

LIGHTBRIDGE INC  
Form 10-Q  
November 09, 2004

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**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 September 30, 2004**

**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)

Former Address:

(Former Name, Former Address and Former Fiscal Year,  
if Changed Since Last Report)

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. x Yes o No

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

As of November 5, 2004, there were 26,503,459 shares of the registrant's common stock, \$.01 par value, outstanding.

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**LIGHTBRIDGE, INC.**

**QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2004**

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**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>September 30, 2004</b>	<b>December 31, 2003</b>
	<hr/>	<hr/>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 41,002	\$ 69,685
Short-term investments	8,517	63,803
Accounts receivable, net	19,717	20,071
Deferred tax assets	3,388	3,267
Other current assets	2,978	4,158
	<hr/>	<hr/>
Total current assets	75,602	160,984
Property and equipment, net	13,943	9,408
Deferred tax assets	4,025	4,553
Other assets, net	510	362
Goodwill	59,293	1,664
Other intangible assets, net	22,617	865
Assets held for sale	250	
	<hr/>	<hr/>
Total assets	\$ 176,240	\$ 177,836
	<hr/>	<hr/>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 14,507	\$ 15,205
Funds due to merchants	7,164	
Deferred revenues	3,630	5,461
Reserve for restructuring	3,484	2,634
Liabilities held for sale	407	
	<hr/>	<hr/>
Total current liabilities	29,192	23,300
Long-term liabilities	401	33
	<hr/>	<hr/>
Total liabilities	29,593	23,333
Commitments and contingencies		
Stockholders' equity:		

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Preferred stock, \$.01 par value; 5,000,000 shares authorized; no shares issued or outstanding at September 30, 2004 and December 31, 2003		
Common stock, \$.01 par value; 60,000,000 shares authorized; 29,940,002 and 29,647,795 shares issued and 26,500,959 and 26,843,352 shares outstanding at September 30, 2004 and December 31, 2003, respectively	299	298
Additional paid-in capital	167,398	166,882
Warrants	206	206
Currency translation	(73)	
Retained earnings	(396)	4,072
Less: treasury stock, at cost	(20,787)	(16,955)
	<u>          </u>	<u>          </u>
Total stockholders' equity	<u>146,647</u>	<u>154,503</u>
Total liabilities and stockholders' equity	<u>\$ 176,240</u>	<u>\$ 177,836</u>

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 September 30,</b>	
	<b>2004</b>	<b>2003</b>
Revenues:		
Transaction	\$ 19,446	\$ 20,029
Software licensing	819	1,413
Consulting and services	4,732	7,922
Hardware	437	202
Payment processing	8,839	
	<hr/>	<hr/>
Total revenues	34,273	29,566
	<hr/>	<hr/>
Cost of revenues:		
Transaction	11,503	11,398
Software licensing	169	349
Consulting and services	2,677	3,544
Hardware	471	123
Payment processing	2,639	
	<hr/>	<hr/>
Total cost of revenues	17,459	15,414
	<hr/>	<hr/>
Gross profit (loss):		
Transaction	7,943	8,631
Software licensing	650	1,064
Consulting and services	2,055	4,378
Hardware	(34)	79
Payment processing	6,200	
	<hr/>	<hr/>
Total gross profit	16,814	14,152
	<hr/>	<hr/>
Operating expenses:		
Engineering and development	7,681	6,878
Sales and marketing	6,601	3,339
General and administrative	4,402	3,240
Restructuring	2,105	3,438

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Total operating expenses	<u>20,789</u>	<u>16,895</u>
Loss from operations	(3,975)	(2,743)
Other income, net	<u>193</u>	<u>377</u>
Loss before provision (benefit) for income taxes	(3,782)	(2,366)
Income tax expense (benefit)	<u>518</u>	<u>(473)</u>
Net loss	<u>\$ (4,300)</u>	<u>\$ (1,893)</u>
Basic and diluted net loss per common share	<u>\$ (0.16)</u>	<u>\$ (0.07)</u>

See notes to unaudited condensed consolidated financial statements.

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

	<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
Revenues:		
Transaction	\$ 59,180	\$58,880
Software licensing	5,784	7,474
Consulting and services	16,712	20,900
Hardware	1,931	2,034
Payment processing	16,976	—
	100,583	89,288
Cost of revenues:		
Transaction	35,912	33,475
Software licensing	955	1,136
Consulting and services	7,540	9,288
Hardware	1,770	1,693
Payment processing	4,831	—
	51,008	45,592
Gross profit:		
Transaction	23,268	25,405
Software licensing	4,829	6,338
Consulting and services	9,172	11,612
Hardware	161	341
Payment processing	12,145	—
	49,575	43,696
Operating expenses:		
Engineering and development	21,926	21,430
Sales and marketing	17,161	10,921
General and administrative	12,196	10,510
Purchased in-process research and development	679	—



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Restructuring	<u>2,624</u>	<u>4,987</u>
Total operating expenses	<u>54,586</u>	<u>47,848</u>
Loss from operations	(5,011)	(4,152)
Equity in loss of partnership investment		(471)
Other income, net	<u>973</u>	<u>1,382</u>
Loss before provision (benefit) for income taxes	(4,038)	(3,241)
Income tax expense (benefit)	<u>430</u>	<u>(908)</u>
Net loss	<u>\$ (4,468)</u>	<u>\$ (2,333)</u>
Basic and diluted net loss per common share	<u>\$ (0.17)</u>	<u>\$ (0.09)</u>

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)**

	<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
Cash flows from operating activities:		
Net loss	\$ (4,468)	\$ (2,333)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Purchased in-process research and development	679	
Depreciation and amortization	7,804	8,163
Deferred income taxes	406	
Loss on disposal of property and equipment	12	876
Changes in assets and liabilities, net of acquired assets and liabilities:		
Accounts receivable	2,170	(1,095)
Other assets	1,297	156
Accounts payable and accrued liabilities	(1,345)	(1,845)
Funds due to merchants	767	
Deferred revenues	(1,423)	(289)
Other liabilities	368	(218)
	<u>6,268</u>	<u>3,415</u>
Net cash provided by operating activities		
Cash flows from investing activities:		
Purchases of property and equipment	(9,339)	(2,883)
Purchase of short-term investments	(28,491)	(153,321)
Proceeds from sales and maturities of short-term investments	83,778	137,390
Acquisition of Authorize.Net, less cash received	(77,510)	
	<u>(31,562)</u>	<u>(18,814)</u>
Net cash used in investing activities		
Cash flows from financing activities:		
Proceeds from issuance of common stock	517	1,168
Repurchase of common stock	(3,832)	(4,032)
	<u>(3,315)</u>	<u>(2,864)</u>
Net cash used in financing activities		
Effects of foreign exchange rate changes on cash and cash equivalents	(73)	

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Net decrease in cash and cash equivalents	(28,683)	(18,263)
Cash and cash equivalents, beginning of period	<u>69,685</u>	<u>90,664</u>
Cash and cash equivalents, end of period	<u>\$ 41,002</u>	<u>\$ 72,401</u>

See notes to unaudited condensed consolidated financial statements.

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, 2003.

**2. BUSINESS AND ACQUISITION ACTIVITY**

On March 31, 2004, the Company acquired all of the outstanding stock of Authorize.Net Corp. ( Authorize.Net ) from InfoSpace, Inc. for \$82 million in cash. In addition, the Company incurred approximately \$2.0 million in acquisition related costs. The total purchase price for the acquisition was \$83.6 million, after giving effect to a working capital adjustment. The purchase price paid by the Company in the Authorize.Net acquisition was reduced by \$430,000 based on the final determination of working capital at closing as set forth in the stock sale agreement. Authorize.Net provides credit card and electronic check payment solutions to companies that process orders for goods and services over the Internet, at retail locations and on wireless devices. Authorize.Net connects small and medium-sized businesses to large credit card processors and banking organizations, allowing those businesses to accept electronic payments. Through the acquisition of Authorize.Net, the Company expanded its customer transaction business to include online payment processing, while reaching a new customer base of small to medium-sized merchants. The results of operations of Authorize.Net were not included in the condensed consolidated statements of operations for the first quarter of 2004 or the first nine months of 2003 since the purchase was effective at the close of business on March 31, 2004. The operations of Authorize.Net were included in the second and third quarter results for 2004.

The aggregate purchase price for the Authorize.Net acquisition has been allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their fair values at the date of acquisition as follows (in thousands):

Tangible assets acquired:	
Cash and cash equivalents	\$ 6,097
Accounts receivable	1,815
Property and equipment	1,655
Other assets	327
Liabilities assumed:	
Accounts payable and accrued expenses	(1,498)
Funds due to merchants	(6,397)
Identifiable intangible assets:	
In-process research and development	679
Reseller network	9,300

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Merchant customer base	7,000
Trademarks	3,600
Existing technology	3,100
Processor relationships	300
Goodwill	<u>57,629</u>
Total allocated purchase price	<u>\$83,607</u>

The tangible assets acquired and liabilities assumed were recorded at their fair values, which approximated their carrying amounts at the acquisition date. The values of the identifiable intangible assets were determined by an independent appraiser using established valuation techniques accepted in the technology and software industries. The appraisal of the intangible assets involved calculations which were based in part on management's judgments and assumptions. These judgments and assumptions included estimates of growth rates, changes to pricing and margins, estimates of the life of the reseller network and merchant customer base, and an assessment of the value of the existing technology. The reseller network value of \$9.3 million and the processor relationships value of \$300,000 will be amortized over twelve years. The merchant customer base value of \$7.0 million and the existing technology value of \$3.1 million will be amortized over five years. The value of the trademarks of \$3.6 million is not amortized. Excluding trademarks, the weighted average amortization term of the intangible assets is 8.4 years.

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In connection with the Authorize.Net acquisition, the Company recorded a \$679,000 charge during the first quarter of 2004 for two in-process research and development ( IPR&D ) projects. The Authorize.Net technology includes payment gateway solutions that enable merchants to authorize, settle and manage electronic transactions via the Internet, at retail locations and on wireless devices. The research projects in process at the date of acquisition related to the development of the Card Present Solution ( CPS ) and the Fraud Tool ( FT ). Development on the FT project and the CPS project was started at the end of 2003 and the beginning of 2004, respectively. The complexity of the CPS technology lies in its fast, flexible and redundant characteristics. The complexity of the FT technology lies in its responsiveness to changing fraud dynamics and efficiency.

The value of the projects was determined by an independent appraiser using the income method. The discounted cash flow method was utilized to estimate the present value of the expected income that could be generated through revenues from the projects over their estimated useful lives through 2009. The percentage of completion for the projects was determined based on the amount of research and development expenses incurred through the date of acquisition as a percentage of estimated total research and development expenses to bring the projects to technological feasibility. At the acquisition date, the Company estimated that the CPS and the FT projects were approximately 15% and 80% complete, respectively, with fair values of approximately \$638,000 and \$41,000, respectively. The discount rate used for the fair value calculation was 30% for the CPS project and 22% for the FT project. At the date of acquisition, development of the technology involved risks to the Company including the remaining development effort required to achieve technological feasibility and uncertainty with respect to the market for the technology.

Lightbridge completed the development of the FT in May 2004 having spent approximately \$129,000 on the project after the acquisition. Total cost to complete the CPS project after acquisition is estimated to be approximately \$650,000. The CPS project is expected to be completed by March 2005. If the development of the technology is not completed on schedule, the potential consequences to the Company may include increased development costs and increased competition from other companies that have competitive products in the market.

The purchase price in excess of the net assets acquired and the identifiable intangible assets acquired was allocated to goodwill. The entire amount of the goodwill is expected to be deductible for tax purposes.

In accordance with Statement of Financial Accounting Standard No. 142 (SFAS 142), 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.

### **Pro forma financial information**

The following table presents the unaudited pro forma financial information of the Company including Authorize.Net for the three months ended September 30, 2003 and for the nine months ended September 30, 2004 and 2003, as if the acquisition had occurred on January 1, 2003, after giving effect to certain purchase accounting adjustments. The pro forma adjustments include elimination of revenue associated with pre-acquisition deferred revenue of Authorize.Net, amortization of intangible assets, elimination of interest income associated with the cash purchase price of the acquisition and related income tax effects.

The pro-forma net loss for the nine months ended September 30, 2004 excludes the expense of IPR&D of \$679,000 related to the Authorize.Net acquisition due to its non-recurring nature. These results are presented for illustrative purposes only and are not necessarily indicative of the actual operating results or financial position that would have occurred if the transaction had been consummated on January 1, 2003.

	<b>Three Months Ended September 30,</b>	<b>Nine Months Ended September 30,</b>	
	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(Amounts in thousands, except per share amounts)</b>		
Pro forma net revenues	\$36,429	\$108,835	\$108,528
Pro forma net loss	\$ (1,859)	\$ (3,138)	\$ (3,826)
Pro forma net loss per basic and diluted share	\$ (0.07)	\$ (0.12)	\$ (0.14)
Shares used for basic and diluted computation	26,912	26,689	27,046

**Table of Contents****3. COMMITMENTS AND CONTINGENCIES**

At September 30, 2004, the Company was holding funds in the amount of \$6.3 million on behalf of merchants utilizing Authorize.Net's eCheck services. The funds are included in cash and cash equivalents and funds due to merchants on the Company's condensed consolidated balance sheet. Authorize.Net typically holds eCheck funds for approximately seven business days; the actual number of days depends on the contractual terms with each merchant. In addition, at September 30, 2004, the Company held funds in the amount of \$882,000 for and on behalf of merchants processing credit card and ACH transactions using the Integrated Payment Solution (IPS) product. The funds are included in cash and cash equivalents and funds due to merchants on the Company's condensed consolidated balance sheet. Credit card funds are typically held for approximately two business days; ACH funds are held for approximately four business days, according to the specifications of the IPS product and the contract between Authorize.Net and the financial institution through which the transactions are processed.

In addition, the Company currently has \$600,000 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. 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.

The Company's primary contractual obligations and commercial commitments are under its operating leases and a letter of credit. The Company maintains an annually renewable letter of credit in the amount of \$1.0 million which extends through January 2005, as required for security under the lease for its headquarters.

On February 10, 2004, the Company entered into a lease agreement with the Region of Queens Municipality to lease 32,144 square feet of space in Liverpool, Nova Scotia, Canada. The lease expires on April 30, 2009, with an option to renew at the end of the current lease term. The lease also gives the Company the right to terminate upon the third anniversary thereof.

As of August 10, 2004, the Company entered into a lease agreement for 14,148 square feet of office space in Bellevue, Washington. The lease commenced in September 2004 and will expire in September 2009.

The Company's future minimum payments due under operating leases are as follows as of September 30, 2004:

	<b>Total</b>	<b>Remainder of 2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>After 2007</b>
			<b>(Dollars in thousands)</b>			
Operating leases	\$21,090	\$1,172	\$4,795	\$3,797	\$2,990	\$8,336

**4. STOCK-BASED COMPENSATION**

The Company applies the intrinsic value based method of accounting for stock options granted to employees. The Company accounts for stock options and awards to non-employees using the fair value method.

Under the intrinsic value method, compensation associated with stock awards to employees is determined as the difference, if any, between the current fair value of the underlying common stock on the date compensation is



measured and the price an employee must pay to exercise the award. The measurement date for employee awards is generally the date of grant. Under the fair value method, compensation associated with stock awards to non-employees is determined based on the estimated fair value of the award itself, measured using either current market data or an established option pricing model. The measurement date for non-employee awards is the date at which the services are provided or the date of grant.

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Had the Company used the fair value method to measure such compensation expense associated with grants of stock options to employees, reported net loss and basic and diluted loss per share would have been as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(Amounts in thousands, except per share amounts)</b>			
Net loss as reported	\$ (4,300)	\$ (1,893)	\$ (4,468)	\$ (2,333)
Deduct (add back) stock based compensation expense (benefit) measured using the fair value method	(126)	1,358	404	2,745
Net loss pro forma	\$ (4,174)	\$ (3,251)	\$ (4,872)	\$ (5,078)
Basic and diluted net loss per share pro forma	\$ (0.16)	\$ (0.12)	\$ (0.18)	\$ (0.19)

Due to the cancellation of a significant amount of unvested stock options held by employees whose employment was terminated in the quarter ended September 30, 2004, the pro forma adjustment for that period's stock based compensation resulted in a net benefit.

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 for the three and nine-month periods ended September 30, 2004 and 2003 are as follows:

	<b>September 30,</b>	
	<b>2004</b>	<b>2003</b>
Risk-free interest rate	2.9% - 4.7%	2.9% - 4.7%
Expected life of options grants	1 - 5 years	1 - 5 years
Expected volatility of underlying stock	83%	90%
Expected dividend payment rate, as a percentage of the stock price on the date of grant		

It should be noted that the option-pricing model used was designed to value readily tradable stock options with relatively short lives. The options granted to employees are not tradable and have contractual lives of up to ten years.

**5. COMPREHENSIVE INCOME**

The Company currently has currency translation and net income (loss) as items of comprehensive income.

## **6. DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION**

Based upon the way management and the Board of Directors monitor the Company's operations, the Company operates in five distinct segments: the transaction business, the software license business, the consulting and services business, the hardware business and the payment processing business. Within these five segments, performance is measured based on gross profit realized from each segment. Information about revenues, cost of revenues and gross profit of each segment is shown separately on the statement of operations. Information about costs and expenses, other than costs of revenues, is not reported by segment. There are no transactions between segments. A majority of the Company's revenues historically have been derived from clients located in the United States. On March 31, 2004, the Company created the payment processing business segment through the acquisition of Authorize.Net. The total assets of this segment as of September 30, 2004 were \$98.6 million.

## **7. REVENUE RECOGNITION**

The Company generates revenue from the processing of qualification and activation transactions; granting of software licenses; services (including maintenance, installation and training); development and consulting contracts; hardware sold in conjunction with certain software licenses; and performing payment processing services. The Company also offers on-demand voice conferencing services through its GroupTalk offering. Revenues from processing of qualification and activation transactions for communications providers are recognized in the period in which services are performed.

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Revenues from our GroupTalk offering are recognized as conference services are utilized. To date, the Company has not recognized any transaction revenues from its GroupTalk offering. If substantial doubt exists regarding collection of fees for the Company's products or services at the time of delivery or performance, the Company defers recognition of the associated revenue until the fees are collected.

The Company's software license agreements have typically provided for an initial license fee and annual maintenance fees based on a defined number of subscribers, as well as additional license and maintenance fees for net subscriber additions in certain circumstances. Revenue from software license agreements are recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, and a fixed fee and collectibility have been determined. To the extent that obligations exist for other services, the Company allocates revenue between the license and the services based upon their relative fair value or by the residual method.

Revenues from consulting and services contracts are generally recognized as the services are performed. Revenues from software maintenance contracts are recognized ratably over the term of the maintenance agreement and are reported as consulting and services revenues. Revenue from hardware sales is recognized upon shipment, unless testing, integration or implementation services are required, in which case hardware revenue is recognized upon commissioning and acceptance of the product. Revenue from hardware sold in conjunction with software licenses is deferred until the related license revenue is recognized and the aforementioned other criteria for hardware revenue recognition are met.

Revenues from payment processing are derived from the Company's credit card processing and eCheck processing services (collectively payment processing services), gateway fees and set-up fees. Payment processing services revenue is based on a fee per transaction or on a percentage of the completed transaction, and is recognized in the period in which the transaction occurs. Gateway fees are monthly subscription fees charged to merchant customers for the use of the payment gateway. Gateway fees are recognized in the period in which the service is provided. Set-up fees represent one-time charges for initiating the Company's payment processing services. Although these fees are generally paid to the Company 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. Commissions paid to outside sales partners are recorded in sales and marketing expense in the Company's statements of operations.

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

Basic EPS is computed by dividing income (loss) 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 using the treasury stock method. A reconciliation of the shares used to compute basic income per share to those used for diluted income per share is as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
	<b>(In thousands)</b>			
Shares for basic computation	26,482	26,912	26,689	27,046
Options and warrants (treasury stock method)				

Shares for diluted computation	<u>26,482</u>	<u>26,912</u>	<u>26,689</u>	<u>27,046</u>
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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 the three and nine months ended September 30, 2004 and 2003. Had such shares been included, shares for the diluted computation would have increased by approximately 4,939,000 and 1,874,000 for the three months ended September 30, 2004 and 2003, respectively, and approximately 3,363,000 and 2,243,000 for the nine months ended September 30, 2004, and 2003, respectively.

In addition, all other stock options and warrants convertible into common stock have been excluded from the diluted EPS computations for the three months ended September 30, 2004 and 2003 and for the nine months ended September 30, 2004 and 2003, as they are anti-dilutive due to the net loss recorded by the Company in those periods. Had such shares been included, the number of shares for the diluted computation would have increased by approximately 48,000 and 374,000 shares for the three months ended September 30, 2004 and 2003, respectively, and 106,000 and 539,000 for the nine months ended September 30, 2004 and 2003, respectively.

**Table of Contents****9. REPURCHASE OF SHARES**

On October 4, 2001, Lightbridge announced that its Board of Directors had authorized the repurchase of up to 2 million shares of the Company's common stock at an aggregate cost of up to \$20 million. The shares may be purchased from time to time depending on market conditions. On April 23, 2003, the Board approved an expansion of the plan to authorize Lightbridge to purchase up to 4 million shares of the Company's common stock at an aggregate cost of up to \$40 million through September 26, 2005. As of September 30, 2004, the Company had purchased approximately 2.5 million shares at a total cost of approximately \$17.9 million since the inception of its repurchase program. There were no repurchases during the third quarter of 2004. The maximum number of shares that could yet be purchased under the plan was 1,452,862 at September 30, 2004.

**10. RESTRUCTURING RESERVES**

In September 2004, the Company announced a restructuring of its business in order to lower overall expenses to better align them with future revenue expectations. This action, a continuation of the Company's emphasis on expense management, resulted in the termination of 64 employees and 2 contractors, in the Company's corporate offices in Burlington, Massachusetts and its Broomfield, Colorado location as follows: 12 in product and service delivery, 16 in engineering and development, 25 in sales and marketing and 13 in general and administrative. The Company recorded a restructuring charge of approximately \$2.1 million relating to employee severance and termination benefits during the three months ended September 30, 2004.

The following summarizes the changes to the September 2004 restructuring reserve since it was accrued:

	<b>Balance at December 31, 2003</b>	<b>Accrued</b>	<b>Utilized</b>	<b>Balance at September 30, 2004</b>
		<b>(In thousands)</b>		
Employee severance and termination benefits	\$	\$2,090	\$ 191	\$ 1,899

In January 2004, the Company announced a reorganization of its internal business operations. This action resulted in the termination of ten individuals in the Company's corporate office in Burlington, Massachusetts. The Company recorded a restructuring charge of approximately \$0.5 million relating to employee severance and termination benefits during the three months ended March 31, 2004.

The following summarizes the changes to the January 2004 restructuring reserves for the nine months ended September 30, 2004:

	<b>Balance at December 31, 2003</b>	<b>Accrued</b>	<b>Utilized</b>	<b>Balance at September 30, 2004</b>
		<b>(In thousands)</b>		

Employee severance and termination benefits	\$	\$489	\$ 429	\$ 60
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>

In June 2003, the Company announced that it would be closing its Irvine, California facility and transferring certain employment positions to its Broomfield, Colorado facility and reducing its headcount by an estimated 70 employees as follows: 16 in product and service delivery, 30 in development, 13 in sales and marketing and 11 in general and administrative. In the quarter ended June 30, 2003, the Company recorded a restructuring charge of approximately \$0.7 million, consisting mainly of workforce reduction costs. In the quarter ended September 30, 2003, the Company recorded an additional restructuring charge associated with this action of approximately \$3.3 million, consisting of \$1.1 million for workforce reduction, \$1.7 million in future lease obligations for unused facilities and \$0.5 million for capital equipment write-offs. In the quarter ended December 31, 2003, the Company recorded an additional restructuring charge of \$0.1 million related to future lease obligations and employee severance benefits. The capital equipment write-offs and a majority of severance costs related to this restructuring were incurred by the end of 2003, and the Company anticipates that all other costs related to this restructuring, consisting principally of lease obligations on unused space, will be paid by the end of 2006.

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The following summarizes the changes to the June 2003 restructuring reserves for the nine months ended September 30, 2004:

	<b>Balance at December 31, 2003</b>	<b>Accrued Utilized</b>		<b>Balance at September 30, 2004</b>
	<b>(In thousands)</b>			
Employee severance and termination benefits	\$ 253	\$	\$ 160	\$ 93
Facility closing and related costs	1,396	33	500	929
<b>Total</b>	<b>\$ 1,649</b>	<b>\$ 33</b>	<b>\$ 660</b>	<b>\$ 1,022</b>

In March 2003, the Company announced that it would be streamlining its existing Broomfield, Colorado call center operations into its Lynn, Massachusetts facility and a smaller facility in Broomfield, Colorado by the end of May 2003. In the quarter ended March 31, 2003, the Company recorded a restructuring charge of approximately \$0.1 million for workforce reductions. In the quarter ended June 30, 2003, the Company recorded an additional restructuring charge associated with this action of approximately \$1.0 million, consisting of approximately \$0.6 million in future lease obligations for unused facilities and approximately \$0.4 million for capital equipment write-offs. The capital equipment write-offs and all of the severance costs related to this restructuring were incurred by the end of 2003, and the Company anticipates that all other costs relating to this restructuring, consisting principally of lease obligations on unused space, will be paid by the end of 2004.

The following summarizes the changes to the March 2003 restructuring reserves for the nine months ended September 30, 2004:

	<b>Balance at December 31, 2003</b>	<b>Accrued Utilized</b>		<b>Balance at September 30, 2004</b>
	<b>(In thousands)</b>			
Facility closing and related costs	\$ 363	\$ 12	\$ 239	\$ 136

In June 2002, the Company announced that it was reducing its workforce by seven percent and consolidating its Waltham, Massachusetts call center operations into its Lynn, Massachusetts and Broomfield, Colorado facilities by the end of 2002. The Company recorded a restructuring charge of approximately \$3.6 million, consisting of \$1.6 million for workforce reductions, \$1.3 million for facilities reductions including lease obligations, utilities and security costs on unused space and \$0.7 million for capital equipment write-offs associated with these measures. The restructuring plan resulted in the termination of 65 personnel as follows: 25 in product and service delivery, 22 in development, 11 in sales and marketing and seven in general and administrative. The capital equipment write-offs and



a majority of severance costs related to this restructuring were incurred by the end of 2002, and the Company anticipates that all other costs relating to this restructuring, consisting principally of lease obligations on unused space, will be paid by the end of 2005.

The following summarizes the changes to the June 2002 restructuring reserves for the nine months ended September 30, 2004:

	<b>Balance at December 31, 2003</b>	<b>Accrued</b>	<b>Utilized</b>	<b>Balance at September 30, 2004</b>
		<b>(In thousands)</b>		
Facility closing and related costs	\$ 622	\$	\$ 254	\$ 368

#### 11. PROVISION FOR (BENEFIT FROM) INCOME TAXES

The Company provides for income taxes on an interim basis based on the full year projected effective tax rate. The income tax provision for the nine months ended September 30, 2004 reflects a current state income tax expense, full valuation on net operating loss carryforwards and a provision for a net increase in the valuation allowance of certain deferred tax assets, which the Company believes that it is more likely than not, will not be used. If the Company generates future taxable income against which these tax attributes may be applied, some portion of the valuation allowance previously established will be reversed and result in an income tax benefit in the current period.

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The income tax provision for the nine months ended September 30, 2003 reflects a net benefit based on the Company's projected annual effective tax rate plus a benefit related to the recognition of prior year research and development tax credits.

**12. RECENT ACCOUNTING PRONOUNCEMENTS**

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51, Consolidated Financial Statements (FIN 46). FIN 46 establishes accounting guidance for consolidation of variable interest entities (VIEs) that function to support the activities of the primary beneficiary. FIN 46 applies to any business enterprise, both public and private, that has a controlling interest, contractual relationship or other business relationship with a VIE.

In December 2003, the FASB published a revision to FIN 46 to clarify some of the provisions and to exempt certain entities from its requirements. Under the new guidance, special effective date provisions apply to enterprises that have fully or partially applied FIN 46 prior to issuance of the revised interpretation. Otherwise, application of Interpretation 46R (FIN 46R) is required in financial statements of public entities that have interests in structures that are commonly referred to as special-purpose entities (SPEs) for periods ending after December 15, 2003. Application by public entities, other than business issuers, for all other types of VIEs other than SPEs, is required in financial statements for periods ending after March 15, 2004. The Company does not have any investments in or contractual relationships or other business relationships with any VIE and therefore the adoption of FIN 46R did not have any impact on the Company's consolidated financial position, results of operations or cash flows.

**13. ASSETS AND LIABILITIES HELD FOR SALE**

On October 1, 2004, the Company closed the sale of its Fraud Centurion products pursuant to an agreement with India-based Subex Systems, Limited (Subex). The Company received net cash proceeds of \$2.2 million as a result of the sale. The Company expects to record a gain of approximately \$2.4 million in the fourth quarter of 2004 due to this transaction.

As part of this transaction, the Company sold equipment with a net book value of approximately \$250,000 to Subex. In addition, the Company assigned certain maintenance contracts to Subex. The deferred revenue related to these contracts as of September 30, 2004 totaled \$407,000. These amounts are classified as assets (and liabilities) held for sale in the accompanying September 30, 2004 balance sheet.

**14. WORLDCOM, INC. SETTLEMENT**

During the quarter ended September 30, 2004, the Company received a settlement payment of approximately \$538,000 as a result of the WorldCom, Inc. bankruptcy proceedings for services provided to WorldCom in 2002. As part of the bankruptcy settlement, the Company also realized a one-time benefit of approximately \$1.2 million related to the release from liability of amounts owed to WorldCom, Inc. and amounts that had been reserved for potential claims against the Company as part of the WorldCom, Inc. bankruptcy proceedings.

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**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 below under the heading Risk Factors 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.*

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**Critical Accounting Policies and Estimates**

We have identified and discussed certain critical accounting policies and estimates in our Annual Report on Form 10-K for the year ended December 31, 2003. We did not modify our critical accounting policies during the quarter ended September 30, 2004. Those policies and estimates have been applied in the preparation of our financial statements included in this Quarterly Report on Form 10-Q.

**Overview**

We develop, market and support a suite of products and services for communications providers and online businesses that support the customer lifecycle, including customer qualification and acquisition, risk management, prepaid billing, mobile data management, voice conferencing, authentication services and payment processing services. We also offer on-demand voice conferencing services. Our software-based solutions are delivered primarily on an outsourced or service bureau basis. These outsourced or service bureau solutions together with our TeleServices offerings comprise our transaction business. We also derive revenues from software licensing, consulting and maintenance services, hardware sales and payment processing services. While our solutions historically have been delivered primarily to wireless carriers, we also provide solutions to online businesses and other non-carrier clients.

The results of operations for Authorize.Net were included for the first time in the three-month period ended June 30, 2004 in our statements of operations.

In June 2002, we announced that we were reducing our workforce by seven percent and consolidating our Waltham, Massachusetts call center operations into our Lynn, Massachusetts and Broomfield, Colorado facilities by the end of 2002. In March 2003, we announced that we would be streamlining our Broomfield, Colorado call center operations into our Lynn, Massachusetts facility and a smaller facility in Broomfield, Colorado by the end of May 2003. In June 2003, we announced we would be closing our Irvine, California facility and transferring certain employment positions to our Broomfield, Colorado facility and reducing our headcount by an estimated 70 employees.

In December 2003, we entered into an agreement to lease approximately 80,000 square feet in a single building in Burlington, Massachusetts for our new principal administrative, sales, consulting, marketing and product development facility. In February 2004, we announced the planned expansion of our call center operations to Liverpool, Nova Scotia, Canada. Our Nova Scotia facility became operational in April 2004 and we commenced occupancy of our new Burlington facility in June 2004.

In January 2004, we announced a reorganization of our internal business operations. This action resulted in the termination of ten individuals in our corporate office in Burlington, Massachusetts. We recorded a restructuring charge of approximately \$0.5 million relating to severance and termination benefits.

On March 31, 2004, we acquired all of the outstanding stock of Authorize.Net from InfoSpace Inc., for \$82 million in cash and incurred approximately \$2.0 million in acquisition related transaction costs. The purchase price paid by us was subject to adjustment based on the final determination of working capital required at closing as set forth in the stock sale agreement. Authorize.Net is a provider of payment solutions for online customer transactions. The Authorize.Net payment gateway provides credit card and electronic check solutions to companies that process orders for goods and services over the Internet. Authorize.Net connects small and medium sized businesses to large credit card processors and banking organizations, allowing those businesses to accept electronic payments.

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In September 2004, we announced a restructuring of our business in order to lower overall expenses to better align them with future revenue expectations. This action, a continuation of our emphasis on expense management, resulted in the termination of 64 employees and 2 contractors, in our corporate offices in Burlington, Massachusetts and Broomfield, Colorado location as follows: 12 in product and service delivery, 16 in engineering and development, 25 in sales and marketing and 13 in general and administrative. We recorded a restructuring charge of approximately \$2.1 million relating to employee severance and termination benefits.

Our transaction revenues are derived primarily from the processing of applications for qualification of subscribers for telecommunications services and the activation of service for those subscribers. Over time, we have expanded our offerings from credit evaluation services to include screening for subscriber fraud, evaluating carriers' existing accounts, interfacing with carrier and third-party systems and providing call center services. We also offer transaction services to screen and authenticate the identity of users engaged in online transactions. We also offer on-demand voice conferencing services through our GroupTalk offering. 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 or, in the case of GroupTalk, on a per-minute basis. We do not expect to recognize any transaction revenues from our GroupTalk offering in 2004. 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.

Our software licensing revenues consist of revenues attributable to the licensing of our CAS Application Modules and Prepaid Billing software. Our CAS modules are designed to assist customers in interfacing with our transaction processing systems as well as to perform other point-of-sale and channel functionality. The Prepaid Billing system allows carriers to market and manage prepaid wireless services to customers. In the quarter ended March 31, 2004, we determined that we would no longer actively market or sell our Retail Management System (RMS) product. On August 6, 2004, we entered into an Asset Purchase Agreement with Subex Systems Limited - NJ ( Subex ) to transfer certain assets related to our Fraud Centurion products. The closing of the transaction occurred on October 1, 2004. We received net cash proceeds of \$2.2 million as a result of the sale. The Fraud Centurion products is designed to assist carriers in monitoring subscriber accounts to identify activity that may indicate fraud. The Mobile Data Management solutions, which we no longer actively market or sell, provide wireless carriers a platform for the development and management of data content and applications. Our software products are licensed as packaged software products and each product generally requires incidental customization or integration with other products and systems to varying degrees. Software licensing revenues are recognized when persuasive evidence of an arrangement exists, delivery of the product has been made, and a fixed fee and collectibility have been determined.

Our consulting and services revenues historically have been derived principally from providing solution development and deployment services and business advisory consulting in the areas of customer acquisition and retention, authentication, prepay billing and risk management. The majority of consulting and services engagements are performed on a time and materials basis and revenues from these engagements are generally recognized as the services are performed. When we perform work under a fixed fee arrangement, revenues are generally recognized as services are performed. Revenues from software maintenance contracts are recognized ratably over the term of the maintenance agreement and are reported as consulting and services revenues.

Our hardware revenues historically have been derived in connection with sales of our PrePay and PhonePrint products. Revenue from hardware is recognized upon shipment, unless testing, integration or other services are required, in which case it is recognized upon commissioning and acceptance of the product. Revenue from hardware

sold in conjunction with software is deferred until the software revenue is recognized.

Revenues from payment processing are derived from our credit card processing and eCheck processing services (collectively, "payment processing services") gateway fees and set-up fees. Payment processing services revenue is based on a fee per transaction or on a percentage of the completed transaction, and 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 payment 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. Commissions paid to outside sales partners are recorded in sales and marketing expense in our statements of operations.

If substantial doubt exists regarding collection of fees for our products or services at the time of delivery or performance, we defer recognition of the associated revenue until the fees are collected.

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Our allowance for doubtful accounts is evaluated on a quarterly basis and the amount is determined based on detailed reserves for specific clients' invoices and a general reserve based on historical amounts written-off.

In the quarter ended September 30, 2004, three clients accounted for 18%, 15% and 10% of our total revenues. In the quarter ended September 30, 2003, four clients accounted for 30%, 23%, 13% and 10% of our total revenues. In the nine months ended September 30, 2004, three clients accounted for 22%, 17% and 10% of our total revenues. In the nine months ended September 30, 2003, four clients accounted for 27%, 21%, 14% and 12% of our total revenues. We entered into a recent amendment to our services agreement with AT&T Wireless Services, Inc. ( "AT&T" ), one of our major clients, extending the term of the agreement through April 1, 2009, subject to earlier termination of the services agreement upon twelve months' notice and designated services upon notice. In February 2004, Cingular Wireless LLC ( "Cingular" ) announced an agreement to acquire AT&T. In October 2004, Cingular announced that it had completed its merger with AT&T. Cingular Wireless is not presently a client of Lightbridge. We are unable to predict the effect of the acquisition on our relationship with AT&T including, without limitation, the timing or extent of any reductions in applications processed or other services provided under our contract with AT&T. A loss of one or more of these major clients, a bankruptcy or period of financial difficulty of one or more of our clients, a decrease in orders by one or more of our major clients or a change in the combination of products and services obtained from us by one or more of our major clients would adversely affect our revenues, margins and net income.

**Table of Contents****Results Of Operations**

The following table sets forth, for the periods indicated, certain financial data as a percentage of total revenues:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2004</b>	<b>2003</b>	<b>2004</b>	<b>2003</b>
Revenues:				
Transaction	56.7%	67.7%	58.8%	65.9%
Software licensing	2.4	4.8	5.8	8.4
Consulting and services	13.8	26.8	16.6	23.4
Hardware	1.3	0.7	1.9	2.3
Payment processing	25.8		16.9	
	<hr/>	<hr/>	<hr/>	<hr/>
Total revenues	100.0	100.0	100.0	100.0
	<hr/>	<hr/>	<hr/>	<hr/>
Cost of revenues:				
Transaction	33.6	38.6	35.7	37.5
Software licensing	0.5	1.2	0.9	1.3
Consulting and services	7.8	12.0	7.5	10.4
Hardware	1.4	0.4	1.8	1.9
Payment processing	7.7		4.8	
	<hr/>	<hr/>	<hr/>	<hr/>
Total cost of revenues	51.0	52.2	50.7	51.1
	<hr/>	<hr/>	<hr/>	<hr/>
Total gross profit	49.0	47.8	49.3	48.9
	<hr/>	<hr/>	<hr/>	<hr/>
Operating expenses:				
Engineering and development costs	22.4	23.3	21.8	24.0
Sales and marketing	19.3	11.3	17.1	12.2
General and administrative	12.8	11.0	12.1	11.8
Purchased in-process research and development			0.7	
Restructuring costs	6.1	11.6	2.6	5.6
	<hr/>	<hr/>	<hr/>	<hr/>
Total operating expenses	60.6	57.2	54.3	53.6
	<hr/>	<hr/>	<hr/>	<hr/>
Loss from operations	(11.6)	(9.4)	(5.0)	(4.7)
Loss on equity investment				(0.5)



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Other income, net	<u>0.6</u>	<u>1.3</u>	<u>1.0</u>	<u>1.5</u>
Loss before provision (benefit) for income taxes	(11.0)	(8.1)	(4.0)	(3.7)
Income tax expense (benefit)	<u>1.5</u>	<u>(1.6)</u>	<u>0.4</u>	<u>(1.0)</u>
Net loss	<u>(12.5)%</u>	<u>(6.5)%</u>	<u>(4.4)%</u>	<u>(2.7)%</u>

**Table of Contents*****Quarter Ended September 30, 2004 Compared with Quarter Ended September 30, 2003.***

**Revenues.** Revenues and certain revenue comparisons for the three months ended September 30, 2004 and 2003 were as follows:

**(Dollars in thousands)**

Revenues	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	\$ Difference	% Difference
Transaction	\$ 19,446	\$ 20,029	\$ (583)	(2.9)%
Software licensing	819	1,413	(594)	(42.1)
Consulting and services	4,732	7,922	(3,190)	(40.3)
Hardware	437	202	235	116.3
Payment processing	8,839		8,839	
Total	\$ 34,273	\$ 29,566	\$ 4,707	15.9%

The decrease in transaction revenues of \$583,000 was a result of lower transaction fees charged to certain clients due to competitive pricing pressures and a less favorable mix of services provided on individual transactions. These unfavorable changes were partially offset by increased client subscriber application volumes and the full third quarter impact in 2004 of a large client for that we began providing transaction services during the third quarter of 2003. In addition, transaction revenues for the quarter ended September 30, 2004 included a settlement payment of approximately \$538,000 as a result of the WorldCom, Inc. bankruptcy proceedings, for services provided to WorldCom, Inc. in 2002. We did not recognize revenue at the time the services were performed due to concerns regarding the collectibility of our fees.

Our transaction revenues will 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). While we saw growth in the number of applications processed in the quarter ended September 30, 2004 as compared to the quarter ended September 30, 2003, we believe that transaction revenues in the remainder of 2004 will continue to be impacted by changes in the demand for our transaction offerings, changes in the combination of services purchased by clients, and competitive pricing pressures. We expect transaction revenues in the fourth quarter of 2004 to be higher than in the third quarter.

The decrease in software licensing revenues of \$594,000 resulted from the absence of new software license transactions in the third quarter of 2004, despite increased user growth license fees for existing customers. The lack of new license fees was partly the result of our decision to discontinue actively marketing our RMS software product. We expect the level of capital spending by carriers to continue to affect the sales of our software products during the remainder of 2004. Our PrePay software clients' growth rates for net new subscribers continue to impact the level of our growth fee license revenue. We expect software licensing revenues in the fourth quarter of 2004 to be lower than in the third quarter of 2004. We are developing plans that are intended to bring the expenses associated with our software business to breakeven or better 2005.

The decrease in consulting and services revenues of \$3.2 million for the quarter ended September 30, 2004 was principally due to a decrease in maintenance and support fees associated with our RMS product, which we no longer actively market and sell, decreased consulting services revenue from one significant transactions client, and the absence of new software licenses in the quarter. Additionally, pricing pressures have resulted in reduced rates for maintenance related to our PrePay software product suite in 2004. We expect that the level of software sales will continue to affect consulting and services revenues during the remainder of 2004. Due to the sale of our Fraud Centurion products to Subex on October 1, 2004, we expect that maintenance and support fees associated with our Fraud Centurion products will end or decline significantly during the remainder of 2004 and thereafter, and, accordingly, negatively affect consulting and services revenues in future periods. Maintenance revenues from the Fraud Centurion products were approximately \$750,000 during the quarter ended September 30, 2004. Overall, we expect consulting and services revenues in the fourth quarter 2004 to be lower than in the third quarter of 2004.

There was an increase in hardware revenues of \$235,000 for the quarter ended September 30, 2004 compared to the same quarter last year. Hardware revenues are largely a function of the number of PrePay software license sales and the number of subscribers each new system sold will support.

Payment processing revenues were included in the third quarter results this year due to the acquisition of Authorize.Net on March 31, 2004. Authorize.Net's revenues for the quarter ended September 30, 2004 increased by approximately 26% versus the same period last year, as reported by Authorize.Net's former owner, InfoSpace, Inc., due to an increase in the number of merchant customers and increased transaction volumes. We expect these revenues to continue to increase through the remainder of 2004.

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**Cost of Revenues and Gross Profit.** Cost of revenues consists primarily of personnel costs, costs of resold third party hardware, software and services, 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 payment processing 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 call centers, changes in pricing to certain clients and changes in the mix of total revenues among transaction revenues, software licensing and maintenance revenues, consulting services revenues and payment processing revenues.

Cost of revenues, gross profit and certain comparisons for the three months ended September 30, 2004 and 2003 were as follows:

**(Dollars in thousands)**

	<b>Three Months Ended September 30, 2004</b>	<b>Three Months Ended September 30, 2003</b>	<b>\$ Difference</b>	<b>% Difference</b>
Cost of revenues:				
Transaction	\$ 11,503	\$ 11,398	\$ 105	0.9%
Software licensing	169	349	(180)	(51.5)
Consulting and services	2,677	3,544	(867)	(24.5)
Hardware	471	123	348	282.9
Payment processing	2,639		2,639	
	<hr/>	<hr/>	<hr/>	<hr/>
Total cost of revenues	\$ 17,459	\$ 15,414	\$ 2,045	13.3%
	<hr/>	<hr/>	<hr/>	<hr/>
Gross profit:				
Transaction \$	\$ 7,943	\$ 8,631	\$ (688)	(8.0)%
Transaction %	41%	43%		
Software licensing	\$ 650	1,064	(414)	(39.0)%
Software licensing %	79%	75%		
Consulting and services	\$ 2,055	4,378	(2,323)	(53.1)%
Consulting and services %	43%	55%		
Hardware	\$ (34)	79	(113)	(143.0)%
Hardware %	(8)%	39%		
Payment processing	\$ 6,200		6,200	
Payment processing %	70%			
	<hr/>	<hr/>	<hr/>	<hr/>

Total gross profit \$	<u>\$ 16,814</u>	<u>\$ 14,152</u>	<u>\$ 2,662</u>	<u>18.8%</u>
Total gross profit %	49%	48%		

Transaction cost of revenues increased by \$105,000 in the third quarter of 2004 from the third quarter of 2003. This increase, which is associated with our call center operations, reflects staffing and training costs due to increased call center transaction volume as well as the expansion of our Liverpool, Nova Scotia call center opened in the second quarter of 2004. Generally, cost of revenue from automated transaction processing tends to be lower than costs of revenue from processing transactions through our TeleServices call centers. Included in transaction cost of revenues for the third quarter of 2004 was a one-time benefit realized by us as part of the settlement of the WorldCom, Inc. bankruptcy of approximately \$200,000 related to the release from liability for certain telecommunications costs which we received from WorldCom, Inc..

Software licensing cost of revenues decreased by \$180,000 in the third quarter of 2004 from the third quarter of 2003. This decrease was primarily attributable to the type of software products provided during the quarter ended September 30, 2004. The third quarter 2004 software licensing cost of revenue is more reflective of average historical and expected future software cost of revenues than the cost in the third quarter of 2003.

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Consulting and services cost of revenues decreased by \$867,000 in the quarter ended September 30, 2004 from the quarter ended September 30, 2003, driven by the reduced consulting and services revenues and reduced use of contract labor primarily for consulting and services related to our RMS product.

Hardware cost of revenues increased by \$348,000 in the quarter ended September 30, 2004 from the quarter ended September 30, 2003. This increase was attributable to the increase in hardware revenues during the quarter ended September 30, 2004. Hardware sales are usually a component of software licensing or service arrangements. The gross margins earned can vary significantly as a percentage of hardware revenues based on discounts given on individual transactions.

Due to the acquisition of Authorize.Net on March 31, 2004, this was the first time payment processing cost of revenues were included in the third quarter results for 2004.

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 five revenue components, particularly revenues from software licensing, consulting services and payment processing, and also because of competitive pricing pressures.

**Operating Expenses.** Operating expenses and certain operating expense comparisons for the three months ended September 30, 2004 and 2003 were as follows:

(Dollars in thousands)

	<b>Three Months Ended September 30, 2004</b>	<b>Three Months Ended September 30, 2003</b>	<b>\$ Difference</b>	<b>% Difference</b>
Engineering and development	\$ 7,681	\$ 6,878	\$ 803	11.7%
Sales and marketing	6,601	3,339	3,262	97.7
General and administrative	4,402	3,240	1,162	35.9
Restructuring	2,105	3,438	(1,333)	(38.8)
Total	<u>\$ 20,789</u>	<u>\$ 16,895</u>	<u>\$ 3,894</u>	<u>23.0%</u>

**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 increase in the engineering and development expenses for the three months ended September 30, 2004 was primarily due to the inclusion of Authorize.Net in this year's results. Authorize.Net represented approximately \$1.2 million of our engineering and development costs during the third quarter of 2004. These cost increases were partially offset by cost savings associated with the January 2004 restructuring and our decision to cease new development and enhancement of our RMS software product. Engineering and development expenses as a percentage of total revenues decreased slightly for the three months ended September 30, 2004 as a result of increased revenues. We expect engineering and development expenses to continue to be greater, in comparison to prior year levels, in the

fourth quarter of 2004 primarily due to the inclusion of Authorize.Net's engineering and development expenses in our 2004 results.

***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. Additionally for Authorize.Net, sales and marketing expenses consist of the costs mentioned above as well as commissions paid to outside sales partners. The increase for the three months ended September 30, 2004, in absolute dollars and as a percentage of total revenues, was due to the acquisition of Authorize.Net in 2004 and the related sales partner commissions included in sales and marketing expense. Authorize.Net represented approximately \$3.5 million of our sales and marketing expenses in the third quarter of 2004. This increase was partially offset by reductions in marketing costs for the other portions of our business as a result of reduced marketing headcount and program spending as compared to the same period last year. We expect sales and marketing expenses to continue to be greater, in comparison to prior year levels, in the remainder of 2004 primarily due to the inclusion of Authorize.Net's sales and marketing expenses in our results this year.

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**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 in general and administrative costs for the three months ended September 30, 2004, in absolute dollars and as a percentage of revenue, was primarily due to increased professional service fees related to regulatory compliance requirements and the inclusion of Authorize.Net's expenditures in the current year. Authorize.Net represented approximately \$643,000 of general and administrative expenses during the quarter ended September 30, 2004.

In addition during the third quarter of 2004, we incurred approximately \$920,000 in separation costs associated with the resignation of our former President and Chief Executive Officer in August 2004. This increase was offset by a one-time benefit of approximately \$1.0 million related to the release from liability of amounts that had been reserved for potential claims against us related to the WorldCom, Inc. bankruptcy proceedings. We expect general and administrative expenses to continue to be greater, in comparison to prior year levels, in the fourth quarter of 2004 primarily due to the inclusion of Authorize.Net's general and administrative expenses in our 2004 results and increased regulatory compliance costs.

**Restructuring.** In September 2004, we announced a restructuring of our business in order to lower overall expenses to better align them with future revenue expectations. This action, a continuation of our emphasis on expense management, resulted in the termination of 64 employees and 2 contractors, in our corporate offices in Burlington, Massachusetts and our Broomfield, Colorado location as follows: 12 in product and service delivery, 16 in engineering and development, 25 in sales and marketing and 13 in general and administrative. We recorded a restructuring charge of approximately \$2.1 million relating to employee severance and termination benefits during the three months ended September 30, 2004.

The following summarizes the changes to the September 2004 restructuring reserve since it was accrued:

	<b>Balance at December 31, 2003</b>	<b>Accrued</b>	<b>Utilized</b>	<b>Balance at September 30, 2004</b>
		<b>(In thousands)</b>		
Employee severance and termination benefits	\$	\$2,090	\$ 191	\$ 1,899

**Other Income, Net.** Other income, net primarily consists of interest income earned on our cash and short-term investment balances as well as other non-operating gains and losses. Other income, net decreased to \$193,000 in the quarter ended September 30, 2004 from \$377,000 in the quarter ended September 30, 2003. This decrease was primarily due to a decline in our cash and short-term investments balance as a result of the payment of the purchase price for the acquisition of Authorize.Net.

**Provision For (Benefit From) Income Taxes.** We estimate our interim income tax expense (benefit) based on our projected annual effective tax rate. Our projected annual effective tax rate differs from the federal statutory rate primarily due to the impact of state taxes, changes in valuation allowances for certain deferred tax assets and benefit from federal and state tax credits. The annual effective tax rate for 2004 will be largely dependent on our performance and could fluctuate significantly with slight changes in the absolute dollar value of our 2004 pre-tax net income (loss).

**Nine Months Ended September 30, 2004 Compared with Nine Months Ended September 30, 2003.**



**Revenues.** Revenues and certain revenue comparisons for the nine months ended September 30, 2004 and 2003 were as follows:

(Dollars in thousands) Revenues	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003	\$ Difference	% Difference
Transaction	\$ 59,180	\$ 58,880	\$ 300	0.5%
Software licensing	5,784	7,474	(1,690)	(22.6)
Consulting and services	16,712	20,900	(4,188)	(20.0)
Hardware	1,931	2,034	(103)	(5.0)
Payment processing	16,976	_____	16,976	_____
 Total	 \$ 100,583	 \$ 89,288	 \$ 11,295	 12.6%

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The increase in transaction revenues of \$300,000 was due to increased volume of client subscriber applications, partially offset by lower transaction fees charged to certain clients as a result of competitive pricing pressures and an unfavorable change in the mix of services provided. In addition, transaction revenues for the quarter ended September 30, 2004 included approximately \$538,000 related to a settlement received, as a result of the WorldCom, Inc. bankruptcy proceedings, for services provided to Worldcom, Inc. in 2002. We did not recognize revenue at the time the services were performed due to concerns regarding the collectibility of our fees.

The decline in software licensing revenues of \$1.7 million in the nine months ended September 30, 2004 was due to lower new software license revenues related to our RMS product and reduced subscriber growth license fees from clients utilizing our PrePay software. These decreases were partially offset by increased new software license revenues related to our PrePay software suite.

The decrease in consulting and services revenues of \$4.2 million for the nine months ended September 30, 2004 was principally due to a decline in consulting and maintenance revenues related to our decision to no longer actively market or develop our RMS product. Additionally, the decrease is related to a decline in maintenance revenues related to our PrePay software product suite as a result of pricing pressures and a decrease in consulting revenue from a significant transactions client. These decreases were partially offset by increased consulting revenues related to our PrePay software suite as a result of an increase in the volume of initial licenses sold.

There was a slight decrease in hardware revenues of \$103,000 for the nine months ended September 30, 2004. Hardware revenues are largely a function of the number of PrePay software license sales and the number of subscribers each new system sold will support.

Payment processing revenues were included in our results beginning in 2004 as a result of the acquisition of Authorize.Net on March 31, 2004. Authorize.Net's revenues for the period from April 1, 2004 to September 30, 2004 have increased 24% compared to the same period in 2003, as reported by Authorize.Net's former owner, InfoSpace, Inc. The increased revenues are the result of an increase in the number of merchant customers and increased volume of transactions processed.

***Cost of Revenues and Gross Profit.***

Cost of revenues, gross profit and certain comparisons for the nine months ended September 30, 2004 and 2003 were as follows:

<b>(Dollars in thousands)</b>	<b>Nine Months Ended September 30, 2004</b>	<b>Nine Months Ended September 30, 2003</b>	<b>\$ Difference</b>	<b>% Difference</b>
Cost of revenues:				
Transaction	\$ 35,912	\$ 33,475	\$ 2,437	7.3%
Software licensing	955	1,136	(181)	(15.9)
Consulting and services	7,540	9,288	(1,748)	(18.8)
Hardware	1,770	1,693	77	4.5
Payment processing	4,831		4,831	

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Total cost of revenues	\$ 51,008	\$ 45,592	\$ 5,416	11.9%
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Gross profit:				
Transaction \$	\$ 23,268	\$ 25,405	\$ (2,138)	(8.4)%
Transaction %	39%	43%		
Software licensing	\$ 4,829	6,338	(1,509)	(23.8)%
Software licensing %	84%	85%		
Consulting and services	\$ 9,172	11,612	(2,441)	(21.0)%
Consulting and services %	55%	56%		
Hardware	\$ 161	341	(179)	(52.6)%
Hardware %	8%	17%		
Payment processing	\$ 12,145		12,145	
Payment processing %	72%			
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total gross profit \$	\$ 49,575	\$ 43,696	\$ 5,878	13.5%
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total gross profit %	49%	49%		

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Transaction cost of revenues increased by \$2.4 million in the first nine months of 2004 from the first nine months of 2003. Spending for our TeleServices call centers increased as a result of increased staffing and training costs related to increased call center volume. Additionally, the opening of our Liverpool, Nova Scotia call center during 2004 has resulted in increased costs as transaction volume was transferred from our previously existing call centers to this new site. Increased client subscriber applications resulted in slightly higher resold services expenses, which are the fees paid to third party service providers whose services we resell in conjunction with the processing of some credit applications. These increases were partially offset by reduced costs of maintaining systems and networks used in processing qualification and activation transactions.

Software licensing cost of revenues decreased slightly by \$181,000 for the nine months ended September 30, 2004 in comparison with the same period in 2003. This decrease was primarily attributable to the mix of software products licensed during 2004 as compared to the prior year.

Consulting and services cost of revenues decreased by \$1.7 million in the nine months ended September 30, 2004. This decrease was attributable to a reduction in headcount associated with the June 2003, January 2004 and September 2004 restructurings and a reduced use of contract labor.

Hardware cost of revenues increased by \$77,000 in the nine months ended September 30, 2004 in comparison with the same period in 2003. Hardware sales are usually a component of software licensing or service arrangements. The gross margins earned can vary significantly based on discounts given on individual transactions.

Payment processing costs of revenues were included in our results beginning in the second quarter of 2004 due to the acquisition of Authorize.Net on March 31, 2004.

**Operating Expenses.** Operating expenses and certain operating expense comparisons for the nine months ended September 30, 2004 and 2003 were as follows:

(Dollars in thousands)	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003	\$ Difference	% Difference
Engineering and development	\$ 21,926	\$ 21,430	\$ 496	2.3%
Sales and marketing	17,161	10,921	6,240	57.1
General and administrative	12,196	10,510	1,686	16.0
Purchased in-process R&D	679		679	
Restructuring	2,624	4,987	(2,363)	(47.4)
	<hr/>	<hr/>	<hr/>	<hr/>
Total	\$ 54,586	\$ 47,848	\$ 6,738	14.1%

**Engineering and Development.** The increase in engineering and development expenses for the nine months ended September 30, 2004 was primarily due to the addition of Authorize.Net, the expenses from which are included in our results beginning on April 1, 2004. Authorize.Net represented \$2.1 million of engineering and development expenses in the current year's results. This increase was partially offset by cost savings associated with the June 2003 and

January 2004 restructurings and our decision to cease new development and enhancement of our RMS software product. Engineering and development expenses as a percentage of total revenues decreased for the nine months ended September 30, 2004 as a result of increased revenues.

**Sales and Marketing.** The increase in sales and marketing expenses for the nine months ended September 30, 2004, in absolute dollars and as a percentage of revenue, was due to the addition of Authorize.Net and the related sales partner commissions included in sales and marketing expense. Authorize.Net represented \$6.7 million of sales and marketing expenses in the current year's results. This increase was partially offset by reductions in marketing costs for the other portions of our business as a result of reduced marketing headcount and program spending as compared to the same period last year.

**General and Administrative.** The increase in general and administrative costs for the nine months ended September 30, 2004, in absolute dollars and as a percentage of revenue, was primarily due to expenses incurred as a result of increased regulatory and compliance requirements and the inclusion of the Authorize.Net expenditures beginning on April 1, 2004. Authorize.Net represented approximately \$1.1 million of general and administrative in the current year's results. In addition, during 2004, we incurred approximately \$920,000 in separation costs associated with the resignation our former President and Chief Executive Officer in August 2004. This increase was offset by a one-time benefit in 2004 of approximately \$1.0 million related to the release from liability of amounts that had been reserved for potential claims against us related to the WorldCom, Inc. bankruptcy proceedings.

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***Purchased In-Process Research and Development ( IPR&D )***. In connection with the Authorize.Net acquisition, we recorded a \$0.7 million charge during the first quarter of 2004 for two IPR&D projects. The Authorize.Net technology includes payment gateway solutions that enable merchants to authorize, settle and manage electronic transactions via the Internet, at retail locations and on wireless devices. The research projects in process at the date of acquisition related to the development of the Card Present Solution ( CPS ) and the Fraud Tool ( FT ). Development on the FT project and the CPS project was started at the end of 2003 and the beginning of 2004, respectively. The complexity of the CPS technology lies in its fast, flexible and redundant characteristics. The complexity of the FT technology lies in its responsiveness to changing fraud dynamics and efficiency.

The value of the projects was determined by an independent appraiser using the income method. The discounted cash flow method was utilized to estimate the present value of the expected income that could be generated through revenues from the projects over their estimated useful lives through 2009. The percentage of completion for the projects was determined based on the amount of research and development expenses incurred through the date of acquisition as a percentage of estimated total research and development expenses to bring the projects to technological feasibility. At the acquisition date, we estimated that the CPS and the FT projects were approximately 15% and 80% complete, respectively, with fair values of approximately \$638,000 and \$41,000, respectively. The discount rate used for the fair value calculation was 30% for the CPS project and 22% for the FT project. At the date of acquisition, development of the technology involved risks to us including the remaining development effort required to achieve technological feasibility and uncertainty with respect to the market for the technology.

We completed the development of the FT in May 2004 having spent approximately \$129,000 on the project after the acquisition. Total cost to complete the CPS project after acquisition is estimated to be approximately \$650,000. The CPS project is expected to be completed by March 2005. If the development of the technology is not completed on schedule, the potential consequences to us may include increased development costs and increased competition from other companies that have competitive products in the market.

***Other Income, Net***. Other income, net decreased to \$973,000 in the nine months ended September 30, 2004 from \$1.4 million in the nine months ended September 30, 2003. This decrease was primarily due to a decline in our cash and short-term investments balance as a result of the payment of the purchase price for the acquisition of Authorize.Net. This decrease was partially offset by a \$250,000 recovery of a note receivable that had been deemed uncollectible and written off in a prior period.

***Provision For (Benefit From) Income Taxes***. The income tax provision for the nine months ended September 30, 2004 reflects a current state income tax expense and an increase in the valuation allowance against certain deferred tax credits, which we believe is more likely than not, will not be used.

**Restructurings**

In September 2004, we announced a restructuring of our business in order to lower overall expenses to better align them with future revenue expectations. This action, a continuation of our emphasis on expense management, resulted in the termination of 64 employees and 2 contractors, in our corporate offices in Burlington, Massachusetts and our Broomfield, Colorado location as follows: 12 in product and service delivery, 16 in engineering and development, 25 in sales and marketing and 13 in general and administrative. We recorded a restructuring charge of approximately \$2.1 million relating to employee severance and termination benefits during the three months ended September 30, 2004.

The following summarizes the changes to the September 2004 restructuring reserve since it was accrued:

	<b>Balance at December 31, 2003</b>	<b>Accrued</b>	<b>Utilized</b>	<b>Balance at September 30, 2004</b>
		<b>(In thousands)</b>		
Employee severance and termination benefits	\$	\$2,090	\$ 191	\$ 1,899

In January 2004, we announced a reorganization of our internal business operations. This action, a continuation of our emphasis on expense management, resulted in the termination of ten individuals in our corporate office in Burlington, Massachusetts. We recorded a restructuring charge of approximately \$0.5 million relating to employee severance and termination benefits during the three months ended March 31, 2004.

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The following summarizes the changes to the January 2004 restructuring reserves for the nine months ended September 30, 2004:

	<b>Balance at December 31, 2003</b>	<b>Accrued</b>	<b>Utilized</b>	<b>Balance at September 30, 2004</b>
	<b>(In thousands)</b>			
Employee severance and termination benefits	\$	\$489	\$ 429	\$ 60

In June 2003, we announced that we would be closing our Irvine, California facility and transferring certain employment positions to our Broomfield, Colorado facility and reducing our headcount by an estimated 70 employees as follows: 16 in product and service delivery, 30 in development, 13 in sales and marketing and 11 in general and administrative. In the quarter ended June 30, 2003, we recorded a restructuring charge of approximately \$0.7 million, consisting mainly of workforce reduction costs. In the quarter ended September 30, 2003, we recorded an additional restructuring charge associated with this action of approximately \$3.3 million, consisting of \$1.1 million for workforce reduction, \$1.7 million in future lease obligations for unused facilities and \$0.5 million for capital equipment write-offs. In the quarter ended December 31, 2003, we recorded an additional restructuring charge of \$0.1 million related to future lease obligations and employee severance benefits. The capital equipment write-offs and a majority of severance costs related to this restructuring were incurred by the end of 2003, and we anticipate that all other costs related to this restructuring, consisting principally of lease obligations on unused space, will be paid by the end of 2006.

The following summarizes the changes to the June 2003 restructuring reserves for the nine months ended September 30, 2004:

	<b>Balance at December 31, 2003</b>	<b>Accrued</b>	<b>Utilized</b>	<b>Balance at September 30, 2004</b>
	<b>(In thousands)</b>			
Employee severance and termination benefits	\$ 253	\$	\$ 160	\$ 93
Facility closing and related costs	1,396	33	500	929
Total	\$ 1,649	\$ 33	\$ 660	\$ 1,022

In March 2003, we announced that we would be streamlining our existing Broomfield, Colorado call center operations into our Lynn, Massachusetts facility and a smaller facility in Broomfield, Colorado by the end of May 2003. In the quarter ended March 31, 2003, we recorded a restructuring charge of approximately \$0.1 million for workforce reductions. In the quarter ended June 30, 2003, we recorded an additional restructuring charge associated



with this action of approximately \$1.0 million, consisting of approximately \$0.6 million in future lease obligations for unused facilities and approximately \$0.4 million for capital equipment write-offs. The capital equipment write-offs and all of the severance costs related to this restructuring were incurred by the end of 2003, and we anticipate that all other costs relating to this restructuring, consisting principally of lease obligations on unused space, will be paid by the end of 2004.

The following summarizes the changes to the March 2003 restructuring reserves for the nine months ended September 30, 2004:

	<b>Balance at December 31, 2003</b>	<b>Accrued Utilized</b>		<b>Balance at September 30, 2004</b>
	<b>(In thousands)</b>			
Facility closing and related costs	\$ 363	\$ 12	\$ 239	\$ 136

In June 2002, we announced that we were reducing our workforce by seven percent and consolidating our Waltham, Massachusetts call center operations into our Lynn, Massachusetts and Broomfield, Colorado facilities by the end of 2002. We recorded a restructuring charge of approximately \$3.6 million, consisting of \$1.6 million for workforce reductions, \$1.3 million for facilities reductions including lease obligations, utilities and security costs on unused space and \$0.7 million for capital equipment write-offs associated with these measures. The restructuring plan resulted in the termination of 65 personnel as follows: 25 in product and service delivery, 22 in development, 11 in sales and marketing and seven in general and administrative. The capital equipment write-offs and a majority of severance costs related to this restructuring were incurred by the end of 2002, and we anticipate that all other costs relating to this restructuring, consisting principally of lease obligations on unused space, will be paid by the end of 2005.

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The following summarizes the changes to the June 2002 restructuring reserves for the nine months ended September 30, 2004:

	<b>Balance at December 31, 2003</b>	<b>Accrued</b>	<b>Utilized</b>	<b>Balance at September 30, 2004</b>
		<b>(In thousands)</b>		
Facility closing and related costs	\$ 622	\$	\$ 254	\$ 368

**Liquidity And Capital Resources**

As of September 30, 2004, we had cash and cash equivalents and short-term investments of \$49.5 million, which included \$7.2 million of cash due to merchants related to our payment processing business. We believe that our current cash balances will be sufficient to finance our operations and capital expenditures for the next twelve months. Thereafter, the adequacy of our cash balances will depend on a number of factors that are not readily foreseeable such as the impact of general market conditions on our operations, cash requirements related to the recent acquisition of Authorize.Net, additional acquisitions or investments, restructurings or obligations associated with the closure of products or facilities, and the sustained profitability of our operations.

Our working capital decreased to \$46.4 million at September 30, 2004 from \$137.7 million at December 31, 2003 due principally to the payment for acquisition of Authorize.Net, net of cash received, of \$77.5 million, a reduction in deferred revenues of \$1.8 million and a reduction of other current assets of \$1.2 million. These reductions were partially offset by an increase of \$7.2 million in funds due to merchants as a result of the Authorize.Net acquisition and an increase in reserves for restructuring of \$0.8 million.

At September 30, 2004, we were holding funds in the amount of \$6.3 million on behalf of merchants utilizing Authorize.Net's eCheck services. The funds are included in cash and cash equivalents and funds due to merchants in our condensed consolidated balance sheet. Authorize.Net typically holds eCheck funds for approximately seven business days; the actual number of days depends on the contractual terms with each merchant. In addition, at September 30, 2004, we held funds in the amount of \$882,000 for and on behalf of merchants processing credit card and ACH transactions using the Integrated Payment Solution (IPS) product. The funds are included in cash and cash equivalents and funds due to merchants on our condensed consolidated balance sheet. Credit card funds are typically held for approximately two business days; ACH funds are held for approximately four business days, according to the specifications of the product and the contract between Authorize.Net and the financial institution through which the transactions are processed.

In addition, we currently have \$600,000 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. 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 Authorize.Net utilizes the ACH processing services of the financial institution, and the amount of the deposit may increase as processing volume increases.

During the first nine months of 2004, we generated cash flows from operating activities of \$6.3 million and used \$31.6 million and \$3.3 million in investing and financing activities, respectively. Included in the cash flow from operations was the receipt of \$538,000 from the settlement of claims related to the WorldCom, Inc. bankruptcy proceedings.

Our capital expenditures totaled \$9.3 million for the nine months ended September 30, 2004. The capital expenditures during this period were principally associated with the opening and expansion of our new headquarters in Burlington, Massachusetts, the opening and expansion of the call center in Liverpool, Nova Scotia, Canada as well as investments in our service delivery infrastructure and computer equipment for software development activities. We lease our facilities and certain equipment under non-cancelable operating lease agreements that expire at various dates through January 2011.

During the nine months ended September 30, 2004, we used \$3.8 million for the repurchase of our common stock under our stock repurchase program.

Our primary contractual obligations and commercial commitments are under our operating leases and a letter of credit. We maintain an annually renewable letter of credit in the amount of \$1.0 million which extends through January 2005, as required for security under the lease for our headquarters.

On February 10, 2004, we entered into a lease agreement with the Region of Queens Municipality to lease 32,144 square feet of space in Liverpool, Nova Scotia, Canada. The lease expires on April 30, 2009, with an option to renew at the end of the current lease term. The lease also gives us the right to terminate upon the third anniversary thereof.

As of August 10, 2004, we entered into a lease agreement for 14,148 square feet of office space in Bellevue, Washington. The lease commenced in September 2004 and will expire in September 2009.



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**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 revenues are concentrated among a few major clients. Our 10 largest clients accounted for approximately 91% of our total revenues in 2003, and we expect that most of our revenues will continue to come from a relatively small number of 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. 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, or as the result of the perceived quality or cost-effectiveness of our products or services. Our services agreements with Sprint Spectrum L.P. ( Sprint ), and Nextel Operations, Inc. ( Nextel ) expire on December 31, 2006. We recently amended our services agreement with AT&T Wireless Services, Inc. ( AT&T ) which now expires on April 1, 2009, but is subject to earlier termination of the services agreement upon twelve months' notice and designated services upon notice. It is possible that Sprint, Nextel and/or AT&T 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. In February 2004, Cingular Wireless LLC ( Cingular ) announced an agreement to acquire AT&T and in October 2004, Cingular announced that it had completed its merger with AT&T. Cingular is not presently a client of Lightbridge. We are unable to predict the effect of the acquisition on our relationship with AT&T including, without limitation the timing or extent of any reductions in applications processed or other services provided under our contract with AT&T. The loss of AT&T 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.

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

Most of 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 Group generally result in significantly higher revenue to us than transactions that are submitted and processed electronically. Therefore, our revenues from a particular client may decline if the client changes the combination of products and services it purchases from us.

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.

**Our Revenues Are Concentrated in the Wireless Telecommunications Industry, Which Is Experiencing Declining Growth Rates, Consolidation and Increasing Pressure to Control Costs.**

We currently derive most of our revenues from companies in the wireless telecommunications industry, and we expect that wireless telecommunications companies will continue to account for a majority of our revenues for the foreseeable future. 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 may in the future seek, pricing concessions when they renew their services agreements with us, which could affect our revenues and profitability. In addition, certain of our carrier clients have sought bankruptcy protection in recent years, and we believe it is likely that additional clients may file for bankruptcy protection if current industry conditions continue. Bankruptcy filings by our clients or former clients such as WorldCom, Inc. may prevent us from collecting some or all of the amounts owing to us at the time of filing, may require us to return some or all of any payments received by us within 90 days prior to a bankruptcy filing and may also result in the termination of our service agreements. 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;

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

continued growth of the domestic wireless telecommunications markets;

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the number of carriers seeking to implement prepaid billing services; and

our ability to increase sales of our products and services internationally.

**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 partners. In 2003, Authorize.Net's revenues were derived predominantly through relationships with distribution partners. In addition, the PrePay billing system is currently marketed primarily through a distribution agreement with Ericsson, which is the source of substantially all of our revenue derived from the PrePay billing system in recent years. That agreement may be terminated by either party on 180 days' notice to the other. We have also entered into a business alliance with VeriSign, Inc. ( VeriSign ) to assist us in penetrating the online transaction market.

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, 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, Ericsson may evaluate and seek to distribute or acquire alternative vendors' prepaid products that compete with PrePay, and VeriSign may elect to market or acquire alternative fraud and identity verification products. Competition from existing and future distributors or other sales and marketing partners could significantly harm sales of our products.

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

We acquired Coral Systems, Inc. in November of 1997, Corsair Communications, Inc. in February of 2001, the assets of Altawave, Inc. in February of 2002 and Authorize. Net in March of 2004. We may also make additional acquisitions in the future if we identify companies, technologies or assets that appear to complement our business. Acquisitions involve risks that could cause the actual results of any acquisitions we make to differ from our expectations. For example:

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.

Our acquisition of Authorize.Net significantly reduced 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. In addition, we may assume contingent liabilities that may be difficult to estimate.

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

**The Success of Our Growth Strategy Is Dependent on Our Ability to Expand into New Markets.**

In order to achieve growth in our business, we are seeking to expand our business into new markets, including the online transaction market and the voice conferencing market. If we are not able to expand successfully into new markets, our financial results and future prospects may be harmed. Our ability to enter new markets depends on a number of factors, including:

growth in the online transaction and voice conferencing markets;

our ability to provide products and services to address the needs of those markets; and

competition in those markets.



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**If We Do Not Continue to Enhance Our Existing Products and Services, and Develop or Acquire New Ones, We Will Not Be Able to Compete Effectively.**

The industries in which we do business or intend to do business have been changing rapidly as a result of increasing competition, technological advances, regulatory changes and evolving industry practices and standards, and we expect these changes will continue. Current and potential clients have also experienced significant changes as the result of consolidation among existing industry participants and economic conditions. In addition, the business practices and technical requirements of our clients are subject to changes that may require modifications to our products and services. In order to remain competitive and successfully address the evolving needs of our clients, we must commit a significant portion of our resources to:

identify and anticipate emerging technological and market trends affecting our core wireless business as well as the online market;

enhance our current products and services in order to increase their cost-effectiveness to clients that are seeking to control costs and to meet regulatory requirements;

develop or acquire new products and services that meet emerging client needs, such as services to allow companies to authenticate the identity of consumers engaged in online transactions, voice conferencing services and products and services for the online market;

modify our products and services in response to changing business practices and technical requirements of our clients, as well as to new regulatory requirements;

integrate our current and future products; and

create and maintain interfaces to changing client and third party systems.

We must achieve these goals in a timely and cost-effective manner and successfully market our new and enhanced products and services to clients. In the past, we have experienced errors or delays in developing new products and in modifying or enhancing existing products. If we are unable to expand or appropriately enhance or modify our products and services quickly and efficiently, our business and operating results will be adversely affected.

**We and Our Clients Must Comply with Complex and Changing Laws and Regulations.**

Government regulation influences our activities and the activities of our current and prospective clients, as well as our clients' expectations and needs in relation to our products and services. Businesses that handle consumers' funds, such as our Authorize. Net business, are subject to numerous regulations, including those related to banking, credit cards, escrow, fair credit reporting, privacy of financial records and others. State money transmitter regulations and federal anti-money laundering and money services business regulations can also apply under some circumstances. The application of many of these laws with regard to electronic commerce is currently unclear. If applied to us, these rules and regulations could require us to change the way we do business in a way that increases costs or makes our business more complex. In addition, violation of some statutes may result in severe penalties or restrictions on our ability to engage in e-commerce, which could have a material adverse effect on our business.

Our clients also include telecommunications companies that, to the extent that they extend consumer credit, may be subject to federal and state regulations. In making credit evaluations of consumers, performing fraud screening or user authentication, our clients are subject to requirements of federal law, including the Equal Credit Opportunity Act ( ECOA ), the Fair Credit Reporting Act ( FCRA ) and the Gramm-Leach-Bliley Act ( GLBA ) and regulations thereunder, as well as state laws which impose a variety of additional requirements. Privacy legislation may also affect the nature and extent of the products or services that we can provide to clients as well as our ability to collect, monitor

and disseminate information subject to privacy protection. Although most of the products and services we provide to the telecommunications industry, other than our ProFile service, are not directly subject to these requirements, we must take these extensive and evolving requirements into account in order to meet our clients' needs. In some cases, consumer credit laws require our clients to notify consumers of credit decisions made in connection with their applications for telecommunications services, and we have contracted with some of our clients, including Sprint, AT&T, Nextel, Western Wireless Corporation and Dobson Communications, Inc., to provide such notices on their behalf. Our software has in the past contained, and could in the future contain, undetected errors affecting compliance by our clients with one or more of these legal requirements. Failure to properly implement these requirements in our products and services in a timely, cost-effective and accurate manner could result in liability, either directly or as indemnitor of our clients, damage to our reputation and relationships with clients and a loss of business.

Consumer protection laws in the areas of privacy, credit and financial transactions have been evolving rapidly at the state, federal and international levels. As the electronic transmission, processing and storage of financial information regarding consumers continues to grow and develop, it is likely that more stringent consumer protection laws may impose additional burdens on companies involved in such transactions. Uncertainty and new laws and regulations, as well as the application of existing laws to e-commerce, could limit our ability to operate in our markets, expose us to compliance costs and substantial liability and result in costly and time consuming litigation.

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**On-Demand Voice Conferencing Services May Become Subject to Traditional Telecommunications Carrier Regulation by Federal and State Authorities, Which Would Increase the Cost of Providing Our Services, Require Us to Suspend Services to Existing Clients, and May Subject Us to Penalties.**

The Federal Communications Commission ( FCC ) and state public service commissions may require us to submit to traditional telecommunications carrier regulations for our GroupTalk on-demand, voice conferencing service under the Communications Act of 1934, as amended, and various state laws or regulations as provider of telecommunications services. If the FCC or any state public service commission seeks to enforce any of these laws or regulations against us, we could be prohibited from providing the voice aspect of our voice conferencing service until we have obtained various federal and state licenses and filed tariffs. We believe we would be able to obtain those licenses, although in some states, doing so could significantly delay our ability to provide services. We also could be required to comply with other aspects of federal and state laws and regulations. Subjecting our voice conferencing service to these laws and regulations would increase our operating costs, may require us to suspend service to existing clients, could require restructuring of those services to charge separately for the voice and other components, and would involve on-going reporting and other compliance obligations. We also might be subject to fines or forfeitures and civil or criminal penalties for non-compliance.

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

New requirements adopted by the Securities and Exchange Commission in response to the passage of the Sarbanes-Oxley Act of 2002 will require annual review and evaluation of our internal control systems, and attestation of these systems by our independent auditors. We are currently reviewing our internal control procedures and considering further documentation of such procedures that may be necessary. There can be no assurance that we will be able to meet all of the new requirements in a timely manner. Any improvements in 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.

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

Our Authorize.Net credit card payment gateway does not directly access the Visa and MasterCard credit card associations. As a result, we must rely on banks and their service providers to process our transactions. 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 process credit card transactions, our Authorize.Net business would be materially and adversely affected.

**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 interrupted, and may continue to attempt 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 large volume of payments that we handle for our clients makes us vulnerable to employee fraud or other internal security breaches. We cannot give assurance that any internal control systems will prevent material losses from employee fraud. 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 of 2001 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.

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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.

### **Our Reliance on Suppliers and Vendors Could Adversely Affect Our Ability to Provide Our Services and Products to Our Clients on a Timely and Cost-Efficient Basis.**

We rely to a substantial extent on third parties to provide some of our equipment, software, data, systems and services. In some circumstances, we rely on a single supplier or limited group of suppliers. For example, our Authorize.Net business requires the services of third-party payment processors. If any of these processors cease to allow us to access their processing platforms, our ability to process credit card payments would be severely impacted. In addition, we depend on our Originating Depository Financial Institution ( ODFI ) partner to process Automated Clearing House transactions, and our ability to process these transactions would be severely impacted if we were to lose our ODFI partner for any reason.

Our reliance on outside vendors and service providers also subjects us to other risks, including a potential inability to obtain an adequate supply of required components and reduced control over quality, pricing and timing of delivery of components. For example, in order to provide our credit verification service, we need access to third-party credit information databases provided to us by outside vendors. Similarly, delivery of our activation services often requires the availability and performance of billing systems which are also supplied by outside vendors. If for any reason we were unable to access these databases or billing systems, our ability to process credit verification transactions could be impaired.

In addition, our business is materially dependent on services provided by various telecommunications providers. A significant interruption in telecommunications services could seriously harm our business.

From time to time, we must also rely upon third parties to develop and introduce components and products to enable us, in turn, to develop new products and product enhancements on a timely and cost-effective basis. In particular, we must rely on the development efforts of third-party wireless infrastructure providers in order to allow our PrePay product to integrate with both existing and future generations of the infrastructure equipment. We may not be able to obtain access, in a timely manner, to third-party products and development services necessary to enable us to develop and introduce new and enhanced products. We may not be able to obtain third-party products and development services on commercially reasonable terms and we may not be able to replace third-party products in the event such products become unavailable, obsolete or incompatible with future versions of our products.

### **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 call 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 requirements, such as those under the ECOA, FCRA, or GLBA.

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.

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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 Initiatives to Improve Our Software Design and Development Processes May Not Be Successful.**

The development of our core products has, in some cases, extended over a period of more than ten years. This incremental development process has resulted in a system which is extremely complex. Systems of the size and complexity of ours are inherently difficult to modify and maintain. Beginning in 2001, we began the process of rebuilding portions of our core products in Java, replacing the proprietary three-tiered software architecture historically employed in our products with a new architecture using a middleware layer and a standard database across all products. We expect that this architecture, which relies on component-based development and reusable frameworks, will accelerate our product development process and make it easier to maintain our software systems. We are also evaluating changes in our product development, testing and control processes to improve the accuracy and timeliness of modifications that we make to our software, including the frequent modifications that we must make in response to changes in the business policies and technical requirements of our clients. We believe that our initiatives to implement a new product architecture and to improve our product development, test and control processes will be important to our future competitive position and success. If we are not successful in carrying out these initiatives on a timely basis or in a manner that is acceptable to our clients, our business and future prospects could be harmed.

### **Our Success Is Dependent in Part on PrePay, Which May Not Achieve Market Penetration.**

Our future operating results will depend to a significant extent on the demand for and market penetration of PrePay, our prepaid metered billing system. To date, only a small number of wireless carriers, almost all of them outside the U.S., have deployed PrePay, and the rate of adoption of the PrePay system will need to increase significantly in order to achieve our revenue targets. PrePay has been sold predominantly by Ericsson. Ericsson, from time to time, may evaluate and seek to distribute or acquire alternative vendors' prepaid product offerings. Any change in the terms of our distribution arrangements with Ericsson or Ericsson's desire to discontinue our relationship would drastically affect sales of PrePay. Although our own sales force also sells PrePay, it has not yet generated significant PrePay sales. We cannot ensure that sales of the PrePay system will increase or that PrePay will gain market penetration. If PrePay does not gain market penetration our future operating results would be adversely affected.

### **If We Are Unable to Acquire Complementary Businesses, Our Future Growth Will Be Limited.**

A key element of our growth strategy is to acquire businesses, technologies or products that expand and complement our business. We believe acquisitions are necessary for us to continue to grow at a desirable rate, and we will continue to evaluate possible acquisition opportunities in the future. Even if we are able to identify suitable companies or businesses to buy, we may not be able to purchase any of these companies at favorable prices, or at all, for any number of reasons. If we are unable to make acquisitions, we may not be able to meet or exceed our historical levels of growth and earnings.

### **We May Not Be Able to Successfully Manage Operational Changes.**

Over the last several years, our operations have experienced rapid growth in some areas and significant restructurings and cutbacks in others. These changes have created significant demands on our executive, operational, development and financial personnel and other resources. If we achieve future growth in our business, or if we are forced to make additional restructurings, we may further strain our management, financial and other resources. Our future operating results will depend on the ability of our officers and key employees to manage changing business conditions and to continue to improve our operational and financial controls and reporting systems. We cannot ensure that we will be able to successfully manage the future changes in our business.

**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, which historically have represented the majority of our total revenues, and may affect demand for our other products and services. Seasonal and retail trends also affect our payment processing 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 twenty-four months. The length of the sales process makes our revenues difficult to predict. The delay of one or more large orders, particularly orders for software, which typically result in a substantial amount of non-recurring revenue, could cause our quarterly revenues to fall substantially below expectations.



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We ship our software products within a short period after receipt of an order, and we usually do not have a material backlog of unfilled orders of software products. Consequently, our revenues from software licenses in any quarter depend substantially on the orders booked and shipped in that quarter. As a result, a delay in the consummation of a license agreement may cause our revenues to fall below expectations for that quarter.

Our consulting services revenues can fluctuate based on the timing of product sales and projects we perform for our clients. Many of our consulting engagements are of a limited duration, so it can be difficult for us to forecast consulting services revenues or staffing requirements accurately more than a few months in advance.

Most of our expenses, particularly employee compensation, 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 changes that may occur in a given quarter.

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.

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

We expect our international revenues will continue to represent a significant portion of our total revenues. We also intend to further expand our sales efforts internationally. In addition to the risks generally associated with sales and operations in the U.S., sales to clients outside the U.S. and operations in foreign countries present us with many 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 import and export laws and treaties;

- political and economic instability that may lead to reduced demand for our products and services;

- changes in tariffs, taxes and other barriers that may reduce our ability to sell our solutions or may reduce the profitability of those solutions;

- longer payment cycles and increased difficulties in collecting accounts receivable;

- fluctuations in interest and currency exchange rates, which may reduce our

earnings if we denominate arrangements with international clients in the currency of the country in which our products or services are provided, or with respect to arrangements with international clients that are U.S. dollar-denominated, which may make our systems less price-competitive;

changes in technology standards, such as interfaces between products, that are developed by foreign groups and may require additional development efforts on our part or change the buying behavior of some of our clients;

reduced protection for intellectual property rights in some countries;

difficulties in managing a global network of distributors or representatives and in staffing and managing foreign subsidiary operations;

costs and risks of localizing systems in foreign countries;

additional complications and expenses related to supporting products internationally; and

the possibility that our purchase agreements may be governed by foreign laws that differ significantly from U.S. laws, which may limit our ability to enforce our rights under these agreements.

**We Face Significant Competition for a Limited Supply of Qualified Software Engineers and Consultants.**

Our business depends on the services of skilled software engineers who can develop, maintain and enhance our products and consultants who can undertake complex client projects. In general, only highly qualified, highly educated personnel have the training and skills necessary to perform these tasks successfully. In order to maintain the competitiveness of our products and to meet client requirements, we need to attract, motivate and retain a significant number of software engineers and consultants. Qualified personnel such as these are in short supply and we face significant competition for these employees, from not only our competitors but also clients and other enterprises. Other employers may offer software engineers and consultants significantly greater compensation and benefits or more attractive career paths than we are able to offer. Any failure on our part to hire, train and retain a sufficient number of qualified personnel would seriously damage our business.



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**Changes in Management Could Affect our Ability to Operate our Business**

Our future success will depend to a significant degree on the skills, experience and efforts of our executive officers. We have experienced recent changes in management including the resignation of Pamela D.A. Reeve, our former President and CEO, on August 2, 2004. The loss of any of our executive officers could impair our ability to successfully manage our current business or implement our planned business objectives and our future operations may be adversely affected.

**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 competitors in the future. We face potential competition from several primary sources:

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. ( TSI ), Fair, Isaac & Co. Inc., Magnum Software Systems, Inc., American Management Systems, Incorporated and SLP Infoware;

telecommunications equipment vendors that market software-based solutions to complement their hardware offerings, such as Hewlett-Packard Company and Ericsson;

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 Oracle Corporation, Microsoft Corporation and International Business Machine Corporation;

providers of online payment processing services, including VeriSign, CyberSource Corporation, PlugnPlay Technologies, Inc. and LinkPoint International, Inc.

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 American Management Systems, Incorporated, Accenture Ltd., BearingPoint, Inc., PeopleSoft, Inc., Siebel Systems, Inc. and Cap Gemini Ernst & Young;

software vendors of prepaid wireless billing products, including Boston Communications Group, Inc., Intervoice, Inc., Converse Technology, Inc., Glenayre Technologies, Inc., VeriSign Telecommunications Services, Telemac Cellular Corporation, Fair, Isaac & Co. Inc., ORGA Kartensysteme GmbH, Schlumberger Sema plc, Alcatel USA, Priority Call Management, Lucent Technologies, Inc., Hewlett-Packard Company (Tandem Division), Telcordia Technologies, Inc. and Sixbell;

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 & Co., Inc.;

vendors that provide products and services in the wireless data market, such as Bridgewater Systems Corporation, OracleMobile, a division of Oracle Corporation, 4thPass, Inc., TSI, Seven Networks, Inc. and Openwave Systems Inc.; and

vendors that provide or resell products and services in the voice conferencing market such as Spectel, Inc., Polycom Inc., Raindance Communications, Inc., Ptek Holdings, Inc., and the major worldwide telecommunications providers such as AT&T, Sprint, and Global Crossing Limited.

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.

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The need for us to work cooperatively with such companies may limit our ability to compete aggressively with those companies in other circumstances.

### **A Failure of, Error in or Damage to Our Computer and Telecommunications Systems Would Impair Our Ability to Conduct Transactions, Payment Processing and Support Services and Harm Our Business Operations.**

We provide transaction services, payment processing and support services using complex computer and telecommunications systems. Our business could be significantly harmed if these systems fail or suffer damage from fire, natural disaster, terrorism including cyber terrorism, power loss, telecommunications failure, unauthorized access by hackers, electronic break-ins, intrusions or attempts to deny our ability to deploy our services, computer viruses or similar events. In addition, the growth of our client base, a significant increase in transaction volume or an expansion of our facilities may strain the capacity of our computers and telecommunications systems and lead to degradations in performance or system failure. Many of our agreements with carriers contain level of service commitments, which we might be unable to fulfill in the event of a natural disaster, an actual or threatened terrorist attack or a major system failure. Errors in our computer and telecommunications systems may adversely impact our ability to provide the products and services contracted for by our clients. We may need to expend significant capital or other resources to protect against or repair damage to our systems that occur as a result of malicious activities, cyber-terrorism, natural disasters or human error, but these protections and repairs may not be completely effective. Our property and business interruption insurance and errors and omissions insurance might not be adequate to compensate us for any losses that may occur as the result of these types of damage. It is also possible that such insurance might cease to be available to us on commercially reasonable terms, or at all.

### **Our Success Depends in Part on Our Ability to Obtain Patents for, or Otherwise 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 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 patents in the U.S. and abroad, 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 provide us with a competitive advantage, or that others will not claim rights in our patents or our proprietary technologies.

Patents issued and patent applications filed relating to products used in the wireless telecommunications 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.

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.

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

We are aware of, and we expect we may become a party to, certain pending lawsuits involving intellectual property infringement claims against businesses providing electronic payment gateway services that seek injunctive relief and monetary damages, which lawsuits were brought by a company that claims to hold patents related to such services. From time to time, we may be forced to respond to or prosecute 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.

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**Our Business Could Require Additional Financing.**

Our future business activities, including our operation of Authorize.Net, the development or acquisition of new or enhanced products and services, the acquisition of additional computer and network equipment, and the international expansion of our business will require us to make significant capital expenditures. If our available cash resources prove to be insufficient, because of unanticipated expenses, revenue shortfalls or otherwise, we may need to seek additional financing or curtail our expansion activities. If we obtain equity financing for any reason, our existing stockholders may experience dilution in their investments. If we obtain debt financing, our business could become subject to restrictions that affect our operations or increase the level of risk in our business. It is also possible that, if we need additional financing, we will not be able to obtain it on acceptable terms, or at all.

**Our Anti-Takeover Provisions May Discourage Potential Acquisitions or Changes of Control.**

Some provisions of our certificate of incorporation and Delaware law could be used by our incumbent management to make it more difficult for a third party to acquire control of us, even if the change in control might be beneficial to our stockholders. This could discourage potential takeover attempts and could adversely affect the market price of our common stock.

In particular, we may issue preferred stock in the future without stockholder approval, upon terms determined by our board of directors. The rights of holders of our common stock would be subject to, and may be adversely affected by, the rights of holders of any preferred stock issued in the future. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring, a majority of our outstanding stock. We also have adopted a stockholder rights plan that may deter or delay attempts to acquire us or to accumulate shares of common stock. Except for the stockholder rights plan, we have no present plans to designate or issue any shares of preferred stock.

In addition, the members of our Board of Directors serve staggered three-year terms, with approximately one-third of the members elected each year. This structure makes it more difficult for stockholders to change the composition of a majority of our Board.

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

The market risk exposure inherent in the Company's financial instruments and consolidated financial position represents the potential losses arising from adverse changes in interest rates. The Company is exposed to such interest rate risk primarily in its significant investment in cash and cash equivalents. Cash and cash equivalents include short-term, highly liquid instruments, which consist primarily of money market accounts, purchased with remaining maturities of three months or less. The Company's short-term investments also include debt securities maturing in one year or less that are classified as available for sale. These investments are carried at fair value. The Company does not execute transactions in or hold derivative financial instruments for trading or hedging purposes.

The carrying value 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.

Market risk for cash and cash equivalents is estimated as the potential change in the fair value of the assets or obligations resulting from a hypothetical ten percent adverse change in interest rates, which would not have been



significant to the Company's financial position or results of operations during the three or nine months ended September 30, 2004.

The Company is not subject to any material market risk associated with foreign currency exchange rates.

For additional information about Lightbridge's financial instruments and debt obligations, see Notes to Consolidated Financial Statements in Lightbridge's Annual Report on Form 10-K for the year ended December 31, 2003.

#### **ITEM 4. 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 September 30, 2004. 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 September 30, 2004, the Company's disclosure controls and procedures were effective to provide a reasonable level of assurance of reaching the Company's disclosure control objectives.

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There has not been any change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) that occurred in the quarter ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II. OTHER INFORMATION****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

On October 4, 2001, Lightbridge announced that its Board of Directors had authorized the repurchase of up to 2 million shares of the Company's common stock at an aggregate cost of up to \$20 million. The shares may be purchased from time to time depending on market conditions. On April 23, 2003, the Board approved an expansion of the plan to authorize Lightbridge to purchase up to 4 million shares of the Company's common stock at an aggregate cost of up to \$40 million through September 26, 2005. As of September 30, 2004, the Company had purchased approximately 2.5 million shares at a total cost of approximately \$17.9 million since the inception of its repurchase program. There were no repurchases during the third quarter of 2004. The maximum number of shares that may yet be purchased under the plan was 1,452,862 at September 30, 2004.

**ITEM 6. EXHIBITS****(a) Exhibits**

No.	Description
10.1	Separation Agreement and Release between Pamela D.A. Reeve and the Company dated August 2, 2004
10.2	Employment Agreement between Robert E. Donahue and the Company dated August 2, 2004
10.3	Office Lease Agreement between EOP Operating Limited Partnership and the Company dated as of August 10, 2004
10.4	Terms and Conditions of Stock Options Granted Under the Lightbridge, Inc. 2004 Stock Incentive Plan
10.5	Form of Notice of Grant of Stock Options Under the Lightbridge, Inc. 2004 Stock Incentive Plan
31.1	Certification of Robert E. Donahue dated November 9, 2004
31.2	Certification of Timothy C. O'Brien dated November 9, 2004
32.1	Certification of Robert E. Donahue and Timothy C. O'Brien dated November 9, 2004 (furnished but not filed with the Securities and Exchange Commission)

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**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: November 9, 2004

By: /s/ Timothy C. O Brien

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