COMMERCETEL CORP
Form 10-Q
November 14, 2011

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the fiscal quarterly period ended September 30, 2011

Commission file number 000-53851

CommerceTel Corporation
(Exact Name of Registrant as Specified in Its Charter)

Nevada	26-3439095
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

8929 Aero Drive, Suite E
San Diego, CA 92123
(Address of Principal Executive Offices & Zip Code)

(866) 622-4261
(Telephone Number)

Dennis Becker
CommerceTel Corporation.
8929 Aero Drive, Suite E
San Diego, CA 92123

Telephone & Facsimile (866) 622-4261

(Name, Address and Telephone Number of Agent for Service)

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

Securities registered pursuant to section 12(g) of the Act:
Common Stock, $.001 par value

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	x

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

As of November 14, 2011, the registrant had 22,514,308 shares of common stock issued and outstanding.

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Part I Financial Information

Item 1. Financial Statements.

CommerceTel Corporation
Condensed Consolidated Balance Sheets

	September 30, 2011 (unaudited)	December 31, 2010 (audited)
Current assets		
Cash	$1,152	$373,439
Accounts receivable	318,919	49,215
Other current assets	52,689	68,030
Total current assets	372,760	490,684
Equipment, net	31,714	1,609
Goodwill	5,120,712	-
Intangible assets, net	2,835,611	-
Other assets	49,650	46,317
TOTAL ASSETS	$8,410,447	$538,610
Current liabilities		
Accounts payable	$581,392	$151,943
Accrued interest	120,923	37,901
Accrued and deferred personnel compensation	160,763	119,641
Deferred revenue and customer deposits	366,277	233,318
Notes payable, net of discount	1,817,275	803,156
Cash payment obligation, net of discount	147,414	-
Derivative liabilities	266,901	334,478
Other current liabilities	143,722	69,142
Total current liabilities	3,604,667	1,749,579
Non-current liabilities		
Earn-out payable	2,664,466	-
Derivative liabilities	315,542	-
Total non-current liabilities	2,980,008	-
Total liabilities	6,584,675	1,749,579
Stockholders' equity (deficit)		
Common stock, $0.001 par value; 150,000,000 shares authorized; 22,360,793 and 17,700,000 shares issued and outstanding as of September 30, 2011 and December 31, 2010, respectively	22,361	17,700
Additional paid-in capital	11,947,645	6,945,584
Accumulated deficit	(10,144,234)	(8,174,253)
Total stockholders' equity (deficit)	1,825,772	(1,210,969)
TOTAL LIABILITIES & STOCKHOLDERS' EQUITY (DEFICIT)	$8,410,447	$538,610

See accompanying notes to condensed consolidated financial statements.

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CommerceTel Corporation
Condensed Consolidated Statements of Operations
(Unaudited)

	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Revenues				
Revenues	$ 842,885	$ 254,274	$ 1,536,630	$ 683,096
Cost of revenues	311,717	109,865	570,605	337,357
Gross margin	531,168	144,409	966,025	345,739
Operating expenses				
General & administrative	523,513	250,528	1,448,955	640,038
Sales & marketing	245,810	79,566	497,936	238,527
Engineering, research, & development	156,851	108,473	445,267	297,505
Depreciation & amortization	191,783	1,569	318,560	4,907
Total operating expenses	1,117,957	440,136	2,710,718	1,180,977
Loss from operations	(586,789)	(295,727)	(1,744,693)	(835,238)
Other income/(expense)				
Interest income	-	-	-	-
Interest expense	(133,055)	(18,396)	(376,548)	(51,901)
Change in fair market value of derivative liabilities	(54,134)	-	152,822	-
Gain on debt extinguishment	-	775	-	115,326
Total other income/(expense)	(187,189)	(17,621)	(223,726)	63,425
Loss before income taxes	(773,978)	(313,348)	(1,968,419)	(771,813)
Income tax expense	(1,600)	-	(1,562)	-
Net loss	$ (775,578)	$ (313,348)	$ (1,969,981)	$ (771,813)
Net loss per share - basic and diluted	$ (0.04)	$ (0.04)	$ (0.10)	$ (0.11)
Weighted average number of shares during the period - basic and diluted	22,048,802	7,110,567	20,381,533	7,214,928

See accompanying notes to condensed consolidated financial statements.

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CommerceTel Corporation
Condensed Consolidated Statements of Stockholders' Equity (Deficit)
(Unaudited)

	Common Stock		Additional Paid-In	Accumulated	Total Stockholders' Equity
	Shares	Amount	Capital	Deficit	(Deficit)
Balance, December 31, 2010	17,700,000	$17,700	$6,945,584	$(8,174,253)	$(1,210,969)
Issuance of common stock and warrants for cash	688,669	689	632,882	-	633,571
Issuance of common stock for acquisitions	3,944,540	3,945	3,992,549	-	3,996,494
Issuance of common stock for patent rights	14,286	14	17,843	-	17,857
Stock-based compensation	13,298	13	380,587	-	380,600
Equity offering costs	-	-	(21,800)	-	(21,000)
Net loss	-	-	-	(1,969,981)	(1,969,981)
Balance, September 30, 2011	22,360,793	$22,361	$11,947,645	$(10,144,234)	$1,825,772

See accompanying notes to condensed consolidated financial statements.

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CommerceTel Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine months ended September 30, 2011	2010
OPERATING ACTIVITIES		
Net loss	$ (1,969,981)	$ (771,813)
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain on debt extinguishment	-	(115,326)
Bad debt expense	-	3,246
Stock-based compensation	380,600	106,788
Depreciation and amortization expense	318,560	4,907
Change in fair market value of derivative liabilities	(152,822)	-
Amortization of deferred financing costs	30,000	-
Amortization of note discounts	248,412	-
Increase (decrease) in cash resulting from changes in:		
Accounts receivable	(269,704)	(9,032)
Other current assets	28,525	1,851
Other assets	(33,333)	(10,000)
Accounts payable	314,920	374,633
Accrued interest	83,022	50,901
Accrued and deferred personnel compensation	41,122	156,106
Deferred revenue and customer deposits	112,639	(79,177)
Other liabilities	74,580	585
Net cash used in operating activities	(793,460)	(286,331)
INVESTING ACTIVITIES		
Purchases of equipment	(12,189)	-
Acquisition of intangible assets	(77,000)	-
Cash paid for acquisitions	(209,833)	-
Acquisition of other assets	-	(1,605)
Net cash used in investing activities	(299,022)	(1,605)
FINANCING ACTIVITIES		
Proceeds from capital contributions by former parent	-	249,897
Proceeds from issuance of notes payable	10,000	53,614
Payments on notes payable	(201,008)	-
Payments on cash payment obligation	(100,000)	-
Proceeds from issuance of common stock and warrants	1,033,003	-
Equity offering costs	(21,800)	-
Net cash provided by financing activities	720,195	303,511
Net change in cash	(372,287)	15,575

Cash at beginning of period		373,439		11,003
Cash at end of period	$	1,152	$	26,578
Supplemental disclosures:				
Cash paid during period for :				
Interest	$	15,289	$	-
Income Taxes	$	-	$	-
Non cash investing and financing activities:				
Common stock issued for patents and trademarks	$	17,857	$	-
Fair value of assets acquired in acquisitions	$	44,414	$	-
Customer contracts		1,026,000		-
Customer relationships		1,406,000		-
Trade name		140,000		-
Technology / IP		458,000		-
Non-compete		16,000		-
Goodwill		5,120,712		-
Assumed liabilities - deferred revenue		(134,849)		-
Subordinated secured note payable		(781,064)		-
Subordinated note payable		(182,460)	-	
Cash payment obligation		(241,960)		-
Earn-out payable		(2,664,466)	-	
Common stock issued for acquisitions		(3,996,494)		-
Cash paid for acquisitions	$	209,833	$	-

See accompanying notes to condensed consolidated financial statements

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CommerceTel Corporation
Notes to Condensed Consolidated Financial Statements

1. Reverse Merger Transaction and Accounting

Reverse Merger Transaction

On November 2, 2010, CommerceTel Corporation (the "Company") acquired CommerceTel, Inc., which was wholly-owned by CommerceTel Canada Corporation ("CTel Canada" or "our former parent"), in a reverse merger, or the "Merger". Pursuant to the Merger, all of the issued and outstanding shares of CommerceTel, Inc. common stock were converted, at an exchange ratio of 0.7268-for-1, into an aggregate of 10,000,000 shares of the Company's common stock, and CommerceTel, Inc. became a wholly owned subsidiary of the Company. The holders of the Company's common stock as of immediately prior to the Merger held an aggregate of 10,000,000 shares of the Company's common stock. The accompanying condensed consolidated financial statements, common share and weighted average common share basic and diluted information has been retroactively adjusted to reflect the exchange ratio in the Merger.

CommerceTel, Inc. was originally incorporated in Nevada in 2005. The Company was originally incorporated as Ares Ventures Corporation in Nevada in 2008, and was renamed CommerceTel Corporation in 2010.

Reverse Merger Accounting

Immediately following the consummation of the Merger, the: (i) former security holders of CommerceTel, Inc. common stock had an approximate 56% voting interest in the Company and the Company stockholders retained an approximate 44% voting interest, (ii) former executive management team of CommerceTel, Inc. remained as the only continuing executive management team for the Company, and (iii) Company's ongoing operations consist solely of the ongoing operations of CommerceTel, Inc. Based primarily on these factors, the Merger was accounted for as a reverse merger and a recapitalization in accordance with generally accepted accounting principles in the United States of America, or "GAAP". As a result, these condensed financial statements reflect the: (i) historical results of CommerceTel, Inc. prior to the Merger, (ii) combined results of the Company following the Merger, and (iii) acquired assets and liabilities at their historical cost. In connection with the Merger, the Company received net assets of $16,496.

On December 7, 2010, the Board of Directors of the Company resolved to change the Company's fiscal year end from September 30 to December 31, effective immediately, to coincide with the fiscal year end of its wholly owned subsidiary CommerceTel, Inc.

2. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Basis of Presentation

The Company is a provider of mobile marketing technology that enables major brands and enterprises to engage consumers via their mobile phones and other smart devices. Interactive electronic communications with consumers is a complex process involving communication networks and software. The Company removes this complexity through its suite of services and technologies thereby enabling brands, marketers, and content owners to communicate with their customers and consumers in general.

Principles of Accounting and Consolidation

The accompanying unaudited interim condensed financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial statements and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying condensed consolidated financial statements include all adjustments that are necessary, which are of a normal and recurring nature, for a fair presentation for the periods presented of the financial position, results of operations and cash flows of the Company and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

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These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2010. The accompanying condensed balance sheet as of December 31, 2010 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results to be anticipated for the entire year ending December 31, 2011, or any other period.

Going Concern

The Company's financial statements have been prepared assuming that it will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business. However, we have incurred continued losses, have a net working capital deficiency, and have an accumulated deficit of approximately $10.1 million as of September 30, 2011. These factors among others create a substantial doubt about our ability to continue as a going concern. The Company is dependent upon sufficient future revenues, additional sales of our securities or obtaining debt financing in order to meet its operating cash requirements. Barring the Company's generation of revenues in excess of its costs and expenses or its obtaining additional funds from equity or debt financing, or receipt of significant licensing prepayments, the Company will not have sufficient cash to continue to fund the operations of the Company through December 31, 2011. These condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In response to our Company's cash needs, we raised additional equity investments pursuant to a private placement totaling $1,033,003 from March 25, 2011, through September 30, 2011. Longer term, we anticipate that we will continue to raise additional equity financing through the sale of shares of the Company's common stock in order to finance our future investing and operating cash flow needs. However, there can be no assurance that such financings will be available on acceptable terms, or at all.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Significant estimates used are those related to stock-based compensation, the valuation of the derivative liabilities, asset impairments, the valuation and useful lives of depreciable tangible and certain intangible assets, the fair value of common stock used in acquisitions of businesses, the fair value of assets and liabilities acquired in acquisitions of businesses, and the valuation allowance of deferred tax assets. Management believes that these estimates are reasonable; however, actual results may differ from these estimates.

Purchase Accounting

The Company accounts for acquisitions pursuant to Accounting Standards Codification ("ASC") No. 805, Business Combinations. The Company records all acquired tangible and intangible assets and all assumed liabilities based upon their estimated fair values.

Cash

The Company minimizes its credit risk associated with cash by periodically evaluating the credit quality of its primary financial institution. The balance at times may exceed federally insured limits. The Company has not experienced any losses on such accounts.

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Fair Value of Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, other assets, accounts payable, accrued expenses, notes payable, cash payment obligation, earn-out payable, derivative liabilities, and other current liabilities. Fair value estimates of these instruments are made at a specific point in time, based on relevant market information. These estimates may be subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. As of September 30, 2011 and December 31, 2010, the carrying amounts of the Company's financial instruments are generally considered to be representative of their respective fair values because of the short-term nature of those instruments or because they have been adjusted to fair value on the reporting date.

Accounts Receivable

Accounts receivable are carried at their estimated collectible amounts. The Company grants unsecured credit to substantially all of its customers. Ongoing credit evaluations are performed and potential credit losses are charged to operations at the time the account receivable is estimated to be uncollectible. Since the Company cannot necessarily predict future changes in the financial stability of its customers, the Company cannot guarantee that its reserves will continue to be adequate.

From time to time, the Company may have a limited number of customers with individually large amounts due. Any unanticipated change in one of the customer's credit worthiness could have a material effect on the results of operations in the period in which such changes or events occurred.

Equipment

Equipment is recorded at cost, consists primarily of computer equipment and is depreciated using the straight-line method over the estimated useful lives of the related assets (generally five years or less). Costs incurred for maintenance and repairs are expensed as incurred and expenditures for major replacements and improvements are capitalized and depreciated over their estimated remaining useful lives. Depreciation expense for the three months ended September 30, 2011 and 2010 was $6,154 and $1,569, respectively. Depreciation expense for the nine months ended September 30, 2011 and 2010 was $13,314 and $4,907, respectively.

Intangible Assets

During the nine months ended September 30, 2011, the Company acquired U.S. Patent Number 6,788,769 from eMediacy, Inc. for cash and 14,286 shares of common stock, and incurred costs to prosecute other patent applications. The Company capitalized $94,858 during this period, and is amortizing the costs on a straight-line basis over an estimated useful life of ten years. Also see Notes 3 and Note 9.

Impairment of Long-Lived Assets

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from five to ten years. The Company evaluates long-lived assets, including intangible assets with finite lives, for impairment whenever events or changes in circumstances indicate their net book value may not be recoverable. When such factors and circumstances exist, the Company compares the projected undiscounted future cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amount. Impairment, if any, is based on the excess of the carrying amount over the fair value, based on market value when available, or discounted expected cash flows, of those assets and is recorded in the period in which the determination is made. The Company's management currently believes there is no impairment of its long-lived assets. There can be no assurance, however, that market conditions will not change or demand for the Company's products under development will continue. Either of these could result in future impairment of long-lived assets.

Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks.

The Company reviews the terms of the common stock, warrants and convertible debt it issues to determine whether there are embedded derivative instruments, including embedded conversion options, which are required to be bifurcated and accounted for separately as derivative financial instruments. In circumstances where the host instrument contains more than one embedded derivative instrument, including the conversion option, that is required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument.

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Bifurcated embedded derivatives are initially recorded at fair value and are then revalued at each reporting date with changes in the fair value reported as non-operating income or expense. When the equity or convertible debt instruments contain embedded derivative instruments that are to be bifurcated and accounted for as liabilities, the total proceeds received are first allocated to the fair value of all the bifurcated derivative instruments. The remaining proceeds, if any, are then allocated to the host instruments themselves, usually resulting in those instruments being recorded at a discount from their face value.

The discount from the face value of the convertible debt, together with the stated interest on the instrument, is amortized over the life of the instrument through periodic charges to interest expense, using the effective interest method.

Revenue Recognition

The Company's "C4" Mobile Marketing and Customer Relationship Management (CRM) platform is a hosted solution, as is the newly acquired Txtstation Control Center platform. The Company generates revenue from licensing its software to clients in its software as a service (Saas) model, per-message and per-minute transactional fees, and customized professional services. The Company recognizes license fees over the period of the contract, service fees as the services are performed, and per-message or per-minute transaction revenue when the transaction takes place. The Company recognizes revenue at the time that the services are rendered, the selling price is fixed, and collection is reasonably assured, provided no significant obligations remain. The Company considers authoritative guidance on multiple deliverables in determining whether each deliverable represents a separate unit of accounting. As for the newly acquired Mobivity and Boomtext platforms, which are both hosted solutions, revenue is principally derived from subscription fees from customers. The subscription fee is billed on a month to month basis with no contractual term and is collected by credit card for Mobivity and collected by cash and credit card for Boomtext. Revenue is recognized at the time that the services are rendered and the selling price is fixed with a set range of plans. Cash received in advance of the performance of services is recorded as deferred revenue.

Stock-based Compensation

The Company accounts for stock-based compensation in accordance with Financial Accounting Standards Board ("FASB") ASC Topic 718 Stock Compensation, which establishes accounting for equity instruments exchanged for employee services. Under such provisions, stock-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense, under the straight-line method, over the employee's requisite service period (generally the vesting period of the equity grant). In accordance with ASC 718, the Company estimates forfeitures at the time of grant and revises the estimates if necessary, if actual forfeiture rates differ from those estimates. Stock options issued to employees are accounted for at their estimated fair value determined using the Black-Scholes option-pricing model.

The Company accounts for equity instruments, including restricted stock or stock options, issued to non-employees in accordance with authoritative guidance for equity based payments to non-employees. Stock options issued to non-employees are accounted for at their estimated fair value determined using the Black-Scholes option-pricing model. The fair value of options granted to non-employees is re-measured as they vest, and the resulting increase in value, if any, is recognized as expense during the period the related services are rendered. Restricted stock issued to non-employees is accounted for at its estimated fair value as it vests.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. The Company is required to record all components of comprehensive income (loss) in the condensed consolidated financial statements in the period in which they are recognized. Net income (loss) and other comprehensive income (loss), including foreign currency translation adjustments and unrealized gains and losses on investments, are reported, net of their related tax effect, to arrive at comprehensive income (loss). For the three and nine months ended September 30, 2011 and 2010, the comprehensive loss was equal to the net loss.

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Net Loss Per Common Share

Net loss per share is presented as both basic and diluted net loss per share. Basic net loss per share excludes any dilutive effects of options, shares subject to repurchase and warrants. Diluted net loss per share includes the impact of potentially dilutive securities. During 2011 and 2010, the Company had securities outstanding which could potentially dilute basic earnings per share in the future, but were excluded from the computation of diluted net loss per share, as their effect would have been anti-dilutive. These outstanding securities consist of 2,415,000 outstanding options and 688,669 outstanding warrants. In addition, see potential issuances associated with warrants and convertible debt in Notes 4 and 5.

Reclassifications

Certain amounts from prior periods have been reclassified to conform to the current period presentation.

Recent Accounting Pronouncements

In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This update clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This update is effective on a prospective basis for annual and interim reporting periods beginning on or after December 15, 2011, which for the Company is January 1, 2012. The Company does not expect that adopting this update will have a material impact on its condensed consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, “Intangibles — Goodwill and Other” (ASU 2011-08). ASU 2011-08 allows a qualitative assessment of whether it is more likely than not that a reporting unit’s fair value is less than its carrying amount before applying the two-step goodwill impairment test. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the two-step impairment test would be performed. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption is permitted. This update is expected to change the process the Company uses to test goodwill for impairment, but is not expected to have a material impact on its consolidated financial statements.

3. Acquisitions

Txtstation Acquisition

On April 1, 2011, the Company acquired substantially all of the assets of the Txtstation interactive mobile marketing platform and services business from Adsparq Limited (“Adsparq”). The purchase price for the acquisition was 2,125,000 shares of the Company’s common stock, $26,184 in cash at closing and $250,000 of scheduled cash payments. The $250,000 of scheduled cash payments are due as follows: $25,000 payable on the 60th day following closing and the balance is payable in $25,000 installments at the end of each of the next nine 30-day periods thereafter. The Company assumed none of Adsparq’s liabilities in the transaction, except for the performance obligation of unearned revenue. For a period of one year following the closing of the transaction, half of the shares of common stock issued to Adsparq will be held in escrow as security for Adsparq’s obligations under the agreement.

In connection with the transaction, the Company also issued 300,000 shares of its common stock to the controlling stockholder of Adsparq in consideration of certain indemnification obligations and other agreements. For one year following the closing of the transaction, the shareholder has agreed not to, directly or indirectly, transfer, donate, sell, assign, pledge, hypothecate, grant a security interest in or otherwise dispose or attempt to dispose of all or any portion of shares issued to it (or any interest therein).

The Company completed the acquisition in furtherance of its strategy to acquire small, privately owned enterprises in the mobile marketing sector through an asset purchase structure. This acquisition was consistent with the Company's purchase price model in which equity will represent most of the purchase price plus a small cash component and, in some cases, the assumption of specific liabilities.

The acquisition has been accounted for as a business combination and the Company valued all assets and liabilities acquired at their fair values on the date of acquisition. An independent valuation expert (Vantage Point Advisors) was hired to assist the Company in determining these fair values. Accordingly, the assets and liabilities of the acquired entity were recorded at their estimated fair values at the date of the acquisition.

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Actual results of operations of Txtstation are included in the Company’s condensed consolidated financial statements from the date of acquisition. The allocation of the purchase price to assets and liabilities based upon fair value determinations was as follows:

Current assets	$10,184
Equipment	31,230
Customer contracts	1,026,000
Trade name	36,000
Technology / IP	182,000
Non-compete	1,000
Goodwill	1,426,730
Assumed liabilities - deferred revenue	(20,000)
Total purchase price	$2,693,144

The purchase price consists of the following:

Cash	$26,184
Present value of scheduled cash payments	241,960
Common stock	2,425,000
Total purchase price	$2,693,144

The $241,960 obligation recorded at closing, represented the present value of the $250,000 payments over the subsequent periods. The Company used a discount rate of 6.25% in calculating the net present value of the scheduled cash payments. The discount rate was based on the Company’s estimated cost of capital. Under the effective interest method, the Company accretes the scheduled cash payment liability to the stated amount payable ($250,000). Accretion of the scheduled cash payment obligation totaled $2,990 and $5,454 for the three and nine months ended September 30, 2011. Accretion of the cash payment obligation was charged to interest expense in accordance with FASB ASC 480.

Mobivity Acquisition

On April 8, 2011, the Company entered into an acquisition agreement with Mobivity, LLC and Mobile Visions, Inc. to acquire the assets of their Mobivity interactive mobile marketing platform and services business. The Company concurrently completed the acquisition effective as of April 1, 2011.

The purchase price for the acquisition was 1,000,000 shares of the Company’s common stock, $64,969 in cash paid at closing and a secured subordinated promissory note of CommerceTel, Inc. in the principal amount of $606,064. The promissory note earns interest at 6.25% per annum; is payable in six quarterly installments of $105,526 (inclusive of interest) starting May 1, 2011; matures on August 1, 2012; is secured by the acquired assets of the Mobivity business; and is subordinated to the Company’s obligations under its outstanding 10% Senior Secured Convertible Bridge Notes due November 3, 2011 (see Note 5). Mobivity, LLC was granted a security interest in the acquired assets, subordinated only to the Company's senior debt (Bridge Loan), and a majority of the Bridge Lenders consented to the junior security interest. There were no liabilities assumed in the acquisition.

The Company completed the acquisition in furtherance of its strategy to acquire small, privately owned enterprises in the mobile marketing sector through an asset purchase structure. This acquisition was consistent with the Company's purchase price model in which equity will represent most of the purchase price plus a small cash component and, in some cases, the assumption of specific liabilities.

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The acquisition has been accounted for as a business combination and the Company valued all assets and liabilities acquired at their fair values on the date of acquisition. An independent valuation expert (Vantage Point Advisors) was hired to assist the Company in determining these fair values. Accordingly, the assets and liabilities of the acquired entity were recorded at their estimated fair values at the date of the acquisition.

Actual results of operations of Mobivity are included in the Company's condensed consolidated financial statements from the date of acquisition. The allocation of the purchase price to assets and liabilities based upon fair value determinations was as follows:

Customer relationships	$814,000
Trade name	65,000
Technology / IP	217,000
Non-compete	5,000
Goodwill	570,033
Total purchase price	$1,671,033

The purchase price consists of the following:

Cash	$64,969
Subordinated secured note payable	606,064
Common stock	1,000,000
Total purchase price	$1,671,033

In determining the value of common stock issued as consideration in the acquisitions of Txtstation and Mobivity, the Company engaged a third party valuation expert (Vantage Point Advisors). The Company determined that the trading price of the Company's common stock was not an accurate indicator of fair value. The Company determined that the fair market value of the Company's common stock was $1.00 per share as of March 31, 2011. This valuation was based on the private placement transaction that occurred in late March 2011 where 140,000 units were sold. The price of the unit sold in the private placement was $1.50. The unit price of $1.50 was bifurcated for the value of common stock, the warrant, an embedded derivative related to down round protection on common stock, and an embedded derivative related to down round protection on the warrant. The Company used a Monte-Carlo simulation to calculate the prices of the common stock and warrants with and without down round protection. The difference of with and without yields the value of each embedded option. Key assumptions used in the valuation model included a volatility factor of 65%, risk-free interest rate of 0.17%, and probability of future private placement financings of 80%. The valuation analysis resulted in an estimated fair market value of $1.00 per share.

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BoomText Acquisition

On August 9, 2011, the Company completed the transactions contemplated under an asset purchase agreement dated June 9, 2011 (the "Agreement") with Digimark, LLC ("Digimark") to acquire substantially all of the assets of its BoomText interactive mobile marketing services business. The effective date of the transaction was August 1, 2011. In accordance with the terms of the Agreement, as amended, the purchase price for the acquisition consisted of the following components: (i) 519,540 shares of the Company's common stock issued at closing; (ii) $120,514 in cash paid at closing; (iii) a secured subordinated promissory note of CommerceTel, Inc. in the principal amount of $175,000. This note earns interest at 6.25% per annum; is payable in full on March 31, 2012; is secured by all of the assets of CommerceTel, Inc. and is subordinated to the Company's obligations under its outstanding 10% Senior Secured Convertible Bridge Notes due November 3, 2011; (iv) an unsecured subordinated promissory note in the principal amount of $194,658 issued by CommerceTel, Inc. This note does not bear interest; is payable in installments (varying in amount) from August 2011 through October 2012; and is subordinated to the Company's obligations under its outstanding 10% Senior Secured Convertible Bridge Notes due November 3, 2011; (v) an earn-out payment (payable 20 months after closing of the transaction) of a number of shares of common stock of the Company equal to (a) 1.5, multiplied by the Company's net revenue from acquired customers and customer prospects for the twelve-month period beginning six months after the closing date, divided by (b) the average of the volume-weighted average trading prices of the Company's common stock for the 25 trading days immediately preceding the earn-out payment (subject to a collar of $1.49 and $2.01 per share). As of September 30, 2011 the dollar value of the earn-out payable is $2,664,466, which is recorded as a non-current liability on the accompanying condensed consolidated balance sheet. The estimated number of common shares to be issued to settle the earn-out payable is 2,422,242. The purchase price also included the assumption of an office lease obligation and certain of Digimark's accounts payable.

For one year following the closing of the transaction, 50% of the shares of common stock issued to Digimark at closing will be held in escrow as security for its indemnification obligations in the transaction.

The Company completed the acquisition in furtherance of its strategy to acquire small, privately owned enterprises in the mobile marketing sector through an asset purchase structure. This acquisition was consistent with the Company's purchase price model in which equity will represent most of the purchase price plus a small cash component and, in some cases, the assumption of specific liabilities.

The acquisition has been accounted for as a business combination and the Company valued all assets and liabilities acquired at their fair values on the date of acquisition. An independent valuation expert (Vantage Point Advisors) was hired to assist the Company in determining these fair values. Accordingly, the assets and liabilities of the acquired entity were recorded at their estimated fair values at the date of the acquisition.

Actual results of operations of Boomtext are included in the Company's condensed consolidated financial statements from the date of acquisition. The allocation of the purchase price to assets and liabilities based upon fair value determinations was as follows:

Prepaid Assets	$3,000
Customer relationships	592,000
Trade name	39,000
Technology/IP	59,000
Non-compete	10,000
Goodwill	3,125,783
Total purchase price	$3,828,783

The purchase price consists of the following:

Cash	$120,514
Subordinated secured promissory note	175,000
Unsecured subordinated promissory note	182,460
Common stock	571,494
Earn-out payable	2,664,466
Liabilities assumed	114,849
Total purchase price	$3,828,783

The $194,658 unsecured subordinated promissory note does not bear interest, accordingly, the Company recorded the promissory note at the present value of the $194,658 payments over the subsequent periods. The Company used a discount rate of 6.25% in calculating the net present value of the unsecured promissory note. The discount rate was based on the Company's estimated cost of capital. Under the effective interest method, the Company accretes the debt discount to the face amount of the promissory note. Accretion of the debt discount totaled $2,745 for the three and nine months ended September 30, 2011. Accretion of the debt discount was charged to interest expense in accordance with FASB ASC 480.

In determining the value of common stock issued as consideration in the acquisition of Boomtext, the Company engaged a third party valuation expert (Vantage Point Advisors). The Company determined that the trading price of the Company's common stock was not an accurate indicator of fair value. The Company determined that the fair market value of the Company's common stock was $1.10 per share as of September 30, 2011. This valuation was based on the private placement transactions that occurred for the three month period ending September 30, 2011, where 318,355 units were sold. The price of the unit sold in the private placement was $1.50. The unit price of $1.50 was bifurcated for the value of common stock, the warrant, an embedded derivative related to down round protection on common stock, and an embedded derivative related to down round protection on the warrant. The Company used a Monte-Carlo simulation to calculate the prices of the common stock and warrants with and without down round protection. The difference of with and without yields the value of each embedded option. Key assumptions used in the valuation model included a volatility factor of 65%, risk-free interest rate of 0.06%, and probability of future private placement financings of 90%. The valuation analysis resulted in an estimated fair market value of $1.10 per share.

The useful lives of the acquired intangibles are as follows:

	Useful Lives (Years)		
	Txtstation	Mobivity	Boomtext
Customer contracts	5	n/a	n/a
Customer relationships	n/a	5	2
Trade name	5	5	1
Technology / IP	5	5	2
Non-compete	2	2.5	2
Goodwill	n/a	n/a	n/a

The Company recorded $24,000 and $87,910 in acquisition-related costs for accounting, legal and other costs in connection with the three acquisitions within the general and administrative expenses in its condensed consolidated statement of operations for the three and nine months ended September 30, 2011.

The following summary presents unaudited pro forma consolidated results of operations for the three and nine months ended September 30, 2011, as if the Txtstation, Mobivity, and Boomtext acquisitions described above had occurred on January 1, 2011 and the results of operations for the three and nine months ended September 30, 2010, as if the Txtstation, Mobivity, and Boomtext acquisitions described above had occurred on January 1, 2010. The following unaudited pro forma financial information gives effect to certain adjustments, including the reduction in compensation expense related to non-recurring executive salary expense and non-recurring acquisition related costs incurred by the Company, the amortization of acquired intangible assets and interest expense on acquisition related debt. The pro forma financial information is not necessarily indicative of the operating results that would have occurred had the acquisition been consummated as of the date indicated, nor are they necessarily indicative of future operating results.

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	Three months ended September 30, 2011	2010	Nine months ended September 30, 2011	2010
Proforma revenue	$948,543	$867,480	$2,691,328	$2,425,519
Proforma net loss	$(792,807)	$(449,014)	$(2,203,092)	$(1,245,890)

4. Derivative Liabilities

As discussed in Note 5, the Company issued convertible notes payable that provide for the issuance of warrants to purchase its common stock at a future date. The conversion term for the convertible notes is variable based on certain factors. The number of warrants to be issued is based on the future price of the Company's common stock. As of September 30, 2011, the number of warrants to be issued remains indeterminate. Pursuant to ASC 815-15 Embedded Derivatives, the fair values of the variable conversion option and warrants / shares to be issued were recorded as derivative liabilities on the issuance date. On November 10, 2011, $210,000 of principal convertible notes was converted for common stock and warrants, the note holders who converted into the unit offering did so in lieu of payback of principal and interest and warrant rights. Convertible note holders representing $800,000 in principal amount agreed to extend the maturity due date of the convertible notes to February, 2012 (see Note 13 Subsequent Events regarding bridge notes extended and converted for further details). Therefore as of November 14, 2011, the number of warrants issuable, for the remaining outstanding principal amount of $800,000 still remains indeterminate.

As discussed in Note 6, the Company commenced a private placement in late March 2011. The private placement structure consists of a series of identical subscription agreements for the sale of units comprised of shares of the Company's common stock at a price of $1.50 per share and an equivalent number of warrants at an exercise price of $2.00. Both the common shares and the warrants contain anti-dilutive, or down round, price protection. The down round protection for the common shares terminates on the earlier of the date on which an effective registration statement is filed with the SEC covering the shares, or the shares become freely tradable pursuant to Rule 144 promulgated under the Securities Act of 1933. The down round protection for the warrant terminates when the warrant expires or is exercised. Pursuant to ASC 815-15 Embedded Derivatives and ASC 815-40 Contracts in Entity's Own Equity, the Company determined that the down round price protection on the common stock represents a derivative liability. Additionally, the Company recorded a derivative liability for the warrant.

The fair values of the Company's derivative liabilities were estimated at the issuance date and are revalued at each subsequent reporting date, using a Monte Carlo simulation. At September 30, 2011, the Company recorded derivative liabilities of $582,443. The change in fair value of the derivative liabilities for the three and nine months ended September 30, 2011 was a loss of $54,134 and a gain of $152,822, respectively, and was reported as other income/expense in the condensed consolidated statements of operations.

5. Bridge Financing, Notes Payable and Accrued Interest

Bridge Financing

From November 2, 2010 through March 31, 2011, the Company issued to a number of accredited investors a series of its 10% Senior Secured Convertible Bridge Note (the "Notes") in the aggregate principal amount of $1,010,000 (the "Financing"). The Notes accrue interest at the rate of 10% per annum. The entire principal amount evidenced by the Notes (the "Principal Amount") plus all accrued and unpaid interest is due on the earlier of (i) the date the Company completes a financing transaction for the offer and sale of shares of common stock (including securities convertible into or exercisable for its common stock), in an aggregate amount of no less than 125% of the principal amounts evidenced by the Notes (a "Qualifying Financing"), and (ii) November 3, 2011. If the Notes are held to maturity, the

Company pays, at the option of the holder: i) cash or ii) in securities to be issued by the Company in the Qualifying Financing at the same price paid by other investors. See Note 13 Subsequent Events regarding bridge notes extended and converted.

On the maturity date of the Notes, in addition to the repayment of the Principal Amount and all accrued and unpaid interest, the Company will issue to each holder of the Notes, at each such holder's option, (i) three year warrants to purchase that number of shares of its common stock equal to the Principal Amount plus all accrued and unpaid interest divided by the per share purchase price of the common stock offered and sold in the Qualifying Financing (the "Offering Price") which warrants shall be exercisable at the Offering Price, or (ii) that number of shares of common stock equal to the product arrived at by multiplying (x) the Principal Amount plus all accrued and unpaid interest divided by the Offering Price and (y) 0.33.

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The Company's obligations under the Notes are secured by all of the assets of the Company, including all shares of CommerceTel, Inc., its wholly owned subsidiary.

WFG Investments, Inc., a registered broker dealer, was paid a placement agent fee in the amount of $40,000 which was capitalized as deferred financing costs, and is being amortized over the term of the Notes using the effective interest method. The Company recorded $10,000 and $30,000 of expense for the amortization of the deferred financing costs during the three and nine months ended September 30, 2011, respectively.

The following table summarizes information relative to all of the outstanding Notes at September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Bridge notes payable	$ 1,010,000	$ 1,000,000
Less unamortized discounts:		
Variable maturity discount	(176)	(1,569)
Warrant discount	(29,794)	(267,259)
Bridge notes payable, net of discounts	$ 980,030	$ 731,172

In accordance with ASC 470-20 Debt with Conversion and Other Options, the Company recorded a discount of $1,876 for the variable conversion feature and a discount of $320,424 for the warrants / shares to be issued. The discounts will be amortized to interest expense over the term of the Notes using the effective interest method. The Company recorded $81,112 and $240,213 of interest expense for the amortization of the note discounts during the three and nine months ended September 30, 2011.

In accordance with ASC 815-15, the Company determined that the variable conversion feature and the warrants / shares to be issued represented embedded derivative features, and these are shown as derivative liabilities on the balance sheet. See Note 4.

The Company calculated the fair value of the compound embedded derivatives associated with the convertible notes payable utilizing a complex, customized Monte Carlo simulation model suitable to value path dependant American options. The model uses the risk neutral methodology adapted to value corporate securities. This model utilized subjective and theoretical assumptions that can materially affect fair values from period to period.

Mobivity Note

As partial consideration for the acquisition of Mobivity, the Company issued a secured subordinated promissory note in the principal amount of $606,064. The promissory note earns interest at 6.25% per annum; is payable in six quarterly installments of $105,526 (inclusive of interest) starting May 1, 2011; matures on August 1, 2012; is secured by the acquired assets of the Mobivity business; and is subordinated to the Company's obligations under its outstanding 10% Senior Secured Convertible Bridge Notes due November 3, 2011. Mobivity, LLC was granted a security interest in the acquired assets, subordinated only to the Company's senior debt (Bridge Loan), and a majority of the Bridge Lenders consented to the junior security interest.

Digimark, LLC Notes

As partial consideration for the acquisition of Boomtext, the Company issued a secured subordinated promissory note in the principal amount of $175,000. The promissory note earns interest at 6.25% per annum; is payable in full on March 31, 2012; is secured by all of the assets of CommerceTel, Inc. and is subordinated to the Company's obligations under its outstanding 10% Senior Secured Convertible Bridge Notes Due November 3, 2011.

As partial consideration for the acquisition of Boomtext, the Company also issued an unsecured subordinated promissory note in the principal amount of $194,658. The promissory note does not bear interest; is payable in installments (varying in amount) from August 2011 through October 2012; and is subordinated to the Company's obligations under its outstanding 10% Senior Secured Convertible Bridge Notes Due November 3, 2011. The $194,658 unsecured subordinated promissory note does not bear interest, accordingly, the Company recorded the promissory note at the present value of the $194,658 payments over the subsequent periods. The Company used a discount rate of 6.25% in calculating the net present value of the unsecured promissory note. The discount rate was based on the Company's estimated cost of capital. Under the effective interest method, the Company accretes the debt discount to the face amount of the promissory note. Accretion of the debt discount totaled $2,745 for the three and nine months ended September 30, 2011. Accretion of the debt discount was charged to interest expense in accordance with FASB ASC 480.

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The following table summarizes the Company's notes payable as of September 30, 2011 and December 31, 2010:

	Notes Payable		Accrued Interest	
	9/30/2011	12/31/2010	9/30/2011	12/31/2010
Bridge notes, net, as discussed above	$980,030	$731,172	$91,115	$15,792
Mobivity note, as discussed above	410,300	-	-	-
Unsecured (as amended) note payable due to our Company's former Chief Executive Officer, interest accrues at the rate of 9% compounded annually, all amounts due and payable December 31, 2008, See Note 12	20,000	20,000	10,181	8,223
Note payable due to a trust, interest accrues at the rate of 10% per annum, all amounts due and payable December 31, 2006. The Company is negotiating the terms of this note.	51,984	51,984	17,774	13,886
Digimark, LLC secured subordinated promissory note, as discussed above	175,000	-	1,853	-
Digimark, LLC subordinated promissory note, as discussed above	179,961	-	-	-
	$1,817,275	$803,156	$120,923	$37,901

Interest expense, including amortization of note discounts, totaled $133,057 and $18,396 for the three months ended September 30, 2011 and 2010. Interest expense, including amortization of note discounts, totaled $376,723 and $51,901 for the nine months ended September 30, 2011 and 2010.

6. Stockholders' Equity (Deficit)

Common Stock

The Company commenced a private placement in late March 2011. The private placement structure consists of a series of identical subscription agreements for the sale of units comprised of shares of the Company's common stock at a price of $1.50 per share and an equivalent number of warrants at an exercise price of $2.00. From July 1, 2011 to September 30, 2011, the Company issued 688,669 shares of common stock at $1.50 per share for cash and issued a four-year warrant to purchase 688,669 shares of common stock at $2.00 per share to several accredited investors raising gross proceeds of $1,033,003. Both the common shares and the warrants contain anti-dilutive, or down round, price protection. The down round protection for the common shares terminates on the earlier of the date on which an effective registration statement is filed with the SEC covering the shares, or the shares become freely tradable pursuant to Rule 144 promulgated under the Securities Act of 1933. The down round protection for the warrant terminates when the warrant expires or is exercised. The Company determined that the down round price protection on the common stock represents a derivative. See Note 4 for further discussion. Additionally, the Company recorded a derivative liability for the warrant as discussed in Note 4.

The Company recorded the par value of the common stock in equity ($689), recorded the fair market value of the down round price protection on the common stock as a derivative liability ($109,633), recorded the fair market value of the warrants as a derivative liability ($289,799), and recorded the remainder of the proceeds as additional paid-in capital. See Note 4.

As of September 30, 2011, the Company has 22,360,793 common shares outstanding.

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Stock-based Compensation

CTel Canada Plan

Certain employees, directors and consultants of the Company (the "Optionees") received stock options exercisable for the common stock of (and issued by) our former parent company, CTel Canada. Effective with the Merger, all of the unvested options became fully vested and the related stock-based compensation was recognized in 2010. The Company recorded stock-based compensation of $38,137 and $106,788 in operating expenses for the three and nine months ended September 30, 2010, respectively, related to stock option grants made to the Optionees.

For purposes of accounting for stock-based compensation, the fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing formula, and the expense is recognized on a straight-line basis over the vesting period. The Company granted one option during the nine months ended September 30, 2010 and used the following valuation assumptions to determine the fair value of the option at the grant date: expected volatility of 152.96%; risk free interest rate of 0.94%; forfeiture rate of 0.0%; expected dividend rate of 0.0%; and expected term of three years.

2010 Incentive Stock Option Plan

On December 24, 2010, the Company adopted the 2010 Incentive Stock Option Plan ("the 2010 Plan"), subject to shareholder approval within one year. If shareholder approval is not obtained within one year, incentive stock options granted under the 2010 Plan convert to non-qualified stock options. The 2010 Plan permits the Company to grant up to 3,124,000 shares of common stock and options to purchase shares of common stock. The 2010 Plan is designed to retain directors, executives and selected employees and consultants and reward them for making major contributions to the success of the Company. These objectives are accomplished by making long-term incentive awards under the 2010 Plan thereby providing participants with a proprietary interest in the growth and performance of the Company.

The Company believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price that equals the fair market value of the Company's stock at the date of grant. These option awards generally vest based on four years of continuous service and have five-year or 10-year contractual terms.

A summary of option activity under the 2010 Plan as of September 30, 2011 and changes during the nine months then ended is presented below:

	Number Outstanding	Weighted - Average Exercise Price Per Share	Weighted - Average Remaining Contractual Life (Years)
Outstanding at January 1, 2011	1,808,750	$0.32	4.73
Granted	750,000	1.52	7.92
Exercised	-	-	-
Canceled/forfeited/expired	(143,750)	1.60	4.29
Outstanding at September 30, 2011	2,415,000	$0.62	5.38
Options vested and exercisable at September 30, 2011	306,247	$0.32	4.24

The aggregate intrinsic value of employee and non-employee stock options outstanding and stock options exercisable at September 30, 2011 was $1,493,700 and $238,873, respectively.

As of September 30, 2011, total compensation cost related to non-vested employee stock options not yet recognized was $717,842, which is expected to be recognized over the next 1.49 years on a weighted-average basis.

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Expense Information

The Company measures and recognizes compensation expense for all stock-based payment awards made to employees, directors and non-employees based upon estimated fair values. The Company recorded stock-based compensation in operating expenses for employees and non-employees of $107,902 and $380,600, for the three months and nine months ended September 30, 2011. The Company recorded stock-based compensation in operating expenses for employees and non-employees of $38,317 and $106,788, for the three months and nine months ended September 30, 2010.

Valuation Assumptions

The Company uses the Black-Scholes option pricing model in determining its option expense. The weighted-average estimated fair value of employee stock options and non-employee stock options granted during the nine months ended September 30, 2011 was $0.50 per share. There were 175,000 options granted during the three months ended September 30, 2011. The Company periodically revalues non-employee stock options as they vest. The ranges of assumptions used during the nine months ended September 30, 2011 are as follows:

	September 30, 2011		Nine months ended September 30, 2011	
	Employee Options	Non-Employee Options	Employee Options	Non-Employee Options
Expected volatility	60% to 61.6%	61.6%	60% to 61.6%	60% to 61.6%
Risk-free interest rate	0.91% to 2.31%	0.96%	0.91% to 2.31%	0.96% to 2.24%
Forfeiture rate	0.0%	0.0%	0.0%	0.0%
Expected dividend rate	0.0%	0.0%	0.0%	0.0%
Expected life (yrs)	3.00 to 6.00	4.00 to 5.00	3.00 to 6.00	4.00 to 5.00

The expected volatility is based on the weighted average of the historical volatility of publicly traded surrogates in the Company's peer group.

The risk-free interest rate assumption is based upon published interest rates appropriate for the expected life of the Company's employee stock options.

The dividend yield assumption is based on the Company's history of not paying dividends and no future expectations of dividend payouts.

The expected life of the stock options represents the weighted-average period that the stock options are expected to remain outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of its stock-based awards.

Warrants

As discussed in Note 5, the Company is obligated to issue warrants or shares pursuant to its Bridge Financing. The number of warrants / shares issuable pursuant to the agreements is not known as of September 30, 2011. See Note 13 Subsequent Events regarding bridge notes extended and converted.

During the nine months ended September 30, 2011, the Company issued warrants for the purchase of 688,669 shares of common stock at $2.00 per share. The warrants are exercisable for four years from the date of issuance, and contains anti-dilution, or down round, price protection as long as the warrant remains outstanding.

No other warrants are issued or outstanding as of September 30, 2011.

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7. Income Taxes

The Company maintains deferred tax assets that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. These deferred tax assets include net operating loss carryforwards, deferred revenue and stock-based compensation. In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. The Company considers projected future taxable income and planning strategies in making this assessment. Based on the level of historical operating results and projections for the taxable income for the future, the Company has determined that it is more likely than not that the deferred tax assets will not be realized. Accordingly, the Company has recorded a valuation allowance to reduce deferred tax assets to zero. There can be no assurance that the Company will ever be able to realize the benefit of some or all of the federal and state loss carryforwards, either due to ongoing operating losses or due to ownership changes, which limit the usefulness of the loss carryforwards.

The Company has determined that during 2010 it experienced a “change of ownership” as defined by Section 382 of the Internal Revenue Code. As such, utilization of net operating loss carryforwards and credits generated before the 2010 change in ownership will be limited to approximately $207,000 per year until such carryforwards are fully utilized. The pre-change net operating loss carryforward was approximately $7,000,000.

8. Fair Value Measurements

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the authoritative guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the Company to develop its own assumptions. This hierarchy requires companies to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value, including its derivative liabilities.

At September 30, 2011, the Company recorded a liability related to the variable maturity feature and the future issuance of warrants / shares in connection with its Bridge Notes (See Note 5), and the common stock and warrants issued in the current year (See Notes 4 and 6) at the aggregate fair market value of $582,443 utilizing unobservable inputs. The change in fair market value of these liabilities is included in other income (expense) in the condensed consolidated statements of operations. The assumptions used in the Monte-Carlo simulation used to value the derivative liabilities involve expected volatility in the Company’s common stock, estimated probabilities related to the occurrence of a future financing, and interest rates. As all the assumptions employed to measure this liability are based on management’s judgment using internal and external data, this fair value determination is classified in Level 3 of the valuation hierarchy.

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The following table provides a reconciliation of the beginning and ending balances of the derivative liabilities as of September 30, 2011:

	Variable maturity conversion liability	Additional security issuance derivative	Down round liability - shares	Down round liability - warrants	Total
Beginning balance January 1, 2011	$1,208	$333,270	$-	$-	$334,478
Issuances	11	1,341	109,636	289,799	400,787
Change in fair market value of derivative liabilities	(1,000)	(123,104)	(54,461)	25,743	(152,822)
Ending balance September 30, 2011	$219	$211,507	$55,175	$315,542	$582,443

9. Intangible assets

Intangible assets consist of the following:

	Balance at December 31, 2010	Additions	Amortization	Balance at September 30, 2011
Patents and trademarks	$-	$94,857	$(3,496)	$91,361
Customer contracts	-	1,026,000	(102,600)	923,400
Customer relationships	-	1,406,000	(130,734)	1,275,266
Trade name	-	140,000	(16,600)	123,400
Technology / IP	-	458,000	(49,733)	408,267
Non-compete	-	16,000	(2,083)	13,917