International Fight League, Inc.
Form 10-Q
November 20, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2008

OR

o **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: 000-21134

International Fight League, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	**04-2893483**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
38 Park Avenue Rutherford, New Jersey	**07070**
(Address of Principal Executive Offices)	(ZIP Code)

201-635-1799

(Registrant s telephone number, including area code)

(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. Yes þ No o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

At November , 2008, there were 79,058,509 shares of Common Stock, par value $0.01 per share, outstanding.

INTERNATIONAL FIGHT LEAGUE, INC.
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PART I.
FINANCIAL INFORMATION

Item 1. *Financial Statements*

Certain information and footnote disclosures required under generally accepted accounting principles have been condensed or omitted from the following consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. International Fight League, Inc. (the registrant , the Company , IFL , we , us our) believes that the disclosures are adequate to assure that the information presented is not misleading in any material respect. The following condensed consolidated financial statements should be read in conjunction with the year-end consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007.

The results of operations for the interim periods presented herein are not necessarily indicative of the results to be expected for the entire fiscal year, or any other period. As previously reported, on September 15, 2008, our wholly-owned subsidiary, IFL Corp. (IFLC), voluntarily filed a petition for reorganization relief under chapter 11 of the United States Bankruptcy Code (Bankruptcy Code) in the United States Bankruptcy Court for the Southern District of New York (the Court). All of our operations were transacted through IFLC, which has ceased operations and, subsequent to September 30, 2008, sold substantially all of its assets pursuant to a sale under Section 363 of the Bankruptcy Code. Accordingly, this report and the condensed consolidated financial statements presented below should be read in conjunction with these developments.

When we refer to our fiscal year in this report, we are referring to the fiscal year ended on December 31 of that year. Thus, we are currently operating in our fiscal 2008 year, which commenced on January 1, 2008. Unless the context expressly indicates a contrary intention, all references to years in this filing are to our fiscal years.

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INTERNATIONAL FIGHT LEAGUE, INC.
and Subsidiary (formerly International Fight League, LLC)
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2008 (unaudited)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 360,273	$ 6,120,500
Accounts receivable, net of allowance for doubtful accounts	87,685	670,990
Prepaid expenses	178,328	457,361
Total current assets	626,286	7,248,851
Property and equipment, net of accumulated depreciation and amortization	23,640	266,967
Other assets	4,300	113,295
Total assets	$ 654,226	$ 7,629,113
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities not subject to compromise:		
Accounts payable	$ 69,850	$ 845,197
Accrued liquidated damages		456,045
Accrued expenses and other current liabilities	73,403	504,915
Total current liabilities not subject to compromise	143,253	1,806,157
Current liabilities subject to compromise:		
Accounts payable	156,128	
Accrued expenses and other liabilities	254,629	
Total current liabilities subject to compromise	410,757	
Total current liabilities	554,010	1,806,157
Commitments and Contingencies		
Stockholders equity:		
Common stock, $0.01 par value per share; 150,000,000 shares authorized; 79,058,509 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively	790,562	790,562

Additional paid-in capital		36,265,931		35,936,112
Accumulated deficit		(36,956,277)		(30,903,718)
Total stockholders equity		100,216		5,822,956
Total liabilities and stockholders equity	$	654,226	$	7,629,113

The accompanying notes are an integral part of the condensed consolidated financial statements.

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INTERNATIONAL FIGHT LEAGUE, INC.
and Subsidiary (formerly International Fight League, LLC)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2008	**2007**	**2008**	**2007**
Revenues:				
Live and television events:				
Advertising sponsorships	$ 1,727	$ 195,846	$ 340,408	$ 337,070
Live events box office receipts	345	588,987	397,074	1,994,550
Television rights	117,952	1,075,000	512,906	1,957,500
Branded merchandise	13,135	18,357	68,017	72,659
Total revenues	133,159	1,878,190	1,318,405	4,361,779
Costs of revenues:				
Live and televised events:				
Advertising sponsorships		55,339	63,137	110,647
Live events costs	152,769	3,102,319	2,869,911	15,104,605
Television distribution fees and production	7,795		94,094	
Branded merchandise		42,610	27,412	67,035
Total costs of revenues	160,564	3,200,268	3,054,554	15,282,287
Selling, general and administrative expenses	842,909	2,161,541	3,617,644	6,604,486
Share-based compensation expense	140,758	247,691	472,658	277,368
Loss before reorganization items	(1,011,072)	(3,731,310)	(5,826,451)	(17,802,362)
Reorganization item:				
Professional fees	(285,000)		(285,000)	
Operating loss	(1,296,072)	(3,731,310)	(6,111,451)	(17,802,362)
Other income (expense):				

Interest expense	(629)	(799)	(3,347)	(2,894)
Interest income	3,017	87,896	62,238	322,035
Total other income, net	2,388	87,097	58,891	319,141
Net loss	$ (1,293,684)	$ (3,644,213)	$ (6,052,560)	$ (17,483,221)
Net loss per common share basic and diluted	$ (0.02)	$ (0.05)	$ (0.08)	$ $(0.30)
Weighted-average number of common shares outstanding basic and diluted	79,058,509	68,683,000	79,058,509	58,627,000

The accompanying notes are an integral part of the condensed consolidated financial statements.

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INTERNATIONAL FIGHT LEAGUE, INC.
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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the Nine Months Ended	
	September 30, 2008	September 30, 2007
Cash flows from operating activities:		
Net loss	$ (6,052,560)	$ (17,483,221)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	69,329	82,043
Loss on disposal of property and equipment	151,158	
Share-based compensation expense and cost of warrants in selling, general and administrative expense	472,658	466,168
Assignment of security deposit	107,152	
Changes in operating assets and liabilities:		
Accounts receivable, net	583,305	(80,809)
Merchandise inventory		(66,476)
Prepaid expenses	136,195	44,645
Accounts payable	(619,219)	(372,188)
Accrued liquidated damages	(456,045)	
Accrued expenses and other current liabilities	(176,883)	(899,225)
Net cash used in operating activities	(5,784,910)	(18,309,063)
Cash flows from investing activities:		
Net refund of security deposits	1,843	8,051
Purchase of property and equipment		(73,739)
Proceeds from sale of property and equipment	22,840	
Net cash provided by (used in) investing activities	24,683	(65,688)
Cash flows from financing activities:		
Receipt of subscription receivable		1,250,000
Proceeds from exercise of stock options		7,448
Payment of accrued commission on private placement		(1,645,400)
Cash received on private placement of common stock and warrants		12,665,000
Costs of private placements		(1,182,861)
Net cash provided in financing activities		11,094,187

Net decrease in cash and cash equivalents		(5,760,227)		(7,280,564)
Cash and cash equivalents at beginning of period		6,120,500		16,623,159
Cash and cash equivalents at end of period	$	360,273	$	9,342,595
Supplemental disclosure of cash flow information:				
Cash payments of interest	$	3,347	$	2,894
Issuance of warrant to placement agent	$		$	518,959
Supplemental disclosure of payments received and expenses incurred in connection with reorganization:				
Professional fees	$	285,000	$	

The accompanying notes are an integral part of the condensed consolidated financial statements.

INTERNATIONAL FIGHT LEAGUE, INC
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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 CESSATION OF OPERATIONS AND CHAPTER 11 BANKRUPTCY FILING

During the three month period ended September 30, 2008, the Company ceased its operations and on September 15, 2008, the Company s wholly-owned subsidiary, IFL Corp. (IFLC), through which the Company conducted it operations, voluntarily filed a petition for reorganization relief under chapter 11 of the United States Bankruptcy Code (Bankruptcy Code) in the United States Bankruptcy Court for the Southern District of New York (the Court). IFLC s bankruptcy case is docketed as *In re IFL Corp.*, Case No. 08-13589 (MG). Under chapter 11 of the Bankruptcy Code, various types of claims against IFLC in existence at the time of the filing of the bankruptcy petition are stayed under the Bankruptcy Code while IFLC continues to operate its business as a debtor-in-possession. These claims are reflected in the September 30, 2008 balance sheet as liabilities subject to compromise. Additional claims against IFLC may arise subsequent to the bankruptcy filing that are also subject to compromise, such as claims resulting from the rejection of executory contracts, allowed claims for contingencies or disputed amounts, and other claims determined by the Court. On November 17, 2008, IFLC sold substantially all of its assets to HDNet LLC pursuant to a sale under Section 363 of the Bankruptcy Code which was approved by the Court on October 28, 2008. See Note 3 below. IFLC plans to file a plan of liquidation with the Court to pay off creditors and to orderly wind down its affairs.

The accompanying unaudited condensed consolidated financial statements have been prepared assuming the Company (the parent company, International Fight League, Inc.) will continue as a going concern. At September 30, 2008, the Company had cash of $360,000, had an accumulated deficit of $36,956,000 and, for the nine months then ended September 30, 2008, incurred a net loss of $6,053,000.

The Company is exploring its options to realize value for its stockholders, which may include seeking a reverse merger transaction with a party with operations. The Company has no present avenues of financing, no source of revenues and no present plans to obtain interim financing while continuing to explore its options. As a result of the foregoing, the lack of liquidity and funding sources pose a substantial risk to the ongoing viability of the Company. These conditions raise substantial doubt about the Company s ability to continue as a going concern. These unaudited condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 2 BASIS OF PRESENTATION AND CONSOLIDATION

Prior to November 29, 2006, the Company was known as Paligent Inc., a Delaware corporation (Paligent). On November 29, 2006, the Company acquired IFLC, then called International Fight League, Inc., a privately held Delaware corporation, pursuant to an agreement and plan of merger, dated as of August 25, 2006, as amended (the Merger Agreement), among the Company, its wholly-owned subsidiary (Merger Sub), and IFLC, providing for the merger of Merger Sub and IFLC, with IFLC being the surviving corporation and becoming the Company s wholly-owned subsidiary (the Merger). Immediately following the Merger, the Company changed its name to International Fight League, Inc. (IFL or collectively, the Company), and IFLC changed its name to IFL Corp. and continued to operate its business of organizing and promoting a mixed martial arts (MMA) sports league under the name International Fight League.

The accompanying unaudited condensed consolidated financial statements represent the accounts of IFL and IFLC. All intercompany accounts and transactions have been eliminated in consolidation. These unaudited condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) that are considered necessary for a fair presentation of consolidated financial position and results of operations as of and for the periods presented. The Company is required to make estimates and assumptions that affect the amounts reported in the unaudited financial statements and footnotes. Estimates and assumptions are periodically reviewed and the effects of any material revisions are reflected in the period that they are determined to be necessary.

In 2007, the Company organized, hosted and promoted a significantly greater number of live and televised MMA sporting events during the first half of our fiscal year than during the second half of our fiscal year. Since the

Company generally incurs most of its costs in connection with such events, our expenses were significantly higher during the first half of 2007 than in the last six months of 2007. During the quarter ended September 30, 2008, the Company ceased its operations and on September 15, 2008, IFLC voluntarily filed a petition for reorganization relief under chapter 11 of Bankruptcy Code. All of the Company s operations were transacted through IFLC, and IFLC owned substantially all of the Company s assets. Subsequent to September 30, 2008, IFLC sold substantially all of its assets pursuant to a sale under Section 363 of the Bankruptcy Code. See Note 3 below.

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The Company s condensed consolidated statements of operations for the periods presented are not necessarily indicative of the results of operations for the full year and should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2007 in the Company s Annual Report on Form 10-K and the disclosures set forth in this report.

The accompanying financial statements have been prepared in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7: Financial Reporting by Entities in Reorganization under the Bankruptcy Code.

NOTE 3 AGREEMENT TO SELL ASSETS AND SUBSEQUENT EVENTS

On September 19, 2008, IFLC filed with the Court a motion for orders (a) authorizing IFLC to sell all or substantially all of its assets to HDNet LLC (HDNet), subject to higher and better offers, (b) approving bid procedures, (c) scheduling auction and sale hearing and (d) granting related relief (the Sale Motion). In connection with the Sale Motion, on September 19, 2008, IFLC and HDNet entered into an asset purchase agreement (the Asset Purchase Agreement), which provided for the sale of substantially all of IFLC s assets (the Purchased Assets) to HDNet for total consideration of $650,000 in cash and the assumption by HDNet of certain liabilities of IFLC. The Asset Purchase Agreement was subject to higher and better offers as set forth in the Sale Motion. The Court granted the Sale Motion on October 10, 2008.

On October 28, 2008, the Court held a hearing on the auction and sale of the Purchased Assets as contemplated by the Sale Motion and entered an order (Sale Order) authorizing IFLC to sell the Purchased Assets to HDNet for total consideration of $650,000 in cash and the assumption by HDNet of certain liabilities of IFLC, as set forth in the Asset Purchase Agreement. The closing took place on November 17, 2008, pursuant to which IFLC transferred to HDNet the Purchased Assets, and HDNet paid $650,000 in cash to IFLC and assumed certain liabilities of IFLC. The Company will recognize a gain on the sale of the Purchased Assets in the quarter ending December 31, 2008.

The Purchased Assets included the name International Fight League, the Company s corporate name. The Company has entered into a name use agreement with HDNet which will permit the Company to continue using International Fight League for general corporate purposes until the earlier of (a) two years or (b) the Company becoming involved in any active trade or business (other than the use of the name for general corporate purposes).

NOTE 4 RECENT ACCOUNTING PRONOUNCEMENTS

Effective January 1, 2008, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157), which did not have a material impact on the Company s consolidated financial statements. SFAS 157 establishes a common definition for fair value, a framework for measuring fair value under generally accepted accounting principles in the United States (GAAP), and enhances disclosures about fair value measurements. In February 2008, the Financial Accounting Standards Board (FASB) issued Staff Position (FSP) No. 157-2, which delays the effective date of SFAS 157 for all nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. The Company is evaluating the expected impact of SFAS 157 for nonfinancial assets and nonfinancial liabilities on its consolidated financial position and results of operations.

In October 2008 the FASB issued FSP No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. FSP No. 157-3 clarifies the application of SFAS. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP No. 157-3 is effective upon issuance, including prior periods for which financial statements have not been issued. Revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate following the guidance in SFAS No. 154, Accounting Changes and Error Corrections. FSP No. 157-3 is effective for the consolidated financial statements included in the Company s quarterly report for the period ended September 30, 2008, and application of FSP No. 157-3 had no impact on the Company s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (Consolidated Financial Statements) (SFAS 160). SFAS 160 establishes accounting and reporting standards for a non-controlling interest in a subsidiary and for the

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deconsolidation of a subsidiary. In addition, SFAS 160 requires certain consolidation procedures for consistency with the requirements of SFAS 141(R), Business Combinations. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 with earlier adoption prohibited. The Company is currently evaluating the impact adoption of SFAS 160 may have on the consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS 141(R)). SFAS 141(R) expands the definition of transactions and events that qualify as business combinations; requires that the acquired assets and liabilities, including contingencies, be recorded at the fair value determined on the acquisition date and changes thereafter be reflected in revenue, not goodwill; changes the recognition timing for restructuring costs; and requires acquisition costs to be expensed as incurred. Adoption of SFAS 141(R) is required for combinations after December 15, 2008. Early adoption and retroactive application of SFAS 141(R) to fiscal years preceding the effective date are not permitted. The Company is currently evaluating the impact adoption of SFAS 141(R) may have on the consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. (SFAS 161) SFAS 161 requires enhanced disclosures about an entity s derivative and hedging activities. Entities will be required to provide enhanced disclosures about: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under SFAS No. 133 and its related interpretations; and (c) how derivative instruments and related hedge items affect an entity s financial position, financial performance and cash flows. The Company is required to adopt SFAS 161 beginning in fiscal year 2009. The Company is currently evaluating the impact adoption of SFAS 161 may have on the consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. Prior to the issuance of SFAS 162, GAAP hierarchy was defined in the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. SAS No. 69 has been criticized because it is directed to the auditor rather than the entity. SFAS 162 addresses these issues by establishing that the GAAP hierarchy should be directed to entities because it is the entity (not its auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. SFAS 162 is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. It is only effective for nongovernmental entities; therefore, the GAAP hierarchy will remain in SAS No. 69 for state and local governmental entities and federal governmental entities. The Company is currently evaluating the impact adoption of SFAS 162 may have on the consolidated financial statements.

In June 2008 the FASB issued Emerging Issues Task Force (EITF) Issue No. 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. EITF 03-6-1 provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform to the provisions of EITF 03-6-1. Management is currently evaluating the requirements of EITF 03-6-1 and has not yet determined the impact on the Company s consolidated financial statements.

NOTE 5 LOSS PER SHARE

The Company complies with the accounting and reporting requirements of SFAS No. 128, Earnings Per Share. Basic earnings per share (EPS) excludes dilution and is computed by dividing net income (loss) applicable

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to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is based upon the weighted-average number of common shares outstanding during the period plus the additional weighted-average common equivalent shares during the period. Common equivalent shares result from the assumed exercises of outstanding stock options and warrants, the proceeds of which are then assumed to have been used to repurchase outstanding shares of common stock (the treasury stock method). Common equivalent shares are not included in the per share calculations where the effect of their inclusion would be anti-dilutive. Inherently, stock options and warrants are deemed to be anti-dilutive when the average market price of the common stock during the period exceeds the exercise price of the stock options or warrants.

At September 30, 2008 and 2007, the Company s common stock equivalents include stock options outstanding of 2,661,209 and 3,097,372 and warrants outstanding of 14,544,513 and 14,611,180, respectively. These common stock equivalents are not included in the diluted EPS calculations because the effect of their inclusion would be anti-dilutive or would decrease the net loss per common share.

NOTE 6 INCOME TAXES

The Company files a federal U.S. income tax return and income tax returns in certain states and cities. Tax returns for the years 2006 through 2007 remain open for examination in various tax jurisdictions in which the Company or its subsidiaries operate. The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109, Accounting for Income Taxes (FIN 48), on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized no material adjustment in the liability for unrecognized income tax benefits. At the adoption date of January 1, 2007, and at September 30, 2008, there were no unrecognized tax benefits. Interest and penalties related to uncertain tax positions will be recognized in income tax expense. As of September 30, 2008, no interest related to uncertain tax positions had been accrued.

NOTE 7 RELATED PARTY TRANSACTIONS

Certain business transactions are transacted among the Company and two business ventures that are controlled by the Company s former Chairman and Chief Executive Officer, Gareb Shamus. Typically, the Company reimbursed these related companies for charges incurred and advances made on the Company s behalf. Further, the Company purchases certain goods and services from these related companies. The Company had no such transactions for the three and nine months ended September 30, 2008 and had transactions in the amounts of $73,400 and $654,000 for the three and nine months ended September 30, 2007, respectively. There were no amounts outstanding related to these transactions at September 30, 2008 and December 31, 2007.

During the nine months ended September 30, 2007, the Company paid amounts to a company controlled by its former President and Chief Executive Officer, Jay Larkin, for consulting services provided to the Company prior to Mr. Larkin s employment with the Company. The total amounts paid by the Company for these services and reimbursement of related expenses were $20,000 and $136,500 for the three and nine month periods ended September 30, 2007. No such amounts have been paid after Mr. Larkin commenced his employment with the Company in September 2007.

The Company also paid amounts to a company controlled by a family member of Kurt Otto, a former director and former commissioner, for logistical and consulting services. The amounts paid were $0 and $5,200 during the three and nine months ended September 30, 2008 and $22,400 and $70,800 during the three and nine months ended September 30, 2007.

In connection with IFLC s lease of the New York City headquarters in August 2006, the Company s former Chairman and Chief Executive Officer executed an unconditional and irrevocable guaranty of IFLC s obligations under the lease. This lease was terminated effective July 31, 2008 and the guaranty released (see Note 14).

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NOTE 8 STOCK OPTION PLAN

Accounting for stock options issued to employees follows the provisions of SFAS No. 123(R), Share-Based Payment and the SEC s Staff Accounting Bulletins (SAB) No. 107 and No. 110, Share-Based Payment. This statement requires an entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide service in exchange for the award. The Company uses the Black-Scholes option pricing model to measure the fair value of options granted to employees.

During the year ended December 31, 2006, the Company adopted the 2006 Equity Incentive Plan (the Plan), which permits the grant of share options and other forms of share-based awards to its employees and service providers for up to 5,000,000 shares of the Company s common stock. Option awards generally vest based on 3 years of continuous service and have 10-year contractual terms. Certain option and share awards provide for accelerated vesting if there is a change in control (as defined in the Plan).

On February 8, 2008 the Company granted 250,000 options to its former President and Interim Chief Executive Officer, Jay Larkin (see Note 12 below). The options were scheduled to vest 1/12 upon the grant of the award, 1/12 on March 21, 2008 and 1/12 every three months thereafter and have an exercise price of $0.12. On November 10, 2008, Mr. Larkin and the Company entered into an agreement to terminate Mr. Larkin s employment with the Company, which also provided for the termination of all of his options, vested and unvested.

In addition, on February 8, 2008, the Company granted 20,000 options to an employee. The options were scheduled to vest 1/2 in April 2008 and 1/6 every six months thereafter and have an exercise price of $0.12. In July 2008, the employee was terminated and forfeited 10,000 unvested options and had three months from the date of termination to exercise the 10,000 vested options, which were not exercised and have been cancelled.

The fair value of the February 8, 2008 option awards were estimated on the date of grant using the Black-Scholes option valuation model that used the assumptions noted in the following table. Expected volatility is based on the Company s trading history from the merger date (November 30, 2006). The expected term of the February 8, 2008 options represents the estimate of time to exercise, since there is no employment history to consider. The risk-free rate for the expected term of the options is based on the U.S. Treasury yield curve in effect at the time of grant.

	February 8, 2008
Expected volatility	187.96%
Expected dividends	0
Expected term (in years)	3
Risk-free rate	3.6%

A summary of option activity under the Plan for the nine months ended September 30, 2008 is presented below:

	Options	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term**
Outstanding at January 1, 2008	2,637,919	$ 0.32	
Granted	270,000	$ 0.12	
Cancelled	(413,486)	$ 0.20	

Outstanding at September 30, 2008	2,494,433	$ 0.32	7.7 years
Exercisable at September 30, 2008	1,373,524	$ 0.24	7.2 years

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In connection with grants of options issued under the Plan, compensation costs of $61,000 and $188,000 were charged against operations for the three and nine months ended September 30, 2008, respectively. For the three and nine months ended September 30, 2007, compensation costs of $13,000 and $43,000 were charged to operations, respectively.

During the three month period ended September 30, 2008, six employees and one independent contractor who were granted a total of 489,730 options were terminated. These individuals were vested in 351,869 options and therefore forfeited 127,861 options upon termination. The 351,869 vested options expire from October 3, 2008 to November 8, 2008. See Note 12.

Restricted Stock

The fair value of restricted stock awards is determined based upon the number of shares awarded and the quoted price of our common stock on the date of the grant. The fair value of the award is recognized as an expense over the service or vesting period, net of forfeitures, using the straight-line method under SFAS No. 123(R). Because the Company does not have historical data on forfeitures and has made only one grant of restricted stock, forfeitures are calculated based upon actual forfeitures, not estimates or assumptions.