice in writing to the other but such determination shall not prejudice the Landlord's rights and remedies in respect of rent and outstanding breaches of covenant.

- Tenant responsible for acts of servants visitors etc. (g) For the purposes of these presents any act, default, neglect or omission of any servant, agent or licensee (as hereinbefore defined) of the Tenant shall be deemed to be the act, default, neglect or omission of the Tenant and the Tenant shall compensate the Landlord for any damages suffered by the Landlord whether or not due to the negligence of the Tenant or all of its contractors, servants, agents, licensees and any person present in, using or visiting the said Premises with the consent of the Tenant express or implied.
- For the purposes of distraint rent in arrear if not paid in advance on due date (h) For the purposes of Part III of the Landlord and Tenant (Consolidation) Ordinance (Chapter 7) and of these presents, the rent payable in respect of the said Premises shall be and be deemed to be in arrear if not paid in advance at the times and in manner hereinbefore provided for payment thereof. All costs and expenses for and incidental to any distraint and legal charges shall be paid by the Tenant and is covertable from him as a debt on a full indemnity basis.
- Tenant waives rights to protection under Landlord and Tenant Ordinances (i) To the extent that the Tenant can lawfully do so, the Tenant hereby expressly agrees to deprive himself of all rights (if any) to protection against eviction or ejection afforded by any existing or future legislation from time to time in force and applicable to the said Premises or to this tenancy and the Tenant agrees to deliver up vacant possession of the said Premises to the Landlord on the expiration or sooner determination of the tenancy hereby created.
- No waiver by Landlord (j) No condoning, excusing or waiving by the Landlord of any default, breach or non-observance or non-performance, by the Tenant at any time or times of any of the Tenant's obligations herein contained shall operate as a waiver of the Landlord's rights hereunder in respect of any continuing or subsequent default, breach or non-observance or non-performance or so as to defeat or affect in any way the rights and remedies of the Landlord hereunder in respect of any such continuing or subsequent default, or affect in any way the rights and remedies of the Landlord hereunder in respect of any such continuing or subsequent default or breach and no waiver by the Landlord shall be inferred from or implied by anything done or omitted by the Landlord unless expressed in writing and signed by the Landlord. Any consent given by the Landlord shall operate as a consent only for the particular matter to which it relates and in no way shall be considered as a waiver or release of any of the provisions hereof nor shall it be construed as dispensing with the necessity of obtaining the specific written consent of the Landlord in the future, unless expressly so provided.
- Landlord can exhibit letting notices during last three months of term (k) During the three months immediately preceding the expiration of the term hereby created, the Landlord shall be a liberty to affix and maintain without interference upon any external part of the said Premises a notice stating that the said Premises are to be let and such other information in connection therewith as the Landlord shall reasonably require.
- Service of notice (l) Any notice required to be served hereunder shall, if to be served on the Tenant, be sufficiently served if addressed to the Tenant and sent by prepaid post to or delivered at the said Premises or the Tenant's last known place of business or residence in Hong Kong and if to be served on the Landlord, shall be sufficiently served if addressed to the Landlord and sent by prepaid post to or delivered to the Landlord's residence or registered office as shown in the Agreement.
- Stamp duty and costs (m) The stamp duty and other disbursements on this Agreement and its counterpart shall be borne by the Landlord and Tenant in equal shares.
- Definitions (n) Unless the context otherwise requires, words herein importing the masculine gender shall include the feminine and neuter and words herein in the singular shall include the plural and vice versa.
- No key money etc. (o) No key or construction money or other premium of a similar nature have been paid or agreed to be paid by the Tenant to the Landlord and no advance payment of rent has been paid to the Landlord except in pursuance of Clause 1 hereof.
- Landlord's right to name the Building (p) The Landlord reserves the right to name the said Building with any such names or styles as in its sole discretion may determine and at any time and from time to time to change, alter, substitute or abandon any such names provided that the Landlord shall give the Tenant and to the Postal and other relevant Government Authorities not less than three months' notice of its intention so to do.
- Lift and Air-conditioning plant (q) The Landlord shall not be liable to pay compensation to the Tenant in respect of any period during which due to circumstances beyond the control of the Landlord the proper operation of the lifts and air-conditioning plant shall be interrupted as a result of mechanical failure or need for repair or overhaul nor shall the Landlord be liable thereby to grant an abatement of rent in respect of such interruption.
- Full agreement (r) This Agreement sets out the full agreement reached between the parties and the Tenant hereby expressly declares that no other representations have been made or warranties given relating to the Landlord or the Tenant or the Building or the said Premises has been made given or implied the same is hereby waived.



- Additional terms (s) The additional terms (if any) as set out in the Part 8 of the First Schedule hereto shall also apply but in the event that any contradiction between such additional terms and the foregoing conditions, the provisions of such additional terms shall prevail.
- No warrant for user (t) It is hereby further agreed between the parties hereto that there is no warranty and/or representation on the part of the Landlord that the said Premises are suitable for the purposes stipulated in paragraph 2(s) hereinabove mentioned.
- No warrant for air-conditioning (u) The Landlord shall at its own cost be responsible for the repairing and maintenance of the air-conditioners by its nominated contractors but the Tenant shall not make any claims against the Landlord in case of any damages caused by malfunction and any leaking of water from the air-conditioners.
- Tenant's deposit 5. (a) The Tenant shall on the signing hereof deposit and maintain with the Landlord a deposit of the amount as set out in the Part 6 of the First Schedule hereto to secure the due observance and performance by the Tenant of the agreements, stipulations and conditions herein contained and on the Tenant's part to be observed and performed. The said deposit shall be retained by the Landlord throughout the said term free of any interest to the Tenant and in the event of any breach or non-observance or non-performance by the Tenant or any of the said agreements, stipulations or conditions aforesaid, the Landlord shall be entitled to terminate this Agreement and to forfeit the said deposit by way of liquidated damages. Notwithstanding the foregoing, the Landlord may in any such event at this option elect not to terminate this Agreement and forfeit the deposit but to deduct therefrom the amount of any monetary loss incurred by the Landlord in consequence of the breach, non-observance or non-performance by the Tenant in which event the Tenant shall as a condition precedent to the continuation of the Tenancy deposit with the Landlord the amount so deducted and if the Tenant shall fail so to do, the Landlord shall forthwith be entitled to re-enter on the said Premises and to determine this Agreement and forfeit the deposit as hereinbefore provided.
- Repayment of deposit (b) Subject as aforesaid, the said deposit shall be refunded to the Tenant by the Landlord without interest within thirty days after the expiration or sooner determination of this Agreement and the delivery of vacant possession to the Landlord within thirty days of the settlement of the last outstanding claim by the Landlord against the Tenant in respect of any unsettled reinstatement charge, any breach, non-observance or non-performance of any of the agreements, stipulations or conditions herein contained and on the part of the Tenant to be observed and performed, whichever is the later.
- (c) Unless the Landlord consents in writing, the deposit shall not be used to set off the rent and/or Management and Maintenance Charges and/or Air-Conditioning payable by the Tenant to the Landlord at any time during the Term of this Tenancy.
- Assignment of ownership (d) If the said Premises shall be assigned by the Landlord during the said term, the Landlord shall have the right but is not obliged to transfer the said deposit or any part thereof after deduction (if any) to the assignee by giving notice in writing to the Tenant notifying the Tenant of such transfer. Upon completion of such transfer and subject to (i) the Landlord having informed the Tenant in writing of any deduction which the Landlord has made from the said deposit and (ii) the assignee having given a written undertaking to the Tenant undertaking to hold the said deposit or such part hereof transferred to the assignee and to refund the same to the Tenant in accordance with the terms and conditions hereof, the Landlord shall notwithstanding anything contained herein to the contrary be released from any further liability and all obligations to return the said deposit or any part thereof to the Tenant. In addition and without prejudice to the generality of the foregoing, the Landlord may but is not obliged to request the Tenant and Tenant shall upon request by the Landlord at the Tenant's costs and expenses sign and execute such document as may be reasonably required by the Landlord to release the Landlord from all claims liabilities demands and proceedings in respect of the refund of the said deposit or any part thereof.
- Re-development (e) The Landlord shall enter into a contract for the sale of the said building or any part thereof or the said Premises or any part thereof or shall resolve to redevelop the said building or any part thereof whether wholly by demolition and rebuilding or otherwise or partially by renovation, refurbishment or otherwise which shall include or affect the said Premises or any part thereof (a copy of a Resolution of the Landlord's Board of Directors certified true and correct by the Landlord's Secretary) shall be conclusive evidence of the aforesaid contract or resolution, as the case may be and be binding on the Tenant, then in any of such events the Landlord shall be entitled to terminate this Agreement by giving six calendar months' notice in writing to the Tenant and immediately upon the expiration of such notice this Agreement shall cease and determine but without prejudice to the rights and remedies of either party against the other in respect of any antecedent claim or breach of any of the agreements stipulations terms and conditions herein set out. Save as hereinbefore expressly provided the Tenant shall have no claim against the Landlord or any other party(ies) for any loss, compensation, damages, costs or expenses arising out of or in connection with the aforesaid or the Landlord's exercising its rights under this clauses.
- (f) The Tenant shall reimburse or pay to the Landlord all expenses and charges (including legal costs on a solicitor and client basis) incurred by the Landlord in connection with the demand of payment of the arrears of the said rent, the maintenance and management fees, the rates, air-conditioning charges and all other outgoings payable by the Tenant hereunder and enforcement of any other provisions and terms herein in Court of otherwise.
- Claim for all expenses and legal charges in regard to any payment in arrears



Condition and state of the said Premises	(g)	The said Premises shall be handed over to the Tenant with the standard fitting-out supplied by the Landlord. No warranty whatsoever is given by the Landlord on the physical state and condition of the said Premises or any part thereof or the installation, additions, alterations, fittings and fixtures therein. The Tenant expressly acknowledges and confirms that he has inspected the said Premises and the installation, additions, alterations, fittings and fixtures therein prior to entering into this Agreement and had satisfied himself in all respects as to the area size suitability and condition in relation to the aforementioned or any other matter pertaining to the tenancy or relating to the installation, additions, alterations, fittings and fixtures in the said Premises. The Tenant shall take up the said Premises on an "as is" basis including all fixtures, fittings, additions, erections and alteration made or installed upon or in the said Premises prior to the commencement of the said term.
House Rules and Regulations	(j)	Such Rules and Regulations shall be in addition to and not in substitution of the terms and conditions in this Agreement. In the event of conflict between the terms and conditions set out in such Rules and Regulations and the terms and conditions of this Agreement, the Landlord or the Manager of the Building shall have the absolute discretion to elect as to which set of terms and conditions are applicable.
Takeover of Fixtures and Fittings	6.	The Tenant agrees to (if applicable) takeover the fixtures and fittings including the glass or wooden door(s) left by the previous tenant and shall at its own cost be solely responsible for their repairing and maintenance and to comply with the regulations and ordinance of the concerned government authority including replacement of the existing glass door to a wooden door. The Tenant shall be fully responsible for reinstating the said Premises to its original states and making good any damages to the satisfaction of the Landlord (if required by the Landlord) upon the expiration or sooner determination of this Tenancy Agreement.
Applicable Law	7.	This Agreement shall be construed and take effect in accordance with the Laws of The Hong Kong Special Administrative Region.
Marginal Notes	9.	The marginal notes are intended for guidance only and do not form part of this Agreement nor shall any of the provisions in this Agreement be construed or interpreted by reference thereto or in any way affected or limited thereby.

THE FIRST SCHEDULE ABOVE REFERRED TO

Part 1- The Landlord

LANDLORD : **THE CHUNG SHUN LAND INVESTMENT COMPANY LIMITED** whose registered office is situate at Unit 2203, 22nd Floor, 88 Hing Fat Street, Causeway Bay, Hong Kong acting by their agent **MUTUAL PROPERTY MANAGEMENT COMPANY LIMITED** whose registered office is situate at Unit 2103, 21st Floor, 88 Hing Fat Street, Causeway Bay, Hong Kong

Part 2 – The Tenant

TENANT : Artificial Life Asia Limited whose registered address is situate at 26th Floor, 88 Hing Fat Street, Causeway Bay, Hong Kong (Business Registration Certificate No. 31171834-000-07-09-9)

Part 3 – The said Premises

PREMISES : ALL THAT the of 27th FLOOR of No. 88 HING FAT STREET, HONG KONG ("the Building") erected on ALL THAT piece of parcel of ground registered in the Land Registry as THE REMAINING PORTION OF INLAND LOT NO.2234

Part 4 – The said Term

TERM : Two-Year Fixed Term commencing on 1st January 2010

Part 5 – The said Rent

RENT : HONG KONG DOLLARS ONLY (HK\$69,300.00) per month (exclusive of government rates, management fee, and air-conditioner fee) payable in advance on the 1st day of each successive calendar month.

MANAGEMENT FEE : HONG KONG DOLLARS ONLY (HK\$9,660.00) per month

AIR-CONDITIONING: CHARGES : HONG KONG DOLLARS ONLY (HK\$12,180.00) per month



Part 6 – The said Deposit

RENTAL DEPOSIT: HONG KONG DOLLARS TWO HUNDRED SEVENTY THREE THOUSAND AND FORTY TWO HUNDRED ONLY (HK\$273,420.00)

Part 7 – The said User

USER : For commercial use only

Part 8 – The Special Conditions

- 1 Subject to the provisions of Clause 2ss herein, the Tenant shall only trade his business at the said Premises in which he is sole proprietor or major partner and he shall notify the Landlord in writing the said business name within one month from the date hereof.
- 2 Should the tenant be found repeated breach of the material terms and conditions as stipulated in this tenancy agreement, the Landlord is entitled to terminate this agreement at any time without any compensation to the tenant during the tenancy
- 3 The said Premises is let on an “as is” condition together with the Landlord’s fixtures. No additional work shall be provided by the Landlord.
- 4 The Landlord shall have no objection to any lawful business purpose for which the said Premises shall be used by the Tenant but the Landlord does not warrant that the said Premises are fit for any particular purpose. The Tenant shall be responsible for obtaining all necessary permits or licences from the appropriate Government authorities for the user of the said Premises and shall at all times comply with all rules and regulations laid down by such authorities for giving such permits and the Tenant shall indemnify the Landlord from and against all proceedings action fines damages claims and demands whatsoever which may arise as a result of the non-compliance by the Tenant of such rules and regulations or any of them.
- 5 At the expiration or sooner determination of the tenancy at the Tenant’s own cost reinstate and restore the same to the plan and design as if such addition or alteration (or such of them as may be specified by the Landlord) has not been made and make good all damages thereto to the satisfaction of the Landlord.
- 6 In the event of the said Premises hereby resumed by the Government or if the said Premises shall be required by the Government for any other purpose whatsoever, then upon the issue of any notice of resumption by the Government or upon any notice being published in the Government Gazette that (1) the said Premises shall be resumed or (2) that the said Premises shall be so required by the Government, then this Agreement shall forthwith be terminated and the Tenant shall vacate the said Premises forthwith whereupon the deposit payable hereunto shall be returned to the Tenant but without compensation interest or costs and the Tenant shall not have any claim against the Landlord for such early determination of this Agreement BUT without prejudice to the right of action of the Landlord in respect of any breach of the Tenant's terms and conditions herein contained and on the Tenant's part to be observed and performed.
- 7 Should the said Premises be declared or condemned dangerous by the Building Authority or any other competent Government Authority during the continuance of the term hereby created, the Tenant shall forthwith vacate the said Premises and waive all his rights and privilege to any claim or demand for damages or compensation which may be afforded to the Tenant by any Ordinance in force and in particular the Demolished Building (Re-development of Sites) Ordinance Cap.337.
- 8 Tenant shall comply with the Fitting Out and House Rules of the Building.
- 9 So far as permitted by law, the Landlord and its servants, agents, visitors, invitees and/or licensees shall not in any circumstances be liable or responsible to the Tenant, its servants, agents, visitors, invitees and or licensees or any of them and/or any other person whomsoever for any loss, injury, damage, nuisance, annoyance and/or inconvenience which may be sustained by the Tenant, its servants, agents, visitors, invitees and licensees or any of them and/or any other person whomsoever (whether personally or to their respective properties) notwithstanding any provision to the contrary.
- 10 The Tenant acknowledge that Mutual Property Management Co. Ltd. (“Mutual”) is the Landlord’s agent in respect of this tenancy and the Tenant agrees and for the avoidance of doubt, hereby confirms that Mutual shall be entitled to the benefit of all provisions for the benefit of the Landlord and Mutual shall be entitled to enforce all provisions enforceable by the Landlord under this Tenancy Agreement.
- 11 For any decoration regarding the captioned premises, Tenant is required to submit the Application Form for decoration to the Building Manger for Landlord’s approval before any commencement of works, such approval not to be unreasonably withheld.
- 12 The Tenant shall be entitled to put up a signboard at its own cost bearing the name(s) “Artificial Life Asia Limited” which name(s) shall also be displayed at the directory board(s) on the main lobby and the 27th Floor of the Building. Provided that the Tenant shall procure the company namely “Artificial Life Asia Limited” to observe and comply with the terms of this Agreement. The Tenant shall indemnify the Landlord for any costs expenses or damages which maybe incurred or suffered by the Landlord in the event that the said company contravenes any provision of this Agreement.

AS WITNESS the hands of the parties hereto the day and year first above written.

SIGNED by /s/ Timothy Lam Jr.

for and on behalf of the Landload
Mutual Property Management Co., Ltd.

SIGNED by /s/ Eberhard Schoneburg

for and on behalf of the Tenant
Artificial Life Asia Ltd.

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Exhibit 21.1

List of Subsidiaries

Entity	Jurisdiction
Artificial Life Asia Ltd.	Hong Kong
Artificial Life Ventures, Inc.	Delaware
Artificial Life USA, Inc.	Delaware
Artificial Life Mobile Computing, Inc.	Delaware
Artificial Life Europe GmbH	Germany
Artificial Life Japan Ltd.	Japan
Artificial Life America, Inc.	California

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Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement on Form S-8 (File No. 333-140068) of Artificial Life, Inc. of our report dated March 15, 2010, on the consolidated financial statements as of December 31, 2009 and 2008, and for each of the years then ended, which appears on page F-1 of this annual report on Form 10-K for the year ended December 31, 2009.

/s/ GHP Horwath, P.C.
GHP Horwath, P.C.
Denver, Colorado
March 15, 2010

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Exhibit 31.1

CERTIFICATIONS

I, Eberhard Schoneburg, certify that:

1. I have reviewed this 10-K 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: March 15, 2010

/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 10-K 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: March 15, 2010

/s/ Eberhard Schoneburg
Eberhard Schoneburg
Chief Financial Officer

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Exhibit 32.1

**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 Annual Report of Artificial Life, Inc. (the "Company") on Form 10-K for the period ended December 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Eberhard Schoneburg, chief executive officer and chief 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.

Date: March 15, 2010

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