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

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2009

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

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

Commission file number 000-25075

**ARTIFICIAL LIFE, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State of incorporation)

**04-3253298**

(I.R.S. Employer Identification No.)

**520 Broadway, Suite 350**

**Santa Monica, CA 90401**

**U.S.A.**

(Address of principal executive offices)

**(310) 496-4288**

(Issuer's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year,  
if changed since last report)

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

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

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

Large accelerated filer

Accelerated filer

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of October 31, 2009 there were 57,309,858 shares of Common Stock, \$.01 par value per share, outstanding.



**ARTIFICIAL LIFE, INC.**

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

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ARTIFICIAL LIFE, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	September 30, 2009 ----- (unaudited)	December 31, 2008 -----
Current assets:		
Cash	\$ 175,023	\$ 1,430,578
Accounts receivable, net	27,379,991	13,859,315
Prepaid expenses and other	696,228	914,372
Deferred tax asset	-	500,000
	-----	-----
Total current assets	28,251,242	16,704,265
	-----	-----
Fixed assets, net	1,808,247	3,140,067
	-----	-----
License rights, net	15,250,107	9,617,198
Prepaid expenses, deposits and other assets	2,005,513	828,943
	-----	-----
	17,255,620	10,446,141
	-----	-----
	\$ 47,315,109	\$ 30,290,473
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Accounts payable	\$ 5,346,399	\$ 669,745
Accrued expenses and other	618,496	472,813
Income tax payable	187,000	60,000
Note payable – officer/stockholder	981,877	737,771
Notes payable	1,000,000	1,000,000
	-----	-----
Total liabilities (all current)	8,133,772	2,940,329
	-----	-----
Stockholders' equity:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized, no shares issued and outstanding		
Common stock, \$.01 par value; 130,000,000 shares authorized, 50,422,073 shares issued and outstanding as of September 30, 2009 and 47,724,132 shares issued and outstanding as of December 31, 2008	-	-
Additional paid-in capital	53,820,682	51,708,712
Notes receivable from stockholders	(19,577)	(19,577)
Accumulated deficit	(15,296,285)	(24,686,144)
Accumulated other comprehensive income (loss)	172,296	(130,088)
	-----	-----
Total stockholders' equity	39,181,337	27,350,144
	-----	-----
	\$ 47,315,109	\$ 30,290,473
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three-month Period Ended September 30,		Nine-month Period Ended September 30,	
	2009	2008	2009	2008
Revenues:				
Software license revenue	\$8,722,381	\$5,835,733	\$23,351,979	\$ 15,430,034
Reseller license revenue	-	769,800	-	769,800
Application services and other revenue	1,100	23,064	12,671	35,237
	-----	-----	-----	-----
	8,723,481	6,628,597	23,364,650	16,235,071
	-----	-----	-----	-----
Cost of revenues:				
Cost of software license revenue	1,676,575	892,258	3,493,825	1,704,384
Cost of application services and other revenue	56,223	31,092	77,992	88,812
	-----	-----	-----	-----
	1,732,798	923,350	3,571,817	1,793,196
	-----	-----	-----	-----
Gross Profit	6,990,683	5,705,247	19,792,833	14,441,875
	-----	-----	-----	-----
Operating expenses:				
General and administrative	1,750,366	451,518	4,726,579	1,480,310
Research and development	1,015,483	928,487	2,798,120	2,279,160
Sales and marketing	474,066	740,696	2,006,594	1,676,952
	-----	-----	-----	-----
Total operating expenses	3,239,915	2,120,701	9,531,293	5,436,422
	-----	-----	-----	-----
Income from operations	3,750,768	3,584,546	10,261,540	9,005,453
	-----	-----	-----	-----
Other income (expenses):				
Interest income and other	219,761	533	329,264	4,492
Interest expense	(39,356)	(64,661)	(105,836)	(162,722)
Foreign currency transaction (losses) gains	(55,749)	(35,368)	(468,109)	323,037
	-----	-----	-----	-----
	124,656	(99,496)	(244,681)	164,807
	-----	-----	-----	-----
Income before income taxes	3,875,424	3,485,050	10,016,859	9,170,260
Income tax benefit (expense)	31,000	-	(627,000)	(501,310)
	-----	-----	-----	-----
Net income	3,906,424	3,485,050	9,389,859	8,668,950
Foreign currency translation adjustment	163,366	(126,116)	302,384	(72,816)
	-----	-----	-----	-----
Comprehensive income	\$ 4,069,790	\$ 3,358,934	\$ 9,692,243	\$ 8,596,134
	=====	=====	=====	=====

Net income per share				
Basic	\$ 0.08	\$ 0.07	\$ 0.19	\$ 0.19
	=====	=====	=====	=====
Diluted	\$ 0.08	\$ 0.07	\$ 0.19	\$ 0.18
	=====	=====	=====	=====
Weighted average shares outstanding				
Basic	50,261,571	47,615,002	48,803,709	45,983,219
	=====	=====	=====	=====
Diluted	50,302,915	49,454,372	48,916,809	48,254,906
	=====	=====	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Nine-month Period Ended September 30,	
	2009	2008
	-----	-----
Cash flows from operating activities:		
Net income	\$ 9,389,859	\$ 8,668,950
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	3,125,255	1,132,005
Write down of fixed assets and license rights	1,794,999	-
Deferred income tax expense	500,000	59,635
Amortization of discount on notes payable	-	66,000
Provision for losses on doubtful accounts receivable	2,623,162	2,469
Foreign currency transaction losses (gains)	468,109	(323,037)
Interest expense accrued on notes payable officer / stockholder	25,099	7,727
Salary accrued to officer / stockholder	223,442	20,361
Changes in operating assets and liabilities:		
Increase in restricted cash	-	(165,000)
Increase in accounts receivable	(22,587,338)	(4,775,893)
Increase in prepaid expenses, deposits and other assets	(958,426)	(932,718)
Increase (decrease) in accounts payable, accrued expenses and other	2,200,057	(413,635)
Increase in income tax payable	127,000	441,675
	-----	-----
Net cash (used in) provided by operating activities	(3,068,782)	3,788,539
	-----	-----
Cash flows from investing activities:		
Purchase of fixed assets	(90,853)	(180,960)
Purchase of license rights	(280,869)	(9,639,981)
Deposits on fixed assets	-	(2,871,800)
	-----	-----
Net cash used in investing activities	(371,722)	(12,692,741)
	-----	-----
Cash flows from financing activities:		
Net proceeds from issuance of common stock	2,072,950	5,596,602
Advances under note payable to officer / stockholder	202,257	-
Repayment of note payable to officer / stockholder	(206,692)	(303,736)
	-----	-----
Net cash provided by financing activities	2,068,515	5,292,866
	-----	-----
Net decrease in cash	(1,371,989)	(3,611,336)
Cash, beginning of period	1,430,578	6,210,435
Effect of exchange rate changes on cash	116,434	95,948
	-----	-----
Cash, end of period	\$ 175,023	\$ 2,695,047
	=====	=====
Supplemental disclosure of non-cash activities:		
Purchase of license rights and related increase in accounts payable	\$ 9,131,779	\$ 320,786
	=====	=====
Issuance of common stock and warrants in satisfaction of accounts payable	\$ 66,000	\$ -
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.



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

**1. BASIS OF PRESENTATION**

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

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

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

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

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

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

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

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

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

**Recently issued and adopted accounting standards**

In June 2009, the Financial Accounting Standards Board ("FASB") approved the FASB Accounting Standards Codification (the "Codification") as the single source of authoritative non-governmental 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 is effective for interim or annual periods ending after September 15, 2009, and 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.

On January 1, 2009, the Company adopted new guidance 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 guidance was effective for the Company on January 1, 2009, and the Company will apply this new guidance prospectively to all business combinations subsequent to January 1, 2009.

On January 1, 2009, the Company adopted new guidance 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.

In April 2009, the FASB issued new accounting guidance 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 (Note 9).

In June 2009, the FASB issued new accounting guidance related to the accounting and disclosures of subsequent events. This guidance incorporates the subsequent events guidance contained in the auditing standards literature into authoritative accounting literature. It also requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. This guidance is effective for all interim and annual 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 (Note10).

**Reclassifications:**

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

**2. STOCK-BASED EMPLOYEE COMPENSATION**

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

Weighted average exercise price	\$0.88
Aggregate intrinsic value	\$237,600
Weighted average remaining contractual term	0.24 year

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

Weighted average exercise price	\$0.83
Aggregate intrinsic value	\$77,000
Weighted average remaining contractual term	0.18 year

**3. CUSTOMER CONCENTRATION**

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

Management performs ongoing credit evaluations, and the Company maintains an allowance for potential credit losses based upon its loss history and its aging analysis. The allowance for doubtful accounts of \$2,095,000 at September 30, 2009, and \$731,500 at December 31, 2008, is the Company's best estimate of the amount of probable credit losses in existing accounts receivable. Management reviews the allowance for doubtful accounts each reporting period based on a detailed analysis of accounts receivable. In the analysis, management primarily considers the age of the customer's receivable, and also considers the creditworthiness of the customer, the economic conditions of the customer's industry, general economic conditions and trends, and the business relationship and history with its clients, among other factors. If any of these factors change, the Company may also change its original estimates, which could impact the level of the Company's future allowance for doubtful accounts. If judgments regarding the collectability of accounts receivable were incorrect, adjustments to the allowance may be required, which would reduce profitability. Since the Company's accounts receivable are often concentrated in a relatively few number of customers, a significant

change in the liquidity or financial position of any one of these customers could have a material adverse effect on the Company's financial statements. During the nine months ended September 30, 2009, the Company entered into agreements with certain of its customers to offset accounts receivable of approximately \$6.4 million from these customers with accounts payable for the same amount to these customers. The offset of these receivables and payables represents a legal right of setoff pursuant to applicable accounting standards.

At September 30, 2009, the Company had 90 telecom carriers, resellers, distributors and general corporate customers compared to 70 such customers at December 31, 2008, and 59 such customers at September 30, 2008. For the three-month and nine-month periods ended September 30, 2009, resellers and distributors represented approximately 78% and 68% of the Company's revenues, respectively.

For the three-month period ended September 30, 2009, the Company had three customers that represented approximately 48%, 30% and 19% of the Company's revenues, respectively. For the three-month period ended September 30, 2008, the Company had two customers that represented approximately 44% and 33% of the Company's revenues, respectively. For the nine-month period ended September 30, 2009, the Company had four customers that represented approximately 56%, 12%, 11% and 11% of the Company's revenues, respectively. For the nine-month period ended September 30, 2008, the Company had three customers that represented approximately 54%, 14% and 13% of the Company's revenues, respectively.

At September 30, 2009, accounts receivable were due from 57 customers. Of these, three customers accounted for approximately 68%, 9% and 9% of the accounts receivable, respectively. At September 30, 2009, 24% and 56% of accounts receivable were aged within 30 days and 91 to 120 days, respectively. At September 30, 2009, the average age of accounts receivable from all customers was 115 days as compared to 83 days at December 31, 2008. The average age of receivables from the Company's three largest customers at September 30, 2009, was 167 days.

#### 4. NET INCOME PER SHARE

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

	Three-month period ended September 30,		Nine-month period ended September 30,	
	2009	2008	2009	2008
Shares used in basic per share calculation	50,261,571	47,615,002	48,803,709	45,983,219
Effect of dilutive securities:				
Options	25,725	1,027,255	69,910	1,146,549
Warrants	15,619	812,115	43,190	1,125,138
Shares used in dilutive per share calculation	50,302,915	49,454,372	48,916,809	48,254,906

#### 5. INCOME TAXES

The difference between the expected and effective income tax expense recorded for the nine-month periods ended September 30, 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 carryforwards.

At September 30, 2009, the Company has recorded a current income tax payable of \$187,000, which consists of estimated state income taxes and U.S. federal alternative minimum tax.

## 6. CONTINGENCIES

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

In September 2008, an action was brought against Artificial Life Europe GmbH in Germany in a contractual dispute, in which a claim of approximately \$375,000 was made against the Company. A court hearing was held in September 2009, before the State Court in Berlin, and the Court recommended a settlement. While the Company cannot predict the outcome of the matter and is in negotiation for a settlement, the Company believes that the final outcome of this matter will not have a material adverse impact on its financial position or results of operation.

## 7. NOTES PAYABLE

### Note payable — officer/stockholder:

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

	<u>2009</u>	<u>2008</u>
Beginning balance, January 1	\$737,771	\$751,860
Advances	202,257	-
Repayments	(206,692)	(303,736)
Accrued salary and bonus	223,442	20,361
Accrued interest	25,099	7,727
	-----	-----
Ending balance, September 30	<u>\$981,877</u>	<u>\$476,212</u>

### Notes payable:

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

## 8. STOCKHOLDERS' EQUITY

During the nine-month period ended September 30, 2009, the Company issued 2,697,941 shares of common stock along with warrants to purchase an additional 1,549,779 shares of common stock for cash of \$2,072,950. As part of the transaction, 100,000 shares and warrants to purchase 100,000 shares were issued in satisfaction of \$66,000 of accounts payable. This private placement was made to nine institutional and four individual accredited investors. In connection with this transaction, the Company retained a selling agent, to whom it paid a commission approximately of \$172,000. The warrants have a two-year term with exercise prices ranging from \$0.80 to \$1.25 per share and are immediately exercisable.

In October 2009, the Company sold 6,447,491 shares of its common stock, at \$1.00 per share, for aggregate consideration of \$6,447,491. The issuance of these shares was made pursuant to terms of a Securities Purchase Agreement (the "SPA") with a U.S. company (the "Purchaser"). The SPA was entered into in conjunction with the execution of a collaboration agreement (the "Alliance Agreement"), in which the Company and the Purchaser 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, the Purchaser has the right to purchase a proportionate number of shares necessary to maintain its defined percentage ownership.

In October 2009, the Company also sold, in three additional private placements, 440,294 shares of common stock for \$423,000.

## 9. 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 September 30, 2009, the Company has no financial assets or liabilities subject to recurring fair value measurements.

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

## 10. SUBSEQUENT EVENTS

In October 2009, the Company entered into a new, two-year lease for its existing Hong Kong office space, which will expire in December 2011. The new lease requires a monthly payment of approximately \$18,000.

The Company's management has evaluated events through November 9, 2009, for consideration as a subsequent event to be included in its September 30, 2009, consolidated financial statements issued November 9, 2009.

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

### *General*

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

### *Overview*

In the third quarter of 2009, we sold over 3,853,000 of our mobile 3G and Java games globally, primarily to resellers, aggregators and hand set manufacturers. The sales include one time downloads, end user subscriptions via operator decks, off-deck sales, bulk reseller packages and pre-installation licenses for cell phones.

Our iPhone games have been downloaded an aggregate of more than 4.6 million times. As of October 31, 2009, we have produced and released 21 games for the iPhone and iPod touch during the last 12 months. So far, the best selling game was downloaded close to 1.8 million times, the second best over 1.4 million times and the third best over 0.55 million times. The average

number of downloads per game was about 0.22 million.

Despite the large amount of games available on the Apple App Store, 20 (or 95%) of our games have climbed up to the Top 100 most downloaded rank or higher; 17 games have been ranked in the Top 50; 15 in the Top 10 downloads; and 11 games have achieved Top 5 or higher. The best games have reached Top 10 download rankings in 56 countries, i.e. 73% of all countries in which the iPhone is officially sold. 8 of our games have even hit rank 1 in 23 countries.

13 of the produced games are based on licensed and branded intellectual property from a variety of licensors, and 8 games are based on Artificial Life's proprietary IP. The games have been sold into 72 countries worldwide. The top 5 countries in terms of numbers of downloads for our products are: United States, United Kingdom, Germany, Australia and France (with 45.93%, 12.08%, 5.38%, 3.88% and 3.64% of sales respectively).

12 games have stayed in the Top 100 for over 30 days, 8 games for over 90 days and 6 for over 180 days. The longest continuous Top 100 ranked game has been in the ranks for over 300 days.

The best performing game categories were motor sports and racing games as well as cartoon based games in which 10 of our games have achieved rankings in the Top 10.

The number of iPhone game downloads is approximately equivalent to 37.8% of the overall number of games sold by the Company so far in 2009. The development time for a high quality iPhone game was on average 3 to 4 months.

Significant events during the third quarter of 2009 include the following:

- In July 2009, we signed a technology licensing and production agreement with the Berlin Organising 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 the City of 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 screens and motion sensitive features of the popular mobile devices and bring to life the action, violence and sex soon to be seen in the series.
- 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 is tentatively scheduled for release in the fourth quarter of 2009.
- 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 iPhone and iPod touch games and applications of the Company 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 & iPod applications for the Chinese market.
- In September 2009, we launched Pandorum, the official movie game for the upcoming horror film of the same name from Overture Films, on the iPhone and iPod touch platform.
- In September 2009, we launched the BMW Sauber F1 Team Racing 09, our first racing title features the current 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 developing iPhone applications.
- 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 forthcoming album "Reality Killed the Video Star" and incorporate cutting edge 3D game play of the rally driving game genre. The launch date of the title is tentatively scheduled for the fourth quarter of 2009, pending approval. The artist is releasing the application in parallel to the new album, which features the music and key visual theme of the record.

- 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 fourth quarter of 2009.
- In September 2009, we released the VfB Stuttgart 2009/10, the official mobile game for the traditional soccer club in the German League. The game is already available on designated channels in Germany, Switzerland and Austria.

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

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

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

As of September 30, 2009, we had total assets of \$47,315,109 and total liabilities of \$8,133,772. As of September 30, 2009, current assets were \$28,251,242 as compared to \$16,704,265 at December 31, 2008, and current liabilities were \$8,133,772 as compared to \$2,940,329 at December 31, 2008.

We had 64 full time employees as of September 30, 2009. We also hire temporary staff, external consultants and interns to support our operations.

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

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

## **Results of Operations**

### *Three months ended September 30, 2009 Compared to three months ended September 30, 2008*

**REVENUES:** Revenues for the quarter ended September 30, 2009 were \$8,723,481 as compared to \$6,628,597 for the quarter ended September 30, 2008. The increase in revenues of \$2,094,884, or 32% was mainly due to increased (a) product license revenue from mobile games, one-time downloads, (b) monthly subscription revenues for 3G games derived from mobile operators, bulk resellers and hand set distributors and (c) license revenues from the sale of our mobile diabetes and mobile property solutions.

**COST OF REVENUES:** Cost of revenues mainly consisted of amortization of intangible assets (license rights). Cost of revenues for the quarter ended September 30, 2009 was \$1,732,798 as compared to \$923,350 for the quarter ended September 30, 2008. The increase of \$809,448, or 88%, was primarily due to the increased amortization of certain license rights of approximately \$560,000.

**GROSS MARGIN:** Gross margin for the quarter ended September 30, 2009 was \$6,990,683 as compared to \$5,705,247 for the quarter ended September 30, 2008. The increase of \$1,285,436, or 23%, was mainly due to increased product license income from mobile games, one-time downloads and monthly subscription revenues for 3G games derived from mobile operators, bulk resellers and hand set distributors and a global license deal for the sale of our mobile diabetes and mobile property solutions offset by amortization of license rights acquired in earlier periods.

**GENERAL AND ADMINISTRATIVE:** General and administrative expenses consisted of salaries of administrative personnel, rent, professional fees and costs associated with employee benefits, supplies, communications and travel. General and administrative expenses for the quarter ended September 30, 2009 were \$1,750,366 as compared to \$451,518 for the quarter ended September 30, 2008. The increase of \$1,298,848, or 288%, was mainly due to the increased depreciation of fixed assets approximately of \$1,235,000.

**RESEARCH AND DEVELOPMENT:** Research and development expenses consisted of salary, training, consulting, subcontracting and other expenses incurred to develop and fulfill the design specifications and production of the products and services from which we derive our revenues. Research and development expenses for the quarter ended September 30, 2009 were \$1,015,483 as compared to \$928,487 for the quarter ended September 30, 2008. The increase of \$86,996, or 9%, was mainly due to increased internet expenses.

**SALES AND MARKETING:** Sales and marketing expenses consisted of salaries of sales and marketing personnel and costs relating to marketing materials, advertising, trade shows, traveling and public relations activities. Sales and marketing expenses for the quarter ended September 30, 2009 were \$474,066 as compared to \$740,696 for the quarter ended September 30, 2008. The decrease of \$266,630, or 36%, was primarily due to reductions in expenses related to marketing, telecommunications and sub-contracting expenses.

**OTHER EXPENSE/INCOME:** Other income for the quarter ended September 30, 2009 totaled \$124,656, as compared to other expenses of \$99,496 for the quarter ended September 30, 2008. The other income of \$124,656 was mainly due to late payment charge income of \$219,761, offset by interest expense of \$39,356 and foreign currency transaction losses of approximately \$55,749 in this quarter compared to income of approximately \$533 in the third quarter of 2008.

**INCOME FROM OPERATIONS AND NET INCOME:** Income from operations for the quarter ended September 30, 2009 was \$3,750,768 as compared to income from operations of \$3,584,546 for the quarter ended September 30, 2008. Income from operations was mainly due to revenue of \$8,723,481 from the sale of product licenses for our mobile games and technology licenses, which was offset by costs of revenue of \$1,732,798 and operational costs of \$3,239,915. Net income for the quarter ended September 30, 2009 was \$3,875,424, compared to net income of \$3,485,050 for the quarter ended September 30, 2008. Basic and diluted net income per share for the quarter ended September 30, 2009 and 2008 was \$0.08 and \$0.07, respectively.

*Nine Months Ended September 30, 2009 Compared with Nine Months Ended September 30, 2008*

**REVENUES:** Revenues for the nine months ended September 30, 2009 were \$23,364,650 as compared to \$16,235,071 for the nine months ended September 30, 2008. The increase of revenues of \$7,129,579, or 44% was mainly due to increased (a) product license revenue from mobile game one-time downloads, (b) monthly subscription revenues for 3G games derived from mobile operators, bulk resellers and hand set distributors and (c) license revenues from the sale of our mobile diabetes and mobile property solutions and our technology platform Mobile Booster™.

**COST OF REVENUES:** Cost of revenues mainly consist of amortization of intangible assets (license rights). Cost of revenues for the nine month ended September 30, 2009 was \$3,571,817 as compared to \$1,793,196 for the nine months ended September 30, 2008. The increase of \$1,778,621, or 99%, was primarily due to the amortized expense of license rights including an increased amortization of certain license rights of approximately \$560,000.

**GROSS MARGIN:** Gross margin for the nine month ended September 30, 2009 was \$19,792,833 as compared to \$14,441,875 for the nine months ended September 30, 2008. The increase of \$5,350,958, or 37%, was mainly due to increased product license income from mobile games, one-time downloads and monthly subscription revenues for 3G games derived from mobile operators, bulk resellers and hand set distributors and a global license deal for the sale of our mobile diabetes and mobile property solutions and our technology platform Mobile Booster™, offset by amortization of license rights acquired in earlier periods.

**GENERAL AND ADMINISTRATIVE:** General and administrative expenses consisted of salaries of administrative personnel, rent, professional fees and costs associated with employee benefits, supplies, communications, travel and the provision for doubtful accounts receivable. General and administrative expenses for the nine months ended September 30, 2009 were \$4,726,579 as compared to \$1,480,310 for the nine months ended September 30, 2008. The increase of \$3,246,269, or 219%, was mainly due to a 2009 provision for doubtful accounts receivable of approximately \$2.1 million and increased depreciation of fixed assets approximately of \$1,235,000.

**RESEARCH AND DEVELOPMENT:** Research and development expenses consisted of salary, training, consulting, subcontracting and other expenses incurred to develop and fulfill the design specifications and production of the products and services from which we derive our revenues. Research and development expenses for the nine months ended September 30, 2009 were \$2,798,120 as compared to \$2,279,160 for the nine months ended September 30, 2008. The increase of \$518,960 or 23%, was mainly due to increased consulting and telecommunication expenses.

**SALES AND MARKETING:** Sales and marketing expenses consisted of salary expenses for sales and marketing personnel and costs relating to marketing materials, advertising, trade shows, traveling and public relations activities. Sales and marketing expenses for the nine months ended September 30, 2009 were \$2,006,594 as compared to \$1,676,952 for the nine months ended September 30, 2008. The increase of \$329,642, or 20%, was primarily due to increased allowances for doubtful accounts.

**OTHER EXPENSE/INCOME:** Other expenses for the nine months ended September 30, 2009 totaled \$244,681, as compared to other income of \$164,807 for the nine months ended September 30, 2008. The other expenses of \$244,681 were mainly due to interest income of \$329,264, interest expense of \$105,836 and foreign currency transaction losses of approximately \$468,109 for the nine months ended September 30, 2009 comparing to a gain of \$164,807 (primarily resulting from foreign currency transaction gains) for the nine months ended September 30, 2008.

**INCOME FROM OPERATIONS AND NET INCOME:** Income from operations for the nine months ended September 30, 2009 was \$10,261,540 as compared to income from operations of \$9,005,453 for the nine months ended September 30, 2008. Income from operations is mainly due to revenue of \$23,364,650 from the sale of product licenses for our mobile games, one-time downloads and monthly subscription revenues for 3G games and technology licenses, offset by costs of revenue of \$3,571,817 and operational costs of \$9,531,293. Net income for the nine months ended September 30, 2009 was \$9,389,859 as compared to net income of \$8,668,950 for the nine months ended September 30, 2008. Basic net income per share for the nine months ended September 30, 2009 and 2008 was \$0.19. Diluted net income per share for the nine months ended September 30, 2009 was \$0.19, as compared to \$0.18 for the nine months ended September 30, 2008.

The difference between the expected and effective income tax expense recorded for the nine-month periods ended September 30, 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 September 30, 2009, the Company has recorded a current income tax payable of \$187,000, which consists of estimated state income taxes and U.S. federal alternative minimum tax.

#### CASH FLOW SUMMARY

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

	<u>2009</u>	<u>2008</u>
Cash provided by (used in):		
Operating activities	\$(3,068,782)	\$3,788,539
Investing activities	(371,722)	(12,692,741)
Financing activities	2,068,515	5,292,866
Effect of exchange rate changes on cash	116,434	95,948
	-----	-----
Net decrease in cash, considering effect of exchange rate changes on cash	\$(1,255,555)	\$(3,515,388)
	=====	=====

Cash used in operating activities was \$3,068,782 for the nine months ended September 30, 2009, which was an increase of \$6,857,321 compared to the nine months ended September 30, 2008. This increase in cash used was due to the increase in the accounts receivable balance compared to the prior period and granting certain customers extended payment terms (up to 180 days), offset by an increase of net income, non-cash depreciation and amortization, the provision for losses on doubtful accounts receivable, foreign currency transaction loss and accounts payable, accrued expenses and other.

Cash used in investing activities was \$371,722 for the nine months ended September 30, 2009, which was a decrease of \$12,321,019 compared to the nine months ended September 30, 2008. This increase was primarily due to decreased cash expenditures relating to license rights and fixed assets.

Cash provided by financing activities was \$2,068,515 for the nine months ended September 30, 2009, which was a decrease of \$3,224,351 compared to the nine months ended September 30, 2008. This decrease was due to the issuance of common stock and warrants at a comparably lower price during the nine months ended September 30, 2009, compared to the prior period.

#### *Liquidity and Capital Resources*

As of September 30, 2009, we had a working capital surplus of \$20,117,470 and stockholders' equity of \$39,181,337.

Through September 30, 2009, we completed a private placement raising total cash proceeds of \$2,072,950 through the issuance of 2,697,941 shares of common stock to a number of investors. As part of this placement, one party received 100,000 shares and warrants to purchase 100,000 shares in satisfaction of \$66,000 of accounts payable.

In October 2009, the Company sold 6,447,491 shares of its common stock at a price of \$1 per share, for aggregate consideration of \$6,447,491. We are also in discussions with other potential investors about investments for the fourth quarter of 2009. However, there can be no guarantees that such funds will be available on commercially reasonable terms, if at all. If such financing is not available on satisfactory terms, we may be unable to expand or continue our business as desired and operating results may be adversely affected. Debt financing will increase expenses and must be repaid regardless of operating results. Equity financing could result in a substantial dilution to existing stockholders.

We have borrowed funds from time to time in the past from our chief executive officer, Eberhard Schoneburg. As of September 30, 2009, we owed Mr. Schoneburg an aggregate amount of \$981,877, as compared to \$737,771 at December 31, 2008. During the three months ended September 30, 2009, Mr. Schoneburg advanced deferred salary of \$111,328 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 remaining 2009 and 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 accounts receivable. Economic activity in the United States and throughout much of the world has undergone a sudden, sharp economic downturn in 2008 and 2009 following the housing downturn and subprime lending collapse in the United States and globally. Global credit and capital markets have experienced unprecedented volatility and disruption. Business credit and liquidity have tightened in much of the world. Some of our suppliers and customers may face credit issues and could experience cash flow problems and other financial hardships. These factors have had a substantial impact on the timeliness of receivable collections from our customers. The Company cannot predict at this point in time how this situation will develop and whether accounts receivable may need to be written off in the coming quarters.

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

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

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

Management performs ongoing credit evaluations, and the Company maintains an allowance for potential credit losses based upon its loss history and its aging analysis. The allowance for doubtful accounts of \$2,095,000 at September 30, 2009, and \$731,500 at December 31, 2008, is the Company's best estimate of the amount of probable credit losses in existing accounts receivable. Management reviews the allowance for doubtful accounts each reporting period based on a detailed analysis of accounts receivable. In the analysis, management primarily considers the age of the customer's receivable and also considers the creditworthiness of the customer, the economic conditions of the customer's industry, the general economic conditions and trends and the business relationship and history with its clients among other factors. If any of these factors change, the Company may also change its original estimates, which could impact the level of the Company's future allowance for doubtful accounts. If judgments regarding the collectability of accounts receivable were incorrect, adjustments to the allowance may be required, which would reduce profitability. Since the Company's accounts receivable are often concentrated in a relatively few number of customers, a significant change in the liquidity or financial position of any one of these customers could have a material adverse effect on the Company's financial statements. During the nine months ended September 30, 2009, the Company entered into agreements with certain of its customers to offset accounts receivable of approximately \$6.4 million from these customers with accounts payable for the same amount to these customers. The offset of these receivables and payables represents a legal right of setoff pursuant to applicable accounting standards.

### ***Recently Issued and Adopted Accounting Pronouncements***

In June 2009, the Financial Accounting Standards Board (“FASB”) approved the FASB Accounting Standards Codification (the “Codification”) 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 is effective for interim or annual periods ending after September 15, 2009, and 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.

On January 1, 2009, the Company adopted new guidance 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 guidance was effective for the Company on January 1, 2009, and the Company will apply this new guidance prospectively to all business combinations subsequent to January 1, 2009.

On January 1, 2009, the Company adopted new guidance 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.

In April 2009, the FASB issued new accounting guidance 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.

In June 2009, the FASB issued new accounting guidance related to the accounting and disclosures of subsequent events. This guidance incorporates the subsequent events guidance contained in the auditing standards literature into authoritative accounting literature. It also requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. This guidance is effective for all interim and annual 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.

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

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

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

Not applicable.

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

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

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

management, as appropriate to allow timely decisions regarding required disclosure. Based on his evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2009.

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

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

## PART II - OTHER INFORMATION

### ITEM 1 - LEGAL PROCEEDINGS

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

In September 2008, an action was brought against Artificial Life Europe GmbH in Germany in a contractual dispute, in which a claim of approximately \$375,000 was made against the Company. A court hearing was held in September 2009 before the State Court in Berlin and the court recommended a settlement. While the Company cannot predict the outcome of the matter and is in negotiation for a settlement, the Company does not believe that the final outcome will have a material adverse impact on its financial position or results of operations.

### ITEM 1A - RISK FACTORS

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

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

Not applicable.

### ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

Not applicable.

### ITEM 5 - OTHER INFORMATION

Not applicable.

### ITEM 6 - EXHIBITS

31.1\* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2\* Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32\* Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Filed herewith

**SIGNATURES**

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

**ARTIFICIAL LIFE, INC.**

Date: November 9, 2009

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

Filename: d25682\_ex31-1.htm  
Type: EX-31.1  
Comment/Description:  
(this header is not part of the document)

Exhibit 31.1

### CERTIFICATIONS

I, Eberhard Schoneburg, certify that:

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

Date: November 9, 2009

/s/ Eberhard Schoneburg  
Eberhard Schoneburg  
Chief Executive Officer

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Exhibit 31.2

### CERTIFICATIONS

I, Eberhard Schoneburg, certify that:

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

Date: November 9, 2009

/s/ Eberhard Schoneburg  
Eberhard Schoneburg  
Chief Financial Officer

Filename: d25682\_ex32.htm  
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Exhibit 32

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

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

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

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

Date: November 9, 2009