

GRYPHON GOLD CORP
Form 10KSB
June 21, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

Q ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended March 31, 2007

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: 333-127635

GRYPHON GOLD CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Nevada

(State of other jurisdiction of incorporation or organization)

92-0185596

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

1130 West Pender, Suite 810

Vancouver, British Columbia, Canada

(Address of Principal Executive Offices)

V6E 4A4

(Zip Code)

(604) 261-2229

(Registrant's Telephone Number, including Area Code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Common Stock, \$0.001 par value

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 ("Exchange Act") during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes

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Q No ☒ £

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

☒ £

Indicate by check mark whether the registrant is a shell company, as defined in Rule 12b-2 of the Exchange Act. Yes

☒ £ No ☐ Q

State issuer's revenues for its most recent fiscal year: NIL

The aggregate market value of the 32,817,739 shares of the registrant's common equity (both voting and non-voting) held by non-affiliates, based on an average bid and asked price for the registrant's common equity of Cdn\$0.82 on June 6, 2007 as quoted on the Toronto Stock Exchange, converted to US\$ based on a noon buying rate as reported by the Federal Reserve Bank of New York of Cdn\$1.0586 to US\$1, was \$25,420,882. For purposes of this computation all officers, directors and 5% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed an admission that such officers, directors and beneficial owners are, in fact, affiliates of the registrant.

Transitional Small Business Disclosure Format (check one): Yes ☒ £ No ☐ Q

Common Shares outstanding as of June 19, 2007: 47,491,395

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FORWARD-LOOKING STATEMENTS

This annual report on Form 10-KSB and the exhibits attached hereto contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward looking statements concern the Company's anticipated results and developments in the Company's operations in future periods, planned exploration and development of its properties, plans related to its business and other matters that may occur in the future. These statements relate to analyses and other information that are based on forecasts of future results, estimates of amounts not yet determinable and assumptions of management.

Any statements that express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, assumptions or future events or performance (often, but not always, using words or phrases such as "expects" or "does not expect", "is expected", "anticipates" or "does not anticipate", "plans", "estimates" or "intends", or stating that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved) are not statements of historical fact and may be forward-looking statements. Forward-looking statements are subject to a variety of known and unknown risks, uncertainties and other factors which could cause actual events or results to differ from those expressed or implied by the forward-looking statements, including, without limitation:

- the timing and possible outcome of pending regulatory and permitting matters;
- the timing and outcome of our possible feasibility study;
- the parameters and design of any potential mining facilities on the Borealis Property;
- future financial or operating performances of Gryphon Gold, its subsidiaries, and its projects;
- the estimation of mineral resources and the realization of mineral reserves, if any, based on mineral resource estimates;

- the timing of exploration, development, and production activities and estimated future production, if any;
- estimates related to costs of production, capital, operating and exploration expenditures;
- requirements for additional capital and our ability to raise additional capital;

- government regulation of mining operations, environmental risks, reclamation and rehabilitation expenses;
- title disputes or claims;
- limitations of insurance coverage; and
- the future price of gold, silver, or other minerals.

This list is not exhaustive of the factors that may affect our forward-looking statements. Some of the important risks and uncertainties that could affect forward-looking statements are described further under the sections titled "Risk Factors and Uncertainties", "Description of the Business" and "Management's Discussion and Analysis" of this prospectus. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, believed, estimated or expected. We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. We disclaim any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

We qualify all the forward-looking statements contained in this prospectus by the foregoing cautionary statements.

PART I

ITEM 1. DESCRIPTION AND DEVELOPMENT OF BUSINESS

Name and Incorporation

Gryphon Gold Corporation was formed under the laws of the State of Nevada on April 24, 2003.

Our principal business office, which also serves as our administration and financing office is located in Canada at Suite 810, 1130 West Pender Street, Vancouver, British Columbia, Canada V6E 4A4, and our telephone number there is 604-261-2229.

We own 100% of the issued and outstanding shares of our operating subsidiary, Borealis Mining Company. We have no other subsidiary. Borealis Mining Company was formed under the laws of the State of Nevada on June 5, 2003.

History and Background of Company

We were established as a private company in April 2003 by Albert Matter and Allen Gordon to acquire and develop gold properties in the United States. Our objective is to establish a producing gold company through the development and extraction of gold deposits.

In July 2003, through our wholly-owned subsidiary Borealis Mining, we acquired from Golden Phoenix an option to earn up to a 70% joint venture interest in the mining lease for the Borealis Property (July 2003 Option and Joint Venture Agreement) by making qualified development expenditures on that property.

In October 2003, we engaged a mining consultant to develop a preliminary scoping study for the redevelopment of the Borealis Property.

During 2004, we completed drilling, technical and engineering work necessary to prepare a Plan of Operation in respect of the development of an open pit, heap leach mine on the Borealis Property. We submitted the Plan of Operation to the U.S. Forest Service on August 27, 2004, and we continue to work on satisfying all the requirements of the various approval agencies and completing all necessary reviews, including the approval of the Nevada Division of Environmental Protection. The principal mine operating permits were granted in 2006. A further discussion of operating permits and other governmental regulation concerns is described under the caption "Permitting," below.

Following the course established by the recommendations in the preliminary scoping study, and based on additional geologic field work that was completed in 2004, we retained Ore Reserves Engineering, consulting resource modeling engineers, to complete an updated resource estimate model in accordance with National Instrument 43-101 of the Canadian Securities Administrators. In May 2005, Ore Reserves Engineering delivered the report titled

Technical

Report on the Mineral Resources of the Borealis Gold Project Located in Mineral County, Nevada which we refer to as the "Technical Report."

On January 10, 2005, Borealis Mining entered into a purchase agreement with Golden Phoenix which gave Borealis Mining the right to purchase the interest of Golden Phoenix in the Borealis Property for \$1,400,000. Golden Phoenix transferred its interest in the Borealis Property to Borealis Mining on January 28, 2005. Borealis Mining paid \$400,000 of the purchase price to Golden Phoenix upon closing of the purchase, and four additional quarterly

payments of \$250,000 were made to Golden Phoenix. With the final payment of \$250,000 on January 24, 2006, Borealis Mining completed all the required payments under the purchase agreement and now has 100% control of the Borealis Property. A portion of the Borealis Property is subject to mining leases, as described under the caption "Borealis Property," below.

As sole shareholder of Borealis Mining, we control all of the lease rights to a portion of the Borealis Property, subject to advance royalty, production royalty, and other payment obligations imposed by the lease. Our acquisition of the interest of Golden Phoenix in the Borealis Property terminated the July 2003 Option and Joint Venture Agreement.

In addition to our leasehold interest to a portion of the Borealis Property, we also own through Borealis Mining numerous unpatented mining claims that make up the balance of the Borealis Property, and all of the documentation and samples from years of exploration and development programs carried out by the previous operators of the Borealis Property, totaling thousands of pages of data including, but not limited to, geophysical surveys, mineralogical studies and metallurgical testing reports.

On July 11, 2005, we accepted a joint proposal for a feasibility study from the firms of Samuel Engineering, Inc. and Knight Piesold and Company. Samuel Engineering provides services including metallurgical process development and design, and Knight Piesold provides mining, metallurgical and environmental engineering services. Both companies have worked together recently on completing similar studies.

During the period from our inception on April 24, 2003 through March 31, 2004, we funded our capital needs by raising \$2,419,200 in private placements, issuing 14,376,000 shares of common stock at prices ranging from \$0.10 per share to \$0.225 per share.

During our fiscal year ended March 31, 2005, we raised \$175,000 by issuing 500,000 shares of common stock to an executive officer at \$0.35 per share under the terms of his employment agreement. We raised an additional \$4,430,375 by issuing 6,815,962 units in a series of private placements. Each unit consisted of one share of common stock and one-half of one share purchase warrant, each whole warrant exercisable to acquire one share of common stock at \$0.90 per share until the earlier of two years from the issue date and nine months following the date on which common stock is listed on a public stock exchange (subsequently revised to expire on December 22, 2006).

During our fiscal quarter ended June 30, 2005, we raised \$3,919,765 by issuing 6,030,408 units in a series of private placements. Each unit consisted of one share of common stock and one-half of one share purchase warrant, each whole warrant exercisable to acquire one share of common stock at \$0.90 per share until the earlier of two years from the issue date and nine months following the date on which common stock is listed on a public stock exchange (subsequently revised to expire on December 22, 2006.).

On August 11, 2005, our Board authorized an increase in our authorized capital to consist of 150,000,000 shares of common stock, par \$0.001, and 15,000,000 shares of preferred stock, par \$0.001. The increase was approved by shareholders.

On December 22, 2005, we completed our initial public offering of 6.9 million units for gross proceeds of approximately \$ 5,036,497 with net proceeds of \$2,794,557 after deducting costs of \$2,241,940. The units were sold at a price of \$0.73 (Cdn\$0.85) each and consisted of one common share and one Class A warrant. Each Class A warrant is exercisable for a period of 12 months at a price of Cdn\$1.15. The common shares are listed on the Toronto Stock Exchange under the symbol "GGN." The offering was underwritten by a syndicate of Canadian underwriters which included Desjardins Securities, CIBC World Markets, Border Investment Partners and Orion Securities. The units were offered for sale pursuant to a prospectus filed in four Canadian provinces (British Columbia, Alberta, Manitoba and Ontario). The units were also registered in a registration statement filed with the United States Securities and Exchange Commission. The proceeds of the offering will be used principally for the completion of the Company's feasibility study for its Borealis Property and its exploration program on the Borealis Property, as well as for working capital.

On March 24, 2006, we closed the private placement of 5,475,000 units for sale at Cdn\$1.25 to a limited number of accredited investors in Canada and the United States. Each unit consisted of one common share and one half of one Series B purchase warrant. The Series B warrants are exercisable until March 23, 2007 at a price of Cdn\$1.65. The private offering raised gross proceeds of Cdn\$6.8 million. We paid qualified registered dealers a 7% cash commission and issued compensation options to acquire 280,500 common shares at price of Cdn\$1.40 until March 23, 2007 on a portion of the private placement. The shares, warrants and underlying shares were not qualified by prospectus and have not been registered under U.S. securities laws and are subject to resale restrictions. The Company granted registration rights to the investors in this private placement and used commercially reasonable efforts to prepare and file with the SEC, within 120 days of closing, a registration statement under the Securities Act and caused such statement to be declared effective and remain effective. The proceeds of this offering have been and will be applied to fund the continuation of our exploration and development program on the Borealis Property.

In June 2006, we closed a private placement with our new Chief Financial Officer and our Corporate Controller. Mr. Longinotti was appointed as new Chief Financial Officer to the Company, effective May 15, 2006, and the Company has agreed to enter into a formal employment agreement with him in due course. Mr. Longinotti received through a private placement as compensation: 100,000 Units of the Company at a price of Cdn\$1.35; with each Unit consisting of one (1) share of the Company's common stock with a par value of \$0.001 and one-half (1/2) of one (1) share purchase Series D Warrant. The common stock was issued May 26, 2006, and the Series D warrants were issued June 10, 2006. Mr. Longinotti's employment commenced April 18, 2006. Mr. Rajwant Kang is the Corporate Controller to the Company. In June of this year, as part of a private placement, Mr. Kang was issued 29,000 Units of the Company at a price of Cdn\$1.35; with each Unit consisting of one (1) share of the Company's common stock with a par value of \$0.001 and one-half (1/2) of one (1) share purchase Series D Warrant. The common stock was issued June 2, 2006, and the Series D warrants were issued June 10, 2006.

On November 30, 2006, our board of directors concluded that we would not proceed with near term construction and production financing of the Borealis heap leach mine. The feed for the proposed mine was remnants from the previously mined open pits, and heap and dump material associated with the historical mining operations. The decision not to proceed was made due to the impact of certain technical corrections to the previously announced Feasibility Study and related NI 43-101 Technical Report, dated August 15, 2006. The technical corrections reduced the anticipated quantity of recoverable gold and silver over the project life, and resulted in a marginal projected return on investment. In light of the decision not to proceed with development of a mine, in December 2006, we closed our Denver office and terminated operations and engineering staff, including our Chief Operating Officer Mr. Allen Gordon and Mr. Matt Bender, our Vice President of Borealis Project Development. Mr. Steven Craig, our Vice President of Exploration, was relocated to Nevada. As of December 1, 2006, our Chief Financial Officer, Mr. Michael Longinotti commenced working on a part-time basis. Under this agreement, his time spent in the office was reduced by 50% along with his salary.

In December 2006, we completed the geophysical survey, which commenced in September 2006. The positive geophysical results obtained from induced polarization (IP) surveys identified multiple chargeability and resistivity anomalies coincident with aeromagnetic lows which extended several kilometers (km) to the north and northwest of the Graben sulphide deposit. The IP surveys identified two new mineralized exploration targets located under the pediments 3.0 km (Central Pediments) and 5.3 km (Western Pediment) northwest of the Graben sulphide deposit.

On January 11, 2007, we announced the results of the revised CIM compliant resource estimate in accordance with NI 43-101 which had been compiled by Mr. Alan C. Noble, P.E. of Ore Reserves Engineering. The results of the report were independently reviewed by AMEC to insure the methodology and assumptions used in the calculations were consistent with industry standards. The resource estimate includes the results of exploration drilling through February 28, 2006. The measured, indicated and inferred gold resource reported in January 2007 is:

Date	Measured			Indicated			Inferred	
	Tons	Grade	Ozs of	Tons	Grade	Ozs of	Tons	Grade

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	(000 s)	opt	Gold	(000 s)	opt	Gold	(000 s)	opt	Ozs of Gold
January, 11, 2007	16,360	0.031	503,700	24,879	0.029	709,800	30,973	0.020	609,200
				4					

The updated report confirmed a total gold resource (measured, indicated and inferred) of 1,822,700 ounces contained in the Borealis property.

We are a Reporting Issuer in Canada and required to disclose mineralization estimates in accordance with Canadian reporting standards. The terms "proven mineral reserve" and "probable mineral reserve" used in this Annual Report are in reference to the mining terms defined in the Canadian Institute of Mining, Metallurgy and Petroleum Standards, which definitions have been adopted by Canadian National Instrument 43-101 Standards of Disclosure for Mineral Projects. The definitions of proven and probable reserves used in NI 43-101 differ from the definitions in the United States Securities and Exchange Commission's Industry Guide 7. In the United States, a mineral reserve is defined as a part of a mineral deposit, which could be economically and legally extracted or produced at the time the reserve determination is made. Accordingly, information contained in this Form 10-KSB and the documents incorporated by reference herein containing descriptions of our mineral deposits in accordance with NI 43-101 may not be comparable to similar information made public by other U.S. companies under the United States federal securities laws and the rules and regulations thereunder.

In addition, the terms "mineral resource", "measured mineral resource", "indicated mineral resource" and "inferred mineral resource" are defined in and required to be disclosed by NI 43-101; however, these terms are not defined terms under SEC Industry Guide 7 and are normally not permitted to be used in reports and registration statements filed with the SEC. Investors are cautioned not to assume that any part or all of mineral deposits in these categories will ever be converted into reserves. "Inferred mineral resources" have a great amount of uncertainty as to their existence, and great uncertainty as to their economic and legal feasibility. It cannot be assumed that all or any part of an inferred mineral resource will ever be upgraded to a higher category. Under Canadian rules, estimates of inferred mineral resources may not form the basis of feasibility or pre-feasibility studies, except in rare cases. Investors are cautioned not to assume that all or any part of an inferred mineral resource exists or is economically or legally mineable. Disclosure of "contained ounces" in a resource is permitted disclosure under Canadian regulations; however, the SEC normally only permits issuers to report mineralization that does not constitute "reserves" by SEC standards as in place tonnage and grade without reference to unit measures.

In January 2007 we retained AMEC to complete a mineral resource estimate covering the entire property that will include drilling results completed through mid- 2007 in the Graben area and will provide a current estimate of the mineral resource in the Central Borealis area including the areas of previous production.

On February 9, 2007 we completed a private placement of 5.0 million units at a price of Cdn\$0.90 per unit for gross proceeds of Cdn\$4.5 million. Each unit consisted of one common share and one full purchase warrant. The two year warrants are exercisable at a price of Cdn\$1.10 if exercised within twelve months of the closing and at a price of Cdn\$1.35 if exercised after the First Anniversary but prior to expiry. We paid qualified registered dealers a 7% cash commission in the amount of Cdn\$77,175 and issued compensation options to acquire 85,050 common shares (at a price of Cdn\$0.90 per share for a period of 12 months from closing) in respect of the 1.225 million units placed by them. The shares, warrants and underlying shares were not qualified by prospectus and have not been registered under U.S. securities laws and are subject to resale restrictions. The Company has granted registration rights to the investors in this private placement and will use commercially reasonable efforts to prepare and file with the SEC, within 120 days of closing, a registration statement under the Securities Act and to cause such statement to be declared effective. The proceeds of this offering will be applied to fund the continuation of our exploration and development program on the Borealis Property.

During the remainder of fiscal 2007 and into fiscal 2008, we plan to continue extension drilling, focused on the expansion of the Graben deposit and exploration drilling for a new gold deposit within the two newly identified potentially gold-bearing hydrothermal systems in the pediments. This 72-hole, \$4.5 million budgeted drilling program consists of a series of Graben deposit expansion drilling and extension drilling north and west of the successful G3 G13 fence of holes. The drilling of the Graben deposit will alternate with follow up exploration drilling in the Central and Western Pediments where 10 holes have intersected two distinct hydrothermal systems hidden beneath the pediments.

Business Objectives

We are in the business of acquiring, exploring, and developing gold properties in the United States, emphasizing the state of Nevada. Our objective is to increase value of our shares through the exploration, development and extraction of gold deposits, beginning with our Borealis Property. The development and extraction may be performed by us or may be performed by potential partners. We will also consider the acquisition and exploration of other potential gold bearing properties within Nevada or areas that have a similar political risk profile. The Plan of Operations that has been approved by the U.S. Forest Service does not present an economic analysis, and we have not placed any information in the Plan of Operations regarding capital expenditures, operating costs, ore grade, anticipated revenues, or projected cash flows. The Plan of Operation was based on the general economic concepts as presented in the Preliminary scoping study.

Corporate Strengths

We believe that we have the following business strengths that will enable us to achieve our objectives:

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- Our management team has significant mining industry experience ranging from exploration to mine development and operation;
- As the Borealis Property was the site of surface mining operations from 1981 to 1990, we believe the process to receive permits and start operations on previously mined operations is less difficult than getting permits for a previously undisturbed area. The USDA Forest Service and the Nevada Bureau of Mining Regulation and Reclamation have both approved the Plan of Operations and Reclamation Plan, allowing us to proceed with the development of a heap leach mine assuming sufficient oxide resources are found and additional financing is available. We have also received approvals for surface exploration and water wells and have successfully progressed through the required agency and public review process for those permits. .
-

Our land position is extensive, controlled by 859 unpatented mining claims covering approximately 17,200 acres. We believe many surface showings of gold mineralization on the property may provide opportunities for discovery of gold deposits. Our property has multiple types of gold deposits including oxidized material, partial oxidized material, and predominantly sulfide material; which we believe may allow us flexibility in our future plans for mine development and expansion, assuming additional financing is available.

We cannot be certain that any mineral deposits will be discovered in sufficient quantities and grade to justify commercial operations. We have no proven or probable reserves. Whether a mineral deposit will be commercially viable depends on a number of factors, including the particular attributes of the deposit; metal prices, which are highly cyclical; the cost to extract and process the mineralized material; and government regulations and permitting requirements. We may be unable to upgrade our mineralized material to proven and probable reserves in sufficient quantities to justify commercial operations and we may not be able to raise sufficient capital to develop the Borealis Property.

We have specifically focused our activities on Nevada, which was rated the highest jurisdiction in the world for mining investment attractiveness by an independent survey. Mining is an integral part of Nevada's economy. In 2004, the mining industry increased Nevada's output by \$5.89 billion including both direct and indirect impacts, up from \$5.35 billion in 2002. Nevada ranks third in the world in gold production, after South Africa and Australia. Located in the State of Nevada are well known geological trends such as the Carlin Trend, Battle Mountain, Getchell Trend and the Walker Lane Trend. The Borealis Property is also located along the Aurora-Bodie trend which crosses the principal Walker Lane Trend. Borealis, Bodie, Aurora, and other historical producing districts, are aligned along this northeast-southwest belt of significant gold deposits.

Gold Industry

Gold Uses

. Gold has two main categories of use: fabrication and investment. Fabricated gold has a variety of end uses, including jewelry, electronics, dentistry, industrial and decorative uses, medals, medallions and official coins. Gold investors buy gold bullion, official coins and jewelry.

Gold Supply

. The supply of gold consists of a combination of production from mining and the draw-down of existing stocks of gold held by governments, financial institutions, industrial organizations and private individuals. In recent years, mine production has accounted for 60% to 70% of the annual supply of gold.

Gold Prices and Market Statistics

The following table presents the annual high, low and average afternoon fixing prices for gold over the past ten years, expressed in U.S. dollars per ounce on the London Bullion Market.

Year	High		Low		Average
1997	\$	362	\$	283	\$ 331
1998	\$	313	\$	273	\$ 294
1999	\$	326	\$	253	\$ 279
2000	\$	313	\$	264	\$ 279

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2001		\$	293	\$	256	\$	271
2002		\$	349	\$	278	\$	310
2003		\$	416	\$	320	\$	363
2004		\$	454	\$	375	\$	410
2005		\$	536	\$	411	\$	444
2006		\$	726	\$	521	\$	604
2007 (January 1	May 30)	\$	691	\$	608	\$	659

Source: Kitco and Reuters

On May 30, 2007, the afternoon fixing price for gold on the London Bullion Market was \$652.65 per ounce and the spot market price of gold on the New York Commodity Exchange was \$652.10 per ounce.

RISK FACTORS AND UNCERTAINTIES

Readers should carefully consider the risks and uncertainties described below before deciding whether to invest in shares of our common stock.

Our failure to successfully address the risks and uncertainties described below would have a material adverse effect on our business, financial condition and/or results of operations, and the trading price of our common stock may decline and investors may lose all or part of their investment. We cannot assure you that we will successfully address these risks or other unknown risks that may affect our business.

Estimates of mineralized material are forward-looking statements inherently subject to error. Although resource estimates require a high degree of assurance in the underlying data when the estimates are made, unforeseen events and uncontrollable factors can have significant adverse or positive impacts on the estimates. Actual results will inherently differ from estimates. The unforeseen events and uncontrollable factors include: geologic uncertainties including inherent sample variability, metal price fluctuations, variations in mining and processing parameters, and adverse changes in environmental or mining laws and regulations. The timing and effects of variances from estimated values cannot be accurately predicted.

Risks Related to Our Operations

Our operations will require future financing.

We are an early stage company and currently do not have sufficient capital to fully fund the Plan of Operation at the Borealis Property. Currently, we have sufficient cash on hand to fund the completion of our current drilling program, permitting and general and administrative expenses for approximately 12 months. However, we will require substantial additional financing for future development activities, if any, or if we encounter unexpected costs or delays.

Failure to obtain sufficient financing may result in the delay or indefinite postponement of exploration, and, development or production on any or all of the Borealis Property and any properties we may acquire in the future or even a loss of our property interest. This includes the Borealis Property, as our lease over claims covering the principal deposits will expire in 2009 unless we are engaged in active mining, development or processing at that time. We cannot be certain that additional capital or other types of financing will be available if needed or that, if available, the terms of such financing will be favorable or acceptable to us. Future financings may cause dilution to our shareholders.

We currently depend on a single property the Borealis Property.

Our only mineral property is the Borealis Property. Even though the Borealis Property encompasses several areas with known gold mineralization, unless we acquire additional properties or projects or discover additional deposits at the Borealis Property, we will be solely dependent upon the success of the Borealis Property as a source of future revenue and profits, if any. We cannot provide any assurance that we will establish any reserves or successfully commence mining operations on the Borealis Property or that we will ever obtain an interest in any other property with mineral potential in order to diversify our business

We have no history of producing metals from our mineral property and there can be no assurance that we will successfully establish mining operations or profitably produce precious metals.

We have no history of producing metals from the Borealis Property. While our plan is to move the Borealis Property into the development stage, production there will be subject to completing construction of the mine, processing plants, roads, and other related works and infrastructure. As a result, we are subject to all of the risks associated with establishing new mining operations and business enterprises including:

- the timing and cost, which can be considerable, of the construction of mining and processing facilities;

- the ability to find sufficient gold resources to support a mining operation;

- the availability and costs of skilled labor and mining equipment;

- the availability and cost of appropriate smelting and/or refining arrangements;

- compliance with environmental and other governmental approval and permit requirements;

- the availability of funds to finance construction and development activities;

- potential opposition from non-governmental organizations, environmental groups, local groups or local inhabitants which may delay or prevent development activities; and

- potential increases in construction and operating costs due to changes in the cost of fuel, power, materials and supplies.

The costs, timing and complexities of mine construction and development may be increased by the remote location of the Borealis Property. It is common in new mining operations to experience unexpected problems and delays during construction, development and mine start-up. In addition, delays in the commencement of mineral production often occur. Accordingly, we cannot assure you that our activities will result in profitable mining operations or that we will successfully establish mining operations or profitably produce metals at any of our properties.

Historical production on the Borealis Property may not be indicative of the potential for future development.

The Borealis Mine actively produced gold in the 1980's, but we currently have no commercial production at the Borealis Property and have never recorded any revenues. You should not rely on the fact that there were historical mining operations at the Borealis Property as an indication that we will ever place the property into commercial production. We expect to continue to incur losses unless and until such time, if ever, as our property enters into commercial production and generates sufficient revenues to fund our continuing operations. The development of new mining operations at the Borealis Property will require the commitment of substantial resources for operating expenses and capital expenditures, which may increase in subsequent years as needed consultants, personnel and equipment associated with advancing exploration, development and commercial production of our properties are added. The amounts and timing of expenditures will depend on the progress of ongoing exploration and development, the results of consultants' analysis and recommendations, the rate at which operating losses are incurred, the execution of any joint venture agreements with strategic partners, our acquisition of additional properties, and other factors, many of which are beyond our control. We may not be able to place the Borealis Property into production or generate any revenues or achieve profitability.

Our exploration activities on the Borealis Property may not be commercially successful, which could lead us to abandon our plans to develop the property and our investments in exploration.

Our long-term success depends on our ability to identify additional mineral deposits on the Borealis Property and other properties we may acquire, if any, that we can then develop into commercially viable mining operations. Mineral exploration is highly speculative in nature, involves many risks and is frequently nonproductive. These risks include unusual or unexpected geologic formations, and the inability to obtain suitable or adequate machinery, equipment or labor. The success of gold exploration is determined in part by the following factors:

- the identification of potential gold mineralization based on surficial analysis;
 - availability of government-granted exploration permits;
 - the quality of our management and our geological and technical expertise; and
 - the capital available for exploration.

Substantial expenditures are required to establish proven and probable reserves through drilling and analysis, to develop metallurgical processes to extract metal, and to develop the mining and processing facilities and infrastructure at any site chosen for mining. Whether a mineral deposit will be commercially viable depends on a number of factors, which include, without limitation, the particular attributes of the deposit, such as size, grade and proximity to infrastructure; metal prices, which fluctuate widely; and government regulations, including, without limitation, regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of minerals and environmental protection. We may invest significant capital and resources in exploration activities and abandon such investments if we are unable to identify commercially exploitable mineral reserves. The decision to abandon a project may have an adverse effect on the market value of our securities and the ability to raise future financing. We cannot assure you that we will discover or acquire any mineralized material in sufficient quantities on any of our properties to justify commercial operations.

Actual capital costs, operating costs, production and economic returns may differ significantly from those we have anticipated and there are no assurances that our development activities will result in profitable mining operations.

We plan to estimate operating and capital costs for the Borealis Property based on information available to us and that we believe to be accurate. However, recently, costs for labor, regulatory compliance, energy, mine and plant equipment and materials needed for mine development and construction have increased significantly industry-wide. In light of these factors, actual costs related to our proposed mine development and construction may exceed any estimates we may make.

We do not have an operating history upon which we can base estimates of future operating costs related to the Borealis Property, and we intend to rely upon our future economic feasibility of the project and any estimates that may be contained therein. Studies derive estimates of cash operating costs based upon, among other things:

- anticipated tonnage, grades and metallurgical characteristics of the ore to be mined and processed;
 - anticipated recovery rates of gold and other metals from the ore;
 - cash operating costs of comparable facilities and equipment; and
 - anticipated climatic conditions.

Capital and operating costs, production and economic returns, and other estimates contained in feasibility studies may differ significantly from actual costs, and there can be no assurance that our actual capital and operating costs will not be higher than anticipated or disclosed.

In addition, any calculations of cash costs and cash cost per ounce may differ from similarly titled measures of other companies and are not intended to be an indicator of projected operating profit.

The figures for our resources are estimates based on interpretation and assumptions and may yield less mineral production under actual conditions than is currently estimated.

Unless otherwise indicated, mineralization figures presented in this prospectus and in our filings with securities regulatory authorities, press releases and other public statements that may be made from time to time are based upon estimates made by independent geologists and our internal geologists. When making determinations about whether to advance any of our projects to development, we must rely upon such estimated calculations as to the mineral reserves and grades of mineralization on our properties. Until ore is actually mined and processed, mineral reserves and grades of mineralization must be considered as estimates only.

These estimates are imprecise and depend upon geological interpretation and statistical inferences drawn from drilling and sampling analysis, which may prove to be unreliable. We cannot assure you that:

- these estimates will be accurate;
- reserve, resource or other mineralization estimates will be accurate; or
- this mineralization can be mined or processed profitably.

Any material changes in mineral reserve estimates and grades of mineralization will affect the economic viability of placing a property into production and a property's return on capital.

Because we have not started mine construction at our Borealis Property and have not commenced actual production, mineralization estimates, including reserve and resource estimates, for the Borealis Property may require adjustments or downward revisions based upon actual production experience. In addition, the grade of ore ultimately mined, if any, may differ from that indicated by our feasibility studies and drill results. There can be no assurance that minerals recovered in small scale tests will be duplicated in large scale tests under on-site conditions or in production scale.

The resource estimates contained in this report have been determined and valued based on assumed future prices, cut-off grades and operating costs that may prove to be inaccurate. Extended declines in market prices for gold and silver may render portions of our mineralization, reserve and resource estimates uneconomic and result in reduced reported mineralization or adversely affect the commercial viability of our Borealis Property. Any material reductions in estimates of mineralization, or of our ability to extract this mineralization, could have a material adverse effect on our results of operations or financial condition.

Changes in the market price of gold, silver and other metals, which in the past has fluctuated widely, will affect the profitability of our operations and financial condition.

Our profitability and long-term viability depend, in large part, upon the market price of gold and other metals and minerals produced from our mineral properties. The market price of gold and other metals is volatile and is impacted by numerous factors beyond our control, including:

- expectations with respect to the rate of inflation;
- the relative strength of the U.S. dollar and certain other currencies;
- interest rates;
- global or regional political or economic conditions;
- supply and demand for jewelry and industrial products containing metals; and
- sales by central banks and other holders, speculators and producers of gold and other metals in response to any of the above factors.

We cannot predict the effect of these factors on metal prices. Gold and silver prices have fluctuated during the last several years. The price of gold was \$513 per ounce at December 31, 2005, and during 2006 has had a high of \$725 and a low of \$525. The price of gold was \$632 per ounce on December 31, 2006. The price of silver also improved from \$8.83 per ounce at December 31, 2005 to close at December 31, 2006 at \$12.90 per ounce, with a yearly high of \$14.94, with a low of \$8.83, during 2006. Historically, gold prices ranged from \$536.50 to \$411.10 per ounce in 2005 and from \$454.20 to \$375.00 per ounce in 2004; and silver prices have ranged from \$9.22 to \$6.39 per ounce in 2005 and from \$8.29 to \$5.49 per ounce in 2004.

A decrease in the market price of gold and other metals could affect the commercial viability of our Borealis Property and our anticipated development and production assumptions. Lower gold prices could also adversely affect our ability to finance future development at the Borealis Property, all of which would have a material adverse effect on our financial condition and results of operations. There can be no assurance that the market price of gold and other metals will remain at current levels or that such prices will improve.

Mining is inherently dangerous and subject to conditions or events beyond our control, which could have a material adverse effect on our business.

Mining involves various types of risks and hazards, including:

- environmental hazards;
 - power outages;
 - metallurgical and other processing problems;
 - unusual or unexpected geological formations;
 - structural cave-ins or slides;
- flooding, fire, explosions, cave-ins, landslides and rock-bursts;
 - inability to obtain suitable or adequate machinery, equipment, or labor;
 - metals losses; and
 - periodic interruptions due to inclement or hazardous weather conditions.

These risks could result in damage to, or destruction of, mineral properties, production facilities or other properties, personal injury, environmental damage, delays in mining, increased production costs, monetary losses and possible legal liability. We may not be able to obtain insurance to cover these risks at economically feasible premiums. Insurance against certain environmental risks, including potential liability for pollution or other hazards as a result of the disposal of waste products occurring from production, is not generally available to us or to other companies within the mining industry. We may suffer a material adverse effect on our business if we incur losses related to any significant events that are not covered by our insurance policies.

We are subject to significant governmental regulations.

Our primary properties, operations and exploration and development activities are in Nevada and are subject to extensive federal, state, and local laws and regulations governing various matters, including:

- environmental protection;
 - management and use of toxic substances and explosives;
 - management of natural resources;
- exploration, development of mines, production and post-closure reclamation;

- exports controls;
- price controls;
- regulations concerning business dealings with native groups;
- labor standards and occupational health and safety, including mine safety; and
- historic and cultural preservation.

Failure to comply with applicable laws and regulations may result in civil or criminal fines or penalties or enforcement actions, including orders issued by regulatory or judicial authorities enjoining or curtailing operations or requiring corrective measures, installation of additional equipment or remedial actions, any of which could result in us incurring significant expenditures. We may also be required to compensate private parties suffering loss or damage by reason of a breach of such laws, regulations or permitting requirements. It is also possible that future laws and regulations, or a more stringent enforcement of current laws and regulations by governmental authorities, could cause additional expense, capital expenditures, restrictions on or suspensions of our operations and delays in the development of our properties.

Our activities are subject to environmental laws and regulations that may increase our costs of doing business and restrict our operations.

All of our exploration and potential development and production activities are in the United States and are subject to regulation by governmental agencies under various environmental laws. These laws address emissions into the air, discharges into water, management of waste, management of hazardous substances, protection of natural resources, antiquities and endangered species and reclamation of lands disturbed by mining operations. Environmental legislation in many countries is evolving and the trend has been towards stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and increasing responsibility for companies and their officers, directors and employees. Compliance with environmental laws and regulations and future changes in these laws and regulations may require significant capital outlays and may cause material changes or delays in our operations and future activities. It is possible that future changes in these laws or regulations could have a significant adverse impact on our Borealis Property or some portion of our business, causing us to re-evaluate those activities at that time.

Land reclamation requirements for our Borealis Property may be burdensome.

Although variable depending on location and the governing authority, land reclamation requirements are generally imposed on mineral exploration companies (as well as companies with mining operations) in order to minimize long term effects of land disturbance.

Reclamation may include requirements to:

- control dispersion of potentially deleterious effluents; and
- reasonably re-establish pre-disturbance land forms and vegetation.

In order to carry out reclamation obligations imposed on us in connection with our potential development activities, we must allocate financial resources that might otherwise be spent on further exploration and development programs. We have set up a provision for our reclamation obligations at the Borealis Property, but this provision may not be adequate. If we are required to carry out unanticipated reclamation work, our financial position could be adversely affected.

We may experience difficulty attracting and retaining qualified management to meet the needs of our anticipated growth, and the failure to manage our growth effectively could have a material adverse effect on our business and financial condition.

We are dependent on the services of key executives including Tony Ker, CEO, Albert Matter, Chairman, Michael Longinotti, CFO, Steve Craig, VP Exploration, and other highly skilled and experienced executives and personnel focused on bringing our Borealis Property into production and managing our interests and on-going exploration programs on our other properties. Our management is also responsible for the identification of new opportunities for growth and funding. Due to our relatively small size, the loss of these persons or our inability to attract and retain additional highly skilled employees required for our development activities may have a material adverse effect on our business or future operations. The failure to hire qualified people for these positions could adversely affect planned operations of the Borealis Property. We do not maintain key-man life insurance on any of our key management employees.

Increased competition could adversely affect our ability to attract necessary capital funding or acquire suitable producing properties or prospects for mineral exploration in the future.

The mining industry is intensely competitive. Significant competition exists for the acquisition of properties producing, or capable of producing, gold or other metals. We may be at a competitive disadvantage in acquiring additional mining properties because we must compete with other individuals and companies, many of which have greater financial resources, operational experience and technical capabilities than us. We may also encounter increasing competition from other mining companies in our efforts to hire experienced mining professionals. Competition for exploration resources at all levels is currently very intense, particularly affecting the availability of manpower, drill rigs, mining equipment and production equipment. Increased competition could adversely affect our ability to attract necessary capital funding or acquire suitable producing properties or prospects for mineral exploration in the future.

We compete with larger, better capitalized competitors in the mining industry.

The mining industry is competitive in all of its phases, including financing, technical resources, personnel and property acquisition. It requires significant capital, technical resources, personnel and operational experience to effectively compete in the mining industry. Because of the high costs associated with exploration, the expertise required to analyze a project's potential and the capital required to develop a mine, larger companies with significant resources may have a competitive advantage over us. We face strong competition from other mining companies, some with greater financial resources, operational experience and technical capabilities than us. As a result of this competition, we may be unable to maintain or acquire financing, personnel, technical resources or attractive mining properties on terms we consider acceptable or at all.

Title to the Borealis Property may be subject to other claims, which could affect our property rights and claims.

Although we believe we have exercised commercially reasonable due diligence with respect to determining title to properties we own or control and the claims that are subject to the Borealis mining lease, there is no guarantee that title to such properties will not be challenged or impugned. The Borealis Property may be subject to prior unrecorded agreements or transfers or native land claims and title may be affected by undetected defects. There may be valid challenges to the title of the Borealis Property which, if successful, could impair development and/or operations. This is particularly the case in respect of those portions of the Borealis Property in which we hold our interest solely through a lease with the claim holders, as such interest is substantially based on contract and has been subject to a number of assignments (as opposed to a direct interest in the property).

All of the mineral rights to the Borealis Property consist of "unpatented" mining claims created and maintained in accordance with the U.S. General Mining Law. Unpatented mining claims are unique property interests, and are

generally considered to be subject to greater title risk than other real property interests because the validity of unpatented mining claims is often uncertain. This uncertainty arises, in part, out of the complex federal and state laws and regulations under the U.S. General Mining Law, including the requirement of a proper physical discovery of valuable minerals within the boundaries of each claim and proper compliance with physical staking requirements.

Also, unpatented mining claims are always subject to possible challenges by third parties or validity contests by the federal government. The validity of an unpatented mining or millsite claim, in terms of both its location and its maintenance, is dependent on strict compliance with a complex body of U.S. federal and state statutory and decisional law. In addition, there are few public records that definitively determine the issues of validity and ownership of unpatented mining claims.

There are differences in U.S. and Canadian practices for reporting reserves and resources.

Our reserve and resource estimates are not directly comparable to those made in filings subject to SEC reporting and disclosure requirements, as we generally report reserves and resources in accordance with Canadian practices. These practices are different from the practices used to report reserve and resource estimates in reports and other materials filed with the SEC. It is Canadian practice to report measured, indicated and inferred resources, which are generally not permitted in disclosure filed with the SEC. In the United States, mineralization may not be classified as a "reserve" unless the determination has been made that the mineralization could be economically and legally produced or extracted at the time the reserve determination is made. United States investors are cautioned not to assume that all or any part of measured or indicated resources will ever be converted into reserves. Further, "inferred resources" have a great amount of uncertainty as to their existence and as to whether they can be mined legally or economically. Disclosure of "contained ounces" is permitted disclosure under Canadian regulations; however, the SEC only permits issuers to report "resources" as in place tonnage and grade without reference to unit measures.

Accordingly, information concerning descriptions of mineralization, reserves and resources contained in this prospectus, or in the documents incorporated herein by reference, may not be comparable to information made public by other United States companies subject to the reporting and disclosure requirements of the SEC.

We will be required to locate mineral reserves for our long-term success.

Because mines have limited lives based on proven and probable mineral reserves, we will have to continually replace and expand our mineral reserves, if any, if and when the Borealis Property produces gold and other base or precious metals. Our ability to maintain or increase its annual production of gold and other base or precious metals once the Borealis Property is restarted, if at all, will be dependent almost entirely on its ability to bring new mines into production.

We do not insure against all risks which we may be subject to in our planned operations.

We currently maintain insurance to insure against general commercial liability claims and losses of equipment. Our insurance will not cover all the potential risks associated with a mining company's operations. We may also be unable to maintain insurance to cover these risks at economically feasible premiums. Insurance coverage may not continue to be available or may not be adequate to cover any resulting liability. Moreover, we expect that insurance against risks such as environmental pollution or other hazards as a result of exploration and production may be prohibitively expensive to obtain for a company of our size and financial means. We might also become subject to liability for pollution or other hazards which may not be insured against or which we may elect not to insure against because of premium costs or other reasons. Losses from these events may cause us to incur significant costs that could negatively affect our financial condition and ability to fund our activities on the Borealis Property. A significant loss could force us to terminate our operations.

Our directors and officers may have conflicts of interest as a result of their relationships with other companies.

Certain of the directors and officers of Gryphon Gold have served as officers and directors for other companies engaged in natural resource exploration and development and may also serve as directors and/or officers of other companies involved in natural resource exploration and development. For example, Richard Hughes is President of Klondike Gold Corp. and a director of Alamos Gold Inc. Our Chief Financial Officer is now working part-time, he

divides his attention between his role with Gryphon Gold and acts as a part-time consultant for a company which is not in the mining industry. Consequently, there is a possibility that our directors and/or officers may be in a position of conflict in the future.

New legislation, including the Sarbanes-Oxley Act of 2002, may make it difficult for us to retain or attract officers and directors.

We may be unable to attract and retain qualified officers, directors and members of board committees required to provide for our effective management as a result of the recent and currently proposed changes in the rules and regulations which govern publicly-held companies. Sarbanes-Oxley Act of 2002 has resulted in a series of rules and regulations by the Securities and Exchange Commission that increase responsibilities and liabilities of directors and executive officers. We are a small company with a very limited operating history and no revenues or profits, which may influence the decisions of potential candidates we may recruit as directors or officers. The perceived increased personal risk associated with these recent changes may deter qualified individuals from accepting these roles.

While we believe we have adequate internal control over financial reporting, we will be required to evaluate our internal controls under Section 404 of the Sarbanes-Oxley Act of 2002, and any adverse results from such evaluation could result in a loss of investor confidence in our financial reports and have an adverse effect on the price of our shares of common stock.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we expect that beginning with our annual report on Form 10-KSB for the fiscal year ended March 31, 2008, we will be required to furnish a report by management on our internal controls over financial reporting. Such report will contain, among other matters, an assessment of the effectiveness of our internal control over financial reporting, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by our management. For our annual report on Form 10-KSB for the fiscal year ended March 31, 2009, such report must also contain a statement that our auditors have issued an attestation report on our management's assessment of such internal controls. Public Company Accounting Oversight Board Auditing Standard No. 2 currently provides the professional standards and related performance guidance for auditors to attest to, and report on, our management's assessment of the effectiveness of internal control over financial reporting under Section 404.

While we believe our internal control over financial reporting is effective, we are still compiling the system and processing documentation and performing the evaluation needed to comply with Section 404, which is both costly and challenging. We cannot be certain that we will be able to complete our evaluation, testing and any required remediation in a timely fashion. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that such internal control is effective. If we are unable to assert that our internal control over financial reporting is effective as of March 31, 2008 (or if our auditors are unable to attest that our management's report is fairly stated or they are unable to express an opinion on the effectiveness of our internal controls as of March 31, 2009), we could lose investor confidence in the accuracy and completeness of our financial reports, which would have a material adverse effect on our stock price.

Failure to comply with the new rules may make it more difficult for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage and/or incur substantially higher costs to obtain the same or similar coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, on committees of our board of directors, or as executive officers.

Risks Related To Our Securities

Broker-dealers may be discouraged from effecting transactions in our common shares because they are considered a penny stock and are subject to the penny stock rules.

Rules 15c-1 through 15c-9 promulgated under the Exchange Act impose sales practice and disclosure requirements on certain brokers-dealers who engage in certain transactions involving a "penny stock." Subject to certain exceptions, a

penny stock generally includes any non-NASDAQ equity security that has a market price of less than \$5.00 per share. Our common stock is expected to trade below \$5.00 per share immediately upon closing of the offering. The additional sales practice and disclosure requirements imposed upon broker-dealers may discourage broker-dealers from effecting transactions in our shares, which could severely limit the market liquidity of the shares and impede the sale of our shares in the secondary market.

A broker-dealer selling penny stock to anyone other than an established customer or "accredited investor," generally, an individual with net worth in excess of \$1,000,000 or an annual income exceeding \$200,000, or \$300,000 together with his or her spouse, must make a special suitability determination for the purchaser and must receive the purchaser's written consent to the transaction prior to sale, unless the broker-dealer or the transaction is otherwise exempt. In addition, the penny stock regulations require the broker-dealer to deliver, prior to any transaction involving a penny stock, a disclosure schedule prepared by the United States Securities and Exchange Commission relating to the penny stock market, unless the broker-dealer or the transaction is otherwise exempt. A broker-dealer is also required to disclose commissions payable to the broker-dealer and the registered representative and current quotations for the securities. Finally, a broker-dealer is required to send monthly statements disclosing recent price information with respect to the penny stock held in a customer's account and information with respect to the limited market in penny stocks.

In the event that your investment in our shares is for the purpose of deriving dividend income or in expectation of an increase in market price of our shares from the declaration and payment of dividends, your investment will be compromised because we do not intend to pay dividends.

We have never paid a dividend to our shareholders, and we intend to retain our cash for the continued development of our business. We do not intend to pay cash dividends on our common stock in the foreseeable future. As a result, your return on investment will be solely determined by your ability to sell your shares in a secondary market.

ITEM 2. DESCRIPTION OF PROPERTY

Executive Offices

We lease our principal executive office at Suite 810, 1130 West Pender Street, Vancouver, BC V6E 4A4. We do not currently maintain any investments in real estate, real estate mortgages or securities of persons primarily engaged in real estate activities, nor do we expect to do so in the foreseeable future.

Borealis Property

Unless stated otherwise, information of a technical or scientific nature related to the Borealis Property is summarized or extracted from the "Technical Report on the Mineral Resources of the Borealis Gold Project" dated August 15, 2006 and revised January 11, 2007, prepared by Mr. Alan C. Noble, P.E. of Ore Reserves Engineering in Lakewood, CO, a "Qualified Person", as defined in National Instrument 43-101 of the Canadian Securities Administrators. Mr. Noble is independent from us. The Technical Report was prepared in accordance with the requirements of National Instrument 43-101.

Management's plans, expectations and forecasts related to our Borealis Property are based on assumptions, qualifications and procedures which are set out only in the full Technical Report. For a complete description of assumptions, qualifications and procedures associated with the following information, reference should be made to the full text of the Technical Report which will be available for review on the System for Electronic Document Analysis and Retrieval (SEDAR) at website: www.sedar.com and on the Company's website at www.gryphongold.com.

The Borealis Property in Nevada is our principal asset, which we hold through our subsidiary, Borealis Mining. In the 1980's previous operators of the Borealis Property mined approximately 600,000 ounces of gold from near-surface oxide deposits. In this report, the previously mined area is referred to as the "Borealis site", the "previously disturbed area" or the "previously mined area", while our references to the Borealis Property refer to the entire property we own or lease through Borealis Mining.

Echo Bay Mines Limited ceased active mining operations in 1991. Full site reclamation was completed in 1994. Reclamation bonds were released and Echo Bay relinquished its lease in 1996.

At Borealis, there is one large hydrothermal system, containing at least 14 known gold deposits, some of which are contiguous. There has been historical production from 8 of these deposits. As there are several other showings of gold mineralization across the property, there is an opportunity to identify additional gold deposits.

Borealis Property Description and Location

The Borealis Property is located in Mineral County in southwest Nevada, 12 miles northeast of the California border. The Borealis Property covers approximately 14,900 acres. The approximate center of the property is at longitude 118° 45' 34" North and latitude 38° 22' 55" West.

The Borealis Property is comprised of 859 unpatented mining claims of approximately 20 acres each, totaling about 17,200 acres (or approximately 27 square miles), and one unpatented millsite claim of approximately 5 acres. Of the 859 unpatented mining claims, 122 claims are owned by others but leased to Borealis Mining, and 737 of the claims were staked by Golden Phoenix or Gryphon Gold and transferred to Borealis Mining. The above claims include a total of 112 claims staked during 2006.

Our rights, through Borealis Mining as the owner or lessee of the claims, allow us to explore, develop and mine the Borealis Property, subject to the prior procurement of required operating permits and approvals, compliance with the terms and conditions of the mining lease, and compliance with applicable federal, state, and local laws, regulations and ordinances. We believe that all of our claims are in good standing.

The 122 leased claims are owned by John W. Whitney, Hardrock Mining Company and Richard J. Cavell, whom we refer to as the "Borealis Owners." Borealis Mining leases the claims from the Borealis Owners under a Mining Lease dated January 24, 1997 and amended as of February 24, 1997. The mining lease was assigned to Borealis Mining by the prior lessee, Golden Phoenix. The mining lease contains an "area of interest" provision, such that any new mining claims located or acquired by Borealis Mining within the area of interest after the date of the mining lease shall automatically become subject to the provisions of the mining lease.

The term of the mining lease extends to January 24, 2009 and continues indefinitely thereafter for so long as any mining, development (including exploration drilling) or processing is being conducted on the leased property on a continuous basis.

The remainder of the Borealis Property consists of 737 unpatented mining claims and one unpatented millsite claim staked by Golden Phoenix, Gryphon Gold or Borealis Mining. Claims staked by Golden Phoenix were transferred to Borealis Mining in conjunction with our January 28, 2005 purchase of all of Golden Phoenix's interest in the Borealis Property. A total of 263 claims of the total 737 claims held by Gryphon Gold are contiguous with the claim holdings, are located outside of the area of interest, and are not subject to any of the provisions of the lease.

All of the mining claims (including the owned and leased claims) are unpatented, such that paramount ownership of the land is in the United States of America. Claim maintenance payments and related documents must be filed annually with the Bureau of Land Management (BLM) and with Mineral County, Nevada to keep the claims from terminating by operation of law. Borealis Mining is responsible for those actions. At present, the estimated annual BLM maintenance fees are \$125 per claim, or \$109,375 per year for all of the Borealis Property claims (859 unpatented mining claims plus one millsite claim).

Royalty Obligations

The leased portion of the Borealis Property is currently subject to advance royalty payments of approximately \$9,094 per month, payable to the Borealis Owners. These advance royalty payments are subject to annual adjustments based on changes in the United States Consumer Price Index.

The terms of the mining lease require the payment of a net smelter returns production royalty by Borealis Mining to the Borealis Owners in respect of the sale of gold (and other minerals) extracted from those claims within the area of interest specified in the mining lease. The royalty rate for gold is determined by dividing the monthly average market gold price by 100, with the result expressed as a percentage. The royalty amount is determined by multiplying that percentage by the amount of monthly gold production from the claims in the "area of interest" and by the monthly average market gold price, after deducting all smelting and refining charges, various taxes and certain other expenses. For example, using an assumed monthly average market gold price of \$400, the royalty rate would be 4%. Using an assumed monthly production of 5,000 ounces of gold from the leased claims, the monthly royalty amount would be 5,000 ounces times \$400 per ounce, less allowable deductions, multiplied by 4%.

At present, there is no royalty payable to the United States or the State of Nevada on production from unpatented mining claims, although legislative attempts to impose a royalty have occurred in recent years.

Accessibility, Climate, Local Resources, Infrastructure and Physiography

Primary access to the Borealis Property is gained from an all weather county gravel road located about two miles south of Hawthorne from State Highway 359. Hawthorne is about 133 highway miles southeast of Reno. The Borealis Property is about 16 road miles from Hawthorne.

The elevation on the property ranges from 7,200 ft to 8,200 ft above sea level. This relatively high elevation produces moderate summers with high temperatures in the 90°F (32°C) range. Winters can be cold and windy with temperatures dropping to 0°F (-18°C). Average annual precipitation is approximately 10 inches, part of which occurs as up to 60 inches of snowfall. Historically, the Borealis Property was operated throughout the year with only limited weather related interruptions.

Topography ranges from moderate and hilly terrain with rocky knolls and peaks, to steep and mountainous terrain in the higher elevations.

The vegetation throughout the project area is categorized into several main community types: pinyon/juniper woodland, sagebrush, ephemeral drainages and areas disturbed by mining and reclaimed. Predominate species include pinyon pine, Utah juniper, greasewood, a variety of sagebrush species, crested wheat grass and fourwing saltbush.

There is a power line crossing the Borealis Property within 2 miles of the center of the potential operations, which we will evaluate for the power source during our potential future engineering feasibility work. Water is available from two water basins located approximately 5 miles and 7 miles south of the planned mine site, respectively. Water for historical mining operations was supplied from the basin 5 miles away from the site. We have obtained permits from the Nevada Division of Water Resources to access water from each of these basins. We believe that each of these basins, individually, would provide a sufficient water supply for our potential operations.

The Borealis site has been reclaimed by the prior operator to early 1990's standards. The pits and the project boundary are fenced for public safety. Currently, access to the pits and leach heap areas is gained through a locked gate. No buildings or power lines or other mining related facilities located on the surface remain. All currently existing roads in the project area are two-track roads with most located within the limits of the old haul roads that have been reclaimed.

The nearest available services for both mine development work and mine operations are in the small town of Hawthorne, via a wide well-maintained gravel road. Hawthorne has substantial housing available, adequate fuel supplies and sufficient infrastructure to meet basic supply requirements. Material required for property development and mine operations are generally available from suppliers located in Reno, Nevada.

History of the District and Borealis Property

The original Ramona mining district, now known as the Borealis mining district, produced less than 1,000 ounces of gold prior to 1981. In 1978 the Borealis gold deposit was discovered by S. W. Ivosevic (1979), a geologist working for Houston International Minerals Company (a subsidiary of Houston Oil and Minerals Corporation). The property was acquired from the Whitney Partnership, which later became the Borealis Owners, following Houston's examination of the submitted property. Initial discovery of ore-grade gold mineralization in the Borealis district and subsequent rapid development resulted in production beginning in October 1981 as an open pit mining and heap leaching operation. Tenneco Minerals acquired the assets of Houston International Minerals in late 1981, and continued production from the Borealis mine. Subsequently, several other gold deposits were discovered and mined by open pit methods along the generally northeast-striking Borealis trend, and also several small deposits were discovered further to the northwest in the Cerro Duro area. Tenneco's exploration in early 1986 discovered the

Freedom Flats deposit beneath thin alluvial cover on the pediment southwest of the Borealis mine. In October 1986, Echo Bay Mines acquired the assets of Tenneco Minerals.

With the completion of mining of the readily available oxide ore in the Freedom Flats deposit and other deposits in the district, active mining was terminated in January 1990, and leaching operations ended in late 1990. Echo Bay left behind a number of oxidized and sulfide-bearing gold mineral resources. All eight open pit operations are reported to have produced 10.7 million tons of ore averaging 0.059 ounces of gold per ton (opt Au). Gold recovered from the material placed on heaps was approximately 500,000 ounces, plus an estimated 1.5 million ounces of silver. Reclamation of the closed mine began immediately and continued for several years. Echo Bay decided not to continue with its own exploration, and the property was farmed out as a joint venture in 1990-91 to Billiton Minerals, which drilled 28 reverse circulation (RC) exploration holes on outlying targets for a total of 8,120 ft. Billiton stopped its farm-in on the property with no retained interest.

Subsequently Santa Fe Pacific Mining, Inc. entered into a joint venture with Echo Bay in 1992-93, compiled data, constructed a digital drill-hole database and drilled 32 deep RC and deep core holes, including a number of holes into the Graben deposit. Echo Bay completed all reclamation requirements in 1994 and then terminated its lease agreement with the Borealis Owners in 1996.

In 1996 J.D. Welsh & Associates, Inc. negotiated an option-to-lease agreement for a portion of the Borealis Property from the Borealis Owners. Prior to 1996, J.D. Welsh had performed contract reclamation work for Echo Bay and was responsible for monitoring the drain-down of the leach heaps. Upon signing the lease, J.D. Welsh immediately joint ventured the project with Cambior Exploration U.S.A., Inc. Cambior performed a major data compilation program and several gradient IP surveys. In 1998 Cambior drilled 10 holes which succeeded in extending one existing deposit and in identifying new zones of gold mineralization.

During the Cambior joint venture period, in late 1997, Golden Phoenix entered an agreement to purchase a portion of J.D. Welsh's interest in the mining lease. J.D. Welsh subsequently sold its remaining interest in the mining lease to a third party, which in turn sold it to Golden Phoenix, resulting in Golden Phoenix controlling a 100% interest in the mining lease

18,608,662

6,824,122

Total liabilities and stockholders' equity

21,280,754

8,907,183

See accompanying notes to the interim consolidated financial statements.

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Interim Consolidated Statements of Operations

	Three months ended June 30		Six months ended June 30		Cumulative from December 22, 1998 (inception) through June 30, 2005
	2005 \$ (Unaudited)	2004 \$ (Unaudited)	2005 \$ (Unaudited)	2004 \$ (Unaudited)	2005 \$ (Unaudited)
Revenue	424,552	44,244	600,185	63,875	2,021,982
Costs and expenses ⁽¹⁾:					
Cost of revenue	231,416	119,231	439,959	275,758	3,991,727
Research and development	397,853	254,685	728,322	518,473	19,307,432
Sales and marketing	450,970	221,556	812,430	540,485	10,393,472
General and administrative	1,078,960	202,123	1,930,575	414,530	9,445,360
Loss in connection with shut-down of operations	-	-	-	-	1,048,446
Total costs and expenses	2,159,199	797,595	3,911,286	1,749,246	44,186,437
Operating loss	(1,734,647)	(753,351)	(3,311,101)	(1,685,371)	(42,164,455)
Interest income (expense), net	144,687	(1,113,418)	230,594	(1,850,452)	(2,344,271)
Gain on extinguishment of debt	-	-	-	-	1,493,445
Other income (expense), net	(21,010)	(8,347)	(20,728)	(4,025)	(606,923)
Loss before income taxes	(1,610,970)	(1,875,116)	(3,101,235)	(3,539,848)	(43,622,204)
Income tax benefits (expenses)	8,984	967	(5,675)	(27,013)	(80,823)
Net loss	(1,601,986)	(1,874,149)	(3,106,910)	(3,566,861)	(43,703,027)

Basic and diluted net loss per common share	(0.23)	(1.08)	(0.48)	(2.38)	(26.18)
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Weighted average shares used in computing basic and diluted net loss per common share	6,986,768	1,727,373	6,512,508	1,498,698	1,669,260
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(1) Includes stock based compensation and costs as follows:

Research and development	29,319	944	30,263	1,888
Sales and marketing	106,701	5,236	213,956	10,472
General and administrative	408,208	9,920	685,574	21,442
	544,228	16,100	929,793	33,802

See accompanying notes to the interim consolidated financial statements.

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Interim Consolidated Statements of Cash Flows

	Six months ended June 30 2005 \$ (Unaudited)	2004 \$ (Unaudited)	Cumulative from December 22, 1998 (inception) through June 30 2005 \$ (Unaudited)
Cash flows from operating activities:			
Net loss	(3,106,910)	(3,566,861)	(43,703,027)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	114,941	69,028	2,326,996
Loss on sale and write off of property and equipment in connection with shut-down of operations	-	-	780,475
Other loss on sale and write off of property and equipment	-	-	549,802
Settlement of obligations for other than cash	-	-	225,589
Increase in liability in respect of employee severance obligations, net	17,806	3,603	86,295
Deferred income taxes, net	2,500	27,013	77,648
Stock issued for domain name	-	-	1,500
Issuance of common stock, stock options and warrants to non-employees for services rendered	809,248	16,570	1,031,852
Revaluation of options issued to non-employees for services rendered	-	-	(42,789)
Amortization of deferred compensation	121,205	17,561	236,414
Accrued interest on promissory notes	-	168,276	-
Amortization of deferred charges relating to convertible promissory notes	-	317,395	889,983
Amortization of discounts on promissory notes	-	1,368,755	1,577,373
Exchange rate differences	12,385	(1,975)	24,131
Changes in operating assets and liabilities:			
Increase in accounts receivable and other current assets	(174,265)	(192,347)	(450,528)
Decrease (increase) in long-term prepaid expenses	35,465	-	(111,535)
Increase in accounts payable	175,920	59,310	347,949
(Decrease) increase in accrued expenses and other current liabilities	460,602	(18,926)	1,154,623
(Decrease) increase in short-term deferred revenues	(95,814)	72,030	75,909
(Decrease) increase in long-term deferred revenues	-	(36,873)	430,783
Net cash used in operating activities	(1,626,917)	(1,697,441)	(34,490,557)
Cash flows from investing activities:			
Capital expenditures	(160,991)	(39,191)	(4,273,892)

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Proceeds from sale of property and equipment	-	-	54,415
Purchase of intangible assets	-	(80,200)	(119,936)
Decrease (increase) in long-term deposits	(13,215)	8,381	(173,652)
Purchases of investment securities	(16,150,000)	-	(22,000,000)
Proceeds from sales of investment securities	5,200,000	-	5,200,000
Other	190	(10,000)	-
Net cash used in investing activities	(11,124,016)	(121,010)	(21,313,065)

Cash flows from financing activities:

Repayment of loan	-	-	(20,000)
Proceeds from loan	-	-	6,500
Proceeds from issuance of convertible preferred stock, net of \$130,697 issuance costs	-	-	32,669,303
Proceeds from issuance of common stock, net of issuance costs	-	(632,970)	10,843,790
Proceeds from issuance of promissory notes, net of \$521,511 issuance costs	-	4,278,489	4,323,373
Repayment of convertible promissory notes	-	-	(3,160,000)
Exercise of common stock options and warrants, net of \$338,162 issuance costs	13,828,281	-	13,829,281
Net cash provided by financing activities	13,828,281	3,645,519	58,492,247

Effect of exchange rate changes on cash and cash equivalents	(12,385)	1,975	(58,247)
Net increase in cash and cash equivalents	1,064,963	1,829,043	2,630,378
Cash and cash equivalents at beginning of period	1,565,415	123,752	-
Cash and cash equivalents at end of period	2,630,378	1,952,795	2,630,378

See accompanying notes to the interim consolidated financial statements.

GuruNet Corporation (Formerly Atomica Corporation)
and Subsidiary
(A Development Stage Enterprise)

Interim Consolidated Statements of Cash Flows (cont'd)

	Six months ended June 30		Cumulative from December 22, 1998 (inception) through June 30 2005
	2005	2004	
	\$	\$	\$
	(Unaudited)	(Unaudited)	(Unaudited)
Supplemental disclosures of cash flow information:			
Income taxes paid	3,175	39,127	94,766
Non-cash investing and financing activities:			
Stock issued for domain name	-	-	1,500
Issuance of common stock in lieu of loan repayments	-	-	6,500
Common stock issued in exchange for notes receivable	-	-	1,842,900
Repurchase of stockholders' common stock and cancellation of notes receivable	-	-	(1,842,900)
Amortization of deferred charges relating to warrants	-	147,080	147,080
Discount on convertible promissory notes	-	-	1,577,373
Conversion of convertible promissory notes into common stock	-	13,720	1,840,000
Issuance costs related to the converted promissory notes	-	232,202	134,255

See accompanying notes to the interim consolidated financial statements.

Notes to the Interim Consolidated Financial Statements as of June 30, 2005

Note 1 - Business

GuruNet Corporation ("the Parent"), formerly Atomica Corporation (a Development Stage Enterprise), was founded as a Texas corporation on December 22, 1998, and reorganized as a Delaware corporation in April 1999. On December 27, 1998 the Parent formed a subsidiary ("the Subsidiary") based in Israel, primarily for the purpose of providing research and development services to the Parent. GuruNet Corporation and the Subsidiary are collectively referred to as "the Company". The Company develops, markets and sells technology that intelligently and automatically integrates and retrieves information from disparate sources and delivers the result in a single consolidated view.

Prior to 2003, the Company focused primarily on enterprise systems for corporate customers and large organizations. Beginning in 2003, the Company's primary product has been its consumer product, which, in 2003 and 2004, was sold to subscribers who paid the Company on a lifetime or annual basis. In January 2005, the Company introduced a free-to-customer product, Answers.com, containing practically all the content that it used to sell via subscriptions and ceased selling subscriptions to individual consumers. The Company generates advertising revenue from Answers.com. Notwithstanding, customers who purchased subscriptions prior to January 2005, will continue to be fully supported through the subscription periods.

As the Company has not yet earned significant revenue from its operations, it considers itself a development stage enterprise, as defined under Statement of Financial Accounting Standards No. 7, *"Accounting and Reporting by Development Stage Enterprises"*.

The accompanying unaudited interim consolidated financial statements were prepared in accordance with the instructions for Form 10-QSB and, therefore, do not include all disclosures necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with generally accepted accounting principles. All adjustments, which are, in the opinion of management, of a normal recurring nature and are necessary for a fair presentation of the interim financial statements, have been included. Nevertheless, these financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2004. The results of operations for the period ended June 30, 2005 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period.

Note 2 - Revenue Recognition

The Company generates advertising revenues, mostly, through pay-per-click keyword advertising. When a user searches sponsored keywords, an advertiser's Website is displayed in a premium position and identified as a sponsored result to the search. Generally, the Company does not contract directly with advertisers, but rather, obtains those advertisers through the efforts of a third party that locates advertisers seeking to display sponsored links in our product. The third party is obligated to pay the Company a portion of the revenue it receives from advertisers, as compensation for the Company's sale of promotional space on its Internet properties. Amounts received from such third parties are reflected as revenue on the accompanying statement of operations in the period in which such advertising services were provided.

The Company continues to recognize revenues generated from subscriptions that were sold in prior years since such subscribers will continue to be fully supported through their subscription periods (see Note 1).

Notes to the Interim Consolidated Financial Statements as of June 30, 2005**Note 3 - Accounting for Stock-Based Compensation**

As allowed by Statement of Financial Accounting Standards (SFAS) No. 123, "*Accounting for Stock-based Compensation*" (SFAS No. 123), the Company utilizes the intrinsic-value method of accounting prescribed by the Accounting Principles Board (APB) Opinion No. 25, "*Accounting for Stock Issued to Employees*" (APB 25), and related interpretations, to account for stock option plans for employees and directors. Compensation cost for stock options, if any, would be measured as the excess of the market price of the Company's stock at the date of grant over the amount an employee or director must pay to acquire the stock.

The fair value of options and warrants granted to non-employees, are measured according to the Black-Scholes option-pricing model with the following weighted average assumptions: no dividend yield; risk-free interest rates of 1.69% to 4.48%; volatility between 46.54% and 74.75%; and an expected life of between one and ten years.

The Company has adopted the disclosure requirements of SFAS No. 123 and SFAS No. 148, "*Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123*", for awards to its directors and employees. For disclosure purposes only, the fair value of options granted to employees and directors prior to May 12, 2004, the date of the Company's first filing with the U.S. Securities and Exchange Commission (the "SEC"), in connection with its initial public offering (the "IPO"), was estimated on the date of grant using the minimum-value method with the following weighted average assumptions: no dividend yield; risk-free interest rates of 2.18% to 6.59%; and an expected life of three to five years. The fair value of options granted to employees and directors subsequent to May 12, 2004, are measured, for disclosure purposes only, according to the Black-Scholes option-pricing model with the following weighted average assumptions: no dividend yield; risk-free interest rates of 3.19% to 4.18%; volatility between 38.62% and 66.76%; and the expected life of the option, generally four years.

The following illustrates the effect on net loss and net loss per share if the Company had applied the fair value methods of SFAS No. 123 for accounting purposes:

	Three months ended June 30		Six months ended June 30		Cumulative from inception through June 30, 2005
	2005	2004	2005	2004	2005
	\$	\$	\$	\$	\$
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Net loss, as reported	(1,601,986)	(1,874,149)	(3,106,910)	(3,566,861)	(43,703,027)
Add:					
Stock-based compensation expense to employees and directors included in reported net loss, net of related tax effects	111,287	8,781	121,205	17,561	161,964
Deduct:					

Stock-based compensation expense to employees and directors determined under fair value based method for all awards, net of related tax effects	(262,131)	(10,661)	(335,017)	(23,516)	(560,734)
Pro-forma net loss	(1,752,830)	(1,876,029)	(3,320,722)	(3,572,816)	(44,101,797)
Net loss per common share, basic and diluted:					
As reported	(0.23)	(1.08)	(0.48)	(2.38)	(26.18)
Pro-forma	(0.25)	(1.09)	(0.51)	(2.38)	(26.42)

Notes to the Interim Consolidated Financial Statements as of June 30, 2005

Note 3 - Accounting for Stock-Based Compensation (cont'd)

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), "*Share-Based Payment*" (SFAS No. 123R). This Statement is a revision of SFAS No. 123, "*Accounting for Stock-Based Compensation*", and it establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. This Statement eliminates the option to use APB 25's intrinsic value method of accounting that was provided in SFAS No. 123 as originally issued and it instead requires a public 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, which is usually the vesting period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. Pursuant to SFAS No. 123R, the Company will apply its provisions beginning the first quarter of 2006. SFAS 123R provides two alternative adoption methods. The first method is a modified prospective method whereby a company would recognize share-based employee costs from the beginning of the fiscal period in which the recognition provisions are first applied as if the fair-value-based accounting method had been used to account for all employee awards granted, modified, or settled after the effective date and to any awards that were not fully vested as of the effective date. Measurement and attribution of compensation cost for awards that are unvested as of the effective date of SFAS 123R would be based on the same estimate of the grant-date fair value and the same attribution method used previously under SFAS No. 123. The second adoption method is a modified retrospective transition method whereby a company would recognize employee compensation cost for periods presented prior to the adoption of SFAS 123R in accordance with the original provisions of SFAS 123; that is, an entity would recognize employee compensation costs in the amounts previously reported in the pro forma disclosures provided in accordance with SFAS 123. A company would not be permitted to make any changes to those amounts upon adoption of SFAS 123R unless those changes represent a correction of an error. The Company is currently considering which of the two methods it will adopt, and the effect that the adoption of SFAS 123R will have on its financial statements.

Notes to the Interim Consolidated Financial Statements as of June 30, 2005

Note 4 - Stockholders' Equity

(a) Common Stock

On March 13, 2005, the Company issued 7,800 shares of common stock to an investor relations firm, pursuant to a one-year agreement that began on December 13, 2004. The fair value of the shares, of \$151,086, is being amortized to general and administrative expenses over the life of the service period.

(b) Stock Warrants

During 2004, in connection with the issuance of Convertible Promissory Notes in January and February of 2004, the Company issued warrants to acquire an aggregate of 2,067,316 shares of Common Stock (the "Bridge Warrants"), at an exercise price of \$7.20 per share, with the exception of 265,837 bridge warrants exercisable at \$3.75 per share.

During the first quarter of 2005, 69,432 of the Bridge Warrants were exercised. As a result, the Company issued an aggregate of 69,432 shares of its Common Stock, \$0.001 par value (the "Common Stock"), for a total consideration of approximately \$500,000.

Additionally, on February 4, 2005 the Company entered into an agreement (the "Warrants Agreement"), with certain holders of Bridge Warrants, pursuant to which such holders exercised an aggregate of 1,871,783 Bridge Warrants at the stated exercise price thereof. As a result, the Company issued an aggregate of 1,871,783 shares of its common stock, for aggregate gross consideration of \$12,559,700. Under the terms of the Warrants Agreement, in order to provide incentive to the warrant holders to exercise their Bridge Warrants, for every share of common stock purchased by the holders through the exercise of Bridge Warrants, the Company issued to the warrant holders new warrants, dated February 4, 2005, to purchase such number of shares of common stock equal to 55% of the number of shares of common stock underlying their respective Bridge Warrants (the "New Warrants"). As a result, the Company issued 1,029,488 of New Warrants at an exercise price of \$17.27 per share. The New Warrants are immediately exercisable and expire on February 4, 2010. On April 6, 2005, and as a part of the Warrants Agreement, the Company filed a Registration Statement, to register for resale the shares of common stock underlying the new warrants (the "Registration Statement") with the SEC. The Registration Statement became effective on April 21, 2005. In the Registration Statement, the Company also registered 111,016 shares, warrants and stock options that had previously not been registered.

On January 20, 2005, the Company entered into an agreement with an investment banking firm, which was also one of the underwriters of the Company's IPO, to provide general financial advisory and investment banking services for \$5,000 per month, and for a minimum service period of six months. Further, upon signing of the contract, the underwriter received fully vested warrants to acquire 100,000 shares of Common Stock at an exercise price of \$11.00. The fair value of the warrants, of \$577,440, is being amortized to general and administrative expenses over the life of the minimum service period.

Notes to the Interim Consolidated Financial Statements as of June 30, 2005

Note 4 - Stockholders' Equity (cont'd)

(c) Stock Options

During the first quarter of 2005, 75,726 of the Company's outstanding stock options were exercised, for total consideration of approximately \$804,000. As a result, the Company issued an aggregate of 75,726 shares of its common stock.

During the second quarter of 2005, 81,879 of the Company's outstanding stock options were exercised, for total consideration of approximately \$303,000. As a result, the Company issued an aggregate of 81,879 shares of its common stock.

During the three months and six months ended June 30, 2005, a strategic consultant of the Company earned 9,445 and 15,556 stock options, respectively, for services he rendered to the Company. In connection therewith, the Company recorded \$106,347 and \$213,248 of stock based compensation for the three months and six months ended on June 30, 2005, respectively. On June 5, 2005, the agreement under which these options were granted, was terminated.

On March 15, 2005, the Company granted 200,000 stock options to one of its officers. The options will vest 25% upon the first anniversary date of the option grant, with the remainder vesting in equal monthly installments over the 36 months thereafter. In the event of a change of control, as defined in the officer's employment agreement, these options may be forfeited by the officer in exchange for 50,000 shares of the Company's common stock.

On May 10, 2005, the Company accelerated the vesting of 7,100 stock options that were granted to a director, in connection with his resignation from the Company's board of directors. As a result, the Company recorded approximately \$85,000 of stock based compensation, based on the intrinsic value of the options on the date they were accelerated.

All stock options that were granted in the first two quarters of 2005, were granted under the Company's 2004 Stock Plan.

(d) Other Comprehensive Income (Loss)

In January 2005, the Company reversed previously recorded unrealized loss on securities.

Notes to the Interim Consolidated Financial Statements as of June 30, 2005

Note 5 - Commitments and Contingencies

- (a) Future minimum lease payments under non-cancelable operating leases for office space and cars, as of June 30, 2005 are as follows:

Year ending December 31	\$
2005	148,842
2006	143,379
2007	106,211
2008	85,446
2009	82,212
2010	41,400
	607,490

Rental expense under operating leases for the six months ended June 30, 2005 and 2004 was approximately \$123,000 and \$108,000, respectively. See Note 6 regarding commitments entered into subsequent to the balance sheet date.

- (b) In April 2005, the Company entered into an operating lease for office space in New York City. The lease commenced on May 1, 2005 and ends on June 30, 2010. Under the terms of the lease, the Company shall have the right to cancel the lease commencing May 1, 2008, upon 90 days prior written notice to the Landlord. The monthly rental due under the lease begins at \$5,500, with a two-month free period, and steps up at various stages throughout the lease, up to \$6,223. The Company will recognize the rent expense for this lease on a straight-line basis over the minimum lease term. In addition to the base rent, the Company will be responsible for certain costs and charges specified in the lease, including real estate taxes and utility charges.
- (c) As security for future rental commitments the Subsidiary provided a bank guarantee in the amount of approximately \$115,000.
- (d) All of the Subsidiary's obligations to its bank, including the bank guarantee that such bank made to the Subsidiary's landlord, are secured by a lien on all of the Subsidiary's deposits at such bank. As of June 30, 2005, deposits at such bank amounted to \$824,209, including a long-term deposit of \$115,156.
- (e) In the ordinary course of business, the Company enters into various arrangements with vendors and other business partners, principally for content, web-hosting, marketing and investor relations arrangements. During the six months ended June 30, 2005, the Company entered into agreements with three consulting firms for the provision of services in the areas of public relations, strategic planning and investment banking. The agreements, which are for periods between six months and one year, are for an aggregate cash amount of \$210,000. In connection with the aforesaid agreements, the Company also granted warrants to acquire 100,000 shares of Common Stock and 15,556 stock options (see Note 4).

Notes to the Interim Consolidated Financial Statements as of June 30, 2005

Note 5 - Commitments and Contingencies (cont'd)

- (f) In December 2002, the Company implemented a reorganization (the "December 2002 Reorganization") which substantially reduced the Company's expenditures. The December 2002 Reorganization included staff reductions of fifteen persons, or approximately 52% of the Company's work force, including senior management, professional services, sales and marketing, research and development and administrative staff. The December 2002 Reorganization also included the shutdown of the Company's California office and resulted in a loss on the disposal of fixed assets. In total, the Company incurred a loss of approximately \$1,048,000 in connection with the December 2002 Reorganization, of which \$780,000 related to the disposal of fixed assets, and \$265,000 related to an accrual for salaries, benefits and office and equipment lease obligations that the Company recorded as of December 31, 2002. Of the amount accrued, \$218,000 was paid during 2003, \$22,000 was paid during 2004, \$8,000 was paid during the first half of 2005 and \$17,000, which relates to a lease obligation for equipment no longer in use, was outstanding as of June 30, 2005.

Note 6 - Subsequent Events

- (a) In July, 2005, following the earlier adoption by the Company's board of directors, the Company's stockholders approved the 2005 Incentive Compensation Plan (the "2005 Compensation Plan"), under which the Company may grant stock options, stock appreciation rights, restricted stock, deferred stock, other stock-related awards and performance awards to officers, directors, employees, consultants and other persons who provide services to the Company. The total number of Company shares of common stock reserved and available for grant under the 2005 Plan was set at 850,000.
- (b) In July 2005, each non-employee director of the Company was granted a stock option, under the Company's 2004 Stock Plan, to acquire up to 7,175 shares of the Company's Common Stock. The options vest 25% upon the first anniversary date of the option grant, and the remainder vest in equal monthly installments over the 36 months thereafter. All options have a maximum term of 10 years measured from the date of grant, subject to earlier termination, if the director's service with the Company is terminated.
- (c) In July 2005, the Subsidiary entered into a supplemental agreement to its operating lease (the "Supplement") in connection with its relocation to new office space. The term of the original lease was extended by 55 additional months beyond its original date of expiration, December 31, 2005. According to the Supplement, the Subsidiary will occupy the new office space commencing September 15, 2005, through July 31, 2010. The monthly rental due under the lease will be 50,802 New Israeli Shekels ("NIS") (\$11,185 based on the exchange rate on July 15, 2005) for the first year, and NIS 69,483 (\$15,298 based on the exchange rate on July 15, 2005) for the remaining four years. The Company will recognize the rent expense for this lease on a straight-line basis over the minimum lease term. The rent payments will be linked to the Israeli Consumer Price Index. In addition to the base rent, the Company will be responsible for certain costs and charges specified in the lease, including maintenance and utility charges.
- (d) On July 19, 2005, the Company announced that its application for listing its common stock on NASDAQ's National Market System was approved. The Company further announced its intention to change its corporate name to Answers Corporation, subject to stockholder approval. On August 2, 2005, the

Company's common stock began trading on NASDAQ under the symbol ANSW.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION OR PLAN OF OPERATION

The following discussion of our financial condition and results of operations should be read in conjunction with the financial statements and the notes to those statements included elsewhere in this filing. This discussion includes forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements.

General

We are the creators of the Answers.com answer-based search engine. We possess technology that helps integrate and retrieve online information from disparate sources and delivers the result in a single consolidated browser view. We seek to differentiate ourselves by providing our users with relevant reference information that enhances results achieved through traditional search engines. Most search engines respond to an Internet user's query with a long list of links to more Websites that in some way relate to the query term. Our answer engine automatically delivers snapshot, multi-faceted definitions and explanations from attributable reference sources about numerous topics in our database, without requiring the user to navigate a list of hyperlinks sequentially.

We devoted the first two quarters of 2005 to launching our Answers.com service. It differed from the previous GuruNet service in five primary ways:

- § Product branding: Answers.com, instead of GuruNet.
- § Business model: free ad-supported, instead of subscription-based
- § Relative emphasis on the Website version, not the downloadable 1-click software version
- § Look and feel: use of a single page format, instead of the previous tabbed interface
- § Expanded content, including, Wikipedia, an open-source encyclopedia

A more detailed discussion regarding the impact of the launch of Answers.com service on our business model follows.

Our Business Model

On January 3, 2005, we announced the release of Answers.com, a website that had been launched in August 2004 in beta version. We also released "1-Click Answers" software - allowing users to click anywhere on the screen for instant facts about a word or phrase. 1-Click Answers allows users working in any application such as e-mail, spreadsheet, word processing, database or other program to click on a word or phrase within a document and access our online library and display information about that word or phrase in a pop-up window. While Web users enjoy our integrated reference information, our basic Web site does not provide the "1-Click" functionality and context analysis that we include in our "1-Click Answers" software version. Our revenue model for Answers.com and 1-Click Answers is based primarily on advertising revenue. When a user searches sponsored keywords, a link to an advertiser's Website is displayed. In contrast to GuruNet, the product we actively marketed prior to January 2005, we do not generate revenues from selling subscriptions to Answers.com.

Prior to January 2005, we sold subscriptions to our answer engine product, GuruNet. Prior to December 2003, we sold lifetime subscriptions to GuruNet, generally for \$40.00. In December 2003, we decided to alter our pricing model and moved to an annual subscription model, generally, \$30.00 per year. In conjunction with selling subscriptions, we also offered free access to dictionary, thesaurus, encyclopedia and other basic reference information through our products. Under our business model during those years, our ability to generate revenues was dependent upon our ability to increase the number of subscribers. Usage of our basic free product was our means of encouraging users to upgrade to our subscription product and increase our subscription revenue. Although we earned some advertising revenue, in 2004, from advertising in our subscription and free products, such amounts were not significant. Our business model

at the time strongly encouraged subscriptions, and thus we limited the amount of content available in our free product. This approach did not facilitate the amount of traffic we needed to earn significant amounts of revenue from advertising. Further, the aforesaid business model required us to maintain an infrastructure for billing and subscriptions, and we met resistance from customers to pay for "information freely accessible on the Internet". A desire to grow revenues led to our current implementation, in January 2005, of a free-to-customer product, Answers.com and "1-Click Answers" software, containing practically all the content that we used to sell via subscriptions.

In conjunction with the release of Answers.com, www.GuruNet.com began functioning primarily as a corporate website. We are no longer offering new subscriptions to GuruNet or downloads of GuruNet software to users who do not have existing subscriptions. Notwithstanding, users who purchased GuruNet subscriptions prior to January 3, 2005, will continue to be fully supported through their subscription periods, and can access GuruNet services through GuruNet software or at GuruNet.com. Most of our subscriptions will terminate by the end of 2005.

Recent Events

The following events have recently transpired:

- On July 19, 2005, we announced that our application for listing our common stock on NASDAQ's National Market System (NMS) was approved. Our common stock began trading on NASDAQ under the symbol ANSW on August 2nd, 2005. Additionally, we plan to change our corporate name to Answers Corporation, subject to stockholder approval.
- In June 2005 we began the implementation of our agreement with Shopping.com to integrate their extensive online product catalog into Answers.com. Whether site visitors are seeking information on clothing, electronics, jewelry, tools, books, or items in many other consumer product categories, the new arrangement enables them to identify, research, compare, and purchase products as part of their quest for answers. This partnership will help our users combine research with the purchase process, and we will receive a portion of revenues generated when consumers click through to merchants' sites.
- In June 2005, we launched a citations tool as part of Answers.com. This new feature enables students and researchers to very simply cite the information that they find at Answers.com, by automatically producing bibliography entries for the site's collection of over a million topics. We expect this new feature will help us further penetrate the education market in the fall, the start of the new school year.
- In June 2005, we established our U.S. headquarters, located in New York City. Our marketing and business development activities will be centered in the New York office.

Results of Operations

Due to the change in our business model in January 2005, our results of operations for the three months and six months ending June 30, 2005, are not easily comparable to the results for the same periods in 2004.

Revenues

Revenues during the three months ended June 30, 2005 were \$424,552 compared to \$44,244 for the three months ended June 30, 2004, an increase of \$380,308 or 860%. Revenues for the six months ended June 30, 2005 were \$600,185 compared to \$63,875 for the six months ended June 30, 2004, an increase of \$536,310 or 840%. Revenues during the three and six months ended June 30, 2005, resulted from advertising revenues of approximately \$357,000 and \$463,000, recognition of previously deferred subscription license revenue of approximately \$40,000 and \$89,000, and other revenues (primarily revenue from partners with whom we market co-branded products) of approximately \$27,000 and \$48,000, respectively. In contrast, revenues during the three and six months ended June 30, 2004 resulted primarily from recognition of previously deferred subscriptions of approximately \$34,000 and \$48,000, maintenance contracts on our corporate enterprise software of approximately \$5,000 and \$10,000, and advertising revenues of approximately \$2,000 and \$3,000, respectively.

As noted earlier, on January 3, 2005, the Company announced the release of Answers.com, the primary revenue model of which is advertising. In contrast, prior to January 3, 2005, our primary source of revenue was selling subscriptions

to the GuruNet product, the forerunner to Answers.com. The launch of Answers.com, from a revenue perspective, has been a multi-tiered process. From launch date until the middle of January, we ran public service announcements on Answers.com and did not display any advertising. In the middle of January we began using and testing various advertising network providers. We reached an important milestone on February 28, 2005, when we began using Google's contextual AdSense advertising on our Answers.com information pages, as well as integrating Google search, with paid search advertising into Answers.com. In the second quarter of 2005, we continued testing various ways to monetize our answers service traffic. For example, we added Shopping.com content, through which we receive a portion of revenues generated when consumers click through to merchants' sites that are provided by Shopping.com. We expect that in the next quarter we will be testing other types of advertising revenue, including high-value display ads.

Our level of advertising revenue is a function of various factors, the most basic of which are the level of our traffic or queries, and how effectively we monetize such traffic. Our average daily queries for Answers.com and GuruNet, including weekend days, as measured by our internal statistical tools, during January, February, March, April, May and June of 2005 were approximately 220,000, 1,150,000, 1,550,000, 1,790,000, 1,850,000 and 1,720,000 respectively. Traditionally, there is less Web activity during the summer months, including June. We expect renewed growth and plan on driving new users in the back-to-school and autumn season. Our advertising revenue from such traffic, during January, February, March, April, May and June of 2005, was \$2,000, \$14,000, \$91,000, \$89,000, \$131,000 and \$137,000, respectively.

Cost of Revenues

Cost of revenues is comprised of fees to third party providers of content, web search service fees, data center costs (including depreciation of information technology assets), and production operations and customer support salaries, benefits and overhead costs.

Cost of revenues for the three months ended June 30, 2005 was \$231,416 compared to \$119,231 for the three months ended June 30, 2004, an increase of \$112,185 or 94%. This increase was due to increased compensation costs of \$36,000, as a result of the addition of staff that manage production operations, increases in data center (including depreciation of information technology assets required to manage more internet traffic) and content costs of \$40,000, fees we began paying Google for the web search results they provide us within the Answers.com website, of \$17,000, and increases in overhead costs of \$16,000.

Cost of revenues for the six months ended June 30, 2005 was \$439,959 compared to \$275,758 for the same period in 2004, an increase of \$164,201 or 60%. This increase was primarily due to increased compensation costs of \$63,000, as a result of the addition of staff that manage production operations, increases in data center (including depreciation of information technology assets required to manage more internet traffic) and content costs of \$44,000, fees we began paying Google for the web search results they provide us within the Answers.com website, of \$26,000, and increases in overhead costs of \$25,000.

Research and Development Expenses

The salaries, benefits and overhead costs of personnel, conducting research and development of software and Internet products comprise research and development expenses.

Research and development expenses for the three months ended June 30, 2005 was \$397,853 compared to \$254,685 for the same period in 2004, an increase of \$143,168 or 56%. Research and development expenses for the six months ended June 30, 2005 was \$728,322 compared to \$518,473 for the same period in 2004, an increase of \$209,849 or 40%. The aforesaid increases are due primarily to compensation-related expense increases as our research and development team grew in order to develop and test newer versions of our products, and due to raises in salaries, and stock-based compensation.

Sales and Marketing Expenses

The salaries, benefits and overhead costs of personnel, marketing consulting, public relations services and advertising costs, comprise sales and marketing expenses.

Sales and marketing expenses in the three months ended June 30, 2005 were \$450,970 compared to \$221,556 during the same period in 2004, an increase of \$229,414 or 104%. The net increase is due primarily to compensation-related expense increases of \$120,000 as we increased the number of employees in our sales and marketing department, including the hiring of our Chief Revenue Officer at the end of the first quarter of 2005. Additionally, in the three months ended June 30, 2005, we retained a strategic consultant who assisted us in formulating our product and

marketing strategy. In connection therewith, we recorded approximately \$10,000 of cash expenses, and \$106,000 in stock compensation. Further, our advertising and public relations costs during the three months ended June 30, 2005, rose by approximately \$76,000, as compared to the same period in the prior year, due to various initiatives including the retention of a public relations firm. The aforementioned increases were offset to a certain degree, by decreases in sales commissions to agents, of \$16,000, since we no longer retain independent sales agents. Additionally, during the three months ended June 30, 2004, we incurred approximately \$67,000 in consulting costs relating to the redesign of our website and marketing strategy.

Sales and marketing expenses in the six months ended June 30, 2005 were \$812,430 compared to \$540,485 during the same period in 2004, an increase of \$271,945 or 50%. The net increase is due primarily to compensation-related expense increases of \$87,000, and recruiting fees during the six months ended June 30, 2005 of \$35,000, as we increased the number of employees in our sales and marketing department, including the hiring of our Chief Revenue Officer at the end of the first quarter of 2005. Additionally, in the six months ended June 30, 2005, we retained a strategic consultant who assisted us in formulating our product and marketing strategy. In connection therewith, we recorded approximately \$35,000 of cash expenses, and \$213,000 in stock compensation. Further, our advertising and public relations costs during the six months ended June 30, 2005, rose by approximately \$123,000, as compared to the prior year, due to various initiatives including the retention of a public relations firm and radio ads. The aforementioned increases were offset to a certain degree by various factors, including, decreases in sales commissions to agents, of \$22,000, since we no longer retain independent sales agents. Additionally, during the six months ended June 30, 2004, we incurred approximately \$188,000 in consulting costs relating to the redesign of our website, and marketing strategy.

General and Administrative Expenses

General and administrative expenses consist primarily of salaries, benefits and overhead costs for executive and administrative personnel, insurance fees, fees for professional services, including investor relations, legal, accounting and other consulting fees, travel costs, investment banking fees, and other general corporate expenses. Overhead costs are comprised primarily by rent, utilities and depreciation.

General and administrative expenses in the three months ended June 30, 2005 were \$1,078,960 compared to \$202,123 during the same period in 2004, an increase of \$876,837 or 434%. The increase is comprised of many individual line expenses, as follows:

On January 20, 2005, we entered into an agreement with an investment-banking firm, which also acted as one of the underwriters of our IPO, to provide general financial advisory and investment banking services for \$5,000 per month, and for a minimum term of six months. Further, upon signing of the contract, the underwriter received fully vested warrants to acquire 100,000 shares of Common Stock at an exercise price of \$11.00. As a result of this agreement, in the three months ended June 30, 2005, we recorded approximately \$15,000 of cash compensation and \$289,000 in stock compensation, which represents the amortization, in the second quarter of 2005, of the fair value of the warrants on the date of their issuance, over the minimum term of the agreement.

In December 2004, we entered into an agreement with an investor relations firm pursuant to which they are to receive \$100,000 over a one-year period for providing us with investor relation services. Additionally, pursuant to the agreement, in March 2005, we issued 7,800 shares of common stock to such firm. As a result of this agreement, in the three months ended June 30, 2005, we recorded approximately \$24,000 of cash compensation and \$38,000 in stock-based compensation, which represents the amortization, in the second quarter of 2005, of the fair value of the stock on the date of its issuance, over the expected life of the agreement, through December 2005.

In May 2005, the Company accelerated the vesting of 7,100 stock options that were granted to a director, in connection with his resignation from the Company's board of directors. As a result, the Company recorded \$85,000 of stock based compensation; based on the intrinsic value of the options on the date they were accelerated.

The remaining increase stems primarily from increases in legal and accounting costs of approximately \$202,000; costs relating to stock administration, including printing, transfer agent and American Stock Exchange fees aggregating \$62,000; increases in the number of personnel, and salaries of personnel, which resulted in an increase, of \$55,000; increases in director fees and expenses of \$22,000; and increases in our insurance costs of \$42,000. Much of the increase to our General and Administrative Expenses, including most of those mentioned previously, are directly or indirectly, related to the increased costs associated with being a public company.

General and administrative expenses in the six months ended June 30, 2005 were \$1,930,575 compared to \$414,530 during the same period in 2004, an increase of \$1,516,045 or 366%. The increase is due primarily to cash and stock based compensation and costs in the amount of \$80,000 and \$681,000, respectively, that we recorded as a result of agreements with an investment-banking firm, entered into on January 20, 2005; and with an investor relations firm, entered into in December 2004; and due to the acceleration of the vesting of 7,100 stock options that were granted to a director, all described more fully above. The remaining increase stems primarily from increases in legal and accounting costs of approximately \$390,000; increases in the expenses of stock administration, including printing, transfer agent and American Stock Exchange fees, of \$71,000; increases in the number of personnel, and salaries of personnel, which resulted in an increase of approximately \$100,000; increases in director fees and expenses of approximately \$59,000; increases in our rent costs of approximately \$16,000 due to the commencement of our New York office lease in May 2005; and increases in our insurance costs of approximately \$70,000. Much of the increase to our General and Administrative Expenses, including most of those mentioned previously, are directly or indirectly, related to the increased costs associated with being a public company.

Interest Income (Expense), Net

Interest income (expense), net in the three months and six months ended June 30, 2005, was \$144,687 and \$230,594, respectively, compared to (\$1,113,418) and (\$1,850,452) during the same periods in 2004, representing net increases in interest income (decrease of expense) of \$1,258,105 and \$2,081,046, respectively. Interest income, net, in the three months and six months ended June 30, 2005 is comprised almost entirely of interest income earned from cash and cash equivalents and investment securities. Interest expense, net for the three and six months ended June 30, 2004 includes approximately \$1,012,000 and \$1,687,000, respectively, of amortization of note discounts and deferred charges relating to convertible promissory notes, which were issued in January and February of 2004. The remainder is comprised of 8% interest on the face of the \$5.0 million convertible promissory notes, approximating \$103,000 and \$168,000 for the three and six months ended June 30, 2004, respectively.

Other Income (Expense), Net

Other income (expense), net for the three months ended June 30, 2005 was (\$21,010) as compared to (\$8,347) for the same period in 2004, representing an increase in other expenses of \$12,663 or 152%. Other income (expense), net for the six months ended June 30, 2005 was (\$20,728) as compared to (\$4,025) for the six months ended June 30, 2004, representing an increase in other expenses of \$16,703 or 415%. The changes in other income (expense) net for the three and six months ended June 30, 2005 as compared to the same periods in 2004, resulted primarily from differences in the amount of foreign exchange gains) losses) and the write-off of withholding taxes that we did not expect to realize, in the respective periods.

Income Tax Expense

Our effective tax rate differs from the statutory federal rate due to differences between income and expense recognition prescribed by the United States and Israeli tax laws and Generally Accepted Accounting Principles. We utilize different methods and useful lives for depreciating property and equipment. The recording of certain provisions results in expense for financial reporting but the amount is not deductible for income tax purposes until actually paid. Our deferred tax assets are mostly offset by a valuation allowance because realization depends on generating future taxable income, which, in our estimation, is not more likely to transpire, than to not transpire.

We had net operating loss carryforwards for federal and state income tax purposes of approximately \$38 million at June 30, 2005 and \$28 million at June 30, 2004. The federal net operating losses will expire if not utilized on various dates from 2019 through 2025. The state net operating losses will expire if not utilized on various dates from 2009 through 2013. Our Israeli subsidiary has capital loss carryforwards of approximately \$600,000 that can be applied to future capital gains for an unlimited period of time under current tax rules.

The Tax Reform Act of 1986 imposed substantial restrictions on the utilization of net operating losses and tax credits in the event of an ownership change of a corporation. Thus, in accordance with Internal Revenue Code, Section 382, our recent Initial Public Offering and other ownership changes that have transpired, will significantly limit our ability to utilize net operating losses and credit carryforwards.

Our subsidiary had income in 2004 and 2003, resulting from its cost plus agreement with the parent company, whereby it charges us for research and development services it provides to us, plus 12.5%. However, the subsidiary is an “approved enterprise” under Israeli law, which means that income arising from the subsidiary’s approved activities is subject to zero tax under the “alternative benefit” path for a period of ten years. In the event of distribution by the subsidiary of a cash dividend out of retained earnings which were tax exempt due to the “approved enterprise” status, the subsidiary would have to pay a 10% corporate tax on the amount distributed, and the recipient would have to pay a 15% tax (to be withheld at source) on the amounts of such distribution received.

As of June 30, 2005, we accrued approximately \$78,000, net, to reflect the estimated taxes that our subsidiary would have to pay if it distributed its accumulated earnings to us. Should the subsidiary derive income from sources other than the approved enterprise during the relevant period of benefits, this income will be taxable at the tax rate in effect at that time (currently 34%, gradually being reduced to 30% in 2005-2008). Through June 30, 2005, our Israeli subsidiary received tax benefits of approximately \$700,000.

Net Loss

Our net loss decreased to \$1,601,986 and \$3,106,910 in the three and six months ended June 30, 2005, respectively, from \$1,874,149 and \$3,566,861 for the comparable periods in 2004, as a result of the changes in our revenues, costs and expenses as described above.

Critical Accounting Estimates

While our significant accounting policies are more fully described in the notes to our audited consolidated financial statements for the year ended December 31, 2004, we believe the following accounting policies to be the most critical in understanding the judgments and estimates we use in preparing our consolidated financial statements.

Revenue Recognition

In 2003, we sold lifetime subscriptions to our consumer product and did not recognize revenue from those sales since the obligation to continue serving such content had no defined termination date and adequate history to estimate the life of the customer relationship was not available. Cash received from such lifetime licenses is reflected as long-term deferred revenues on the accompanying balance sheets. Beginning December 2003 and throughout 2004, we generally, sold consumers one-year subscriptions to GuruNet. We recognize the amounts we received from those subscriptions over the life of the related subscription. Beginning April 2004, certain users who purchased lifetime subscriptions in 2003 exchanged their lifetime subscriptions for free two-year subscriptions to a newer, enhanced version of the GuruNet product. The cash previously received from such users is being recognized as revenues over the new two-year subscription. Beginning January 2005, we no longer offer subscriptions to our consumer products and/or websites. Rather, our consumer business model is now an advertising-only model. Notwithstanding, we have not terminated fixed-term and lifetime subscriptions to GuruNet that we previously sold. This means that those users will continue to receive content and will not have to upgrade their software. The software they downloaded in conjunction with their subscription will be supported. Our accounting treatment relating to those subscriptions has not changed, since we continue to honor those subscriptions.

Accounting for Stock-based Compensation

In January 2003, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 148, "*Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123*" ("SFAS 148"), which provides alternative methods of transition for a voluntary change to a fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement of Financial Accounting Standards No. 123 "*Accounting for Stock-based Compensation*" ("SFAS 123") to require prominent disclosures in annual financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We account for stock-based compensation for employees under APB 25, and elect the disclosure-only alternative under SFAS 123 and provide the enhanced disclosures as required by SFAS 148.

We record deferred stock-based compensation expense for stock options granted to employees and directors if the market value of the stock at the date of grant exceeds the exercise price of the option. We recognize expenses as we amortize the deferred stock-based compensation amounts over the related vesting periods. The market value of our stock, so long as we were a private company, was determined by us based on a number of factors including comparisons to private equity investments in us. These valuations are inherently highly uncertain and subjective. If we had made different assumptions, our deferred stock-based compensation amount, our stock-based compensation expense, our net loss and our net loss per share could have been significantly different.

The fair value of stock warrants and stock options granted to non-employees are measured throughout the vesting period as they are earned, at which time we recognize a charge to stock-based compensation. The fair value is determined using the Black-Scholes option-pricing model, which considers the exercise price relative to the market value of the underlying stock, the expected stock price volatility, the risk-free interest rate and the dividend yield, and an estimate of the life of the warrant or option. As discussed above, the market value of the underlying stock was based on assumptions of matters that are inherently highly uncertain and subjective. Since, prior to our IPO there had been no public market for our stock, our assumptions about stock price volatility are based on the volatility rates of comparable publicly held companies. These rates may or may not reflect our stock price volatility following the offering. If we had made different assumptions about the fair value of our stock or stock price volatility, or our estimate of the time stock warrants and stock options will be outstanding before they are ultimately exercised, the related stock based compensation expense and our net loss and net loss per share amounts could have been significantly different.

For example, in the first quarter of 2005, we estimated that the fair value of 100,000 common stock warrants that our investment banker received in connection with an agreement pursuant to which it provides the Company with general financial advisory and investment banking services, to be \$577,000. Such amount is being amortized over the minimum life of the agreement, which is six months. One of the assumptions driving the fair value of the warrants was the estimate of the date the warrants will be exercised. As required, we assumed the warrants will be exercised on the last day before they expire, which is five years after the date the warrants were issued. If, for example, we had assumed that the warrants would be exercised one year after their issuance, their value, and the charge would have been approximately \$146,000, rather than \$577,000.

We are required in the preparation of the disclosures required under SFAS 148 to make certain estimates when ascribing a value to employee stock options granted during the year. These estimates include, but are not limited to, an estimate of the average time option grants will be outstanding before they are ultimately exercised and converted into common stock. These estimates are integral to the valuing of these option grants. Any changes in these estimates may have a material effect on the value ascribed to these option grants. This would in turn affect the amortization used in the disclosures we make under SFAS 148, which could be material. For disclosure purposes only, the fair value of options granted in the past to employees was estimated on the date of grant using the minimum-value method with the following weighted average assumptions: no dividend yield; risk-free interest rates of 2.18% to 6.59%; and an

expected life of three to five years. The fair value of options granted to employees subsequent to May 12, 2004, the date of our first filing with the U.S. Securities and Exchange Commission in connection with our IPO is measured, for disclosure purposes only, according to the Black-Scholes option-pricing model, with the following weighted average assumptions: no dividend yield; risk-free interest rates of 3.19% to 4.18%; volatility between 38.62% and 66.76%, and the expected life of the option, generally four years. If we had made different assumptions than those noted above, the related disclosures under SFAS 148 could have been significantly different.

Finally, the FASB recently enacted Statement of Financial Accounting Standards 123 (revised 2004) , *"Share-Based Payment"* ("SFAS 123R"), which replaces SFAS 123, *"Accounting for Stock-Based Compensation"*. The impact of SFAS 123R on future periods is discussed in the section of this Management's Discussion & Analysis titled "Recently Issued Accounting Pronouncements".

Accounting For Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves management estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax item in the statement of operations. Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We have fully offset our US deferred tax asset with a valuation allowance. Our lack of earnings history and the uncertainty surrounding our ability to generate taxable income prior to the expiration of such deferred tax assets were the primary factors considered by management in establishing the valuation allowance. Deferred tax assets and liabilities in the financial statements result from the tax amounts that would result if our Israeli subsidiary distributed its retained earnings to us. This subsidiary is entitled to a tax holiday, as described above, yet continues to generate taxable income in respect of services provided to us, and therefore were the subsidiary to distribute its retained earnings to us, we believe that the deferred tax asset relating to the Israeli subsidiary would be realized. In the event that our subsidiary's products would not generate such taxable income, we would need to write off the deferred tax asset as an expense in the statement of operations. It should be noted that as the income is derived from us, it is eliminated upon consolidation.

Foreign Currency Translation

Beginning February 2004, our Israeli subsidiary began paying substantially all of its salaries linked to the U.S. dollar ("USD"), rather than the New Israeli Shekel ("NIS"). Based on this change, and in conjunction with all other relevant factors, our management has determined that the subsidiary's functional currency, beginning the first quarter of 2004, is the USD. SFAS 52, Appendix A, paragraph 42 cites economic factors that, among others, should be considered when determining functional currency. We determined that the cash flow, sales price and expense factors for our subsidiary, which prior to 2004 all indicated functional currency in foreign currency, have changed in 2004 to indicate the functional currency is the USD.

Our subsidiary's revenue is calculated based on costs incurred plus a profit margin. Prior to 2004, salary expense, its primary expense, was determined in the foreign currency resulting in income and expenses being based on foreign currency. However, in 2004, a triggering event occurred that, in our opinion, warranted a change of the functional currency of our subsidiary to that of our currency, USD. Salary expense, the primary expense of our subsidiary, began to be denominated in USD. This led to a change with respect to the currency of the cash flow, sales price and expense economic factors and resulted in a determination that our subsidiary's functional currency had changed to that of our functional currency.

Had we determined that our subsidiary's functional currency was different than what was actually used, we believe that the effect of such determination would not have had a material impact on our financial statements.

Recently Issued Accounting Pronouncements

In March 2004, the Emerging Issues Task Force (“EITF”) reached a consensus on Issue No. 03-01, “*The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*” (“EITF 03-1”). EITF 03-1 provides guidance on other-than-temporary impairment models for marketable debt and equity securities accounted for under SFAS No. 115, “*Accounting for Certain Investments in Debt and Equity Securities*” (“SFAS No. 115”), and non-marketable equity securities accounted for under the cost method. The EITF developed a basic three-step model to evaluate whether an investment is other-than-temporarily impaired. On September 30, 2004, the FASB issued FSP 03-1-1, “Effective Date of Paragraphs 10-20 of EITF Issue 03-1, ‘The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments’,” delaying the effective date for the recognition and measurement guidance of EITF 03-1, as contained in paragraphs 10-20, until certain implementation issues are addressed and a final FSP providing implementation guidance is issued. Until new guidance is issued, companies must continue to comply with the disclosure requirements of EITF 03-1 and all relevant measurement and recognition requirements in other accounting literature. We do not expect the adoption of EITF 03-1 to have a material effect on our financial statements.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets - an amendment to APB No. 29." This Statement amends Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Adoption of this statement is not expected to have a material impact on our results of operations and financial condition.

In December 2004, the FASB issued SFAS 123R, which requires the measurement of all employee share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such expense in our consolidated statements of income. We are required to adopt SFAS 123R in the first quarter of fiscal 2006. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. See Note 3 in our notes to the consolidated financial statements for the pro forma net loss and net loss per share amounts, as if we had used a fair-value-based method similar to the methods required under SFAS 123 to measure compensation expense for employee stock incentive awards. Although we have not yet determined the method of adoption and whether the adoption of SFAS 123R will result in amounts that are similar to the current pro forma disclosures under SFAS 123, we are evaluating the requirements under SFAS 123R and the impact their adoption will have on our consolidated statements of operations and net income (loss) per share.

Liquidity and Capital Resources

General

Our principal sources of liquidity are our cash, cash equivalents and investment securities, and to a lesser extent, the cash flow that we generate from our operations.

As of June 30, 2005, we had \$21,280,754 of assets consisting of \$2,630,378 in cash and cash equivalents, \$16,800,000 in investment securities, \$584,610 in other current assets and the remaining balance in property and equipment and other long-term assets. Total liabilities as of June 30, 2005, reflect current liabilities of \$1,566,797, consisting primarily of accounts payable and accrued expenses and compensation. Long-term liabilities of \$1,105,295 are comprised primarily of liabilities in respect of employee severance obligations and deferred revenues, long-term.

Cash flows for the six months ended June 30, 2005 and 2004 were as follows:

	June 30, 2005	June 30, 2004
Net cash used in operating activities	\$ (1,626,917)	\$ (1,697,441)
Net cash used in investing activities	\$ (11,124,016)	\$ (121,010)
Net cash provided by financing activities	\$ 13,828,281	\$ 3,645,519

Despite a net loss of \$3,106,910 during the six months ended June 30, 2005, our net cash used in operations was \$1,626,917. The primary reasons for the large difference is that \$930,000 of our operating expenses was the result of non-cash, stock-based compensation, and due to various changes in our operating assets and liabilities. Despite a net loss of \$3,566,861 during the six months ended June 30, 2004, our net cash used in operations was \$1,697,441. This was due to many factors, the most significant of which is non-cash amortization of promissory note discounts, of \$1,368,755.

Cash used in investing activities of \$11,124,016, during the six months ended June 30, 2005 is attributable primarily to purchases of investment securities of \$16,150,000, less proceeds from the sale of investment securities, of \$5,200,000, and to capital expenditures of \$161,000. Investment securities consist of investments in auction rate, investment grade, corporate and municipal debt instruments, and auction rate preferred shares of closed-end investment funds that invest in long-term fixed income securities, with auction reset periods of 28 days, classified as available-for-sale securities and stated at fair value. Cash used in investing activities of \$121,010 during the six months ended June 30, 2004 resulted primarily from the purchase of the Answers.com domain name for \$80,200 and capital expenditures of \$39,000.

Cash flow from financing activities during the six months ended June 30, 2005 was comprised of the net proceeds, of approximately \$12,225,000 from the exercise of warrants via the Warrant Reload Agreement, with the remainder resulting from other exercises of stock warrants and stock options. Cash flow from financing activities during the six months ended June 30, 2004 resulted from the net proceeds of \$4.3 million of bridge notes that were issued in January and February 2004, reduced by \$630,000 of issuance costs related to our IPO.

Current and Future Financing Needs

We have incurred negative cash flow from operations since our inception. We have spent, and expect to continue to spend, substantial amounts in connection with implementing our business strategy. We raised approximately \$10,786,000, net of underwriting fees and offering expenses, through our IPO and the exercise of the over-allotment option in the last quarter of 2004. After repaying the portion of the bridge notes that did not convert to common shares, of \$3,160,000, approximately \$7.6 million remained. In February 2005 we entered into the Warrant Reload Agreement with certain holders of warrants that were issued by us in 2004 in connection with the bridge financing, pursuant to which such holders exercised an aggregate of 1,871,783 Bridge Warrants. As a result, we raised approximately \$12,225,000, net of costs relating to the exercise. Further, during the six months ended June 30, 2005, we raised approximately \$1.6 million, from other exercises of warrants and options. Based on our current plans, we believe that the net proceeds of the aforementioned financings will be sufficient to enable us to meet our planned operating needs for the next twelve months. Notwithstanding, we may need to raise additional capital through future debt or equity financing to make acquisitions, license products and technologies complementary to our business or finance growth. Additional financing may not be available at all or on terms favorable to us.

Off-Balance Sheet Arrangements

We have not entered into any transactions with unconsolidated entities in which we have financial guarantees, subordinated retained interests, derivative instruments or other contingent arrangements that expose us to material continuing risks, contingent liabilities or any other obligations under a variable interest in an unconsolidated entity that provides us with financing, liquidity, market risk or credit risk support.

ITEM 3. CONTROLS AND PROCEDURES

Based on their evaluations as of the end of the period covered in this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time

periods specified in the rules and forms of the SEC.

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We believe that a controls system, no matter how well designed and operated, is based in part upon certain assumptions about the likelihood of future events, and therefore can only provide, reasonable, not absolute, assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

In addition, we have reviewed our internal controls over financial reporting and have made no changes during the quarter ended June 30, 2005, that our certifying officers concluded materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On July 14, 2005, Mr. Steven Tover ("Tover"), former Vice President, Business Development & Sales of the Company, filed a statement of claim with the Regional Labor Court in Jerusalem, Israel, against (i) the Company, (ii) Mr. Robert Rosenschein (the Company's CEO and a Chairman of the Board), and (iii) Mr. Steven Steinberg (the Company's CFO) in the amount of approximately US\$50,000, for deferred salary, severance pay and allegedly unpaid commissions. Tover's action further claims that he is entitled to certain additional and future commissions pursuant to various business transactions and to exercise stock options granted to him, which, according to the Company, have expired at the close of fiscal 2004. The stock options discussed in Tover's claim consist of 43,441 options to purchase such number of shares of common stock of the Company, with an exercise price of \$2.76 per share. After consultation with legal counsel, management believes that the probability of Tover's action prevailing is low. The named defendants completely reject the validity of Tover's claims and will file a statement of defense in the next several weeks.

ITEM 2. CHANGES IN SECURITIES

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

- | | |
|------|--|
| 31.1 | Certification of Principal Executive Officer required under Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as amended. |
| 31.2 | Certification of Principal Financial Officer required under Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as amended. |

32.1*

Certification of Principal Executive Officer required under Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.

32.2* Certification of Principal Financial Officer required under Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.

* The certifications attached as Exhibits 32.1 and 32.2 accompany this Quarterly Report on Form 10-QSB pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed "filed" by GuruNet Corporation for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

SIGNATURES

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

GURUNET CORPORATION

Date: August 4th, 2005

By: /s/ Robert S. Rosenschein

Robert S. Rosenschein
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Steven Steinberg

Steven Steinberg
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

- | | |
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