
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10 - QSB

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

For the Quarterly Period Ended March 31, 2003

Commission file number 0-25159

LION, Inc.

(Exact name of small business issuer as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

91-2094375
(I.R.S. Employer Identification No.)

4700-42nd Ave. SW, Suite 430, Seattle, WA
(Address of principal executive offices)

98116
(Zip code)

(206) 577-1440
(Issuer's telephone number)

NA
(Former name, former address and former fiscal year, if changed since last report)

As of May 6, 2003, approximately 31,649,978 shares of the Company's common stock were outstanding.

LION, Inc.
Form 10 – QSB
For the Quarter Ended March 31, 2003

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LION, Inc.
BALANCE SHEETS

ASSETS

	March 31, 2003 (Unaudited)	December 31, 2002
CURRENT ASSETS		
Cash and cash equivalents	\$ 585,605	\$ 403,917
Accounts receivable, less allowance for doubtful accounts of \$49,500 and \$62,400 in 2003 and 2002, respectively	425,787	347,661
Prepaid expenses and other	105,470	71,388
	<u>1,116,862</u>	<u>822,966</u>
PROPERTY AND EQUIPMENT - net	989,970	940,372
OTHER ASSETS		
Goodwill - net	273,955	273,955
Other assets	37,908	37,908
	<u>\$ 2,418,695</u>	<u>\$ 2,075,201</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES		
Accounts payable	\$ 184,309	\$ 111,340
Accrued liabilities	381,872	329,671
Current maturities of long-term obligations	47,711	35,330
Deferred revenue	320,521	295,497
	<u>934,413</u>	<u>771,838</u>
LONG-TERM OBLIGATIONS, less current maturities	67,092	52,495
COMMITMENTS AND CONTINGENCIES	-	-
STOCKHOLDERS' EQUITY		
Preferred stock - authorized, 5,000,000 shares of \$.001 par value, liquidation value \$900,000	1,500	1,500
Common stock - authorized, 50,000,000 shares of \$.001 par value	31,604	31,442
Additional contributed capital	11,751,558	11,741,101
Accumulated deficit	(10,367,472)	(10,523,175)
	<u>1,417,190</u>	<u>1,250,868</u>
	<u>\$ 2,418,695</u>	<u>\$ 2,075,201</u>

The accompanying notes are an integral part of these statements.

LION, Inc.

STATEMENTS OF OPERATIONS
(Unaudited)

	<u>Three months ended March 31,</u>	
	<u>2003</u>	<u>2002</u>
Revenues	\$ 1,786,720	\$ 1,510,963
Expenses		
Direct costs	315,556	219,350
Selling and marketing	573,468	482,024
General and administrative	539,653	638,637
Research and development	87,401	89,805
Depreciation and amortization	111,002	119,682
	<u>1,627,080</u>	<u>1,549,498</u>
Operating income (loss)	159,640	(38,535)
Other income (expense)		
Interest expense	(4,046)	(3,202)
Interest income	109	841
	<u> </u>	<u> </u>
NET INCOME (LOSS)	<u>\$ 155,703</u>	<u>\$ (40,896)</u>
Net income (loss) per common share, basic and diluted	<u>\$ -</u>	<u>\$ -</u>

The accompanying notes are an integral part of these statements.

LION, Inc.

STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended March 31,	
	2003	2002
Cash flows from operating activities		
Net income (loss)	\$ 155,703	\$ (40,896)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	111,002	119,682
Stock options issued for services received	961	3,566
Common stock issued in lieu of cash compensation	9,658	4,629
Changes in assets and liabilities		
Accounts receivable	(78,126)	2,628
Prepaid expenses and other	(34,082)	(42,616)
Accounts payable	72,969	47,546
Accrued liabilities	52,201	86,054
Deferred revenue	25,024	12,445
Net cash provided by operating activities	315,310	193,038
Cash flows from investing activities		
Capitalized software development costs	(80,911)	(94,317)
Purchase of property and equipment	(41,995)	(56,170)
Net cash used in investing activities	(122,906)	(150,487)
Cash flows from financing activities		
Payments on notes payable and long-term obligations	(10,716)	(24,503)
Proceeds from issuance of common stock and exercise of stock options	-	900
Net cash used in financing activities	(10,716)	(23,603)
Net increase in cash and cash equivalents	181,688	18,948
Cash and cash equivalents at beginning of period	403,917	480,910
Cash and cash equivalents at end of period	<u>\$ 585,605</u>	<u>\$ 499,858</u>
Supplemental non-cash investing and financing activities:		
Assets acquired under capital leases	\$ 37,694	\$ -

The accompanying notes are an integral part of these statements.

LION, Inc.

Form 10 - QSB

NOTES TO FINANCIAL STATEMENTS

NOTE 1. FINANCIAL STATEMENTS

The unaudited financial statements and related notes are presented as permitted by Form 10 – QSB, and do not contain certain information included in the Company’s audited financial statements and notes for the fiscal year ended December 31, 2002. The information furnished reflects, in the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2003. The accompanying unaudited financial statements and related notes should be read in conjunction with the audited financial statements and the Form 10 – KSB of LION, Inc. and notes thereto, for its fiscal year ended December 31, 2002.

NOTE 2. NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is based on the average number of shares outstanding during each period. The weighted average number of common shares outstanding was 31,489,489 and 31,055,111 for the three months ended March 31, 2003 and 2002, respectively.

Preferred shares outstanding were included in the computation of diluted EPS for the three month period ended March 31, 2003 but excluded in the three month period ended 2002 as their effect was anti-dilutive. Warrants and options to purchase 6,600,567 and 7,143,667 shares of common stock outstanding at March 31, 2003 and 2002, respectively, were not included in the computation of diluted earnings per share because their exercise price was greater than the average market price of the common shares.

NOTE 3. STOCK-BASED COMPENSATION

Effective January 1, 2003, the Company adopted the fair value recognition provision of FASB Statement No. 123, “Accounting for Stock-Based Compensation,” prospectively, to all employee awards granted on or after January 1, 2003, pursuant to FASB Statement No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure.”

During the quarter ended March 31, 2003, the Company issued options to purchase 100,000 shares under the 1998 Stock Option Plan (the “Plan”). Compensation expense will be based on the fair value of the options at the respective grant dates utilizing the Black-Scholes model for estimating fair value. The Company will recognize compensation expense of approximately \$6,120 ratably over the vesting period for these options granted. Under the intrinsic value method reported previously, no compensation expense had been recognized on options granted through December 31, 2002, as the exercise price of the options granted equaled the market price on the date of grant for all prior grants.

The following table illustrates the effect on net income (loss) and on net income (loss) per common share as if the fair value based method had been applied to all outstanding and unvested awards in each period:

	Three months ended	
	March 31,	
	2003	2002
Net income (loss), as reported	\$ 155,703	\$ (40,896)
Add: Stock-based employee compensation expense included in reported net income	195	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards*	(195)	-
Pro forma net income (loss)	<u>\$ 155,703</u>	<u>\$ (40,896)</u>
Net income (loss) per share:		
Basic and diluted – as reported	<u>\$ -</u>	<u>\$ -</u>
Basic and diluted – pro forma	<u>\$ -</u>	<u>\$ -</u>

* *All awards* refers to awards granted, modified, or settled in fiscal periods beginning after December 15, 1994 – awards for which the fair value was required to be measured under Statement 123.

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

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the Financial Statements and the related Notes included elsewhere in this document. Any statistical information provided in this report is as of March 31, 2003 unless otherwise noted.

In addition to historical information, the following discussion and analysis of management contains forward-looking statements. All statements that look forward in time or include anything other than statements of historical fact are forward-looking statements. These forward-looking statements involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to: substantial dependence on mortgage brokers and the mortgage broker industry; mortgage market trends; interest rate changes; housing and consumer trends effecting home purchases; the effectiveness of our joint-marketing and sales agreements; our need for additional financing; our ability to attract and retain high quality employees; changes in the overall economy and in Internet technology; the number and size of our Internet competitors, and other risks faced by us described below in the section entitled “Risk Factors” and elsewhere in this report, and in other documents we file with the Securities and Exchange Commission. You should not place undue reliance on these forward-looking statements, which are based on information available to the Company as of the date of this report and which reflect management’s opinions only. LION undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements.

OVERVIEW

LION provides marketing and website technology to help mortgage originators attract customers and originate loans more efficiently and cost effectively. With proven online strategies, the LION mortgage solution delivers a competitive advantage that generates more originator business, saves time and money, increases loan production and streamlines the approval process.

LION's "consumer to business" and "business to business" portals connect the originator to a large marketplace of customers seeking home mortgages and to a powerful network of lenders and vendors in the mortgage industry. The Company's "consumer to business" portal, www.mortgage101.com, is one of the nation's leading consumer mortgage portals. Accessible through a variety of leading search engines, Mortgage 101 and its network of LION affiliate Internet sites attract over 1,000,000 unique visitors each month. Its content is co-branded to approximately 22,500 realtor sites, over 2,400 originator websites, and a variety of developer direct and association websites. The Company's "business to business" portal, www.lioninc.com, allows members to search for the best mortgage for their customers by checking and comparing lender pricing from one of the largest wholesale lender databases in the country, locking the rate and sending the loan application file to a number of lenders electronically through an advanced loan origination software system. LION also provides this complete software package to large originator companies under a private label license allowing them to customize their own services under their own brand.

In LION's business model, there are four distinct revenue categories from its mortgage broker/originator and lender customers. The categories are membership, marketing, technology and software.

MEMBERSHIP FEES are generated from LION's subscription-based products and services. They are LION Pro, Mortgage 101 and Free Mortgage Dot Com.

LION Pro, used by approximately 5,800 mortgage brokers nationwide, consists of LION Loan Search, LoanLink, News Now and Ratesheets on Demand. Through this password protected product, originators can access one of the nation's largest databases of wholesale mortgage rate, fee, and program information to instantly price any mortgage loan. This database is updated daily in 77 regions in the country. There are over 120 participating lenders and nearly 70,000 regionalized wholesale and correspondent loan programs in the loan search database. The LoanLink feature is a subprime loan exchange platform where originators can submit hard to place loans to participating lenders. The News Now feature of LION Pro allows originators to make informed decisions with high-value content and market data featuring mortgage backed securities, real time market information, financial market analysis, economic indicators, business/service directories and calendars. Finally, the Ratesheets on Demand service allows members to request ratesheets from all participating lenders and receive them by either fax or email.

Mortgage 101 consists of hundreds of mortgage information pages, home buying articles, economic and market data, prequalification tools, interactive calculators, live interest rates displayed from LION's Multi-Lender Rate Feed and prequalification and application tools. Mortgage 101 content educates consumers about the mortgage process and connects them to a large network of local originators that can provide a competitive loan product. Through the Mortgage 101 brand, the Company has grown its co-branded real estate sites to approximately 22,500 which consist of realtors, real estate offices, relocation sites, associations, and city portals. In addition, the Mortgage 101 brand includes approximately 2,400 mortgage companies that have their web sites hosted by LION. LION also has a Spanish translation of Mortgage101.com located at Hipoteca101.com.

Originators also pay a fee for **Mortgage 101 Originator Tools** which include a suite of back-end tools used to manage and customize rates, leads and content. This valuable management tool is integrated into their company's existing website. This service is provided to over 2,700 mortgage brokers nationwide.

Free Mortgage Dot Com is a template web site using Mortgage101 technology with the mortgage originator's logo and colors delivered with no set up fees and free one-year domain name registration. Users pay a monthly hosting fee for this entry level service. In many cases this product becomes the first step before moving into a series of upgrades toward larger more comprehensive enterprise websites. There are approximately 1,150 mortgage brokers using this template web site.

MARKETING FEES are generated through both of LION's portal web sites; www.lioninc.com and www.mortgage101.com. Consumers visiting the mortgage101.com web site, check live interest rates, use pre-qualification tools, and submit "1003" loan applications through links connecting them to LION's network of advertisers. Originator advertisers attract customers by paying marketing fees for ad banners, directory listings, interest rate display, web site promotion, and lead generation. Originators visit the lioninc.com web site to check daily wholesale rates, submit loans, and access mortgage specific news and content. Wholesale lenders and industry vendors attract these customers by paying marketing fees for ad banners, web site promotion, and lead generation.

TECHNOLOGY FEES are generated through the sale of website development and hosting to mortgage originators and wholesale/retail lenders. LION web sites offer both template and custom design solutions that deliver a combination of standard and custom content which feature calculators to deliver valuable information to the user, integrated consumer tools, distinct user access modules, a preferred lender selection, business document publishing and loan file management accessible from any business location.

For the wholesale and/or retail lender, LION has developed technology under the LoanCAT brand. This technology allows lenders to electronically submit rate pricing, receive rate lock requests and "1003" loan application files.

SOFTWARE FEES, in conjunction with the Company's alliance with ABC Virtual, are generated from the sale of the ECLoanPro[®] loan origination and processing system. See "LOAN ORIGINATION SOFTWARE" below under "PRODUCTS AND SERVICES INITIATIVES FOR 2003."

PRODUCTS AND SERVICES INITIATIVES FOR 2003

LION's current subscription based business model performs well in a competitive market with higher interest rates. This more competitive market forces mortgage brokers to compete aggressively for loan volume. They use LION's products and services as creative ways to attract and capture more customers. This model however, does not effectively capture larger revenue opportunities for LION when loan volumes increase during low interest rate cycles. LION is in the process of developing a new performance/transaction based business model that will accelerate the Company's growth potential. LION's new model will be a blend between both the subscription based and performance/transaction based models.

LEAD GENERATION. To leverage the growing traffic to its consumer marketplace, LION has improved the conversion of its consumer traffic into higher quality leads by enhancing profiling,

filtering and routing to its mortgage originator customers. The Company will be introducing additional improvements throughout 2003 by incorporating more advanced qualifying criteria.

PRODUCTIVITY TOOLS FOR BROKERS. The Company is developing an office-based version of its LION Pro product. This product offers productivity software for both small offices (LION Pro Office) and multi-user larger customers (LION Pro Corporate). The product will include a private database that features a comprehensive searchable database of each broker company's specific group of lenders. It will feature new loan program search parameters, management tools and an advanced version of the News Now content. This improved high-value content and market data section will feature real time market information, financial market analysis, economic indicators combined with the broker company's current business/service directories and calendars. LION has delivered this private database product and management software to several large originator companies and anticipates wider scale launches of the full product throughout the second and third quarters of 2003.

SUBPRIME DECISION ENGINE. Plans are also under way to improve LION's LoanLink subprime exchange platform. In November 2002, LION signed a strategic alliance agreement that will introduce a subprime decision engine to its network of mortgage originators and lenders. This technology will enable LION members to submit a file and receive instantly priced, conditional loan approvals from some of the nation's top subprime lenders. In addition, LION is planning to offer a private label version of this product engine to the nation's wholesale and retail lending institutions.

LOAN LOCKING WITH LENDERS. Through a strategic agreement, LION has also introduced broker approval, online loan program and product search, real-time pricing, lock processing and file submission between mortgage brokers and wholesale lenders. This is mostly for conforming loans, but there is also subprime loan functionality that is beginning to be used.

LOAN ORIGINATION SOFTWARE. In October 2002, through a key strategic alliance with ABC Virtual, LION introduced an advanced loan origination software (LOS) product known as ECLoanPro®. This new LOS offers a revolutionary straight-through processing software system that leverages the Internet and wireless devices to allow origination teams to easily prospect and process mortgage loans. With this product, originators are empowered to access and share files with others anytime, anywhere, without having to re-key data, and without traditional hardware and software expenses. Through this alliance, LION will be able to offer a complete "lead to loan" package that will begin to streamline the entire loan process for its members by bundling the software with its online advertising, lead generation, website and membership services. This software is the vehicle that delivers the loan application to the lender and lies at the heart of driving increased loan production to the lender. This LOS functionality will be one of the keys to the success of LION's new performance/transaction based business model. The integration of this LOS functionality will occur throughout 2003 and into 2004.

SUMMARIZED RESULTS OF OPERATIONS

Condensed Results

	Three months ended March 31,	
	2003	2002
Revenues	\$ 1,786,720	\$ 1,510,963
Operating expenses	1,627,080	1,549,498
Operating income (loss)	159,640	(38,535)
Other expense - net	(3,937)	(2,361)
Net income (loss)	<u>\$ 155,703</u>	<u>\$ (40,896)</u>

For the first quarter of 2003, revenue was \$1.79 million, up 18% from \$1.51 million for the first quarter of 2002. Net income for the quarter improved to approximately \$156,000 compared to a net loss of approximately \$41,000 for the same quarter in the prior year.

Growth in revenues came primarily from our broker customers who comprise 85% of all revenues with the remainder coming from our lender customers. Most of the growth came from the Company's marketing segment, primarily lead generation for our broker and lender customers, besides contributions also coming from the membership, technology and software segments.

Towards the end of 2002, the Company began ramping up its resources in order to support on-going and new initiatives along with supporting its alliance partnerships. Cost increases during the first quarter of 2003 compared to the same quarter in the prior year came primarily from expanding and supporting the Company's large database of wholesale and correspondent loan programs along with increases in our commissioned broker sales force and related customer support. The Company was able to keep its costs in line with its revenue base and appears positioned to do the same during the remainder of 2003.

DETAILED RESULTS OF OPERATIONS

REVENUES

	Three months ended March 31,	
	2003	2002
Revenues by category:		
Membership fees	\$ 764,310	\$ 740,314
Marketing fees	700,164	512,105
Technology fees	272,460	258,514
Software fees	46,942	-
Other fees	2,844	30
Total revenues	<u>\$ 1,786,720</u>	<u>\$ 1,510,963</u>

Revenues increased to \$1,786,720 from \$1,510,963 for the three months ended March 31, 2003 and 2002, respectively. This represents an increase of \$275,757 or 18%. Total revenues of \$1,786,720 for the three months ended March 31, 2003 were comprised of mortgage broker fees of \$1,521,130 or 85% and lender fees of \$265,590 or 15%. Total revenues of \$1,510,963 for the three

months ended March 31, 2002 were comprised of mortgage broker fees of \$1,274,728 or 84% and lender fees of \$236,235 or 16%.

Fees from mortgage brokers increased to \$1,521,130 from \$1,274,728 for the three months ended March 31, 2003 and 2002, respectively. This represents an increase of \$246,402 or 19%. The increase was due primarily to growth in membership fees (LION Pro - Loan Search, Mortgage 101 - originator tools, and Free Dot Com - template websites) totaling \$23,996, marketing fees (lead generation and advertising) totaling \$153,291, technology fees (website development and hosting) totaling \$19,359, software fees (ECLoanPro loan origination software setup and related fees) totaling \$46,942 and other revenues totaling \$2,814.

Fees from lenders increased to \$265,590 from \$236,235 for the three months ended March 31, 2003 and 2002, respectively. This represents an increase of \$29,355 or 12%. The increase was due to an increase in marketing fees (lead generation and advertising) totaling \$34,768 which were offset by a decrease in technology fees (website development and hosting) totaling \$5,413.

DIRECT COSTS

Direct costs are comprised primarily of web site fulfillment, technology infrastructure support, project management, quality control, and salaries related to the daily updates to rates, fees, and other loan program information in the mortgage lender database. Direct costs increased to \$315,556 from \$219,350 for the three months ended March 31, 2003 and 2002, respectively. This represents an increase of \$96,206 or 44%. Direct costs as a percentage of revenues increased to 18% from 15% for the three months ended March 31, 2003 and 2002, respectively. The increase in expense is due to (i) database support functions as LION continues to expand its database of wholesale and correspondent loan programs, (ii) additional resources to support the development of broker websites and (iii) expanded telecommunications infrastructure to support new services and increased volumes through the Company's consumer and business facing web portals.

SELLING AND MARKETING

Marketing and selling expenses are comprised of marketing and advertising costs, sales salaries and related support costs. Marketing and selling expenses increased to \$573,468 from \$482,024 for the three months ended March 31, 2003 and 2002, respectively. This represents an increase of \$91,444 or 19%. These expenses as a percentage of revenues were 32% for both of the three month periods ended March 31, 2003 and 2002. The increase is due to growth in the commissioned broker sales force, customer support costs, and trade show participation.

GENERAL AND ADMINISTRATIVE

General and administrative expenses are comprised of management and administrative salaries and related costs, legal and audit fees, outside consulting services, telecommunications expenses, occupancy costs, and other administrative related expenses. General and administrative expenses decreased to \$539,653 from \$638,637 for the three months ended March 31, 2003 and 2002, respectively. This represents a decrease of \$98,984 or 15%. General and administrative expenses as a percentage of revenues were 30% and 42% for the three months ended March 31, 2003 and 2002, respectively. The decrease in costs was due primarily to an improvement in the bad debt experience

and lower legal fees. The overall decrease was offset by additional telecommunications and other administrative support expenses.

RESEARCH AND DEVELOPMENT

Research and development expenses are comprised primarily of engineering salaries and related costs. Research and development expenses decreased slightly to \$87,401 from \$89,805 for the three months ended March 31, 2003 and 2002, respectively. This represents a decrease of \$2,404 or 3%. Research and development expenses as a percentage of revenues decreased to 5% from 6% for the three months ended March 31, 2003 and 2002, respectively. The Company continues to focus on various key initiatives including but not limited to the enhancement of core online services for brokers and the conversion of consumer traffic into higher-value lead generation.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense decreased to \$111,002 from \$119,682 for the three months ended March 31, 2003 and 2002, respectively. This represents a decrease of \$8,680 or 7%. The decrease is due to equipment, computers and software which became fully depreciated at the beginning of 2003.

INTEREST EXPENSE

Interest expense increased to \$4,046 from \$3,202 for the three months ended March 31, 2003 and 2002, respectively. Interest expense is primarily related to capitalized lease financing on computer hardware, software, and furniture.

LIQUIDITY AND CAPITAL RESOURCES

During the first quarter of 2003, the Company primarily funded its activities through operations and lease financing. At March 31, 2003, we had approximately \$586,000 in cash and cash equivalents.

	Three months ended	
	March 31,	
	2003	2002
Net cash provided by (used in)		
Operating activities	\$ 315,310	\$ 193,038
Investing activities	(122,906)	(150,487)
Financing activities	(10,716)	(23,603)
Net increase	<u>\$ 181,688</u>	<u>\$ 18,948</u>

Operating Activities

During the first quarter of 2003, operating activities provided net cash of \$315,310 compared to \$193,038 for the same quarter in 2002. The net cash provided by operating activities for 2003 was primarily attributable to (i) revenue growth, primarily from our mortgage broker customers, (ii) improved bad debt experience, and (iii) a reduction in legal fees. The increase was offset by additional

(i) database support costs related to increased wholesale and correspondent loan programs, (ii) telecommunications infrastructure costs to support new services and increased volumes through the Company's consumer and business web portals, (iii) resources to support the development of broker websites and (iv) growth in the commissioned broker sales force and related customer support costs.

The net cash provided in operating activities for the first quarter of 2002 was primarily attributable to (i) revenue growth, primarily from our mortgage broker customers, (ii) improved bad debt experience, (iii) and a reduction in occupancy costs and other related costs due to moving the company headquarters to a smaller, more efficient location in Seattle, Washington. This was offset by additional legal expenses during the quarter.

Investing Activities

During the first quarter of 2003, we used net cash of \$122,906 for our investing activities which was primarily for (i) the capitalized portion of software development costs related to the enhancement of core online services for brokers and the conversion of consumer traffic into higher-value lead generation and (ii) upgrades to computer hardware and software.

During the first quarter of 2002, we used net cash of \$150,487 for our investing activities which was primarily for (i) the capitalized portion of software development costs related to the Company's three initiatives; enhancement of core online services for brokers, the conversion of consumer traffic into high-value business generation, and new online management tools for lenders and (ii) upgrades to hardware and software for the data center that delivers the Company's products and services.

Financing Activities

During the first quarter of 2003, the net use of cash for financing activities was \$10,716. Cash used was primarily related to notes payable and capitalized lease obligations on the acquisition of application and database software, computers, servers, furniture and telecommunications systems upgrades.

During the first quarter of 2002, the net use of cash for financing activities was \$23,603. Cash used was primarily related to notes payable and capitalized lease obligations on the acquisition of application and database software for the Company's data center.

2003 plans

The Company is continuing to implement its business plan which includes enhancing core products and services through internal research and development projects and strategic alliances with companies providing "best of breed" products and services. In addition, the Company is in the process of moving to a blend of its existing subscription based business model combined with a performance/transaction based model which will allow the Company to take advantage of cyclical swings in mortgage loan volumes. See additional comments under the heading "PRODUCTS AND SERVICES INITIATIVES FOR 2003" in Item 2 above.

To ensure operational success of our plans for 2003, the Company expects to make greater investments in marketing, personnel, and professional services. It is management's belief that working capital from operations will be adequate to fund the Company's initiatives, integrate with its strategic alliance partners, and enhance core business.

During 2002 and again during the first quarter of 2003, we were able to fund our initiatives from operations. Management anticipates positive cash flow from operations and profitability during the remainder of 2003.

Critical Accounting Policies and Estimates

LION's financial statements and accompanying notes are prepared in accordance with U.S. GAAP. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Critical accounting policies for LION include revenue recognition, goodwill, accounting for internally-developed software, accounting for research and development costs, and accounting for income taxes.

Revenue recognition

Subscription and service fees are recognized as revenue over the respective subscription periods or at the time the services are provided. Deferred revenue is recorded on prepaid subscriptions for periods ranging from 3 to 12 months and on advance billings for the subsequent months' subscriptions and services provided. Large web development contracts expected to span greater than 30 days are recognized over the production period, which approximates the percentage of completion method of revenue recognition.

Goodwill

LION accounts for goodwill in accordance with SFAS 142, *Goodwill and Other Intangible Assets*, which requires that goodwill be tested for impairment at the reporting unit level on an annual basis and between annual tests in certain circumstances. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.

Accounting for internally developed software and research and development

LION accounts for research and development costs in accordance with several accounting pronouncements, including SFAS 2, *Accounting for Research and Development Costs*, and SFAS 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*. SFAS 86 specifies that costs incurred internally in creating a computer software product should be charged to expense when incurred as research and development until technological feasibility has been established for the product. Once technological feasibility is established, all software costs should be capitalized until the product is available for internal use by the Company. Judgment is required in determining when the technological feasibility of a product is established. The Company expenses all research and development costs when incurred.

Income taxes

SFAS 109, *Accounting for Income Taxes*, establishes financial accounting and reporting standards for the effect of income taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could materially impact the Company's financial position or its results of operations.

New accounting pronouncements

In December 2002, the FASB issued Statement of Financial Accounting Standards 148, "Accounting for Stock-Based Compensation Transition and Disclosure," ("SFAS 148"). This statement amends Statement of Financial Accounting Standards 123 ("SFAS 123"), "Accounting for Stock-Based Compensation," and establishes three alternative methods of transition from the intrinsic value method to the fair value method of accounting for stock-based employee compensation. In addition, SFAS 148 requires prominent disclosure about the effects on reported net income and requires disclosure of these effects in interim financial reporting. See "NOTE 3" to the financial statements regarding the Company's adoption of the fair value recognition provision of SFAS 123 pursuant to SFAS 148.

RISK FACTORS

Set forth below and elsewhere in this Quarterly Report and in the other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this Quarterly Report. You should carefully consider the risks before you decide to buy shares of our common stock. If any of the following risks actually occur, our business, results of operations or financial condition would likely suffer. In such case, the trading price of our common stock could decline, and you may lose all or part of the money you paid to buy our stock.

We have no history of sustained profits and our future profitability remains uncertain. In addition, financial results for any particular period will not predict results for future periods.

We are working toward a goal of revenue growth and sustained profitability. Annual revenues increased to \$6,410,000 from \$6,011,000 for 2002 and 2001, respectively. Revenues for the first quarter of 2003 were \$1,787,000 and appear on track to exceed the 2002 results. While we did achieve profitability for 2001 totaling \$42,000, we sustained a loss in 2002 totaling \$109,000. The Company has once again achieved profitability during the first quarter of 2003 totaling \$156,000.

We currently anticipate that 2003 will be a profitable year, however, our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in new and rapidly evolving markets, including uncertainty of revenues, markets, profitability and the need to raise capital to fund our ongoing operations. We cannot assure you that we will be successful in addressing these risks or that we can be operated profitably, which depends on many factors, including the success of our marketing program, the control of expense levels and the success of our business

activities. Our future operating results will depend on a variety of factors, including those discussed in the other risk factors set forth below.

We will need additional financing; our current funds are insufficient to finance our plans for growth and our operations at the desired rapid pace.

Our existing working capital is not sufficient to allow us to execute our business plan as fast as we would like. We are planning to fund internally the development and implementation of our initiatives and the integration of our strategic alliances through funds generated from Company operations.

While the Company did grow its cash reserves during the first and second quarters of 2002, we had to pay out \$340,000 in early July 2002 related to a judgment on a lawsuit. During the fourth quarter of 2002 and again in the first quarter of 2003, we were able to increase our cash reserves while continuing to fund our initiatives and integration with strategic alliances. We will continue to grow our cash reserves and fund the development and implementation of our plans through operations, but additional resources are needed to grow at our desired pace. If we are unable to obtain adequate capital financing through equity or other financings, we may not be able to successfully implement our short-term or long-term plans for expansion or to meet our working capital requirements. However, even if we succeed in our business plans, we may experience rapid growth requiring additional funds to expand our operations and organization.

We do not have current commitments for financing sufficient to fund our expansion and marketing plans at our desired pace. In order to provide adequate working capital, we intend to explore a number of options to secure financing. We might not succeed, however, in raising equity capital or in negotiating and obtaining additional and acceptable financing when we need it. Our ability to obtain additional capital may depend on market conditions (including the market for Internet stocks), national and global economies and other factors beyond our control. If adequate capital were not available or were not available on acceptable terms at a time when we needed it, our ability to execute our business plans, develop or enhance our services or respond to competitive pressures would be significantly impaired.

We are substantially dependent on mortgage brokers and the mortgage broker industry.

LION's most critical customer continues to be the mortgage broker. Mortgage broker fees comprised of memberships, website services, lead generation and ad banners were 85% of our total revenues during the first quarter of 2003. Customer agreements are short-term and renewable. There can be no assurance that these subscribers will continue to participate in the LION marketplace, or that we will be able to attract new mortgage brokers at rates sufficient to maintain a stable or growing revenue base. We cannot assure you that the market for our products and services will continue to develop as expected. If the mortgage broker market develops more slowly than expected or becomes saturated with competitors, or if our products and services do not continue to achieve market acceptance, our business operating results and financial condition may be materially adversely affected.

During the last 15 years, the mortgage brokerage industry has grown from infancy to capturing a significant portion of the mortgage origination market, and the current trend shows continued gains. While there are no clear threats that would cause one to conclude today that the industry will not continue to thrive, the health of the industry is important to LION's future, and there are potential

risks. These include potential lawsuits over broker and wholesale lender compensation systems, increased regulation that may add costs or limit profitability, and possible changes in how consumers obtain mortgages, possibly driven by technology or by efforts to standardize and automate the mortgage process. In addition, the overall volume of business is directly related to interest rates and overall economic conditions. Recessionary economic conditions or a rise in interest rates may adversely affect the ability of prospective consumers to obtain financing required for construction and refinance. Any of these may reduce the overall share of the market handled by mortgage brokers, which could materially adversely affect our business.

We are largely dependent on key personnel who may not continue to work for us.

We are substantially dependent on the continued services of our key personnel, including our officers, engineers and other significant employees. These individuals have acquired specialized knowledge and skills with respect to LION and its operations. With respect to our proprietary software, while backup has been provided by the other full-time company engineers, currently there are portions of the database management and development that rely solely on Sam Ringer who is a co-author of the LION Pro software. We are continuing to create the engineering redundancy that will reduce the reliance on this individual, but have not completed this task and will not for some time. Furthermore, we have not entered into employment agreements with these significant employees except for our CEO/President, CFO and COO. If any of these individuals were to leave LION unexpectedly, we could face substantial difficulty in hiring qualified successors and could experience a loss in productivity while any such successor obtains the necessary training and experience. We provide stock options, which currently serve to retain and motivate key employees as they become vested in their initial stock option grants. While management personnel are typically granted additional stock options, which will usually vest over a period of four years, subsequent to their hire date to provide additional incentive to remain at LION, the initial option grant is typically the largest and an employee may be more likely to leave our employ upon completion of the vesting period for the initial option grant. We expect that we will need to attract, train, retain and motivate additional technical, managerial, marketing and customer support personnel. Competition for these personnel may be intense, particularly for individuals with suitable experience. We face the risk that if we are unable to attract and integrate new personnel, or retain and motivate existing personnel, our business will be adversely affected.

Our operations may be vulnerable to disruption problems.

We have in place comprehensive data tape backup procedures for our operational and administrative databases. Our replication software provides a high level of hardware backup for the database by duplicating our database across several powerful servers. However, despite protective measures, our operations could be vulnerable to damage from floods, fire, earthquakes, power loss, telecommunications failures, break-ins, terrorism, and similar events. In addition, the majority of our network infrastructure is located in Seattle, Washington, in a co-location site north of the city and at our corporate headquarters, an area susceptible to earthquakes. The prospect of such unscheduled interruptions is quite possible in the foreseeable future, and we are unable to predict their occurrence, duration or cessation. We do not have multiple site capacity for all of our services in the event of any such occurrence.

Despite the implementation of security measures, our systems may be vulnerable to unauthorized access, computer viruses and other disruptive problems. We could experience interruptions in service as a result of the accidental or intentional actions of Internet users, current and

former employees or others. Unauthorized access might lead to interruptions, delays or cessation in service to subscribers or deter potential subscribers. Although we intend to constantly update industry-standard security measures, these measures have been circumvented in the past, and there can be no assurance that measures we adopt will not be circumvented in the future. We do not carry sufficient business interruption insurance to compensate us for losses that may occur as a result of any of these events. Eliminating computer viruses and alleviating other security problems may require interruptions, delays or cessation of service to our subscribers, which could have a materially adverse affect on our business, operating results and financial condition.

Our stock trades on the OTC Bulletin Board. Our stock price has been volatile historically, which may make it more difficult for you to resell shares when you want at prices you find attractive.

The trading price of our common stock has been and may continue to be subject to wide fluctuations. During 2002, the closing sale prices of our common stock on the OTC Bulletin Board ranged from \$.03 to \$.10 per share and the sale price of our common stock closed at \$.065 per share on May 6, 2003. Our stock price may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products by us or our competitors, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable, and news reports relating to trends in our markets. In addition, the stock market in general, and the market prices for Internet-related companies in particular, have experienced extreme volatility that often has been unrelated to the operating performance of these companies. These broad market and industry fluctuations may adversely affect the price of our stock, regardless of our operating performance.

The OTC Bulletin Board is an electronic quotation medium used by subscribing broker dealers to reflect dealer quotations on a real-time basis. This over-the-counter market provides significantly less liquidity than the NASDAQ Stock Market. Quotes for stocks included on the OTC Bulletin Board are not listed in the financial sections of newspapers as are those for The NASDAQ Stock Market. Shares that are thinly traded on the Bulletin Board often trade only infrequently and experience a significant spread between the market maker's bid and asked prices. Therefore, prices for securities traded solely on the OTC Bulletin Board may be difficult to obtain and holders of common stock may be unable to resell their securities at or near their original offering price or at any price. Furthermore, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain key employees, all of whom have been granted stock options. In the event our securities are not included on the OTC Bulletin Board and do not qualify for the NASDAQ, quotes for the securities may be included in the electronic "pink sheets" for the over-the-counter market.

Volume of shares eligible for sale could impair our stock price and hinder future financing efforts.

As of December 31, 2002, a substantial majority of the 31,441,978 outstanding shares of common stock and 1,500,000 shares of convertible preferred stock held by existing shareholders were issued and sold by the Company in private transactions in reliance on exemptions from the registration provisions of the Securities Act and are restricted securities within the meaning of Rule 144 under the Securities Act. Of the outstanding shares, including shares held by affiliates, 32,401,978 or 98% were issued on or before December 31, 2001, and may be currently eligible for resale in the open market, if any, subject to the volume and other conditions of Rule 144. There are no contractual restrictions on the resale of the outstanding common stock. The sale in the public market of these shares of restricted

common stock, or the perception that these sales may occur, may depress prevailing market prices of the common stock.

Outstanding options and warrants, when exercised, will further dilute common shareholders.

As of December 31, 2002, there were outstanding stock options to purchase an aggregate of 5,803,900 shares of common stock at exercise prices ranging from \$.05 to \$2.00 per share, and warrants to purchase 1,471,667 shares of common stock at exercise prices ranging from \$.40 to \$.78 per share. Employee options are subject to a restriction whereby option holders have agreed to not sell or otherwise transfer or dispose of shares of the common stock issued upon exercise of options in an amount which shall exceed 250,000 shares during any three-month period. The exercise of these outstanding options and warrants will dilute the percentage ownership of common stockholders, and any sales in the public market of shares of common stock underlying such securities may adversely affect prevailing market prices for the common stock. Furthermore, the terms upon which we will be able to obtain additional equity capital may be adversely affected since the holders of these outstanding securities can be expected to exercise their respective rights therein at a time when we would, in all likelihood, be able to obtain any needed capital on terms more favorable to the Company than those provided in such securities.

ITEM 3. CONTROLS AND PROCEDURES

Within 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC reports. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

In addition, there have been no significant changes in our internal controls or in other factors that could significantly affect those controls subsequent to the date of their last evaluation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company has initiated a lawsuit against its insurance carrier, Great American Insurance Company, seeking reimbursement of defense costs and payments made by way of settlement related to the action initiated against the Company by a former director on December 21, 2000. The lawsuit has been filed in Superior Court of Washington For King County, Case No. 02-2-34891-2SEA, (*LION, Inc., a Washington corporation (f/k/a Plenum Communications, Inc., a Minnesota corporation); and Allen Ringer and Jane Doe Ringer, individually and as a marital community vs. Great American Insurance Co., an Ohio corporation*). The Company is seeking for judgment against Great American in the amount of \$392,820 for costs of defense; for the amount of \$340,000 for the indemnity payment to the former director, for an amount no less than \$57,600 for prejudgment interest on amounts paid, and for all of the Company's attorney's fees and costs. The Company is further seeking an award of

damages under the Washington Consumer Protection Act and an award of consequential damages incurred and sustained by LION as a result of the alleged bad faith conduct of Great American. The action was commenced on April 1, 2003, by service on the Insurance Commissioner of the State of Washington as agent for the defendant.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the first quarter of 2003, common stock totaling 162,000 shares at prices ranging from \$.055 to \$.072 per share totaling \$9,658 were issued to two employees in lieu of cash for deferred compensation. The recipients were accredited, had access to all material information concerning the Company, and acquired the securities for investment. Appropriate legends were affixed to the certificates issued in the transactions. The issuances were deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act as transactions by an issuer not involving any public offering.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits to Part II:

99.1 Certification by Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes – Oxley Act of 2002

(b) Reports on Form 8-K

There were no reports on Form 8-K filed during the quarter ended March 31, 2003, however, a report on Form 8-K was filed on May 1, 2003, in which a press release announcing LION's preliminary financial results for the first quarter ended March 31, 2003 was furnished.

SIGNATURES

In accordance with Section 12 of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LION, Inc.
(Registrant)

Date: May 15, 2003

By: /s/ David Stedman
David Stedman
President and
Chief Executive Officer

CERTIFICATION

I, David Stedman, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of LION, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, is made known to us by others within the organization, particularly during the period in which this quarterly report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/s/ David Stedman
David Stedman
President and
Chief Executive Officer

CERTIFICATION

I, Steve Thomson, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of LION, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, is made known to us by others within the organization, particularly during the period in which this quarterly report is being prepared;
 - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

/s/ Steve Thomson
Steve Thomson
Chief Financial Officer

EXHIBIT INDEX

Exhibit No. Description

99.1 Certification by Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes – Oxley Act of 2002

EXHIBIT 99.1

**CERTIFICATION PURSUANT
TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

**by the
Chief Executive Officer and Chief Financial Officer***

In connection with the Quarterly Report of LION, Inc. (the “Registrant”) on Form 10-QSB for the period ended March 31, 2003 as filed with the Securities and Exchange Commission on May 15, 2003, hereof (the “Report”), each of David Stedman, Chief Executive Officer, and Steve Thomson, Chief Financial Officer, of LION, Inc., a Washington corporation (the “Company”), hereby certifies that:

- (1) Based on our knowledge, the Company’s periodic report on Form 10 – QSB for the period ended March 31, 2003 fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) Based on our knowledge, the information contained in the Form 10 – QSB fairly presents, in all material respects, the financial condition and results of operations of the Company.

CHIEF EXECUTIVE OFFICER

CHIEF FINANCIAL OFFICER

/s/ David Stedman
David Stedman

/s/ Steve Thomson
Steve Thomson

May 15, 2003

May 15, 2003

* A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002, has been provided to LION, Inc. and will be retained by LION, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.