Flying the Coop: TeleSign’s Incubator Exit

Twenty-somethings Ryan Disraeli, Darren Berkovitz, and Stacy Stubblefield hurried around in a cramped office kitchen, taking out their frustrations by sniping at one another. They had just returned from a meeting at Starbucks with a potential client, which they had taken offsite under the guise that their conference room was booked with other critical meetings. In reality, they did not have a conference room. They knew that their humble, tiny office would be an obvious giveaway of the company’s limited means and small size. Just as they returned from their meetings, they learned that their office building’s management company would be shutting off the power that evening to perform routine maintenance. As a small technology company housed at an incubator, they used the office kitchen as their server room. If they lost power, their customers would undoubtedly face an outage.

The three entrepreneurs met at the incubator in 2006, four years prior, when they were all in their early twenties. During their years together, they hustled to eventually begin a company managing online account security. Theirs was a story of product iteration and customer feedback, originating in an online backgammon company’s need for order verification for gamblers.

Equal parts brainstorming session and group meltdown, their bickering in the kitchen paid off. Berkovitz agreed to run to the store before it closed to purchase an uninterruptible power source. When he returned, the three of them installed it on the spot to protect their servers—and therefore their customers.

The experience left the entrepreneurs exhausted. It was yet another example of why they needed to exit the incubator. However, the task seemed overwhelming: they had little money, limited professional experience, and they continually struggled to get potential clients to commit. However, they also knew that staying in the incubator would stifle the company’s potential, which they envisioned as a global, multi-million-dollar enterprise.

Curious Minds

Ryan Disraeli grew up in San Diego, California and never imagined that he would spend his undergraduate years at the University of Southern California (USC). “The previous three generations of men in my family went to USC, and they were all dentists. But I didn’t want to be a dentist. I wanted to carve my own path. I have always been passionate about technology and doing something new,” Disraeli shared. Disraeli surprised even himself when he enrolled at USC in 2005, attracted by a combination of scholarships and his desire to stay in California. His first student internship was with
a large medical insurance company. “I was bored and unimpressed. It became clear to me that I wanted to work in a more entrepreneurial environment. None of my family members really had a history working in large corporations either, so it didn’t seem like a far stretch,” Disraeli recalled. After this experience, Disraeli came across a job posting for a business incubator in Los Angeles called Curious Minds. Disraeli landed an interview with the founder, Sam Gonen. An Israeli-American businessman and entrepreneur, Gonen had founded the incubator with the idea of hiring young people to work on his myriad ideas and turn them into businesses. Disraeli was offered an internship at Curious Minds in early 2006, while he was a sophomore at USC.

When Disraeli arrived at the incubator, he met the small team of employees, which included some of Gonen’s younger relatives. He quickly started to work with Darren Berkovitz and Stacy Stubblefield, who had both been at Curious Minds for approximately a year, having started their positions on the same day. Gonen originally intended to only hire for one position but could not decide whether to hire Berkovitz or Stubblefield, so he asked them both to join the incubator at its inception. “We showed up to desks in a box that we had to build ourselves. The whole incubator was basically this concept of throwing spaghetti against the wall to see what would stick. We were always working on multiple ideas,” Stubblefield recalled.

Stubblefield grew up outside of Houston, Texas as an only child. As a young girl, she liked to read Entrepreneur magazine. At the age of 10, she embarked on her first entrepreneurial venture. “It was puppy arbitrage,” Stacy joked. She found puppies that were for sale deep into the suburbs, purchased them, cared for them, and then sold them for a higher price to customers closer to the city. She continued this operation for a year, until she saved enough money for her class field trip to Washington, D.C. In the early 1990s, her father, an entrepreneur himself, bought Stubblefield her first computer. She quickly became fascinated by the internet and taught herself HTML. When she was 12 years old, Stubblefield began to create webpages for businesses. Completely self-taught, she later wrote an unpublished book to teach others how to code. “The neighbor kids would always ask why I didn’t come out to play. But I just wanted to be inside doing stuff on the computer.”

Stubblefield, attracted by USC’s entrepreneurship program, committed to studying there sight unseen, and quickly declared a business major with an entrepreneurship emphasis. She spent her summers working various jobs, which ranged from waiting tables to assisting a private investigator and working at a law firm.

Stubblefield recalled, “I hated my job as a waitress. It was then that I knew I wouldn’t be a good employee for someone else. I needed to work for myself. The legal job was uninteresting to me because you were never allowed to question the process, even for minor things like filing protocol. Working for the PI was interesting because I learned a lot about fraud and started to think in a different way.”

Soon after her graduation, she found an online job posting for Curious Minds. “It sounded like a telemarketing scam, but I went to the interview anyway. At the interview, everything seemed legitimate. It had a low salary, but I could work on starting up companies, so I was excited,” Stubblefield said.
Berkovitz had a similar path to Curious Minds. Like Disraeli and Stubblefield, he had been drawn to entrepreneurship from an early age. “Even as a kid, I wanted to start my own business. It’s like it was in my DNA. When I was in high school I took an AP Computer Science course and realized it didn’t come naturally to me, but I loved tech. So, I decided that I’d get in on the business side of tech,” he explained. After high school, he wanted to start a business, and attempted to persuade his parents to provide seed funding. His parents were unconvinced, so Berkovitz enrolled at USC, although he, Disraeli, and Stubblefield never crossed paths there. In 2005, he found the same online job posting that caught Stubblefield’s attention. “It was the perfect balance because I wasn’t risking my own money. The salary was low, so I was living at home when I started working there. I had to make sacrifices to make it work, but I learned a ton in the process,” Berkovitz said.

Berkovitz and Stubblefield had been bouncing between multiple projects when Disraeli arrived as an intern. “The incubator was very focused on doing things rather than pontificating about them. There was a ton of ambiguity, not a lot of structure, and a lot of problems. It was chaotic but exciting,” Berkovitz related. The trio immediately hit it off. “All of us wanted to work together. We had different skill sets but we all got along. The group dynamic was great. If you would take one person out of our group, it wouldn’t work as well. Left alone, Stacy and I would get too negative, like the sky is falling. If it was just me and Darren, we would get too ‘big picture.’ When it was just the two of them, they would start fighting. We’re really lucky that the three of us met when we did,” Disraeli shared.

Disraeli and Berkovitz agreed that Stubblefield had a pragmatic approach and the strongest technical skills in the group. “She’s probably the smartest person I’ve ever worked with,” Disraeli confided. Disraeli characterized Berkovitz as optimistic, extroverted, and a holistic thinker; he was the most oriented to sales and marketing of the three. Disraeli described himself as product-oriented, always watching where the market was going for various projects. The trio agreed that Disraeli exhibited the most centrist personality of the group. “Our relationships are built on trust and honesty. There’s not a lot of BS or double speak. Even though we’re all different, we each understand how the others think,” Berkovitz related fondly.

**Incubating a Clutch of Opportunities**

“I started the incubator so that I could turn an investment of a few million dollars into a company or companies worth billions—what I refer to as ‘M2B’ [millions to billions],” Gonen shared. He funded all the companies and retained all of the equity. He required his employees to be agile and frugal, prioritizing profit potential over formalized procedures, processes, or strategic plans for any new idea or business. “It may sound a little crazy, but since these weren’t venture-backed companies, the cost of drawing up equity agreements wasn’t worth it. We were very frugal with our time and money,” Berkovitz explained.

Disraeli, Berkovitz, and Stubblefield quickly leveraged the efficiency of their working dynamic. “We became known within the incubator as a savvy team,” Disraeli remembered. Disraeli was still a full-time student, but his internship at the incubator had soon demanded full-time hours as well. He frequently worked on incubator projects during class time, and sometimes stepped into the hallway to take calls related to the budding businesses. Disraeli, Berkovitz, and Stubblefield were each working on many business ideas, with their attention and time split in several different ways. Even in this environment, they were always working in tandem with the goal of bringing products to market.

Incubator businesses they worked on at the time included:

- **DoMyStuff.com**: a web-based platform in which a user could post a task or errand, and other users could bid to complete the items
- **TeleRoute**: a technology solution to route phone calls to experts based on a bidding system. For example, if a user needed to speak with a doctor, the technology would route the caller to a doctor based upon the doctor’s bid for the call.

- **BlueBid**: a website in which users could bid to purchase intangible property, such as owed debts.

Stubblefield recalled, “Our businesses and the incubator were our entire lives at the time. We sat in a small room together all day. The three of us argued all the time, like siblings. We were constantly questioning what the others were working on and asking them to explain why that was the thing with the most potential. We never took our disagreements personally though; we always trusted each other. That was just the dynamic.”

**Winging It: The Beginnings of TeleSign**

One business, known as TeleSign, stood apart from the rest for Disraeli, Berkovitz, and Stubblefield. The idea originated with Gonen’s nephew, who owned an online backgammon company. The company, based in Israel, was rooted in gambling. Players wagered money on the outcome of online backgammon games. Gonen’s nephew had seen an uptick in fraud, with players using stolen credit cards to play. He eventually asked the employees at his uncle’s incubator to automate phone calls with customers for payment verification of purchases on the website.

The incubator team created the software and launched the first version of this verification product in 2005. At first, the product lost money on each automated phone call because the telecommunications cost more than anyone could reasonably expect to charge a customer business. “We went to market with a product that didn’t work very well. We just continued to iterate and make it better. TeleSign was not an ‘aha moment;’ it was a real solution for a real customer,” Disraeli recalled.

Disraeli had been spending most of his time on this project and had frequently urged Berkovitz and Stubblefield to devote as much time as possible to it as well. “I’d drag Stacy to meetings because she’s awesome in front of customers. I really needed her to work on TeleSign full-time,” Disraeli recalled. Harkening back to Gonen’s insistence on profitability, the team did not invest significant time into TeleSign’s logo, website, or name. The top priority was finding customers and making sales, even above perfecting the product. “It was all grind. We had no network and no introductions. Nobody would do anything with us until they met us face-to-face, so that was our goal,” Disraeli explained.

“We always appeared bigger than we were. We had an automated answering service, but all of those lines rang to my cell phone. I’d be sitting in class and the caller ID would show ‘billing call,’ so I’d step in the hallway and answer as the TeleSign billing department,” Disraeli chuckled. The team relied on other creative tactics, such as booking $39 hotel rooms in San Jose and then telling Silicon Valley technology companies that they were in town for other meetings and offering to visit. “Large customers were interested, but once they started digging under the covers [conducting due diligence], they weren’t comfortable with our size and financials. So, they’d start to try to build tech solutions themselves, but those didn’t work. Sometimes we’d even offer our source code to the company in the event that we went under, but they still considered us too big of a risk,” Disraeli lamented. Berkovitz added, “I remember a large online auction company that typified this challenge. We nearly had a deal, but eventually a woman from that company called me to reject us. She said they just couldn’t take the risk with our financials, and she wasn’t interested in any type of ‘source code escrow.’”

Around 2007, the trio began to shift TeleSign’s focus from customer order verification to aiding businesses in account security. Stubblefield explained the initial demand for account security:
It first arose as somebody's sick joke, it wasn't a professional fraudster. There was an e-commerce company getting hit by a fraudster who was taunting the company's owner. The client installed phone verification to put an end to it, but the fraudster came back with new anonymous phone numbers and then sent an email telling our client he would always find a way around the systems. We did a lot of research and figured out how to identify those phone numbers and create a system to refuse VoIP numbers. I did all the early prototyping and built an API on a small server on a shared host because we didn't have time to do it professionally. The fraudster went away and the client never heard from him again.

Stubblefield was eager to combine her technological savvy with the skills she learned from her time working for a private investigator, and she recognized that fraud was both a tremendous threat to the technology industry and a tremendous opportunity for TeleSign. Disraeli and Berkovitz agreed, and the team quickly became experts in the nascent field. “TeleSign started to feel less like a project, and more like a company. We knew it could be scaled if it were given the right resourcing,” Disraeli explained. Berkovitz added, “Our identities had become very closely tied with TeleSign.”

However, the area was so new that technology companies themselves often did not understand the need for this type of fraud protection. “When we started TeleSign, nobody knew what we were talking about with two-step authentication,” recalled Disraeli. Stubblefield expounded, “For the first three years, we were ahead of the market. Fraud back then was single actors, a smaller scale. It wasn’t professionalized. So, we were selling the solution to a problem that wasn’t really there yet.” Additionally, it was difficult for TeleSign to gain broad name recognition as a business-to-business model. “We definitely weren’t media darlings,” Stubblefield quipped.

In the spring of 2008, TeleSign brought on its first major client, a large website which offered classified advertisements for categories such as jobs, housing, personals, items for sale, etc. “It was kind of a miracle. Here we were, three young people doing upwards of $30,000/month in sales. It really showed the potential to be financially successful. TeleSign wasn’t a hot consumer-based business, but it was obvious that the potential was there,” Stubblefield recounted. “That client paid us about $300,000 the first year, but it felt like a million dollars to us,” Disraeli added. Gonen chimed in, “TeleSign was a ‘unicorn’ [rare and valuable]. It had the potential to grow into a billion-dollar company.”

Bolstered by this success, Disraeli, Berkovitz, and Stubblefield set their sights on the largest websites and mobile applications in the world, each with hundreds of millions of users. The well-known online classifieds client provided TeleSign with credibility and a reference point, which the team used as convincing leverage with other potential clients.

**Ready to Hatch**

Inside the incubator, frustrations mounted. Disraeli, Berkovitz, and Stubblefield had focused almost all their time on TeleSign and viewed themselves more as TeleSign’s leaders than incubator employees. They made most of the company’s strategic decisions and secured its clients but felt confined by the structure of their employment. Disraeli recalled:

*We were surrounded by other people who were all working on multiple projects. We were being managed as a family-owned business rather than a company that could continue to scale and grow. We had big ambitions for where we wanted to take TeleSign. Other projects weren't doing as well. It's not the best environment*
for a company that’s producing revenue [TeleSign]. There was an incentive for other people to latch on.

Stubblefield threatened to quit her job multiple times, but each time, Gonen convinced her to stay. “We had a business generating a million dollars, but we made small salaries and had no ownership,” she argued. Berkovitz added, “Outside venture capitalists were interested, but then when they found out during their due diligence process that we were part of an incubator, we became unattractive to them.”

These issues were less urgent for Gonen, who had provided 100% of the funding and salaries, and whose idea provided the seed from which TeleSign grew. However, Disraeli, Berkovitz, and Stubblefield were in alignment in their desires for equity and more formal control over the company. Together, they made a persuasive case to Gonen, who had previously said that if a company became wildly successful, they could discuss equity arrangements.

Gonen eventually agreed, and in 2009 he offered equity to the three, with the understanding that he also retained some for himself. Disraeli, Berkovitz, and Stubblefield’s celebration was short-lived, though. The process to actually obtain equity proved lengthier and more cumbersome than the entrepreneurs were accustomed to in their fast-moving incubator environment. “The full process of valuation and getting lawyers to agree on draft equity agreements took forever and we definitely had anxiety about getting this finalized,” Berkovitz shared. “We thought this agreement would take a matter of weeks once we got Gonen to agree. We were frustrated because it was taking forever to get this done,” Disraeli noted. The trio was also aggravated because the process distracted them from the work of running TeleSign’s core business.

During the ongoing process of obtaining equity, Disraeli, Berkovitz, and Stubblefield relocated offices to maintain a separate physical space for TeleSign. The team did not go very far, however. The office was located on the eighth floor of the same building that Curious Minds occupied. Although it was in a separate office, TeleSign was still legally part of the incubator. Roles remained loose, but Berkovitz became CEO of TeleSign, while Stubblefield focused on technology and Disraeli focused on sales and marketing. However, the three were sharing major responsibilities and making most decisions as a team. Gonen remained a close advisor as the CEO of the incubator. Over the next year, the company grew from the three original entrepreneurs to a staff of ten (see Exhibit 1 for photos of TeleSign’s offices over the years).

In 2010, a year after they reached the informal agreement, Disraeli, Berkovitz, and Stubblefield were finally granted equity in TeleSign. “The rest of the world is not in startup mode like we are. Things always take longer than you think they should in the business world. That was a frustrating lesson to learn,” Disraeli remarked.

About to Crack

Around the same time that TeleSign moved into a separate office, the company brought on a major internet search engine as a client. The search engine client began with a test project worth $1,000 per month and had the potential to grow to well over $1 million per month if the relationship went well. “When the search engine company joined, we knew TeleSign was about to blow up. But we had to figure out how to keep our servers running [with the significant increase in volume]. We had to use other vendors to deliver SMS and those vendors were falling over. There was a lot of technical difficulty because we were pushing so many transactions,” Stubblefield explained.

Late one night, Berkovitz was awoken to learn that the company was experiencing a denial of service attack [a malicious attack on a web resource which makes it unavailable to users or consumers], leading to multiple systems going down. TeleSign’s data center was located near Los
Angeles International Airport (LAX), so Berkovitz quickly got dressed and drove there to meet with the network engineer. He shared:

*It was 3 a.m. and I was at the Carl’s Jr. drive-through buying food for Miller [the network engineer] to get him through the night. If we’re down, our clients are down, and that’s just an unacceptable outcome. We’re a security company; we need to protect ourselves from these kinds of attacks. It was an all-nighter, sitting with Miller and freaking out between calls to Cisco. It was imperative that we protect our servers, but we needed to make investments and hire people who really knew how to do that. But we couldn’t afford to make investments when the revenue wasn’t there. On the other hand, we couldn’t increase our revenue without these things in place first. It was a classic chicken and egg problem. It was a stressful night, wondering if clients would leave us because of the downtime.*

Berkovitz immediately chose to communicate directly with the base of affected clients. “We learned that it’s all about how you respond to challenges. We learned to over-communicate and tell the truth. We own up. We tell them what’s wrong, what we’re doing to fix it, and how we’ll make it right. It reinforced our customer service philosophy,” Berkovitz said. The team resolved the issue and TeleSign did not lose any clients.

This moment also reinforced fears with which Berkovitz was struggling. “I was in over my head as CEO. I haven’t been through this before and I don’t always know what to do. It’s scary. Bringing in another CEO also doesn’t seem like an easy fix, though. We are in a specialty field and I’m not sure where to find a person with technology CEO experience who also had expertise in security,” he said. In addition to those issues, the team would also need Gonen’s approval for such a major decision.

**Life Beyond the Nest**

Disraeli, Berkovitz, and Stubblefield knew that they were facing a turning point for the company. “It sounds cheesy, but we just want to win. The line between success and failure is razor thin. We’ll do whatever it takes to make the company be successful. Ego and glory don’t really matter at the end of the day. It’s all about making the company successful,” Disraeli emphasized.

The entrepreneurs considered the issues of scale and logistics that would be required to grow their company. Their time in the incubator had helped them form their team and gave them the original idea for the company. But the trio was ready to spread their wings, and they wondered the best way to go about it.

“Sam [Gonen] is good at starting businesses and thinking about ways to solve problems at startups. He’s not an operational thinker who concerns himself with scale. We need someone to help run the business. We know TeleSign has the potential to become a huge operation, but we don’t know if we have the ability to take it to that point,” Stubblefield shared. Disraeli agreed: “Sam was pessimistic about TeleSign’s growth as opposed to other projects, like a tele-medicine idea. He’s more excited about futuristic, big-picture ideas. TeleSign is starting to get operational.”

Simultaneously, TeleSign was gaining attention from investors. Disraeli, Berkovitz, and Stubblefield continually turned down meetings with venture capitalists. Eventually, the TeleSign team’s curiosity led them to begin taking the calls. “We started getting a lot of interest from investors, but we were profitable and didn’t really need to raise money to maintain operations. On the other hand, we thought that raising money might make us seem more legitimate and would help force an exit from the incubator,” Disraeli remembered (see Exhibit 3 for TeleSign’s financial information from 2009). “We had many people who wanted to invest. We didn’t necessarily need it, but wondered
if we should pursue it. We also didn’t know if we’d be taken seriously as a company because we were all in our early/mid-twenties” Stubblefield added.

As the TeleSign team began to take meetings, they once again ran up against their own youth and inexperience. “We had no idea how to put together a pitch deck,” Disraeli laughed. Berkovitz shared, “It’s basically a full-time job to raise money. It’s a tremendous drain on energy and time. It’s hard to manage that and also run the business at the same time. We just didn’t have much experience with all of the requirements.” On top of those issues, investors asked questions about the capability of the company’s leadership. Berkovitz continued, “Investors generally want to see a track record of success. They appreciate our passion and intelligence, but they also value experience.”

Eventually, the trio entered serious conversations with Summit Partners, a firm which specialized in growth equity to aid companies in expansion. The firm presented a package deal, which would require TeleSign to seek external advisors with more age and expertise. As part of the deal, Summit offered to make initial introductions with industry experts. Intrigued but not completely convinced, the TeleSign team allowed Summit to introduce them to Steve Jillings in the summer of 2010. Jillings was CEO of Vantage Media and held a board seat with another company in which Summit had invested. What was intended to be a 45-minute meeting turned into a half-day conversation. Jillings possessed many attractive features: access to capital, a network of potential investors and senior leaders, and relationships with ideal TeleSign customers. “He had experience running companies, and he previously ran a security company that later sold to Microsoft. There really wasn’t a lot of security-related executive experience in Los Angeles, so we were excited to meet him,” Berkovitz recounted.

Finding Wings

Although the TeleSign team had initially met Jillings as a potential advisor as part of an investment deal, they began to view him as a potential CEO who could bring needed experience, structure, and contacts to the company. They also knew that potential investors strongly preferred a team led by an experienced industry veteran, which Jillings represented. But the triad worried about whether to give up control of their company at all. Bringing in a CEO and an investment partner was a big decision, and if it went wrong, the company could be ruined, or they could be pushed out. While Jillings was impressive and highly-recommended, he was ultimately an unknown quantity. “It’s not a clear-cut decision and it’s a unique situation, figuring out how to spin out of the incubator and whether to bring in a CEO,” Disraeli said.

If the three decided to bring in an external CEO, they wondered how they might sell Jillings on the job. “It’s sort of like dating. You don’t want to seem desperate. We all like him, but we don’t want to give the impression that we need him too much. We need to find a balance,” Berkovitz recalled.

Further complicating the situation was the fact that they would need to convince Gonen to allow TeleSign to officially leave the incubator’s nest and come under the leadership of someone new. “I’m concerned that graduating from the incubator and bringing on a larger executive team might mean that the TeleSign team loses its garage mentality and the quick, innovative culture we created,” Gonen shared. Disraeli, Berkovitz, and Stubblefield enjoyed collaboration and blurred lines of responsibility, and pondered how this might need to change in the future.

In addition, Disraeli, Berkovitz, and Stubblefield worried about how a potential meeting between Gonen and Jillings would play out. “Sam is a big picture, early stage dreamer guy. Steve is more of an operational CEO. We’re afraid they won’t understand each other,” Berkovitz said. “They’re almost opposites. They’re both successful but from different ends of the spectrum...like oil and water,” Stubblefield clarified. Disraeli chimed in, “It’s a political thing, making sure everybody on all sides is comfortable.”
The team knew that a CEO's salary was steep, and they pondered whether they could use the money more efficiently if they continued to run the company themselves and brought on more staff and a team of senior advisors instead. They also knew that an external CEO would expect a significant ownership stake in the company, and that their own newly acquired equity would need to be diluted for this to happen.

The entrepreneurs thought about how they might maintain their internal influence if they hired Jillings, expecting that an external CEO would want to hire a full executive team. Company culture and corporate agility was of utmost importance to the trio, and they mused about whether it was possible to maintain those qualities as the company professionalized and grew.

Disraeli, Berkovitz, and Stubblefield considered the package from Summit Partners and whether they should accept the investment money. “We don’t need to raise money for cash flow. But maybe we should do it for other reasons, like credibility or quicker growth,” Stubblefield explained. The team also suspected that accepting an outside investment would help them force their way out of the incubator.

As they thought about their options, they knew that they could easily create a combined deal to accept an investment from Summit Partners while simultaneously offering Jillings the CEO position. Alternatively, they could try to independently pursue either an investment or Jillings as an external hire for CEO.

Although many questions swirled through the young entrepreneurs’ minds, one thing was certain: if they wanted to see TeleSign reach its potential, they needed to make a change, and they needed to act quickly.
Exhibit 1: TeleSign Photos

Stacy Stubblefield in TeleSign’s first office.

Ryan Disraeli (L), Darren Berkovitz (Center), and Stacy Stubblefield (R) celebrate TeleSign reaching a $1 million run rate.
### Exhibit 2: Annual Income Statement

*Thousands of Dollars*

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