

LIGHTBRIDGE INC  
Form 10-Q  
July 27, 2006

**Table of Contents**

**SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q**

**(MARK ONE)**

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

**For the quarterly period ended June 30, 2006**

**OR**

**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: 000-21319**

**LIGHTBRIDGE, INC.**

**(Exact Name of Registrant as Specified in Its Charter)**

**Delaware**

**(State or Other Jurisdiction of  
Incorporation or Organization)**

**04-3065140**

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

**30 Corporate Drive**

**Burlington, Massachusetts 01803**

**(Address of Principal Executive Offices) (Zip Code)**

**(781) 359-4000**

**(Registrant's Telephone Number, Including Area Code)**

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  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of July 24, 2006, there were 27,303,475 shares of the registrant's common stock, \$.01 par value, outstanding.

**LIGHTBRIDGE, INC.**  
**QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2006**  
**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u></b>	3
<u>Balance Sheets as of June 30, 2006 and December 31, 2005</u>	3
<u>Statements of Operations for the three and six months ended June 30, 2006 and 2005</u>	4
<u>Statements of Cash Flows for the six months ended June 30, 2006 and 2005 (as restated)</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<b><u>Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u></b>	17
<b><u>Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u></b>	27
<b><u>Item 4. CONTROLS AND PROCEDURES</u></b>	28
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1. LEGAL PROCEEDINGS</u></b>	28
<b><u>Item 1A. RISK FACTORS</u></b>	28
<b><u>Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u></b>	35
<b><u>Item 6. EXHIBITS</u></b>	36
<b><u>SIGNATURE</u></b>	37
<u>EX-31.1 Section 302 Certification of C.E.O.</u>	
<u>EX-31.2 Section 302 Certification of C.F.O.</u>	
<u>EX-32.1 Section 906 Certification of C.E.O. &amp; C.F.O.</u>	

**Table of Contents**

**PART I. FINANCIAL INFORMATION**  
**ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**LIGHTBRIDGE, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Amounts in thousands, except share and per share amounts)

<b>ASSETS</b>	<b>June 30, 2006</b>	<b>December 31, 2005</b>
Current assets:		
Cash and cash equivalents	\$ 96,310	\$ 83,120
Short-term investments	1,917	1,688
Accounts receivable, net	10,449	11,911
Other current assets	2,812	3,432
Total current assets	111,488	100,151
Property and equipment, net	8,763	10,804
Other assets, net	635	438
Restricted cash	2,100	2,100
Goodwill	57,628	57,628
Intangible assets, net	16,998	18,414
Total assets	\$ 197,612	\$ 189,535

**LIABILITIES AND STOCKHOLDERS EQUITY**

Current liabilities:		
Accounts payable	\$ 3,805	\$ 3,448
Accrued compensation and benefits	3,259	5,724
Other accrued liabilities	4,732	5,203
Deferred rent	633	656
Deferred revenues	3,074	2,863
Funds due to merchants	8,455	7,112
Accrued restructuring	877	989
Total current liabilities	24,835	25,995
Deferred rent, less current portion	2,304	2,548
Deferred tax liability	3,553	3,074
Other long-term liabilities	1,246	965

Total liabilities	31,938	32,582
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized; no shares issued or outstanding at June 30, 2006 and December 31, 2005		
Common stock, \$.01 par value; 60,000,000 shares authorized; 30,738,455 and 30,259,882 shares issued and 27,299,412 and 26,820,839 shares outstanding at June 30, 2006 and December 31, 2005, respectively	307	303
Additional paid-in capital	175,810	169,648
Accumulated other comprehensive income	179	110
Retained earnings	10,165	7,679
Less: treasury stock, at cost; 3,439,043 shares	(20,787)	(20,787)
Total stockholders' equity	165,674	156,953
Total liabilities and stockholders' equity	\$ 197,612	\$ 189,535

See notes to unaudited condensed consolidated financial statements.

**Table of Contents**

**LIGHTBRIDGE, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Amounts in thousands, except per share amounts)

	<b>Three Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
Revenues:		
Transaction services	\$ 24,551	\$ 25,147
Consulting and maintenance services	672	1,417
Total revenues	25,223	26,564
Cost of revenues:		
Transaction services	10,391	11,459
Consulting and maintenance services	391	557
Total cost of revenues	10,782	12,016
Gross profit:		
Transaction services	14,160	13,688
Consulting and maintenance services	281	860
Total gross profit	14,441	14,548
Operating expenses:		
Engineering and development	2,946	3,554
Sales and marketing	4,939	4,444
General and administrative	5,781	4,091
Restructuring charges and related asset impairments	937	(8)
Total operating expenses	14,603	12,081
Income (loss) from operations	(162)	2,467
Other income, net	1,099	328
Income from continuing operations before provision for income taxes	937	2,795
Provision for income taxes	83	442
Income from continuing operations	854	2,353

Discontinued operations, net of income taxes:		
Gain on sale of INS assets		12,689
Discontinued operations		170
Total discontinued operations, net of income taxes		12,859
Net income	\$ 854	\$ 15,212
Net income per common shares (basic):		
From continuing operations	\$ 0.03	\$ 0.09
From discontinued operations		0.48
Net income per common share (basic)	\$ 0.03	\$ 0.57
Net income per common share (diluted):		
From continuing operations	\$ 0.03	\$ 0.09
From discontinued operations		0.47
Net income per common share (diluted):	\$ 0.03	\$ 0.56
Basic weighted average shares	27,243	26,623
Diluted weighted average shares	28,331	27,014

See notes to unaudited condensed consolidated financial statements.

**Table of Contents**

**LIGHTBRIDGE, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Amounts in thousands, except per share amounts)

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
Revenues:		
Transaction services	\$ 50,233	\$ 50,801
Consulting and maintenance services	1,532	2,936
Total revenues	51,765	53,737
Cost of revenues:		
Transaction services	21,595	24,190
Consulting and maintenance services	924	1,322
Total cost of revenues	22,519	25,512
Gross profit:		
Transaction services	28,638	26,611
Consulting and maintenance services	608	1,614
Total gross profit	29,246	28,225
Operating expenses:		
Engineering and development	6,183	7,476
Sales and marketing	9,710	8,915
General and administrative	10,540	7,621
Restructuring charges and related asset impairments	2,330	376
Total operating expenses	28,763	24,388
Income from operations	483	3,837
Other income, net	2,109	590
Income from continuing operations before provision for income taxes	2,592	4,427
Provision for income taxes	574	920
Income from continuing operations	2,018	3,507



Discontinued operations, net of income taxes:		
Gain on sale of INS assets		12,689
Discontinued operations	468	(2,084)
Total discontinued operations, net of income taxes	468	10,605
Net income	\$ 2,486	\$ 14,112
Net income per common shares (basic):		
From continuing operations	\$ 0.07	\$ 0.13
From discontinued operations	0.02	0.40
Net income per common share (basic)	\$ 0.09	\$ 0.53
Net income per common share (diluted):		
From continuing operations	\$ 0.07	\$ 0.13
From discontinued operations	0.02	0.39
Net income per common share (diluted):	\$ 0.09	\$ 0.52
Basic weighted average shares	27,134	26,592
Diluted weighted average shares	28,059	26,963

See notes to unaudited condensed consolidated financial statements.

**Table of Contents**

**LIGHTBRIDGE, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Amounts in thousands)

	Six Months Ended June 30,	
	2006	2005 (As Restated, See Note 2)
Cash flows from operating activities:		
Net income	\$ 2,486	\$ 14,112
Income from discontinued operations	468	10,605
Income from continuing operations	2,018	3,507
Adjustments to reconcile net income to net cash provided by operating activities for continuing operations:		
Depreciation and amortization	3,908	4,638
Asset impairment related to restructuring	862	
Loss on disposal of property and equipment		8
Deferred income taxes	479	816
Stock compensation expense	2,766	
Changes in assets and liabilities:		
Accounts receivable	1,462	1,167
Other assets	387	(1,285)
Accounts payable and accrued liabilities	(2,695)	(2,033)
Funds due to merchants	1,343	882
Deferred rent	(267)	(902)
Deferred revenues	211	1,260
Other liabilities	281	801
Net cash provided by operating activities of continuing operations	10,755	8,859
Cash flows from investing activities of continuing operations:		
Purchases of property and equipment	(1,193)	(1,799)
Restricted cash		(1,600)
Purchase of short-term investments	(520)	(3,928)
Proceeds from sales and maturities of short-term investments	291	11,222
Net cash provided by (used in) investing activities for continuing operations	(1,422)	3,895
Cash flows from financing activities of continuing operations:		

Edgar Filing: LIGHTBRIDGE INC - Form 10-Q

Proceeds from issuance of common stock	3,400	597
Net cash provided by financing activities of continuing operations	3,400	597
Effects of foreign exchange rate changes on cash and cash equivalents	(11)	211
Net cash provided by (used in) operating activities of discontinued operations	468	(3,313)
Net cash provided by investing activities of discontinued operations		15,017
Net cash financing activities of discontinued operations		
Net increase in cash and cash equivalents	13,190	25,266
Cash and cash equivalents, beginning of period	83,120	39,036
Cash and cash equivalents, end of period	\$ 96,310	\$ 64,302

See notes to unaudited condensed consolidated financial statements.

6

---

**Table of Contents****LIGHTBRIDGE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****1. BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements include the accounts of Lightbridge, Inc. and its subsidiaries (collectively, Lightbridge or the Company). Lightbridge believes that the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of Lightbridge's financial position, results of operations and cash flows at the dates and for the periods indicated. Although certain information and disclosures normally included in Lightbridge's annual financial statements have been omitted, Lightbridge believes that the disclosures provided are adequate to make the information presented not misleading. Results of interim periods may not be indicative of results for the full year or any future periods. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in Lightbridge's Annual Report on Form 10-K for the year ended December 31, 2005.

**2. RESTATEMENT OF FINANCIAL STATEMENTS FOR DISCONTINUED OPERATIONS**

Subsequent to the issuance of the Company's interim condensed consolidated financial statements for the period ended June 30, 2005, the Company concluded that it was necessary to restate the statement of cash flows for the six months ended June 30, 2005 previously filed by the Company on Form 10-Q/A, to correct the error as set forth below in reporting the gain on the sale of the Company's INS business. The gain on the sale of the INS business of \$12.7 million and the net proceeds from the sale of the INS business of \$15.0 million were previously improperly presented in net cash provided by (used in) operating activities of continuing operations and net cash provided by investing activities of continuing operations, respectively.

The following table summarizes the amounts as previously reported and as restated in the Statements of Cash Flows for the six months ended June 30, 2005. The amounts have been adjusted to reflect discontinued operations (see Note 4) (dollars in thousands):

	<b>Six months ended June 30, 2005</b>	
	<b>As previously reported</b>	<b>As restated</b>
Net cash provided by (used in) operating activities of continuing operations	\$ (5,524)	\$ 8,859
Net cash provided by investing activities of continuing operations	\$ 18,912	\$ 3,895
Net cash provided by (used in) operating activities of discontinued operations	\$ 11,070	\$ (3,313)
Net cash provided by investing activities of discontinued operations	\$	\$ 15,017

**3. SHARE-BASED COMPENSATION***Stock Option Plans*

*Stock Incentive Plans (active)* The Company awards stock options and restricted share awards under the 2004 Stock Incentive Plan (the 2004 Plan). No further grants can be made under the 1996 Incentive and Nonqualified Stock Option Plan (the 1996 Plan) and the 1998 Non-Statutory Stock Option Plan (the 1998 Plan). Also, the Company does not plan to make any further grants under the 1997 Stock Incentive Plan and Restricted Stock Purchase Plan.

In April and June 2004, respectively, the Board authorized and the stockholders approved the adoption of the 2004 Plan which provides for the issuance of options and other stock-based awards to purchase up to 2,500,000 shares of the Company's common stock, plus the number of shares then remaining available for future grants under the Company's 1996 Plan and the 1998 Plan, plus the number of shares subject to any stock option granted pursuant to the 1996 Plan or the 1998 Plan that expires, is cancelled or otherwise terminates (other than by exercise) after the effective date of the 2004 Plan. Options are granted with an exercise price of no less than the common stock's market value at the date of grant. Options generally have a four-year graded vesting and have 10-year contractual terms. Certain option and plan awards provide for accelerated vesting based on stock price performance or if there is a change in control (as defined in the 2004 Plan). At June 30, 2006, 3,216,941 shares were available for grant under the 2004 Plan.



**Table of Contents**

*Employees Stock Purchase Plan* On June 14, 1996, the Board authorized and the stockholders approved the adoption of the 1996 Employee Stock Purchase Plan (ESPP Plan). The ESPP Plan provided for the sale of up to 600,000 shares of the Company's common stock to employees. Employees may have up to 6% of their base salary withheld through payroll deductions to purchase common stock during semi-annual offering periods. The purchase price of the stock is the lower of 85% of (i) the fair market value of the common stock on the enrollment date (the first day of the offering period), or (ii) the fair market value on the exercise date (the last day of each offering period). Offering period means approximately six-month periods commencing (a) on the first trading day on or after February 1 and terminating on the last trading day in the following July, and (b) on the first trading day on or after August 1 and terminating on the last trading day in the following January.

During the six months ended June 30, 2006, and 2005, the Company issued approximately 20,000 and 51,000 shares, respectively, under the ESPP Plan. The ESPP Plan was terminated upon expiration of the offering period on January 31, 2006.

*Stock Option Valuation and Expense Information under SFAS 123(R)*

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R) (SFAS No. 123(R)), *Share-Based Payment*, which establishes accounting for equity instruments exchanged for employee services. Under the provisions of SFAS No. 123(R), share-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant). Prior to January 1, 2006, the Company accounted for share-based compensation to employees in accordance with Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. The Company also followed the disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. The Company elected to adopt the modified prospective transition method as provided by SFAS No. 123(R) and, accordingly, financial statement amounts for the prior periods presented in this Form 10-Q have not been restated to reflect the fair value method of expensing share-based compensation.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* (the FSP). The FSP provides that companies may elect to use a specified "short-cut" method to calculate the historical pool of windfall tax benefits upon adoption of SFAS No. 123(R). The Company elected to use the "short-cut" method when SFAS No. 123(R) was adopted by the Company on January 1, 2006.

Share-based compensation expense recognized in the condensed consolidated statement of operations for the three and six months ended June 30, 2006 is based on awards ultimately expected to vest, and has been reduced for estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based partially on historical experience. In the Company's pro forma information required under SFAS No. 123 for the periods prior to January 1, 2006, the Company did not established estimates for forfeitures.

The following table summarizes the share-based compensation expense included in operating expense captions that the Company recorded within the accompanying condensed consolidated statements of income (amounts in thousands):

	<b>Three Months Ended June 30, 2006</b>	<b>Six Months Ended June 30, 2006</b>
Cost of revenues	\$ 51	\$ 146
Engineering and development	106	287
Sales and marketing	27	69
General and administrative	971	2,264

Share-based compensation expense	\$	1,155	\$	2,766
----------------------------------	----	-------	----	-------

Except as noted below, the Company estimates the fair value of options granted using the Black-Scholes option valuation model. It estimates the volatility of the Company's common stock at the date of grant based on its historical volatility rate, consistent with Staff Accounting Bulletin No. 107 (SAB 107). The Company's decision to use historical volatility was based upon the limited amount of actively traded options on its common stock and its assessment that historical volatility is more representative of future stock price trends than implied volatility. Lightbridge estimates the expected term to be consistent with the simplified method identified in SAB 107 for share-based awards granted during the six months ended June 30, 2006. The simplified method calculates the expected term as the average of the vesting and contractual terms of the award. The dividend yield assumption is based on historical and expected dividend payouts. The risk-free interest rate assumption is based on observed interest rates appropriate for the term of the Company's employee options. The Company uses historical data to estimate pre-vesting option forfeitures and records share-based compensation expense only for those awards that are expected to vest. For options granted, the Company amortizes the fair value on a straight-line basis over the vesting period of the options.

**Table of Contents**

Lightbridge used the following assumptions to estimate the fair value of share-based payment awards:

	<b>Six Months Ended June 30, 2006</b>		
	<b>Stock Options</b>		<b>Employee Stock Purchase Plan (1)</b>
Expected term (years)	6.25		0.50
Expected volatility	60%	62%	38%
Risk-free interest rate (range)	4.3	5.2%	4.6%
Expected dividend yield	0.0%		0.0%

(1) The 1996 Employee Stock Purchase Plan was terminated upon expiration of the offering period ended January 31, 2006.

During 2004 and 2005, the Company granted stock options to certain executive officers that provide for vesting of the options upon the achievement of stock price performance. During the three months ended March 31, 2006, 125,000 of these options vested because the average closing price of the Company's common stock reached \$10.00 for over 20 consecutive days. During the three months ended June 30, 2006, 50,000 of these options vested because the average closing price of the Company's common stock reached \$12.50 for over 20 consecutive days. Additional vesting of 50,000, and 50,000 shares under such stock options could occur if the average closing price of the Company's common stock over 20 consecutive days reaches \$15.00, and \$17.50, respectively. The estimated fair value of these options was calculated using a Monte Carlo simulation model that estimated (i) the probability that the performance goal will be achieved, and (ii) the length of time required to attain the target market price. The Company recognized approximately \$0.1 million and \$1.0 million of share-based compensation expense related to these options during the three months ended June 30 and March 31, 2006, respectively.

*Share Awards*

The value of restricted share awards is determined by their intrinsic value (as if the underlying shares were vested and issued) on the grant date. The following table summarizes the Company's time-based non-vested share activity for the six months ended June 30, 2006:

The following table summarizes the status of the Company's non-vested restricted shares:

	<b>Number of Shares</b>	<b>Weighted Average Fair Value</b>
Non-vested at December 31, 2005		\$
Granted	30,000	13.17
Vested		
Forfeited		



Non-vested at June 30, 2006	30,000	\$	13.17
-----------------------------	--------	----	-------

*Stock Option Pro Forma Information under SFAS 123*

The Company did not recognize compensation expense for employee share-based awards for the three and six months ended June 30, 2005, when the exercise price of the Company's employee stock awards equaled the market price of the underlying stock on the date of grant. The Company had previously adopted the provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, (SFAS 123), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, through disclosure only. The following table illustrates the effects on net income and earnings per share for the three and six months ended June 30, 2005, as if the Company had applied the fair value recognition provisions of SFAS 123 to share-based employee awards.

**Table of Contents**

	<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Income from continuing operations as reported	\$ 2,353	\$ 3,507
Add: Stock-based compensation included in income		
Deduct: Total stock-based employee compensation expense determined under fair value method	(342)	(799)
Pro forma income from continuing operations	\$ 2,011	\$ 2,708
Income from continuing operations per common share basic and diluted as reported	\$ 0.09	\$ 0.13
Income from continuing operations per common share basic pro forma	\$ 0.08	\$ 0.10
Income from continuing operations per common share diluted pro forma	\$ 0.07	\$ 0.10
Net income as reported	\$ 15,212	\$ 14,112
Add: Stock-based compensation included in (loss) income		
Deduct: Total stock-based employee compensation expense determined under fair value method	(408)	(977)
Pro forma net income	\$ 14,804	\$ 13,135
Net loss per common share basic as reported	\$ 0.57	\$ 0.53
Net loss per common share diluted as reported	\$ 0.56	\$ 0.52
Net loss per common share basic pro forma	\$ 0.56	\$ 0.49
Net loss per common share diluted pro forma	\$ 0.55	\$ 0.49

The fair value of options on their grant date was measured using the Black-Scholes Option Pricing Model. Key assumptions used to apply this pricing model are as follows:

**Six Months  
Ended  
June 30,**

Risk-free interest rate	<b>2005</b> 2.8%
Expected life of options grants	1- 5 years
Expected volatility of underlying stock	63%
Expected dividend payment rate, as a percentage of the stock price on the date of grant	0.0%

The following table presents activity under all stock option plans:

	<b>Shares (In thousands)</b>	<b>Weighted- Average Exercise Price</b>	<b>Weighted- Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value (In thousands)</b>
Outstanding at December 31, 2005	3,821	\$ 7.23	7.55	
Granted	626	11.31		
Exercised	(459)	7.14		
Forfeited or expired	(705)	10.69		
Outstanding at June 30, 2006	3,283	\$ 7.30	8.19	\$ 19,100
Options exercisable at June 30, 2006	1,553	\$ 7.15	7.58	\$ 9,500

**Table of Contents**

The following table sets forth information regarding options outstanding at June 30, 2006:

<b>Number of Options (In thousands)</b>	<b>Range of Exercise Prices</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>	<b>Number Currently Exercisable (In thousands)</b>	<b>Weighted Average Exercise Price for Currently Exercisable</b>
	\$3.75				
314	\$3.76	\$ 3.76	8.10	306	\$ 3.76
323	4.44 4.67	4.67	8.21	117	4.67
358	4.82 5.60	5.42	7.90	174	5.46
207	5.76 6.10	5.91	8.07	116	5.91
400	6.11	6.11	8.52	128	6.11
368	6.16	6.16	8.55	108	6.16
344	6.17 7.70	6.82	7.91	172	6.88
503	7.72 9.78	9.39	8.40	196	9.01
346	9.81 13.17	12.34	8.33	130	11.66
	13.37				
120	37.32	17.13	6.73	106	17.54
3,283		\$ 7.30	8.19	1,553	\$ 7.15

The weighted average grant date fair value of options granted during the six months ended June 30, 2006 was \$6.97. The aggregate intrinsic value of outstanding options as of June 30, 2006 was \$19.1 million. The intrinsic value of options exercised during the period was \$1.5 million.

As of June 30, 2006, there was \$6.4 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Company's stock plans including non-vested restricted share awards. That cost is expected to be recognized over a weighted-average period of 2.78 years.

The Company received \$3.4 million in cash from option exercises and issuances of stock under the ESPP Plan for the six months ended June 30, 2006. The excess tax benefits of \$0.5 million attributable to option exercises and issuances are reflected on a with-and-without method and will be recognized when the benefit is realized.

#### **4. DISCONTINUED OPERATIONS**

##### **Intelligent Network Solutions (INS) Business**

On April 25, 2005, the Company announced that it had entered into an asset purchase agreement for the sale of its INS business, which included its PrePay IN product and related services, to VeriSign, Inc. The sale was completed on June 14, 2005 for \$17.45 million in cash plus assumption of certain contractual liabilities. Of the sale price \$1.745 million is being held in escrow, \$1.495 million is being held by VeriSign, and \$0.25 million is being held by the Company. The Company will record the amounts in escrow as a gain upon the expiration of certain representations and warranties expire after an 18-month period after closing and will be recorded as a gain, net of possible indemnity claims at that time.

In addition, a liability has been established of \$0.45 million in accordance with FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, based on the estimated cost if the Company were to purchase an insurance policy to cover up to \$5 million of indemnification obligations for certain potential breaches of its intellectual property representations and warranties in the asset purchase agreement with VeriSign. Such representations and warranties extend for a period of two years and expire on June 14, 2007. The operating results and financial condition of this former INS segment

have been reported as discontinued operations in the accompanying consolidated financial statements in accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*, as the sale was completed during the second quarter of 2005. All comparative prior period amounts have been restated in a similar manner.

Included in the amounts reported for net income from discontinued operations for the three and six months ended June 30, 2005 is the gain on the sale of the INS business of \$12.7 million (net of income tax provision of \$0.1 million) and a \$1.4 million settlement received by the Company from a lawsuit between Lucent Technologies, Inc. and the Company that was finalized in the second quarter of 2005.

**Table of Contents****Instant Conferencing Business**

In the first quarter of 2005, the Company made the decision to no longer actively market or sell its GroupTalk product and took actions to outsource the continuing operations of its Instant Conferencing business. On August 17, 2005, the Company and America Online, Inc. mutually agreed to terminate the master services agreement under which the Company provided our GroupTalk instant conferencing services to America Online, Inc. Lightbridge subsequently terminated all of the outsourcing agreements for its GroupTalk services and ceased operations of the Instant Conferencing business in the third quarter of 2005.

In accordance with SFAS 144, the operating results of the former INS and Instant Conferencing segments have been included as part of the financial results from discontinued operations in the accompanying consolidated financial statements. The components of losses from operations of discontinued operations previously classified as operating activities are as follows (amounts in thousands):

	<b>Three Months Ended June</b>	
	<b>2006</b>	<b>30, 2005</b>
Results of operations:		
Total Gross Profit	\$	\$ 2,841
Total Operating Expenses		2,671
Discontinued operations		170
Gain on sale of INS		12,689
Total discontinued operations, net of income taxes	\$	\$ 12,859
	<b>Six Months Ended June</b>	
	<b>2006</b>	<b>30, 2005</b>
Results of operations:		
Total Gross Profit	\$ 468	\$ 4,457
Total Operating Expenses		6,541
Discontinued operations	468	(2,084)
Gain on sale of INS		12,689
Total discontinued operations, net of income taxes	\$ 468	\$ 10,605

The Company recorded net income from discontinued operations of \$0 and \$12.9 million for the three months ended June 30, 2006 and 2005, respectively, and the Company recorded net income from discontinued operations of \$0.5 million and \$10.6 million for the six months ended June 30, 2006 and 2005, respectively. The net income from discontinued operations in 2006 represents a refund received for telecommunications costs previously paid which

related to the Instant Conferencing segment. The net income from discontinued operations for the three and six months ended June 30, 2005 includes a gain on sale of the INS business of \$12.7 million and the operating results of the INS and Instant Conferencing segments.

**5. DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION**

Based upon the way financial information is provided to the Company's Chief Executive Officer for use in evaluating allocation of resources and assessing performance of the business, the Company reports its operations in two distinct operating segments, described as follows:

Payment Processing Services (Payment Processing) This segment provides a transaction processing system under the

Authorize.Net® brand that allows businesses to authorize, settle and manage credit card, electronic check and other electronic payment transactions online.

Telecom Decisioning Services (TDS) This segment provides wireless subscriber qualification, risk assessment, fraud screening, consulting services and contact center services to telecommunications and other companies.

**Table of Contents**

In the Company's Quarterly Report on Form 10-Q, as amended, for the three and six months ended June 30, 2005, the Company reported segment information for the Instant Conferencing Services (Instant Conferencing) business as a separate segment. The operating results and financial condition of the Instant Conferencing segments have been included as part of the financial results from discontinued operations in the accompanying condensed consolidated financial statements and, accordingly, the Company's segment information has been restated. All prior period segment financial information has been restated to conform with the current presentation. See Note 4, Discontinued Operations, for additional information about these businesses.

Within segments, performance is measured based on revenue, gross profit and operating income (loss) realized from each segment. There are no transactions between segments. The Company generally does not allocate share-based compensation, corporate or centralized marketing and general and administrative expenses to its business unit segments, because these activities are managed separately from the business units. Also, the Company does not allocate restructuring expenses and other non-recurring gains or charges to its business unit segments because the Company's Chief Executive Officer evaluates the segment results exclusive of these items. Asset information by operating segment is not reported to or reviewed by the Company's Chief Executive Officer, and therefore the Company has not disclosed asset information for each operating segment.

Financial information for each reportable segment from continuing operations as restated for the three and six months ended June 30, 2006, and 2005 were as follows (amounts in thousands):

<b>Three Months Ended June 30, 2006</b>	<b>TDS</b>	<b>Payment Processing</b>	<b>Sub-total Reportable Segments</b>	<b>Reconciling Items</b>	<b>Consolidated Total</b>
Revenues	\$ 11,306	\$ 13,917	\$ 25,223	\$	\$ 25,223
Gross profit	3,452	11,040	14,492	(51)(1)	14,441
Operating income (loss)	1,345	4,180	5,525	(5,687)(2)	(162)
Depreciation and amortization	701	1,094	1,795	157(3)	1,952

<b>Three Months Ended June 30, 2005</b>	<b>TDS</b>	<b>Payment Processing</b>	<b>Sub-total Reportable Segments</b>	<b>Reconciling Items</b>	<b>Consolidated Total</b>
Revenues	\$ 15,817	\$ 10,747	\$ 26,564	\$	\$ 26,564
Gross profit	6,078	8,470	14,548		14,548
Operating income	3,204	2,453	5,657	(3,190)(2)	2,467
Depreciation and amortization	983	1,039	2,022	217(3)	2,239

<b>Six Months Ended June 30, 2006</b>	<b>TDS</b>	<b>Payment Processing</b>	<b>Sub-total Reportable Segments</b>	<b>Reconciling Items</b>	<b>Consolidated Total</b>
Revenues	\$ 24,395	\$ 27,370	\$ 51,765	\$	\$ 51,765
Gross profit	7,762	21,630	29,392	(146)(1)	29,246
Operating income	3,540	8,169	11,709	(11,226)(2)	483
Depreciation and amortization	1,386	2,209	3,595	313(3)	3,908

<b>Six Months Ended June 30, 2005</b>	<b>TDS</b>	<b>Payment Processing</b>	<b>Sub-total Reportable Segments</b>	<b>Reconciling Items</b>	<b>Consolidated Total</b>
Revenues	\$ 32,890	\$ 20,847	\$ 53,737	\$	\$ 53,737
Gross profit	11,950	16,275	28,225		28,225
Operating income	5,679	4,550	10,229	(6,392)(2)	3,837
Depreciation and amortization	2,132	2,086	4,218	420(3)	4,638



- (1) Represents share-based compensation included in the unallocated gross profit.

**Table of Contents**

- (2) Reconciling items from segment operating income to consolidated operating income include the following (amounts in thousands):

	<b>Three Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Restructuring charges	\$ 937	\$ (8)
Litigation settlement, net	1,500	
Unallocated corporate and centralized marketing, general and administrative expenses	2,146	3,198
Unallocated share-based compensation	1,104	
 Total	 \$ 5,687	 \$ 3,190

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Restructuring charges	\$ 2,330	\$ 376
Litigation settlement, net	1,500	
Unallocated corporate and centralized marketing, general and administrative expenses	4,776	6,016
Unallocated share-based compensation	2,620	
 Total	 \$ 11,226	 \$ 6,392

- (3) Represents depreciation and amortization included in the unallocated corporate or centralized marketing, general and administrative expenses.

## **6. GOODWILL IMPAIRMENT ANALYSIS**

In accordance with Statement of Financial Accounting Standard No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*, the Company is required to analyze the carrying value of goodwill and other intangible assets against the estimated fair value of those assets for possible impairment on an annual basis. If impairment has occurred, the Company will record a charge in the amount by which the carrying value of the assets exceeds their estimated fair value. Estimated fair value will generally be determined based on discounted cash flows. On March 31, 2006, the Company performed the annual impairment test for the goodwill balance of \$57.6 million related to the acquisition of Authorize.Net. The Company used the discounted cash flow and market methodologies to determine the fair value of the reporting unit related to these intangible assets. The discounted cash flow methodology is based upon converting expected cash flows to present value. A comparison of the resulting fair value of the reporting unit to its carrying amount, including goodwill, indicated that the goodwill balance was not impaired as of March 31, 2006. There have been no events since March 31, 2006 that would require us to perform an additional assessment of goodwill.

## **7. COMMITMENTS AND CONTINGENCIES**

### **Merchant Funds**

At June 30, 2006, the Company was holding funds in the amount of \$8.5 million due to merchants comprised of \$7.5 million held for Authorize.Net's eCheck.Net® product, and \$1.0 million held for Authorize.Net's Integrated Payment Solution (IPS) product. The funds are included in cash and cash equivalents and funds due to merchants on the Company's consolidated balance sheet. Authorize.Net typically holds eCheck.Net funds for approximately seven business days; the actual number of days depends on the contractual terms with each merchant. The \$1.0 million held for IPS includes funds from processing both credit card and Automated Clearing House (ACH) transactions. IPS credit card funds are held for approximately two business days; IPS ACH funds are held for approximately four business days, according to the requirements of the IPS product and the contract between Authorize.Net and the financial institution through which the transactions are processed.

In addition, the Company has \$0.5 million on deposit with a financial institution to cover any deficit account balance that could occur if the amount of eCheck.Net transactions returned or charged back exceeds the balance on deposit with the financial institution. To date, the deposit has not been applied to offset any deficit balance, and management believes that the likelihood of incurring a deficit balance with the financial institution due to the amount of transactions returned or charged back is remote. The deposit will be held continuously for as long as Authorize.Net utilizes the ACH processing services of the financial institution, and the amount of the deposit may increase as processing volume increases.

**Table of Contents****Legal Proceedings***Litigation Settlement*

In May 2006, the Company entered into a settlement agreement with respect to certain litigation involving Net MoneyIN, Inc. Pursuant to the agreement, the Company agreed to pay Net MoneyIN, Inc. a lump sum payment of \$1.75 million in exchange for a license grant, release and covenant not to sue. The cost of the settlement to the Company was \$1.5 million net of \$0.25 million received from another party named in the litigation. The Company recorded this cost in its general and administrative expenses.

The Company had incurred legal expenses in 2005 and 2004 of approximately \$1.1 million and \$0.2 million, respectively, in connection with the defense of this lawsuit following the Company's acquisition of Authorize.Net. The Company does not expect to incur any further litigation costs related to this lawsuit after the second quarter of 2006.

The Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business. On a quarterly basis, the Company reviews its commitments and contingencies to reflect the effect of ongoing negotiations, settlements, rulings, advice of counsel, and other information and events pertaining to a particular case.

**Leases**

As of June 30, 2006, the Company's primary contractual obligations and commercial commitments are under its operating leases and a letter of credit. The Company maintains a letter of credit in the amount of \$1.6 million, as required for security under the operating lease for its corporate headquarters.

The Company has non-cancelable operating lease agreements for office space and certain equipment. These lease agreements expire at various dates through 2011 and certain of them contain provisions for extension on substantially the same terms as are currently in effect.

Future minimum payments under operating leases, including facilities affected by restructurings and the Company's headquarters lease, consisted of the following at June 30, 2006 (amounts in thousands):

	<b>Operating Leases</b>
Remainder of 2006	\$ 1,845
2007	3,763
2008	3,164
2009	2,511
2010	2,075
Thereafter	1,686
Total minimum lease payments	 \$ 15,044

**8. RESTRICTED CASH**

As of June 30, 2006, the Company has provided \$1.6 million of cash as collateral for a letter of credit, which is required for security under an operating lease for its corporate headquarters. The Company is required to maintain this letter of credit throughout the term of the lease, which expires in 2011. In addition, as described in Note 7 above, the Company has \$0.5 million on deposit with a financial institution to cover any deficit account balance that could occur if the amount of transactions returned or charged back exceeds the balance on deposit with the financial institution.

**9. EARNINGS PER SHARE (EPS)**

Basic EPS is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock.

**Table of Contents**

A reconciliation of the shares used to compute basic income per share from continuing operations to those used for diluted income per share from continuing operations is as follows (in thousands):

	<b>Three Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Shares for basic computation	27,243	26,623
Options and warrants (treasury stock method)	1,088	391
Shares for diluted computation	28,331	27,014
	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Shares for basic computation	27,134	26,592
Options and warrants (treasury stock method)	925	371
Shares for diluted computation	28,059	26,963

Stock options for which the exercise price exceeds the average market price over the period have an anti-dilutive effect on EPS and, accordingly, are excluded from the diluted computations for both periods presented. Had such shares been included, shares for the diluted computation would have increased by approximately 345,000 and 1,945,000 for the three months ended June 30, 2006 and 2005, respectively, and approximately 373,000 and 2,459,000 for the six months ended June 30, 2006 and 2005, respectively. The EPS calculation has been restated to reflect the change in income from continuing operations due to the Company's INS and Instant Conferencing segments now being accounted for as discontinued operations.

**10. RESTRUCTURING**

The following table summarizes the activity in the restructuring accrual for the six months ended June 30, 2006 (amounts in thousands):

	<b>Employee Severance and Termination Benefits</b>	<b>Facility Closing and Related Costs</b>	<b>Asset Impairment</b>	<b>Total</b>
Accrued restructuring balance at December 31, 2005	\$ 17	\$ 972	\$	\$ 989
Restructuring accrual January 2006	1,396			1,396
Cash payments	(1,198)	(39)		(1,237)
Restructuring adjustments	(3)			(3)
Accrued restructuring balance at March 31, 2006	\$ 212	\$ 933	\$	\$ 1,145

Restructuring accrual	May 2006	61		862	923
Impairment of assets				(862)	(862)
Cash payments		(184)	(159)		(343)
Restructuring adjustments		3	11		14
Accrued restructuring balance at June 30, 2006		\$ 92	\$ 785	\$	\$ 877

In May 2006, the Company announced the planned closing of the Liverpool, Nova Scotia contact center. Related to this closing, the Company recorded a charge of \$0.9 million during the second quarter of 2006 related to the asset impairment. The Company expects to incur a charge of approximately \$0.5 million to \$0.7 million during the third quarter of 2006 for employee severance and facility closing related costs. The Company expects to close the center in the third quarter of 2006.

In January 2006, the Company announced a workforce reduction focused primarily within the TDS business, as well as reductions in general and administrative expenses. The restructuring consisted of a total workforce reduction of about 28 positions, and the Company recorded a restructuring charge of \$1.4 million in the first quarter of 2006, primarily related to employee severance and termination benefits.

**Table of Contents****11. PROVISION FOR INCOME TAXES**

The Company provides for income taxes on an interim basis based on the full-year projected effective tax rate. The Company's effective tax rate was 22% for the six months ended June 30, 2006, as compared to 21% for the six months ended June 30, 2005. The income tax provision for the six months ended June 30, 2006 of \$0.6 million reflects a current provision of \$0.1 million for federal, state and foreign taxes and a deferred federal and state provision of \$0.5 million attributable to amortization of intangibles for tax purposes with indefinite lives. The income tax provision for the six months ended June 30, 2005 of \$0.9 million reflects a current provision for state and foreign taxes of \$0.1 million and a deferred federal and state provision of \$0.8 million attributable to amortization of intangibles for tax purposes with indefinite lives. At June 30, 2006, the Company continues to believe a full valuation allowance is required until an appropriate level of profitability is sustained that would enable the Company to conclude that it is more likely than not that a portion of the Company's deferred taxes would be realizable.

**12. COMPREHENSIVE INCOME**

The amounts that comprise comprehensive loss for the three and six months ended June 30, 2006 and 2005 are as follows (in thousands):

	<b>Three Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Net income as reported	\$ 854	\$ 15,212
Other comprehensive income:		
Unrealized loss on short-term investments	6	
Foreign currency gain	67	15
Comprehensive income	\$ 927	\$ 15,227

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Net income as reported	\$ 2,486	\$ 14,112
Other comprehensive income:		
Unrealized loss on short-term investments	10	
Foreign currency gain	59	225
Comprehensive income	\$ 2,555	\$ 14,337

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

*This Quarterly Report on Form 10-Q contains Forward-Looking Statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, plans, expects and similar expressions are intended to identify forward-looking statements. The forward-looking statements involve known and unknown risks, uncertainties and other factors, including the factors set forth under the heading Risk Factors in Part II., Item I.A. below that may cause the actual results, performance and achievements of Lightbridge to differ materially from those indicated by the forward-looking statements. Lightbridge undertakes no obligation to update any forward-looking statements it makes.*

AIRPAY BY AUTHORIZE.NET, ALIAS, ALTALINKS, AUTHORIZE-IT, AUTHORIZE.NET, the Authorize.Net logo, AUTHORIZE.NET WHERE THE WORLD DOES BUSINESS ON THE WEB, AUTHORIZE.NET WHERE THE WORLD TRANSACTS, CAS, CUSTOMER ACQUISITION SYSTEM, ECHECK.NET, FRAUDBUSTER, FRAUD CENTURION, FRAUDSCREEN.NET, FRAUD SENTINEL, LIGHTBRIDGE, the Lightbridge logo, POCKET AUTHORIZE.NET, and PROFILE are registered trademarks of Lightbridge, and @RISK, AUTOMATED RECURRING BILLING, AUTHENTICATENOW, AUTHORIZE.NET YOUR GATEWAY TO IP TRANSACTIONS, CDS, CREDIT DECISION SYSTEM, ECHECK, EDM, ENHANCED DECISION MANAGEMENT, FRAUDBRIDGE, FRAUD DETECTION SUITE, INSIGHT, LIGHTBRIDGE TELESERVICES, POPS, POINT OF PURCHASE SYSTEM, RMS, and RETAIL MANAGEMENT SYSTEM are trademarks of Lightbridge. All other trademarks or trade names appearing in this Quarterly Report on Form 10-Q are the property of their respective owners.



**Table of Contents**

The following discussion and analysis of our financial conditions and results of operations has been restated to give effect to the restatement of the cash flows as described in Note 2 to the consolidated financial statements and the operations that were discontinued during 2005. See *Discontinued Operations* below and Note 4 to the consolidated financial statements for further information concerning discontinued operations.

**Overview**

We develop, market and support a suite of products and services for both merchants and communication providers. Our Payment Processing segment offers a transaction processing system under the Authorize.Net® brand that allows businesses to authorize, settle and manage credit card, electronic check and other electronic payment transactions online. Our Telecom Decisioning Services (TDS) segment provides wireless subscriber qualification, risk assessment, fraud screening, consulting services and contact center services to telecommunications and other companies.

A majority of our revenues historically have been derived from clients located in the United States. Our revenues are derived from transaction services and consulting and maintenance services.

Transaction services revenues related to payment processing are derived from our credit card processing and ACH processing services, and other services (collectively, *processing services*). Processing services revenue is based on a one-time set up fee, a monthly gateway fee, and a fee per transaction. The per transaction fee is recognized in the period in which the transaction occurs. Gateway fees are monthly subscription fees charged to our merchant customers for the use of our payment gateway. Gateway fees are recognized in the period in which the service is provided. Set-up fees represent one-time charges for initiating our processing services. Although these fees are generally paid to us at the commencement of the agreement, they are recognized ratably over the estimated average life of the merchant relationship, which is determined through a series of analyses of active and deactivated merchants.

Our transaction service revenues are derived primarily from the processing of applications for qualification of subscribers for telecommunications services, the activation of services for those subscribers and from the processing of payment transactions for merchants. Our telecommunications transactions offerings include screening for subscriber fraud, evaluating carriers' existing accounts, interfacing with carrier and third-party systems and providing contact center services. We also offer transaction services to screen and authenticate the identity of users engaged in online transactions. Our transaction-based solutions provide multiple, remote, systems access for workflow management, along with centrally managed client-specified business policies, and links to client and third-party systems. Transaction services are provided through contracts with carriers and others, which specify the services to be utilized and the markets to be served. Our clients are charged for these services on a per transaction basis. Pricing varies depending primarily on the volume and type of transactions, the number and type of other products and services selected for integration with the services and the term of the contract under which services are provided. The volume of transactions processed varies depending on seasonal and retail trends, the success of the carriers and others utilizing our services in attracting subscribers and the markets served by our clients. Transaction revenues are recognized in the period in which the services are performed.

We believe we may continue to experience changes in the combination of services acquired by TDS clients and that competitive pricing pressures will continue to negatively affect transaction revenues in 2006. In order to add to our business, we are seeking to expand our reach in the e-commerce and payment processing business markets and to target industry sectors in the TDS business we do not currently serve and to add new telecommunications clients. Commissions paid to outside sales partners are recorded in sales and marketing expense in our statements of operations in the month in which the related revenue is recognized.

Our consulting revenues are derived principally from providing solution development and deployment services and business advisory consulting in the areas of customer acquisition and retention, authentication, and risk management. The majority of consulting engagements are performed on a time and materials basis and revenues from these engagements are recognized based on the number of hours worked by our consultants at an agreed upon rate per hour and are recognized in the period in which services are performed. When we perform work under a fixed fee arrangement, revenues are generally recognized on the proportional performance method of accounting based on the ratio of labor hours incurred to estimated total labor hours. In instances where the customer, at its discretion, has the right to reject the services prior to final acceptance, revenue is deferred until such acceptance occurs. Revenues from software maintenance and support contracts are recognized ratably over the term of the agreement.

**Recent Developments**

In May 2006, we announced the planned closing of the Liverpool, Nova Scotia contact center. Related to this closing, we recorded a charge of \$0.9 million during the second quarter of 2006 related to the asset impairment and we expect to incur a charge of approximately \$0.5 million to \$0.7 million during the third quarter of 2006 for employee severance and facility closing related costs. We expect the center will be closed in the third quarter of 2006.

**Table of Contents**

In May 2006, we were advised by T-Mobile USA, Inc. (T-Mobile) that T-Mobile planned to consolidate its contact center business and begin the transition of that business from us to other vendors. Commencing in the third quarter of 2006, we do not expect T-Mobile to be a significant contact center customer. In the first and second quarters of 2006, revenue from T-Mobile was approximately \$2.3 and \$2.1 million respectively.

In May 2006, we entered into a settlement agreement with respect to certain litigation involving Net MoneyIN, Inc. Pursuant to the agreement, we agreed to pay Net MoneyIN, Inc. a lump sum payment of \$1.75 million in exchange for a license grant, release and covenant not to sue. The cost of the settlement to us was \$1.5 million net of \$0.25 million received from another party named in the litigation. We recorded this cost in general and administrative expenses. We had incurred legal expenses in 2005 and 2004 of approximately \$1.1 million and \$0.2 million, respectively, in connection with the defense of this lawsuit and we expected to incur additional costs of approximately \$1.5 million in 2006 had we not entered in to the settlement agreement. We do not expect to incur any further litigation costs related to this lawsuit after the second quarter of 2006.

On January 13, 2006, we announced a restructuring focused primarily within the TDS business, as well as reductions in general and administrative expenses. This action reflects our continued commitment to align cost and revenue. The restructuring consisted of a total workforce reduction of about 28 positions, and we recorded a restructuring charge of approximately \$1.4 million in the first quarter of 2006, primarily related to employee severance and termination benefits.

During 2005, we evaluated strategic alternatives for the TDS business. We engaged investment bankers to investigate a range of possibilities, including a sale or other disposition of the TDS business. In December 2005, we announced that we had concluded the investigation of possible strategic alternatives, and decided to continue to operate the TDS business. Also during 2005, we sold our INS business and ceased the operation of our Instant Conferencing business. The INS business and our Instant Conferencing business are presented as discontinued operations.

**Critical Accounting Policies and Estimates**

Management's discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements 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 condensed consolidated financial statements and the reported amounts of revenue and expense during the reporting period. On an ongoing basis, we evaluate our estimates, including those listed below. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. However, our actual results could differ from those estimates.

We believe the following critical accounting policies affect our significant estimates and assumptions used in the preparation of our condensed consolidated financial statements. A full discussion of the following accounting policies is included in our 2005 Annual Report on Form 10-K filed with the Securities and Exchange Commission and we refer the reader to that discussion.

Revenue Recognition

Allowance for Doubtful Accounts

Income Taxes and Deferred Taxes

Restructuring Estimates

Goodwill and Acquired Intangible Assets

We updated our critical accounting policies during the six months ended June 30, 2006 as follows:

*Share-Based Compensation.* Effective January 1, 2006, we account for employee stock-based compensation costs in accordance with Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS

123(R)). Except as noted below, we utilize the Black-Scholes option pricing model to estimate the fair value of employee stock based compensation at the date of grant, and used the Monte Carlo simulation model for the share-based performance options, which both require the input of highly subjective assumptions, including expected volatility and expected life. Further, as required under SFAS 123(R), we now estimate forfeitures for options granted that are not expected to vest. Changes in these inputs and assumptions can materially affect the measure of estimated fair value of our share-based compensation.

**Table of Contents**

*Internal-use Software.* Costs incurred to develop internal-use software during the application development stage are capitalized and reported at cost, subject to an impairment test as described below. Application development stage costs generally include costs associated with internal-use software configuration, coding, installation and testing. Costs of significant upgrades and enhancements that result in additional functionality are also capitalized whereas costs incurred for maintenance and minor upgrades and enhancements are expensed as incurred. We assess potential impairment of capitalized internal-use software whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted net cash flows that are expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. This analysis requires us to estimate future net cash flows associated with the assets. If these estimates change, reductions or write-offs of internal-use software costs could result.

**Operating Segments**

Based upon the way financial information is provided to our chief operating decision maker, the Chief Executive Officer, for use in evaluating allocation of resources and assessing performance of the business, we now report our operations in two distinct operating segments: Payment Processing Services, and Telecom Decisioning Services (TDS).

The Payment Processing segment offers a transaction processing system under the Authorize.Net® brand that allows businesses to authorize, settle and manage credit card, electronic check and other electronic payment transactions online. The TDS segment provides wireless subscriber qualification, risk assessment, fraud screening, consulting services and contact center services to telecommunications and other companies. Within these two segments performance is measured based on revenue, gross profit and operating income (loss) realized from each segment. There are no transactions between segments.

We do not allocate shared-based compensation, certain corporate or centralized marketing and general and administrative expenses to our business unit segments, because these activities are managed separately from the business units. Also, we do not allocate restructuring expenses and other non-recurring gains or charges to our business unit segments because our Chief Executive Officer evaluates the segment results exclusive of these items. Asset information by operating segment is not reported to or reviewed by our Chief Executive Officer and therefore we have not disclosed asset information for each operating segment.

The historical operating results associated with our Retail Management System (RMS) product, which we no longer actively market or sell, are included in our TDS segment.

**Results Of Operations*****Quarter Ended June 30, 2006 Compared with Quarter Ended June 30, 2005.***

*Revenues.* Revenues and certain revenue comparisons for the quarters ended June 30, 2006 and 2005 were as follows:

	<b>Quarter Ended June 30, 2006</b>	<b>Quarter Ended June 30, 2005</b>	<b>\$ Difference</b>	<b>% Difference</b>
	<b>(Dollars in thousands)</b>			
Transaction services:				
Payment Processing (Authorize.Net)	\$ 13,917	\$ 10,747	\$ 3,170	29.5%
TDS	10,634	14,400	(3,766)	(26.2)
Total Transaction services revenues	24,551	25,147	(596)	(2.4)

Consulting and maintenance services:

TDS	672	1,417	(745)	(52.6)
Total	\$ 25,223	\$ 26,564	\$ (1,341)	(5.0)%

The decrease in transaction services revenues was primarily due to a \$3.8 million decline in transactions services revenues from our TDS segment offset by a \$3.2 million increase in Authorize.Net's revenue. Authorize.Net's revenues for the quarter increased 29.5% compared to the same period in 2005. The increased revenues were primarily the result of an increase in the number of merchant customers and the volume of transactions processed. The decline in TDS transaction services revenues was primarily a result of a \$3.5 million reduction in transaction fees charged to Sprint/Nextel following the merger between Sprint Spectrum L.P. (Sprint) and Nextel Operations, Inc. (Nextel), a decrease in transaction fees charged to AT&T Wireless Services, Inc. (AT&T Wireless), and an unfavorable change in the mix of services provided to our TDS clients.

**Table of Contents**

In the near term, we expect transaction services revenue from Authorize.Net to continue to increase. However, in the near term, we also expect transaction services revenue associated with our TDS segment to decline from the second quarter 2006 level as a result of continued pricing pressures and as a result of T-Mobile's decision to consolidate its contact center business with other vendors. We expect TDS transaction services revenues to continue to reflect the industry's rate of growth of new subscribers as well as the rate of switching among carriers by subscribers (subscriber churn). We believe that transaction revenue in future periods will continue to be impacted by changes in the demand for our transaction offerings, changes in the combination of services purchased by clients, carrier consolidation, and competitive pricing pressures.

The decrease in consulting and maintenance services revenues of \$0.7 million was principally due to a decrease in consulting fees charged to AT&T of \$0.3 million and a decline in consulting and maintenance revenues related to our decision to no longer actively market, sell or develop our RMS product. We believe that consulting and maintenance services revenue related to our TDS segment will continue to be impacted by pricing pressures and a reduced level of consulting activity.

**Cost of Revenues and Gross Profit.** Cost of revenues consists primarily of personnel costs, costs of maintaining systems and networks used in processing qualification and activation transactions (including depreciation and amortization of systems and networks) and amortization of capitalized software and acquired technology. Cost of revenues for Authorize.Net, included in transaction services cost of revenues, consists of expenses associated with the delivery, maintenance and support of Authorize.Net's products and services, including personnel costs, communication costs, such as high-bandwidth Internet access, server equipment depreciation, transactional processing fees, as well as customer care costs. In the future, cost of revenues may vary as a percentage of total revenues as a result of a number of factors, including changes in the volume of transactions processed, changes in the mix of transaction revenues between those from automated transaction processing and those from processing transactions through our TeleServices contact centers (which have a higher cost component), changes in pricing to certain clients and changes in the mix of total revenues among transaction services revenues, consulting and maintenance services revenues.

Cost of revenues, gross profit and certain comparisons for the quarters ended June 30, 2006 and 2005 were as follows:

	<b>Quarter Ended June 30, 2006</b>	<b>Quarter Ended June 30, 2005</b>	<b>\$ Difference</b>	<b>% Difference</b>
<b>(Dollars in thousands)</b>				
Cost of revenues:				
Transaction services	\$ 10,391	\$ 11,459	\$ (1,068)	(9.3)%
Consulting and maintenance services	391	557	(166)	(29.8)
<b>Total cost of revenues</b>	<b>\$ 10,782</b>	<b>\$ 12,016</b>	<b>\$ (1,234)</b>	<b>(10.3)%</b>
Gross profit:				
Transaction services \$	\$ 14,160	\$ 13,688	\$ 472	3.4%
Transaction services %	57.7%	54.4%		
Consulting and maintenance services \$	\$ 281	\$ 860	\$ (579)	(67.3)%
Consulting and maintenance services %	41.8%	60.7%		
<b>Total gross profit \$</b>	<b>\$ 14,441</b>	<b>\$ 14,548</b>	<b>\$ (107)</b>	<b>(0.7)%</b>

Total gross profit %	57.3%	54.8%
----------------------	-------	-------

Transaction services cost of revenues decreased by \$1.1 million in the quarter ended June 30, 2006 from the prior year. Transactions services cost of revenues from our TDS segment decreased approximately \$1.7 million compared to the same period in 2005. Transactions services cost of revenues from our Payment Processing segment increased by approximately \$0.6 million compared to the same period in the prior year. In our TDS business, we realized reductions in third party data and services costs as a result of processing fewer transactions. We also realized personnel-related savings resulting from our restructuring activities. The increase in our Payment Processing transaction services cost of revenues was primarily due to the increase in the number of transactions processed.

Transaction services gross profit and gross profit percentage increased primarily as a result of Authorize.Net's higher contribution to the transaction services gross profit amount. Authorize.Net's percent of the transaction services gross profit amount was 78% in the quarter ended June 30, 2006 versus 62% in the same quarter of the preceding year as a result of higher revenues. This increase was partially offset by a decrease in the transaction services gross profit related to our TDS segment, where the revenue reduction exceeded the cost of sales expense reduction.



**Table of Contents**

Authorize.Net generated a higher gross profit percentage than our TDS segment, resulting in increased transaction services gross profit percentage in the quarter ended June 30, 2006 than in the same quarter of 2005.

Consulting and maintenance services cost of revenues decreased by \$0.2 million in the second quarter of 2006. This decrease was attributable to a reduction in personnel-related expenses as a result of our restructuring activities. Consulting and maintenance services gross profit and gross profit percentage decreased in the second quarter of 2006 due to the lower revenues from AT&T and our RMS product partially offset by the reduction in personnel-related expenses.

We expect that fluctuations in gross profit may occur in future periods primarily because of a change in the mix of revenue generated from our two revenue components, and also because of competitive pricing pressures.

**Operating Expenses.** Operating expenses and certain operating expense comparisons for the three months ended June 30, 2006 and 2005 were as follows:

	<b>Quarter Ended June 30, 2006</b>	<b>Quarter Ended June 30, 2005</b>	<b>\$ Difference</b>	<b>% Difference</b>
	<b>(Dollars in thousands)</b>			
Engineering and development	\$ 2,946	\$ 3,554	\$ (608)	(17.1)%
Sales and marketing	4,939	4,444	495	11.1
General and administrative	5,781	4,091	1,690	41.3
Restructuring charges and related asset impairments	937	(8)	945	
<b>Total</b>	<b>\$ 14,603</b>	<b>\$ 12,081</b>	<b>\$ 2,522</b>	<b>20.9%</b>

**Engineering and Development.** Engineering and development expenses include software development costs, consisting primarily of personnel and outside technical service costs related to developing new products and services, enhancing existing products and services, and implementing and maintaining new and existing products and services. The \$0.6 million decrease in engineering and development expenses for the quarter ended June 30, 2006 as compared with the same quarter in 2005 was primarily due to cost savings associated with our restructuring activities. The cost savings were partially offset by a \$0.1 million share-based compensation expense due to the adoption of SFAS No. 123(R).

We expect engineering and development expenses for the quarter ending September 30, 2006 to continue to decline in comparison to the prior year level, primarily due to benefits of restructuring activities partially offset by a planned increase in the level of funded development associated with our Authorize.Net services and products.

**Sales and Marketing.** Sales and marketing expenses consist primarily of salaries, commissions and travel expenses of direct sales and marketing personnel, as well as costs associated with advertising, trade shows and conferences. For Authorize.Net, sales and marketing expenses also include commissions paid to outside sales agents. The increase of \$0.5 million in sales and marketing expenses in the quarter ended June 30, 2006 as compared with the same quarter in 2005, in absolute dollars and as a percentage of revenue, was due to the increase in expenses for Authorize.Net. Authorize.Net represented \$4.6 million of sales and marketing expenses in the second quarter of 2006 as compared to \$4.0 million in the second quarter of 2005. This increase was partially offset by reductions in marketing costs for the other portions of our business, restructuring activities, and reduced sales and marketing program spending as compared with the second quarter of 2005.

We expect that sales and marketing expenses for the quarter ending September 30, 2006 will continue to increase with growth in Authorize.Net's revenues as a result of greater sales agent commissions associated with these revenues.

**General and Administrative.** General and administrative expenses consist principally of salaries of executive, finance, human resources and administrative personnel and fees for certain outside professional services. The increase

of \$1.7 million in general and administrative expenses, as compared to the same quarter in 2005, in absolute dollars and as a percentage of revenues, was due to the \$1.0 million share-based compensation expense due to the adoption of SFAS No. 123(R) and the litigation settlement in the net amount of \$1.5 million, with Net MoneyIN, Inc. This increase was partially offset by reductions in consulting costs and restructuring activities as compared with the second quarter of 2005.

We expect a decrease in the level of general and administrative expenses in the quarter ending September 30, 2006 from the second quarter of 2006 as a result of a decrease in share-based compensation expenses.

**Table of Contents**

**Restructuring charges and related asset impairments.** In May 2006, the Company announced the planned closing of the Liverpool, Nova Scotia contact center. Related to this closing, the Company recorded a charge of \$0.9 million during the second quarter of 2006 related to the asset impairment and the Company expects to incur a charge of approximately \$0.5 million to \$1.2 million during the third quarter of 2006 for employee severance and facility closing related costs. The Company expects to close the center in the third quarter of 2006.

The quarter ended June 30, 2005 has been adjusted for discontinued operations.

**Other Income, Net.** Other income, net primarily consists of interest income earned on our cash and short-term investment balances. Other income, net increased by \$0.8 million in the quarter ended June 30, 2006 in comparison with the same period in 2005. This increase was primarily due to an increase in our cash and short-term investments balance as a result of the cash provided by the operating activities of continuing operations, cash received for the sale of our INS business, an increase in the prevailing interest rates, and cost savings from our restructuring activities.

**Provision for (Benefit from) Income Taxes.** We provide for income taxes on an interim basis based on the full-year projected effective tax rate. The income tax provision for the three months ended June 30, 2006 of \$0.1 million reflects a deferred federal and state provision attributable to amortization of intangibles for tax purposes with indefinite lives. The income tax provision for the three months ended June 30, 2005 of \$0.4 million reflects a deferred federal and state provision attributable to amortization of intangibles for tax purposes with indefinite lives. At June 30, 2006, the Company continues to believe a full valuation allowance is required until an appropriate level of profitability is sustained that would enable the Company to conclude that it is more likely than not that a portion of the Company's deferred taxes would be realizable.

**Six Months Ended June 30, 2006 Compared with Six Months Ended June 30, 2005.**

**Revenues.** Revenues and certain revenue comparisons for the six months ended June 30, 2006 and 2005 were as follows:

	<b>Six Months Ended June 30, 2006</b>	<b>Six Months Ended June 30, 2005</b>	<b>\$ Difference</b>	<b>% Difference</b>
	<b>(Dollars in thousands)</b>			
Transaction services:				
Payment Processing (Authorize.Net)	\$ 27,370	\$ 20,847	\$ 6,523	31.3%
TDS	22,863	29,954	(7,091)	(23.7)
Total Transaction services revenues	50,233	50,801	(568)	(1.1)
Consulting and maintenance services:				
TDS	1,532	2,936	(1,404)	(47.8)
Total	\$ 51,765	\$ 53,737	\$ (1,972)	(3.7)%

The decrease in transaction services revenues was primarily due to a \$7.1 million decline in transactions services revenues from our TDS segment offset by a \$6.5 million increase in Authorize.Net's revenue. Authorize.Net's revenues for the six months ended June 30, 2006 increased 31.3% compared to the same period in 2005. The increased revenues were primarily the result of an increase in the number of merchant customers and the volume of transactions processed. The decline in TDS transaction services revenues was primarily a result of a \$7.0 million reduction in transaction fees charged to Sprint/Nextel following the merger between Sprint Spectrum L.P. (Sprint) and Nextel

Operations, Inc. (Nextel).

The decrease in consulting and maintenance services revenues of \$1.4 million was principally due to a decrease in consulting fees charged to AT&T of \$0.5 million and a decline in consulting and maintenance revenues related to our decision to no longer actively market, sell or develop our RMS product.

**Cost of Revenues and Gross Profit.** Cost of revenues consists primarily of personnel costs, costs of maintaining systems and networks used in processing qualification and activation transactions (including depreciation and amortization of systems and networks) and amortization of capitalized software and acquired technology. Cost of revenues for Authorize.Net, included in transaction services cost of revenues, consists of expenses associated with the delivery, maintenance and support of Authorize.Net's products and services, including personnel costs, communication costs, such as high-bandwidth Internet access, server equipment depreciation, transactional processing fees, as well as customer care costs. In the future, cost of revenues may vary as a percentage of total revenues as a result of a number of factors, including changes in the volume of transactions processed, changes in the mix of transaction revenues between those from automated transaction processing and those from processing transactions through our TeleServices contact centers (which have a higher cost component), changes in pricing to certain clients and changes in the mix of total revenues among transaction services revenues, consulting and maintenance services revenues.

**Table of Contents**

Cost of revenues, gross profit and certain comparisons for the six months ended June 30, 2006 and 2005 were as follows:

	<b>Six Months Ended June 30, 2006</b>	<b>Six Months Ended June 30, 2005</b>	<b>\$ Difference</b>	<b>% Difference</b>
	<b>(Dollars in thousands)</b>			
Cost of revenues:				
Transaction services	\$ 21,595	\$ 24,190	\$ (2,595)	(10.7)%
Consulting and maintenance services	924	1,322	(398)	(30.1)
<b>Total cost of revenues</b>	<b>\$ 22,519</b>	<b>\$ 25,512</b>	<b>\$ (2,993)</b>	<b>(11.7)%</b>
Gross profit:				
Transaction services \$	\$ 28,638	\$ 26,611	\$ 2,027	7.6%
Transaction services %	57.0%	52.4%		
Consulting and maintenance services \$	\$ 608	\$ 1,614	\$ (1,006)	(62.3)%
Consulting and maintenance services %	39.7%	55.0%		
<b>Total gross profit \$</b>	<b>\$ 29,246</b>	<b>\$ 28,225</b>	<b>\$ 1,021</b>	<b>3.6%</b>
<b>Total gross profit %</b>	<b>56.5%</b>	<b>52.5%</b>		

Transaction services cost of revenues decreased by \$2.6 million for the six months ended June 30, 2006 compared to the same period in 2005. Transaction services cost of revenues from our TDS segment decreased approximately \$3.8 million compared to the same period in 2005. Transaction services cost of revenues from our Payment Processing segment increased by approximately \$1.2 million compared to the same period in the prior year. In our TDS business, we realized reductions in third party data and services costs as a result of processing fewer transactions. We also realized personnel-related savings resulting from our restructuring activities. The increase in our Payment Processing transaction services cost of revenues was primarily due to the increase in the number of transactions processed.

Transaction services gross profit and gross profit percentage increased primarily as a result of Authorize.Net's higher contribution to the transaction services gross profit amount. Authorize.Net's percent of the transaction services gross profit amount was 75% for the six months ended June 30, 2006 versus 61% for the same period in the prior year as a result of higher revenues. This increase was partially offset by a decrease in the transaction services gross profit related to our TDS segment, where the revenue reduction exceeded the cost of sales expense reduction.

Consulting and maintenance services cost of revenues decreased by \$0.4 million for the six months ended June 30, 2006 compared to the same period in 2005. This decrease was attributable to a reduction in personnel-related expenses as a result of our restructuring activities. Consulting and maintenance services gross profit and gross profit percentage decreased for the six months ended June 30, 2006 compared to the same period in 2005 due to the lower revenues from AT&T and our RMS product partially offset by the reduction in personnel-related expenses.



**Table of Contents**

**Engineering and Development.** The \$1.3 million decrease in engineering and development expenses for the six months ended June 30, 2006 compared to the same period in 2005 was primarily due to cost savings associated with our restructuring activities. The cost savings were partially offset by a \$0.3 million share-based compensation expense due to the adoption of SFAS No. 123(R).

**Sales and Marketing.** The increase of \$0.8 million in sales and marketing expenses for the six months ended June 30, 2006 compared to the same period in 2005, in absolute dollars and as a percentage of revenue, was due to the increase in expenses for Authorize.Net. Authorize.Net represented \$9.1 million of sales and marketing expenses for the six months ended June 30, 2006 as compared to \$7.9 million for the same period in 2005. This increase was partially offset by reductions in marketing costs for the other portions of our business, restructuring activities, and reduced sales and marketing program spending as compared to the same period in 2005.

**General and Administrative.** The increase of \$2.9 million in general and administrative expenses, as compared to the same period in 2005, in absolute dollars and as a percentage of revenues, was due to the \$2.3 million share-based compensation expense due to the adoption of SFAS No. 123(R), and the litigation settlement in the net amount of \$1.5 million, with Net MoneyIN, Inc. This increase was partially offset by reductions in consulting costs and restructuring activities as compared to the same period in 2005.

**Restructuring charges and related asset impairments.** In May 2006, the Company announced the planned closing of the Liverpool, Nova Scotia contact center. Related to this closing, the Company recorded a charge of \$0.9 million during the second quarter of 2006 related to the asset impairment and the Company expects to incur a charge of approximately \$0.5 million to \$0.7 million during the third quarter of 2006 for employee severance and facility closing related costs. The Company expects the center will be closed in the third quarter of 2006.

In January 2006, we announced a workforce reduction focused primarily within the TDS business, as well as reductions in general and administrative expenses. The restructuring consisted of a total workforce reduction of about 4%, and we recorded a restructuring charge of \$1.4 million in the first quarter of 2006, primarily related to employee severance and termination benefits.

In January 2005, we announced the closing of our Broomfield, Colorado call center in order to take advantage of our other existing call center infrastructure and operate more efficiently. This action resulted in the termination of approximately 40 employees associated with product service and delivery at this location. We recorded a restructuring charge of approximately \$0.4 million relating to facility closing and employee severance and termination benefits during the three months ended March 31, 2005.

The six months ended June 30, 2005 have been adjusted for discontinued operations.

**Other Income, Net.** Other income, net primarily consists of interest income earned on our cash and short-term investment balances. Other income, net increased by \$1.5 million in the six months ended June 30, 2006 in comparison with the same period in 2005. This increase was primarily due to an increase in our cash and short-term investments balance as a result of the cash provided by the operating activities of continuing operations, cash received for the sale of our INS business, an increase in the prevailing interest rates, and cost savings from our restructuring activities.

**Provision for (Benefit from) Income Taxes.** We provide for income taxes on an interim basis based on the full-year projected effective tax rate. The income tax provision for the six months ended June 30, 2006 of \$0.6 million includes a current provision for federal, state and foreign taxes of \$0.1 million and a deferred federal and state provision of \$0.5 million attributable to amortization of intangibles for tax purposes with indefinite lives. The income tax provision for the six months ended June 30, 2005 of \$0.9 million includes a current provision for state and foreign taxes of \$0.1 million and a deferred federal and state provision of \$0.8 million attributable to amortization of intangibles for tax purposes with indefinite lives. At June 30, 2006, the Company continues to believe a full valuation allowance is required until an appropriate level of profitability is sustained that would enable the Company to conclude that it is more likely than not that a portion of the Company's deferred taxes would be realizable.

**Discontinued Operations**

**INS Segment** On April 25, 2005, we announced that we had entered into an asset purchase agreement for the sale of our INS business, which includes our PrePay IN product and related services, to VeriSign. The sale was completed on June 14, 2005 for \$17.45 million in cash plus assumption of certain contractual liabilities. Of the \$17.45 million in

consideration, \$1.495 million is being held in escrow by VeriSign, and \$0.25 million is being held by us as a liability to VeriSign, until certain representations and warranties expire 18 months after closing and will be recorded as a gain, net of possible indemnity claims at that time.





products and services. Some agreements provide for indemnification for claims relating to property damage or personal injury resulting from the performance of services or provision of products by us, breaches of contract by us or the failure by us to comply with applicable laws in the performance of services or provision of products by us to its clients.

In May 2006, we entered into a settlement agreement which resolved ongoing litigation with Net MoneyIN, Inc. Pursuant to the agreement, we agreed to pay Net MoneyIN, Inc. a lump sum payment of \$1.75 million in exchange for a license grant, release and covenant not to sue. Our net cost of the settlement after contribution from another party is \$1.5 million. We had incurred legal expenses in 2005 and 2004 of approximately \$1.1 million and \$0.2 million, respectively, in connection with the defense of this lawsuit and we expected to incur additional costs of approximately \$1.5 million in 2006 had we not entered in to the settlement agreement. We do not expect to incur any further litigation costs related to this lawsuit after the second quarter of 2006.

**Table of Contents**

Except for the litigation settlement and legal expenses we incurred in connection with the Net MoneyIN, Inc. litigation, historically, our costs to defend lawsuits, or settle or pay claims relating to such indemnification provisions, have not been material. Accordingly, the estimated fair value of these indemnification provisions is not material.

At June 30, 2006, we were holding funds in the amount of \$8.5 million due to merchants. The funds are included in both cash and cash equivalents and the funds due to merchants liability on our consolidated balance sheet. We were holding funds in the amount of \$7.5 million on behalf of merchants utilizing Authorize.Net's eCheck.Net product. Authorize.Net holds merchant funds for approximately seven business days; the actual number of days depends on the contractual terms with each merchant. In addition, at June 30, 2006, we held funds in the amount of \$1.0 million for and on behalf of merchants processing credit card and ACH transactions using the Integrated Payment Solution (IPS) product. The funds are included in both cash and cash equivalents and the funds due to merchants liability on our consolidated balance sheet. Credit card funds are held for approximately two business days; ACH funds are held for approximately four business days, according to the requirements of the IPS product and the contract between Authorize.Net and the financial institution through which the transactions are processed.

In addition, we have \$0.5 million on deposit with a financial institution to cover any deficit account balance that could occur if the amount of eCheck.Net transactions returned or charged back exceeds the balance on deposit with the financial institution. To date, the deposit has not been applied to offset any deficit balance, and we believe that the likelihood of incurring a deficit balance with the financial institution due to the amount of transactions returned or charged back is remote. The deposit will be held continuously for as long as we utilize the ACH processing services of the financial institution, and the amount of the deposit may increase as processing volume increases.

We have a letter of credit in the amount of \$1.6 million which was renewed in January 2006 and is renewable each year. We restricted \$1.6 million of cash as collateral for the renewed letter of credit.

**Off-Balance Sheet Arrangements**

As of June 30, 2006, we had no off-balance sheet arrangements other than operating lease obligations, and we were not a party to any material transactions involving related persons or entities (other than employment, separation and other compensation agreements with certain executives). Future annual minimum rental lease payments are detailed in Note 7 of the Notes to Consolidated Financial Statements.

**Inflation**

Although certain of our expenses increase with general inflation in the economy, inflation has not had a material impact on our financial results to date.

**ITEM 3. QUANTITATIVE AND QUALITATIVE MARKET RISK DISCLOSURES**

The market risk exposure inherent in our financial instruments and consolidated financial position represents the potential losses arising from adverse changes in interest rates and foreign currency exchange rates.

We consider all highly liquid marketable securities purchased with a maturity of three months or less to be cash equivalents and those with maturities greater than three months and less than one year are considered to be short-term investments. Cash equivalents are stated at cost plus accrued interest, which approximates fair value. Short-term investments are stated at fair value based on quoted market prices.

The amortized cost of available-for-sale debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Realized gains and losses, and declines in value judged to be other than temporary on available-for-sale debt securities, if any, are included in interest income, net. The cost of securities sold is based on the specific identification method. Interest and dividends on securities are included in interest income, net.

Our marketable securities and cash equivalent investments are generally high credit quality instruments, primarily U.S. Treasury and government agency obligations, taxable municipal obligations and money market investments with the average maturity of the total investment portfolio being one year or less. Accordingly, we believe that our potential interest rate exposure in investments is not material.

Our exposure to currency exchange rate fluctuations has been limited. All revenue transactions are executed in U.S. dollars. We pay for certain foreign operating expenses such as foreign payroll, rent and office expense in foreign currency and, therefore, currency exchange rate fluctuations could have a material and adverse impact on our operating results and financial condition. Currently, we do not engage in foreign currency hedging activities. The impact of any currency exchange rate fluctuations is recorded in the period incurred.



**Table of Contents****ITEM 4. CONTROLS AND PROCEDURES***Evaluation of Disclosure Controls and Procedures*

The Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of June 30, 2006. The Company's Chief Executive Officer and its Chief Financial Officer supervised and participated in this evaluation. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2006, the Company's disclosure controls and procedures were effective to provide a reasonable level of assurance of reaching the Company's disclosure control objectives.

*Changes in Internal Controls over Financial Reporting*

There were no significant changes to our internal during the quarter ended June 30, 2006 that have materially affected our internal controls over financial reporting.

*Inherent Limitations of Disclosure Controls and Internal Control Over Financial Reporting*

The effectiveness of our disclosure controls and procedures and our internal control over financial reporting is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, there can be no assurance that any system of disclosure controls and procedures or internal control over financial reporting will be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management

**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

In May 2006, we entered into a settlement agreement with respect to certain litigation involving Net MoneyIN, Inc. Pursuant to the agreement, we agreed to pay Net MoneyIN, Inc. a lump sum payment of \$1.75 million in exchange for a license grant, release and covenant not to sue. The cost of the settlement to us is \$1.5 million net of \$0.25 million received from another party named in the litigation. We recorded this cost in general and administrative expenses.

We had incurred legal expenses in 2005 and 2004 of approximately \$1.1 million and \$0.2 million, respectively, in connection with the defense of this lawsuit following our acquisition of Authorize.Net, and we expected to incur defense costs of approximately \$1.5 million in 2006. We do not expect to incur any litigation costs related to this lawsuit after the second quarter of 2006.

We are subject to legal proceedings, claims, and litigation arising in the ordinary course of business. On a quarterly basis, we review our commitments and contingencies to reflect the effect of ongoing negotiations, settlements, rulings, advice of counsel, and other information and events pertaining to a particular case.

**Item 1A. Risk Factors**

*The following risk factors contain changes from the risk factors set forth in our Annual Report on Form 10-K for the year ended December 31, 2005 and should be reviewed together with the risk factors set forth in such Annual Report. The changes may be deemed material.*

**Risk Factors**

*If One or More of Our Major Clients Stops Using Our Products or Services or Changes the Combination of Products and Services It Uses, Our Operating Results Would Suffer Significantly.*

Our TDS revenues are concentrated among a few major clients with Sprint and Nextel being the largest of them. Sprint and Nextel accounted for a majority of our TDS revenues for the quarter ended June 30, 2006 and we expect that their share of our TDS revenues will increase further in the near term. Our 10 largest clients accounted for approximately 44% and 46% of our total revenues in the three and six months ended June 30, 2006, respectively. We have no significant merchant concentration in our Payment Processing business. Although our client concentration has declined, we expect that a substantial part of our revenues will continue to come from a few clients for the foreseeable future. Consequently, our revenues, margins and net income may fluctuate significantly from quarter to quarter based on the actions of a single significant client.



**Table of Contents**

A client may take actions that significantly affect us for reasons that we cannot necessarily anticipate or control, such as reasons related to the client's financial condition, changes in the client's business strategy or operations, the introduction of alternative competing products or services, acquisitions, or as the result of the perceived quality or cost-effectiveness of our products or services. Our services agreements with Sprint and Nextel expire in December 2006. The Sprint agreement renews automatically on a quarterly basis unless either party gives the other thirty (30) days' notice of termination. Our services agreement with AT&T Wireless expires on April 1, 2009, but is subject to earlier termination upon twelve months' notice and designated services upon notice. In October 2004, Cingular Wireless LLC announced that it had completed its merger with AT&T Wireless. Cingular is not presently a client of Lightbridge. AT&T Wireless has given us notice of termination of certain designated services under our agreement with that carrier. We do not expect that client to generate significant revenue in 2006. On August 12, 2005, the merger transaction between Sprint and Nextel was completed to form Sprint Nextel Corporation (Sprint/Nextel). Following the merger, we decreased certain transaction fees to Sprint/Nextel commencing in the third quarter of 2005, and, as a result, we expect our future revenues for Sprint/Nextel to decrease in comparison to the historical levels for Sprint and Nextel when they were separate customers.

We are unable to predict the long term effect of the merger on our relationship with Sprint/Nextel, which represented approximately 33% of our total revenues in 2005 including, without limitation, the timing or extent of any reductions in applications processed or other services provided under our contracts with those clients or further price reductions. Although we continue to engage in the discussions with Sprint and Nextel regarding extensions of their contracts, it is possible that Sprint, Nextel or both could elect not to renew their agreements, to reduce the volume of products and services they purchase from us or to request significant changes to the pricing or other terms in any renewal agreement. The loss of Sprint, Nextel or both, or any of our other major clients would cause sales to fall below expectations and materially reduce our revenues, margins and net income and adversely affect our business.

In May 2006, we were advised by T-Mobile that T-Mobile planned to consolidate its contact center business and begin the transition of that business from us to other vendors. Commencing in the third quarter of 2006, we do not expect T-Mobile to be a significant contact center customer. In the first and second quarters of 2006, revenue from T-Mobile was approximately \$2.3 million and \$2.1 million, respectively, for the quarter.

***Certain of Our Future Revenues Are Uncertain Because Our Clients May Reduce the Amounts of or Change the Combination of Our Products or Services They Purchase.***

Generally, our communications client contracts extend for terms of between one and three years. During the terms of these contracts, our communications clients typically may elect to purchase any of several different combinations of products and services. The revenue that we receive for processing a transaction for such a client may vary significantly depending on the particular products and services used to process the transaction. In particular, transactions handled through our TeleServices Call Centers generally result in significantly higher revenue than transactions that are submitted and processed electronically, but also result in higher cost of revenues. Therefore, our revenues or margins from a particular client may decline if the client changes the combination of products and services it purchases from us. In May 2006, we were advised by T-Mobile of its plans to consolidate its contact center business with other vendors. Accordingly, we do not expect T-Mobile to be a significant customer commencing in the third quarter of 2006.

To the extent our client contracts contain minimum purchase or payment requirements, these minimums are typically at levels significantly below actual or historical purchase or payment levels. Therefore, our current clients may not continue to utilize our products or services at levels similar to previous years or at all, and may not generate significant revenues in future periods. If any of our major clients significantly reduces or changes the combination of products or services it purchases from us for any reason, our business would be seriously damaged.

***A Substantial Portion of Our Revenues Are Concentrated in the Wireless Telecommunications Industry, Which Has Experienced Declining Growth Rates, Consolidation and Increasing Pressure to Control Costs.***

In 2006, we expect revenues from our Payment Processing business to constitute a majority of our revenues. Prior to 2006, we derived a majority of our revenues from companies in the wireless telecommunications industry, and we expect that wireless telecommunications companies will continue to account for a substantial part of our revenues in 2006. In recent years, the growth rate of the domestic wireless industry has slowed. In addition, consolidation has

affected the number of carriers to whom our products and services can be marketed and sold, and competition among wireless carriers has continued to increase, resulting in heightened efforts by carriers to control costs. Many of our carrier clients have sought and received, and may in the future seek, pricing concessions when they renew their services agreements with us or at other times, which would adversely affect our revenues, margins and net income. As a result of the foregoing conditions, our success depends on a number of factors:

- our ability to maintain our profit margins on sales of products and services to companies in the wireless telecommunications industry;

- the financial condition of our clients and their continuing ability to pay us for services and products;



**Table of Contents**

our ability to develop and market new or enhanced products and services to new and existing clients; and

our ability to increase market penetration in the wireless telecommunications market.

***We May Become a Party to Intellectual Property Infringement Claims, Which Could Harm Our Business.***

From time to time, we have had and may be forced to respond to or prosecute other intellectual property infringement claims to protect our rights or defend a client's rights. These claims, regardless of merit, may consume valuable management time, result in costly litigation or cause product shipment delays, all of which could seriously harm our business and operating results. Furthermore, parties making such claims may be able to obtain injunctive or other equitable relief that could effectively block our ability to make, use, sell or otherwise practice our intellectual property, whether or not patented or described in pending patent applications, or to further develop or commercialize our products in the U.S. and abroad and could result in the award of substantial damages against us.

We may be required to enter into royalty or licensing agreements with third parties claiming infringement by us of their intellectual property in order to settle these claims. These royalty or licensing agreements, if available, may not have terms that are acceptable to us. In addition, if we are forced to enter into a license agreement with terms that are unfavorable to us, our operating results would be materially harmed.

We may also be required to indemnify our clients for losses they may incur under indemnification agreements if we are found to have violated the intellectual property rights of others. We may also seek to settle intellectual property infringement claims which could require payment of material amounts to the third parties claiming infringement. Please refer to Part II Item 1, Legal Proceedings for a discussion of certain matters related to our intellectual property.

In connection with the sale of our INS business to VeriSign on June 14, 2005, we agreed to indemnify VeriSign for up to \$5 million in damages incurred for potential breaches of our intellectual property representations and warranties in the asset purchase agreement. Such representations and warranties extend for two years from the date of closing.

***Our Future Revenues May Be Uncertain Because of Reliance on Third Parties for Marketing and Distribution.***

Authorize.Net distributes its service offerings primarily through outside sales distribution partners and its revenues are derived predominantly through these relationships. In addition, our TDS business has entered into a business alliance with VeriSign to assist us in penetrating the online transaction market for authentication services.

We intend to continue to market and distribute our current and future products and services through existing and other relationships both in and outside of the United States. There are no minimum purchase obligations applicable to any existing distributor or other sales and marketing partners and we do not expect to have any guarantees of continuing orders. Failure by our existing and future distributors or other sales and marketing partners to generate significant revenues or our failure to establish additional distribution or sales and marketing alliances or changes in the industry that render third party distribution networks obsolete could have a material adverse effect on our business, operating results and financial condition. In addition, we may be required to pay higher commission rates in order to maintain loyalty among our third-party distribution partners, which may have a material adverse impact on our profitability.

In addition, distributors and other sales and marketing partners may become our competitors with respect to the products they distribute either by developing a competitive product themselves or by distributing a competitive offering. For example, outside sales partners of Authorize.Net products and services are permitted to and generally do market and sell competing products and services. With respect to the TDS business, VeriSign may elect to market or acquire alternative fraud and identity verification products for authentication services. Competition from existing and future distributors or other sales and marketing partners could significantly harm sales of our products.

***Changes to Credit Card Association and ACH Rules or Practices Could Adversely Impact Our Authorize.Net Business.***

Our Authorize.Net credit card payment gateway does not directly access the credit card associations. As a result, we must rely on banks and their credit card processing providers to process our transactions. Nevertheless, as a payment gateway we must comply with the operating rules of the credit card associations. The associations' member banks set these rules, and the associations interpret the rules. Some of those member banks compete with Authorize.Net. Visa, MasterCard, American Express or Discover could adopt new operating rules or interpretations of existing rules which we might find difficult or even impossible to comply with, resulting in our inability to give

customers the option of using credit cards to fund their payments. If we were unable to provide a gateway for credit card transactions, our Authorize.Net business would be materially and adversely affected.

**Table of Contents**

In December 2004, the Payment Card Industry Data Security Standard was created by major credit card companies to safeguard customer information. Visa, MasterCard, American Express, and other credit card associations mandate that merchants and service providers meet certain minimum standards of security when they store, process and transmit cardholder data. Our Payment Processing business must comply with this standard in order to continue as an internet payment gateway. Changes to this standard may require us to invest significant resources in engineering and hardware in order to comply.

Additionally, our eCheck.Net service is required to be compliant with Automated Clearing House processing rules promulgated by the National ACH Association (NACHA). NACHA could adopt new operating rules or interpretations of existing rules which we might find difficult or impossible to comply with, resulting in our inability to give customers the option of using the ACH network for payment processing services, as well as significantly hinders our ability, or makes us unable, to utilize the ACH network for our own billing and collection activities for our own services.

***We Could Be Subject to Liability as a Result of Security Breaches, Service Interruptions by Cyber Terrorists or Fraudulent or Illegal Use of Our Services.***

Because some of our activities involve the storage and transmission of confidential personal or proprietary information, such as credit card numbers and social security numbers, and because we are a link in the chain of e-commerce, security breaches, service interruptions and fraud schemes could damage our reputation and expose us to a risk of loss or litigation and possible monetary damages. Cyber terrorists have periodically interrupted, and may continue to interrupt, our payment gateway services in attempts to extort payments from us or disrupt commerce. Our payment gateway services may be susceptible to credit card and other payment fraud schemes, including unauthorized use of credit cards or bank accounts, identity theft or merchant fraud. We expect that technically sophisticated criminals will continue to attempt to circumvent our anti-fraud systems. If such fraud schemes become widespread or otherwise cause merchants to lose confidence in our services in particular, or in Internet systems generally, our business could suffer.

In addition, the storage and transmission of confidential personal data, coupled with the large volume of payments that we handle for our clients makes us vulnerable to third-party or employee fraud or other internal security breaches. Further, we may be required to expend significant capital and other resources to protect against security breaches and fraud to address any problems they may cause.

Our payment system may also be susceptible to potentially illegal or improper uses. These uses may include illegal online gambling, fraudulent sales of goods or services, illicit sales of prescription medications or controlled substances, software and other intellectual property piracy, money laundering, bank fraud, child pornography trafficking, prohibited sales of alcoholic beverages and tobacco products and online securities fraud. Despite measures we have taken to detect and lessen the risk of this kind of conduct, we cannot ensure that these measures will succeed. In addition, regulations under the USA Patriot Act may require us to revise the procedures we use to comply with the various anti-money laundering and financial services laws. Our business could suffer if clients use our system for illegal or improper purposes or if the costs of complying with regulatory requirements increase significantly.

Authorize.Net is compliant with the Payment Card Industry's (PCI) Security Standard which incorporates Visa's Cardholder Information Security Program (CISP) and MasterCard's Site Data Protection (SDP) standard. However, there is no guarantee that we will maintain such compliance or that compliance will prevent illegal or improper use of our payment system.

We have expended, and may be required to continue to expend, significant capital resources to protect against security breaches, service interruptions and fraud schemes. Our security measures may not prevent security breaches, service interruptions and fraud schemes and the failure to do so may disrupt our business, damage our reputation and expose us to risk of loss or litigation and possible monetary damages.

***We Have Made and May Continue to Make Acquisitions, Which Involve Risks.***

We may continue to make acquisitions in the future if we identify companies, technologies or assets that appear to expand or complement our business. Acquisitions involve risks that could cause the actual results of any acquisitions we make to differ from our expectations. At the same time, if we are not able to make acquisitions, we may not be able to expand our business. Some examples of the difficulties posed by acquisitions are that:

We may experience difficulty in integrating and managing acquired businesses successfully and in realizing anticipated economic, operational and other benefits in a timely manner. The need to retain existing clients, employees, and sales and distribution channels of an acquired company and to integrate and manage differing corporate cultures can also present significant risks. If we are unable to successfully integrate and manage acquired businesses, we may incur substantial costs and delays or other operational, technical or financial problems.

## **Table of Contents**

Our acquisition of other businesses could significantly reduce our available cash and liquidity. In other future acquisitions, we may issue equity securities that could be dilutive to our shareholders or we may use our remaining cash, which may have an adverse effect on our liquidity. We also may incur additional debt and amortization expense related to intangible assets as a result of acquisitions. This additional debt and amortization expense, as well as the potential impairment of any purchased goodwill, may materially and adversely affect our business and operating results. We may also be required to make continuing investments in acquired products or technologies to bring them to market, which may negatively affect our cash flows and net income.

We may also incur additional costs relating to the integration, review and evaluation and enhancement of our internal controls for businesses we acquire. In addition, we may assume contingent liabilities that may be difficult to estimate and costs and liabilities associated with assumed litigation matters.

Acquisitions may divert management's attention from our existing business and may damage our relationships with our key clients and employees.

Acquisitions may also result in liabilities for claims not known at the time of acquisition as well as for assumed obligations.

### ***We Need to Continue to Improve or Implement our Procedures and Controls.***

Requirements adopted by the SEC in response to the passage of the Sarbanes-Oxley Act of 2002 require annual review and evaluation of our internal control over financial reporting, and attestation of these systems by our independent public accounting firm. In January 2006, we re-evaluated our disclosure controls and procedures for the first three quarters of fiscal 2005 and concluded, based upon management's January 2006 evaluation of those disclosure controls and procedures, that as of March 31, June 30, September 30, and December 31, 2005, our disclosure controls and procedures were not fully effective as of those dates to provide a reasonable level of assurance of reaching the Company's disclosure control objectives. Specifically at December 31, 2005, we had material weaknesses in our procedures for income tax accounting and our ability to properly account and report complex transactions and we restated our financial results for the year ended December 31, 2004 and the quarterly periods ended March 31, June 30 and September 30, 2005 to correct our reporting for income taxes. In addition, in connection with the audit of our financial statements for 2005, management identified an error in accounting and reporting the sale of the INS business in the statement of cash flows, which has been identified as a material weakness. Previously, we had evaluated our disclosure controls and procedures as of March 31 and September 30, 2005 and found them effective to provide a reasonable level of assurance of reaching our disclosure control objectives. However, our previous evaluation as of June 30, 2005 had identified a separate material weakness as a result of which adjustments were needed to properly account for the gain on the sale of our INS business. During the first quarter of 2006, we took certain steps to address these matters. We continue to evaluate such disclosure controls and procedures, and may modify, enhance or supplement them as appropriate in the future. There can be no assurance that we will be able to maintain compliance with all of the new requirements.

Any modifications, enhancements or supplements to our internal control systems or in documentation of such internal control systems could be costly to prepare or implement, divert attention of management or finance staff, and may cause our operating expenses to increase over the ensuing year. Our stock price may be adversely affected if our internal controls over financial reporting are not effective.

### ***Our Business May Be Harmed by Errors in Our Software.***

The software that we develop and license to clients, and that we also use in providing our transaction processing and contact center services, is extremely complex and contains hundreds of thousands of lines of computer code. Large, complex software systems such as ours are susceptible to errors. The difficulty of preventing and detecting errors in our software is compounded by the fact that we maintain multiple versions of our systems to meet the differing requirements of our major clients, and must implement frequent modifications to these systems in response to these clients' evolving business policies and technical requirements. Our software design, development and testing processes are not always adequate to detect errors in our software prior to its release or commercial use. As a result, we have from time to time discovered, and may likely in the future discover, errors in software that we have put into commercial use for our clients, including some of our largest clients. Because of the complexity of our systems and

the large volume of transactions they process on a daily basis, we sometimes have not detected software errors until after they have affected a significant number of transactions. Software errors can have the effect of causing clients that utilize our products and services to fail to comply with their intended credit or business policies, or to fail to comply with legal, credit card, and banking requirements, such as those under the Fair Credit Reporting Act, Gramm-Leach-Bliley Act, MasterCard's Site Data Protection (SDP) Standard, Visa's Cardholder Information Security Program (CISP) and Payment Card Industry's (PCI) Security Standard.

## **Table of Contents**

Such errors, particularly if they affect a major client, can harm our business in several ways, including the following:

we may suffer a loss of revenue if, due to software errors, we are temporarily unable to provide products or services to our clients;

we may not be paid for the products or services provided to a client that contain errors, or we may be liable for losses or damages sustained by a client or its subscribers as a result of such errors;

we may incur additional unexpected expenses to correct errors in our software, or to fund product development projects that we may undertake to minimize the occurrences of such errors in the future;

we may damage our relationships with clients or suffer a loss of reputation within our industry;

we may become subject to litigation or regulatory scrutiny; and

our clients may terminate or fail to renew their agreements with us or reduce the products and services they purchase from us.

Our errors and omissions insurance may not adequately compensate us for losses that may occur due to software errors. It is also possible that such insurance might cease to be available to us on commercially reasonable terms or at all.

### ***Our Quarterly Operating Results May Fluctuate.***

Our operating results are difficult to predict and may fluctuate significantly from quarter to quarter. If our operating results fall below the expectations of investors or public market analysts, the price of our common stock could fall dramatically. Our common stock price could also fall dramatically if investors or public market analysts reduce their estimates of our future quarterly operating results, whether as a result of information we disclose, or based on industry, market or economic trends, or other factors.

Our revenues are difficult to forecast for a number of reasons:

Seasonal and retail trends affect our transaction revenues, in both our Payment Processing and TDS businesses, as well as our other products and services. Transaction revenues historically have represented the majority of our total revenues. As a result, our revenues can fluctuate. For example, our revenues generally have been highest in the fourth quarter of each calendar year, particularly in the holiday shopping season between Thanksgiving and Christmas. In addition, marketing initiatives undertaken by our clients or their competitors may significantly affect the number of transactions we process.

The sales process for our products and services offered to telecommunications clients is lengthy, sometimes exceeding eighteen months. The length of the sales process makes our revenues difficult to predict. The delay of one or more large orders could cause our quarterly revenues to fall substantially below expectations.

The factors described above under the headings *If One or More of Our Major Clients Stops Using Our Products or Services or Changes the Combination of Products and Services It Uses, Our Operating Results Would Suffer Significantly*, *Certain of Our Future Revenues Are Uncertain Because Our Clients May Reduce the Amounts of or Change the Combination of Our Products or Services They Purchase*, and *A Substantial Portion of Our Revenues are Concentrated in the Wireless Telecommunications Industry, Which Has Experienced Declining Growth Rates, Consolidation and Increasing Pressure to Control Costs*.

Most of our expenses, particularly employee compensation and facilities, are relatively fixed. As a result, even relatively small variations in the timing of our revenues may cause significant variations in our quarterly operating results and may result in quarterly losses.

Our quarterly results may also vary due to the timing and extent of restructuring and other charges that may occur in a given quarter.

Our quarterly results may be affected by new changes in accounting rules, such as the requirement to record share-based compensation expense for employee stock option grants made at fair market value. Since the Company has adopted the modified prospective transition method to report share-based compensation expense, periods prior to 2006 have not been restated to reflect the fair value method of expensing share-based compensation. See Note 3 to the unaudited condensed consolidated financial statements for further discussion on share-based compensation.

As a result of these factors, we believe that quarter-to-quarter comparisons of our results of operations are not necessarily meaningful. You should not rely on our quarterly results of operations to predict our future performance.



**Table of Contents**

***We Face Competition from a Broad and Increasing Range of Vendors.***

The market for products and services offered to communications providers and participants in online transactions is highly competitive and subject to rapid change. Each of these markets is fragmented, and a number of companies currently offer one or more products or services competitive with ours. We anticipate continued growth and the formation of new alliances in each of the markets in which we compete, which will result in the entrance of new or the creation of bigger competitors in the future. For example, in October 2005, VeriSign, Inc. announced that PayPal, Inc., a wholly owned subsidiary of eBay, Inc., agreed to acquire VeriSign's payment gateway business and to form a strategic alliance with VeriSign, Inc. for on-line commerce and security. In addition, in June 2006 Google, Inc. announced Google Checkout, a new payment service that may compete with us. We face potential competition from several primary sources:

providers of online payment processing services, including CyberSource Corporation, Plug & Pay Technologies, Inc., PayPal, Inc., Google, Inc. and LinkPoint International, Inc.

software vendors that provide one or more customer acquisition, customer relationship management and retention or risk management solutions, including ECTel Ltd., TSI Telecommunications Services Inc., Fair Isaac Corporation, Magnum Software Systems, Inc., CGI Group, Inc. and SLP Infoware;

service providers that offer customer acquisition, customer relationship management and retention, risk management or authentication services in connection with other services, including Choicepoint Inc., Visa U.S.A., Experian Information Solutions, Inc., Equifax, Inc., Lexis Nexis, Trans Union, L.L.C., Schlumberger Sema plc and Amdocs Ltd;

information technology departments within larger carriers that have the ability to provide products and services that are competitive with those we offer;

information technology vendors that offer wireless and internet software applications such as CGI Group, Inc, Oracle Corporation, Microsoft Corporation and International Business Machines Corporation;

consulting firms or systems integrators that may offer competitive services or the ability to develop customized solutions for customer acquisition and qualification, customer relationship management and retention or risk management, such as CGI Group, Inc., Accenture Ltd., BearingPoint, Inc., PeopleSoft, Inc., Siebel Systems, Inc. and Cap Gemini Ernst & Young; and

a number of alternative technologies, including profilers, personal identification numbers and authentication, provided by companies such as Verizon Communications, Inc., Authentix Network Inc. and Fair Isaac Corporation.

Because competitors can easily penetrate one or more of our markets, we anticipate additional competition from other established and new companies. In addition, competition may intensify as competitors establish cooperative relationships among themselves or alliances with others.

Many of our current and potential competitors have significantly greater financial, marketing, technical and other competitive resources than we do. As a result, these competitors may be able to adapt more quickly to new or emerging technologies and changes in client requirements, or may be able to devote greater resources to the promotion and sale of their products and services. In addition, in order to meet client requirements, we must often work cooperatively with companies that are, in other circumstances, competitors. The need for us to work cooperatively with such companies may limit our ability to compete aggressively with those companies in other circumstances.

***Our Success Depends in Part on Our Ability to Protect Our Proprietary Technologies.***

We rely on a combination of copyright, patent, trademark and trade secret laws, license and confidentiality agreements, and software security measures to protect our proprietary rights. Much of our know-how and other

proprietary technology is not covered by patent or similar protection, and in many cases cannot be so protected. If we cannot maintain or obtain patent or other protection for our proprietary software and other proprietary intellectual property rights, other companies could more easily enter our markets and compete successfully against us.

We have a limited number of U.S. and foreign patents, and have pending applications for additional patents, but we cannot be certain that any additional patents will be issued on those applications, that any of our current or future patents will protect our business or technology against competitors that develop similar technology or products or services or provide us with a competitive advantage, or that others will not claim rights in our patents or our proprietary technologies.

**Table of Contents**

Patents issued and patent applications filed relating to products used in the wireless telecommunications and payment processing industry are numerous and it may be the case that current and potential competitors and other third parties have filed or will file applications for, or have received or will receive, patents or obtain additional proprietary rights relating to products used or proposed to be used by us. We may not be aware of all patents or patent applications that may materially affect our ability to make, use or sell any current or future products or services.

The laws of some countries in which our products are licensed do not protect our products and intellectual property rights to the same extent as U.S. laws. We generally enter into non-disclosure agreements with our employees and clients and restrict access to, and distribution of, our proprietary information. Nevertheless, we may be unable to deter misappropriation of our proprietary information or detect unauthorized use of and take appropriate steps to enforce our intellectual property rights. Our competitors also may independently develop technologies that are substantially equivalent or superior to our technology.

***Our Foreign Operations Subject Us to Risks and Concerns Which Could Negatively Affect Our Business Overall.***

We have operations outside the U.S. at our contact centers located in Liverpool, Nova Scotia, Canada and Costa Rica. In addition to the risks generally associated with operations in the U.S., operations in foreign countries present us with additional risks, including the following:

the imposition of financial and operational controls and regulatory restrictions by foreign governments;

the need to comply with a wide variety of complex U.S. and foreign laws including, without limitation, import and export laws and treaties;

fluctuations in interest and currency exchange rates;

security risks; and

difficulties in managing staffing and managing foreign subsidiary operations.

**Item 4. Submission of Matters to a Vote of Security Holders**

On June 29, 2006, Lightbridge, Inc. held a Special Meeting in Lieu of Annual Meeting of Stockholders to vote upon the proposal to Elect Two Directors:

- a) To re-elect Gary E. Haroian to serve as a Class I director for a three-year term beginning on June 29, 2006 and ending at our 2008 annual meeting of stockholders; and
- b) To re-elect Andrew G. Mills to serve as a Class I director for a three-year term beginning on June 29, 2006 and ending at our 2008 annual meeting of stockholders.

The number of votes cast for and against, as well as the number of votes withheld or abstentions (including broker non-votes), on the above proposal were as follows:

<b>PROPOSAL</b>	<b>VOTES FOR</b>	<b>VOTES AGAINST</b>	<b>VOTES WITHHELD</b>	<b>ABSTENTIONS</b>
a) For Gary E. Haroian	23,559,085		1,523,059	
b) For Andrew G. Mills	23,560,801		1,521,343	
	35			

**Table of Contents****Item 6. Exhibits****(a) Exhibits**

<b>Exhibit No.</b>	<b>Description</b>	<b>Filed with this Form 10-Q</b>	<b>Incorporated by Reference</b>		
			<b>Form</b>	<b>Filing Date</b>	<b>Exhibit No.</b>
3.1	Amended and Restated Certificate of Incorporation		S-1	August 27, 1996	3.2
3.2	Amended and Restated By-Laws		S-1	June 21, 1996	3.4
3.3	Amendment to Amended and Restated By-Laws, adopted October 29, 1998		10-Q	November 13, 1998	3.1
4.2	Rights Agreement dated November 14, 1997 with American Stock Transfer and Trust Company as Rights Agent		8-A	November 21, 1997	1
4.3	Form of Certificate of Designation of Series A Participating Cumulative Preferred Stock		8-A	November 21, 1997	A
4.4	Form of Rights Certificate		8-A	November 21, 1997	B
10.1	Employee s Restricted Stock Agreement dated May 22, 2006		8-K	May 11, 2006	10.1
10.2	Confidential Settlement Agreement dated May 22, 2006 by and among Net MoneyIN, Inc. and InfoSpace, Inc., E-Commerce Exchange LLC, Lightbridge, Inc. and Authorize.Net Corp		8-K	May 25, 2006	10.1
31.1	Certification of the chief executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
31.2	Certification of the chief financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X			
32.1	Certification of the chief executive officer and the chief financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X			

**Table of Contents**

**SIGNATURE**

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.

LIGHTBRIDGE , INC.

Date: July 27, 2006

By: /s/ Timothy C. O Brien

Timothy C. O Brien  
Vice President, Finance and Administration,  
Chief Financial Officer and Treasurer  
(Principal Financial and Chief Accounting Officer)

37