# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

## FORM 10-QSB

(Mark One)

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

For the quarterly period ended June 30, 2007

☐ TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to _________

Commission file number 0-33037

# NBO SYSTEMS, INC.

| | |
|---|---|
| Maryland | 55-0795927 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

3676 W. California Ave. Bldg. D
Salt Lake City, Utah 84104
(Address of Principal Executive Offices)

(801) 746-8000
(Registrant's telephone number)

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

Yes ___X____ No _______

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

State the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date:

As of August 14, 2007, the number of shares outstanding of the issuer's only class of common stock was 48,350,447.

Transitional Small Business Disclosure Format (check one): Yes ________ No ___X_____

NBO SYSTEMS, INC.

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**Forward-looking Statements**

*This Report on Form 10-QSB, contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to expectations concerning matters that are not historical facts. Words such as "projects," "believes," "anticipates," "will," "estimate," "plans," "expects," "intends," and similar words and expressions are intended to identify forward-looking statements. Although we believe that such forward-looking statements are reasonable, we cannot assure you that such expectations will prove to be correct. Important language regarding factors which could cause actual results to differ materially from such expectations are disclosed in this Report, including without limitation under the caption "Risk Factors" beginning on page 12 of this Report. All forward-looking statements attributable to NBO Systems, Inc. are expressly qualified in their entirety by such language. We do not undertake any obligation to update any of the forward-looking statements.*

**PART I. FINANCIAL INFORMATION**

**ITEM 1. CONDENSED FINANCIAL STATEMENTS**

CONDENSED BALANCE SHEETS
(UNAUDITED)
ASSETS

| | June 30, 2007 | December 31, 2006 |
|---|---|---|
| CURRENT ASSETS | | |
| Cash | $ 133,762 | $ 941,562 |
| Restricted cash | 5,760,624 | 15,210,598 |
| Accounts receivable, net of allowance for doubtful accounts of $7,000 at each of June 30, 2007 and December 31, 2006 | 171,417 | 767,738 |
| Inventory | 31,014 | 53,284 |
| Prepaid expenses | 585,959 | 566,573 |
| Employee advances | 9,973 | 903 |
| Total current assets | 6,692,749 | 17,540,658 |
| PROPERTY AND EQUIPMENT, NET | 265,615 | 305,937 |
| OTHER ASSETS | | |
| Deposits and reserves | 44,928 | 47,575 |
| Other assets | 280,818 | 362,711 |
| | 325,746 | 410,286 |
| | $ 7,284,110 | $ 18,256,881 |

LIABILITIES AND STOCKHOLDERS' DEFICIT

| | June 30, 2007 | December 31, 2006 |
|---|---|---|
| CURRENT LIABILITIES | | |
| Gift certificates/cards payable | $ 5,850,914 | $ 14,540,980 |
| Accounts payable | 1,248,878 | 5,108,409 |
| Accrued liabilities | 558,877 | 1,034,935 |
| Accrued interest | 3,293,080 | 1,924,937 |
| Secured note | 3,262,338 | - |
| Notes to stockholders | 7,744,895 | 8,286,683 |
| Notes to officer | 464,139 | 564,289 |
| Current maturities of secured long-term note | 480,874 | - |
| Total current liabilities | 22,903,995 | 31,460,233 |
| LONG-TERM LIABILITIES | | |
| Secured long-term note, less current maturities | 431,187 | - |
| Total liabilities | 23,335,182 | 31,460,233 |
| COMMITMENTS AND CONTINGENCIES (NOTES K and M) | | |
| STOCKHOLDERS' DEFICIT | | |
| Capital stock | | |
| Convertible redeemable preferred stock, par value $1.00; authorized 1,000,000 shares; 86,724 shares issued and outstanding; redemption value $190,793 | 86,724 | 86,724 |
| Common stock, par value $0.0005; authorized 50,000,000 shares; 18,669,916 and 18,390,750 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively | 9,335 | 9,195 |
| Deferred financing costs | (2,500) | (7,500) |
| Additional paid-in capital | 33,220,675 | 32,848,989 |
| Accumulated deficit | (49,365,306) | (46,140,760) |
| Total stockholders' deficit | (16,051,072) | (13,203,352) |
| | $ 7,284,110 | $ 18,256,881 |

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

NBO SYSTEMS, INC.

CONDENSED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Revenues | $ 1,821,682 | $ 2,085,451 | $ 3,631,323 | $ 3,857,434 |
| Other income | 45,687 | 69,470 | 62,497 | 65,955 |
| Total revenues and other income | 1,867,369 | 2,154,921 | 3,693,820 | 3,923,389 |
| Operating expenses | | | | |
| Cost of revenues and other income | 1,560,079 | 1,814,012 | 2,848,611 | 3,217,033 |
| Selling, general and administrative expenses | 1,170,944 | 1,146,870 | 2,367,836 | 2,382,439 |
| Total operating expenses | 2,731,023 | 2,960,882 | 5,216,447 | 5,599,472 |
| Operating loss | (863,654) | (805,961) | (1,522,627) | (1,676,083) |
| Interest expense | (890,259) | (910,365) | (1,720,547) | (1,517,039) |
| Other income | 1,730 | 9,181 | 12,836 | 8,215 |
| Loss before income tax provision | (1,752,183) | (1,707,145) | (3,230,338) | (3,184,907) |
| Income tax provision | - | (1,635) | (3,794) | (4,698) |
| Net Loss | $(1,752,183) | $(1,708,780) | $(3,234,132) | $(3,189,605) |
| Deemed dividends on warrants | - | - | (7,082) | - |
| Net Loss Attributable to Common Stockholders | $(1,752,183) | $(1,708,780) | $(3,241,214) | $(3,189,605) |
| Net loss per common share – basic and diluted | $ (0.09) | $ (0.09) | $ (0.18) | $ (0.18) |
| Weighted-average number of common shares outstanding – basic and diluted | 18,670,000 | 18,194,000 | 18,513,000 | 18,193,000 |

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

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NBO SYSTEMS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Six months ended June 30, 2007 | Six months ended June 30, 2006 |
|---|---|---|
| Increase (decrease) in cash | | |
| Cash flows from operating activities: | | |
| Net loss | $ (3,234,132) | $ (3,189,605) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 59,558 | 66,657 |
| Loss (income) on disposal of other assets and property and equipment | (263) | 13,145 |
| Common stock options and warrants issued for services and compensation | 309,909 | 284,725 |
| Common stock warrants issued for payment of interest | 12,128 | 22,882 |
| Common stock issued for services | - | 30,778 |
| Amortization of debt discount and deferred financing costs | 10,000 | 675,937 |
| Provision for losses on accounts receivable | 30 | 7,247 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 596,291 | 87,739 |
| Employee advances | (9,070) | 3,827 |
| Inventory | 22,270 | (26,979) |
| Prepaid expenses and other assets | 62,640 | 257,844 |
| Accounts payable | (595,827) | (2,174,706) |
| Accrued liabilities | 964,273 | 208,226 |
| Total adjustments | 1,431,939 | (542,678) |
| Net cash used in operating activities | (1,802,193) | (3,732,283) |
| Cash flows used in investing activities: | | |
| Purchase of property, equipment and other assets | (16,459) | (22,315) |
| Net cash used in investing activities | (16,459) | (22,315) |
| Cash flows provided by financing activities: | | |
| Increase in checks written in excess of cash in the bank | - | 53,545 |
| Increase in advances on restricted cash | 759,908 | 286,354 |
| Common stock redeemed | (50,000) | - |
| Proceeds from issuance of notes to officer | - | 42,000 |
| Principal payments on notes to officer | (62,963) | (15,918) |
| Proceeds from issuance of notes to stockholders | - | 1,475,000 |
| Principal payments on notes to stockholders | (546,788) | (125,000) |
| Proceeds from issuance of secured notes | 1,000,000 | - |
| Principal payments on secured notes | (89,305) | - |
| Net cash provided by financing activities | 1,010,852 | 1,715,981 |
| Net decrease in cash | (807,800) | (2,038,617) |
| Cash at beginning of period | 941,562 | 2,038,617 |
| Cash at end of period | $ 133,762 | $ - |
| Supplemental disclosures of cash flow information | | |
| Cash paid during the period for interest | $ 330,277 | $ 412,787 |
| Cash paid during the period for income taxes | 3,794 | 4,698 |
| Non-cash investing and financing activities | | |
| Transfers of property and equipment to other assets | $ (1,750) | $ (3,809) |
| Transfers of other assets to property and equipment | 4,543 | 3,907 |
| Proceeds from debt allocated to debt discount | - | 17,000 |
| Deferred financing costs from refinance of convertible debt | - | 472,010 |
| Rescind preferential dividend paid in common stock | (16,668) | - |
| Deemed dividends on warrants | 7,082 | - |
| Exercise of stock options paid through reductions of $37,187 in notes to officer, $188 of accrued interest and $72,000 of accrued liabilities for paid time off (net of tax) | (109,375) | - |
| Secured note issued to repay accounts payable | (3,263,704) | - |

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

## NOTE A - BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements of NBO Systems, Inc. ("NBO" or the "Company") were prepared in accordance with U.S. generally accepted accounting principles ("US GAAP") for interim financial information and with the instructions for Form 10-QSB. Accordingly, these financial statements do not include all of the information and note disclosures required by US GAAP for complete financial statements. These financial statements and note disclosures should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2006, included in the Company's Form 10-KSB. In the opinion of management, the accompanying unaudited condensed financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary to fairly present the Company's financial position as of June 30, 2007, its results of operations for the three- and six-months ended June 30, 2007 and 2006, and its cash flows for the six months ended June 30, 2007 and 2006. The results of operations for the three- and six-months ended June 30, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007, or any other period.

## NOTE B – GOING CONCERN

The Company has incurred net losses since inception, negative cash flows from operating activities and is in default on notes to stockholders. During the six months ended June 30, 2007, the Company had negative cash flows of $1,802,193 from operating activities. On June 30, 2007, the Company had a deficit in working capital of $16,211,246 and an accumulated deficit of $49,365,306. These conditions, among others, raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to meet its obligations as they come due is dependent upon its ability to obtain additional financing as required, and ultimately to achieve and sustain profitability.

The Company is continuing its efforts to raise capital through private equity or debt offerings, as well as from institutional investors, to fund its operations until internally generated profitability is achieved. The Company may attempt to establish a line of credit with a financial institution or raise bridge financing until a liquidity event can be achieved. The Company is currently restructuring its capital to eliminate up to $11.75 million of debt as described in the preliminary proxy filed with the Securities and Exchange Commission on July 24, 2007, Schedule 13E-3 filed with the Securities and Exchange Commission on July 24, 2007 and Form 8-K filed with the Securities and Exchange Commission on July 31, 2007. The Company is taking steps to improve profitability by restructuring contracts to increase the amount of revenue generated by each contract, and to minimize costs on existing contracts.

There can be no assurance that the Company will be successful in executing its plans to improve operations or obtain additional debt or equity financing. Based on the Company's inability to obtain additional debt and equity financing, the Company is restructuring its capital and operations as referenced in the documents above. However, there can be no assurance that the Company will be able to achieve its plan or to continue operating without additional financing. The Company has considered selling some or all of its assets, or merging with or being acquired by another entity to eliminate any remaining debt and provide working capital.

## NOTE C – RESTRICTED CASH

Restricted cash consists of funds held for the payment of obligations associated with issued and outstanding gift certificates and gift cards to customers. These funds are maintained at several financial institutions in demand deposit accounts and associated sweep accounts held by NBO. The Federal Deposit Insurance Corporation insures balances amounting to $100,000 cumulatively, per institution. Uninsured balances aggregate to approximately $94,000 as of June 30, 2007. Withdrawals of the funds are restricted to the payment to merchants in connection with the use of issued and outstanding gift certificates and gift cards. Restricted funds for gift cards are transferred to operating accounts at the time fees are charged to the cards or when the cards expire. For gift certificates, restricted funds may be transferred to operating accounts based on estimated breakage. Gift certificate and gift card breakage is determined based on (1) expiration, (2) legal statute of limitation, or (3) the accumulation of sufficient historical breakage data upon which to make reliable estimates. Breakage by expiration or legal statute of limitation is recorded as income, and a corresponding amount is removed from gift certificates and gift cards payable. The same amount is removed from restricted cash and recorded as unrestricted cash. Estimated unused gift certificates and gift cards ("estimated breakage") is based on Company historical breakage data and is not recorded as income until the expiration date or the legal statute of limitation passes. However, the Company may transfer cash equal to all or a portion of estimated breakage from restricted cash accounts to the Company's general operating accounts, upon issuance of the gift certificate. Any estimated breakage amount transferred to unrestricted cash decreases the restricted cash balance but remains in gift certificates payable, until such estimated breakage becomes actual breakage and is recognized as income. At such time, the amount of the obligation associated with gift certificates payable is reduced by a corresponding amount.

## NOTE D – INVENTORY

Inventory consists of gift certificates and gift cards purchased from third-party retailers. Darden gift cards are pledged as collateral against the note due and outstanding. Gift certificates and gift cards are recorded at cost (specific identification method).

## NOTE E - NOTES TO STOCKHOLDERS

| | June 30, 2007 | December 31, 2006 |
|---|---|---|
| Unsecured note to stockholder in default as of June 30, 2007. This note was converted to Series B Preferred Stock on July 20, 2007. | $ 3,750,000 | $ 3,750,000 |
| Unsecured note to stockholder in default as of June 30, 2007. This note was converted to Series B Preferred Stock on July 20, 2007. | 1,000,000 | 1,000,000 |
| Unsecured note to stockholder in default as of June 30, 2007. This note was converted to Series B Preferred Stock on July 20, 2007. | 800,000 | 800,000 |
| Unsecured note to stockholder in default as of June 30, 2007. This note was converted to Series B Preferred Stock on July 20, 2007. | 800,000 | 800,000 |
| Secured note to stockholder with interest at 15%, due October 18, 2007. This note was converted to Series B Preferred Stock on July 20, 2007. | 375,000 | 375,000 |
| Secured note to stockholder with interest at 15%, due October 18, 2007. This note was converted to Series B Preferred Stock on July 20, 2007. | 375,000 | 375,000 |
| Unsecured note to stockholder in default as of June 30, 2007. This note was converted to Series B Preferred Stock on July 20, 2007. | 250,000 | 250,000 |
| Unsecured notes to stockholders, with interest at 20%, in default, due on demand. | 147,329 | 147,329 |
| Unsecured note to stockholder in default as of June 30, 2007. This note was converted to Series B Preferred Stock on July 20, 2007. | 100,000 | 100,000 |
| Unsecured note to stockholder, with interest at 20%, in default, interest payments of $4,500 due every 90 days, convertible into common stock at $4.00 per share at option of holder. | 100,000 | 100,000 |
| Unsecured note to stockholder, with interest at 25%, in default. At time of execution of note, 7,500 warrants were issued at an exercise price of $3.00. | 50,065 | 50,065 |
| Unsecured note to stockholder. Paid in full on May 14, 2007. | - | 317,939 |
| Unsecured note to stockholder. Paid in full in February 26, 2007 | - | 218,850 |
| Unsecured note to stockholder. Paid in full on February 27, 2007 | - | 10,000 |
| Discount on notes payable | (2,499) | (7,500) |
| Total | $ 7,744,895 | $ 8,286,683 |

## NOTE F – SECURED NOTE

During the six-month period ended June 30, 2007, the Company defaulted on accounts payable due to GMRI for fulfillment services for GMRI's gift cards. GMRI extended credit to the Company at an annual rate of 10%. The secured note totals $3,263,338 as of June 30, 2007 and is due as fee income from MetaBank is payable to the Company, after the Company's secured long-term note to MetaBank is retired.

## NOTE G – SECURED LONG-TERM NOTE

During the six-month period ended June 30, 2007, the Company borrowed $1,000,000 from MetaBank of Sioux Falls, South Dakota, the primary issuer of the Company's gift cards. This loan is secured by certain future revenue streams to NBO from fees assessed to gift cards in the form of monthly maintenance fees and breakage when the gift cards expire. The term of the loan is 24 months and bears interest at an annual rate of 9.75%. Until this loan is retired, fees due to the Company from MetaBank will first be applied to the outstanding principal and interest balance.

NOTE G – SECURED LONG-TERM NOTE - CONTINUED

| | June 30, 2007 |
|---|---|
| Secured note to MetaBank | $ 912,061 |
| Less current portion | (480,874) |
| Secured long-term note to MetaBank | $ 431,187 |

NOTE H – EQUITY

During the six-month period ended June 30, 2007, the Company:

- Recognized, in accordance with SFAS No. 123(R), $309,909 (includes $22,391 of re-priced options explained below) in employee and director compensation expense determined using the fair value based method. This expense was classified as general and administrative expense in the accompanying financial statements.
- Issued 312,500 shares of common stock to the Company's President upon exercise of 312,500 stock options at $0.35 per share, in payment of $188 of accrued interest, $37,187 of principal on notes payable to officer, and $72,000 of accrued liabilities for paid time off (net of tax).
- Amortized $5,000 of beneficial conversion costs. As of June 30, 2007, the remaining deferred beneficial conversion costs total $2,500.
- Issued 76,666 warrants to purchase common stock with an exercise price of $2.00 per share with an aggregate fair value of $12,128 as payment of interest in connection with note agreements. The note agreements call for the quarterly issuance of a specified number of warrants. The fair value of the warrants issued is recorded as interest expense.
- In connection with previously issued debt, reinstated, to an existing stockholder of the Company, warrants to purchase 39,063 shares of common stock that had previously expired unexercised. The warrants have an exercise price of $2.00 per share. The warrants were recorded at fair value as a deemed dividend of $7,082.
- Redeemed 25,000 shares of common stock from a stockholder for $50,000 in cash. In connection with this redemption, the Company rescinded 8,334 shares of common stock that were previously issued under the terms of a September 2005 offering agreement. Recognized rescinded preferential dividends paid in common stock of $16,668.
- Re-priced 57,500 options held by the Company's independent director to $2.00 per share. These options previously had an exercise price of $4.00 per share. The fair value of the re-priced options was $24,477, of which $22,391 was expensed for vested options and $2,086 will be expensed as the unvested options vest in accordance with the option terms.

NOTE I – STOCK BASED COMPENSATION

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment*, ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options and employee stock purchases related to the Employee Stock Purchase Plan ("ESPP") based on estimated fair values. In accordance with this standard, the Company recognizes the compensation cost of all share-based awards on a straight-line basis over the vesting period of the award. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123").

The Company adopted SFAS 123(R) using the modified prospective transition method. The Company's condensed financial statements for the six months ended June 30, 2007 and 2006 reflect the impact of SFAS 123(R). Under that transition method, compensation cost recognized in the first six months of 2007 and 2006 includes: (a) amortization related to the compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) amortization related to compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R).

As of June 30, 2007, unrecognized stock-based compensation expense expected to be recognized over an estimated weighted-average amortization period of 2.08 years, was $1,416,000.

The Company's weighted-average assumptions used in the Black-Scholes option-pricing model for equity awards with time-based vesting provisions granted during the six months ended June 30, 2007 and 2006 are shown below:

NOTE I – STOCK BASED COMPENSATION - CONTINUED

| | June 30, 2007 | June 30, 2006 |
|---|---|---|
| Expected dividend yield | - | - |
| Expected price volatility | 36.08% | 34.19% |
| Risk-free interest rate | 4.87% | 4.81% |
| Expected life of options (years) | 7.5 | 10.0 |

During the six months ended June 30, 2007, the Company issued nonqualified options to purchase 142,597 common shares to three current employees. The same quantity of options expired during the same six-month period, and had previously been issued to these employees as qualified options. Because these options will only vest if there is a change in control at the Company (which management believes is probable) they were valued using different assumptions, as follows:

| | June 30, 2007 |
|---|---|
| Expected dividend yield | - |
| Expected price volatility | 36.39% |
| Risk-free interest rate | 4.98% |
| Expected life of options (years) | 0.75 |

In the recent past, the Company has not had an adequate number of stock transactions to establish an expected volatility of the Company's stock to use in Black-Scholes calculations. Under these circumstances, SFAS 123(R) provides guidance to select comparable public companies and to use their historical volatility. The Company selected eight comparable companies to obtain volatility for Black-Scholes calculations. The Company believes that these eight companies were most similar to the Company as comparatives for determining the Company's volatility. The actual volatility data was weighted based upon how similar the descriptions of the products and services provided by the various companies were to the products and services provided by the Company.

The pre-vesting forfeiture rate used for the six months ended June 30, 2007 and 2006 was based on historical rates and forward-looking factors. As required under SFAS 123(R), the Company adjusts the estimated forfeiture rates periodically based on changes in employee turnover. Prior to adoption of SFAS 123(R), the Company accounted for forfeitures as they occurred.

A summary of the time-based stock option awards for the six months ended June 30, 2007, is as follows:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (years) |
|---|---|---|---|
| Outstanding at January 1, 2007 | 5,260,785 | $ 1.66 | |
| Granted | 217,597 | 0.85 | |
| Exercised | (312,500) | 0.35 | |
| Forfeited or expired | (246,222) | 1.53 | |
| Outstanding at June 30, 2007 | 4,919,660 | $ 1.69 | 2.08 |
| Exercisable at June 30, 2007 | 4,067,388 | $ 1.40 | 1.15 |

The weighted average fair value of options granted during the six months ended June 30, 2007 and 2006, is $0.85 and $2.28, respectively. Stock-based compensation expense related to stock options recognized under SFAS 123(R) for the six months ended June 30, 2007 and 2006 was $309,909 and $284,725, respectively.

NOTE J – NET LOSS PER COMMON SHARE

Basic net income (loss) per share (EPS) is calculated using income (loss) attributable to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted EPS is similar to Basic EPS except that the weighted-average number of common shares outstanding is increased using the treasury stock method to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Such potentially dilutive common shares include stock options and warrants granted or sold, convertible preferred stock and convertible debt. Shares having an anti-dilutive effect on periods presented are not included in the computation of dilutive EPS. As of June 30, 2007 and December 31, 2006, respectively, the Company had 8,596,716 and 8,897,113 potentially dilutive shares of common stock from the exercise of stock options and warrants, 406,520 and 369,550 potentially dilutive shares of common stock from the conversion of preferred stock and 4,810,946 and 3,815,075 potentially dilutive shares of common stock from the conversion of debt, respectively, not included in the computation of diluted net loss per common share because it would have decreased the net loss per common share. The shares of common stock issuable upon exercise of stock options and warrants and upon conversion of debt and preferred stock to common stock could be dilutive in the future.

NOTE K - COMMITMENTS AND CONTINGENCIES

The Company is not a party to any material threatened or pending legal proceedings, which if adversely determined, would have an adverse material effect on the Company's financial condition or results of operations. From time to time, however, the Company may become subject to legal proceedings, claims, and litigation arising in the ordinary course of business, including, but not limited to, creditor, employee, customer and vendor disputes. During the six months ended June 30, 2007, the Company entered into employment agreements with one executive officer and one senior manager, as well as letters of understanding (collectively, "Compensation Arrangements") regarding compensation with five other members of management. The Compensation Arrangements set forth certain benefits, some of which are triggered by a change of control event including, but not limited to base salaries, cash bonuses or payments based on a percentage of a change in control transaction value, stock option awards, reinstatement of certain stock options that had previously expired, option vesting upon a change in control of the Company, severance payments that range from three to nine months of salary, and provisions for up to one year of health insurance benefits under certain conditions. The Company has entered into a compensation agreement with a member of the board of directors, which provides for monthly cash compensation, re-pricing of all previously issued stock options to an exercise price of $2.00 per share, and the payment of a change of control bonus calculated as a percentage of the transaction value.

NOTE L – SIGNIFICANT CUSTOMER

One mall customer, Glimcher Properties, accounted for approximately 31% of the total gift card and gift certificate transaction volume in the six months ended June 30, 2007, representing approximately 14% of total revenue and other income. The Company's fulfillment operations for Darden products accounted for 20% of the total transaction volume in the six months ended June 30, 2007, representing approximately 59% of total revenue and other income. Sales with Darden ceased as of August 3, 2007. No other customers accounted for more than 10% of the Company's total transaction volume or total revenue and other income for the six months ended June 30, 2007 or 2006.

NOTE M – SUBSEQUENT EVENTS

The Company is a reporting company under the Securities and Exchange Act of 1934, as amended. The shares of common stock of the Company have never traded on any exchange, electronic trading network, over-the-counter, on the bulletin board, or in the pink sheets. The costs of compliance under the Securities Act of 1934, as amended, impose a significant financial burden on the Company and its stockholders. During the preceding 18 months, the executive officers and directors of the Company attempted to raise additional capital, enter into a business combination, and/or sell the Company or its assets. The Company engaged Houlihan Lokey Howard & Zukin to assist in fundraising activities as well as in finding a buyer for the Company, in addition to the efforts of the Company. All attempts to raise capital from institutional investors through equity or debt offerings, to enter into a business combination, or to sell the Company or its assets were unsuccessful. The Company has raised working capital in the form of debt issued to existing stockholders at interest rates that are unfavorable to the Company's cash flow. The Company is exhausting its cash resources. The Board of Directors of the Company determined that a restructuring of its capital structure is essential to the survival of the Company. The directors determined the value of the Company is substantially less than its outstanding indebtedness, and accordingly, that the outstanding shares of preferred stock and common stock of the Company have minimal value. The directors determined that it is in the best interests of the Company, its stockholders, and its debtholders (some of whom are also stockholders) to restructure the Company through the steps described below, rather than through a voluntary or involuntary bankruptcy proceeding, and that such restructuring includes the issuance of shares of common stock and shares of Series B Preferred Stock to the debtholders in order to reduce the outstanding debt of the Company. The directors further

NOTE M – SUBSEQUENT EVENTS - CONTINUED

determined it is in the best interests of the Company and its stockholders to recommend to the stockholders of the Company for their approval a restructuring to be effected through a reverse stock split of 250,000 shares of common stock for one share of common stock and to redeem any fractional shares for cash. As a result of such reverse stock split, the continuing holders of common shares would be fewer than the minimum number of stockholders required for continuing registration with the Securities and Exchange Commission. Accordingly, the Company would benefit from terminating its registration with the Securities and Exchange Commission by filing Form 15. The directors further determined that it is in the best interests of the Company and its stockholders to recommend to the stockholders of the Company a conversion of their Series A Preferred Stock into shares of common stock as part of the reverse stock split. With the proposed simplified capital structure, the Company will be in a better position to raise additional capital.

The directors have determined that the Company should use its best efforts to raise additional capital to fund the Company's business, and that the Company will be unable to raise additional capital unless the Company undertakes the restructuring as described above, reduces the interest payable to the debtholders and improves the working capital situation of the Company. Accordingly on July 12, 2007, the Company, by unanimous written consent of the Board of Directors of the Company:

- Acting pursuant to Article EIGHTH of the Articles of Incorporation, amended the Bylaws of the Company by adding language that allows the Company to issue shares of any class of its authorized stock to its stockholders or non-stockholders for the cancellation of all or some of the outstanding indebtedness owed by the Company to such stockholders or non-stockholders.
- Filed with the state of Maryland, pursuant to Article SIXTH of the Articles of Incorporation, as amended, Articles of Amendment of Articles of Incorporation for Series B Preferred Stock of the Company.
- Authorized the Company to offer and issue to one or more debtholders of the Company, shares of Series B Preferred Stock and shares of common stock in consideration for the cancellation of up to a total of $11,750,000 of indebtedness owed to them by the Company. For each $20.00 of indebtedness cancelled by a debt holder, the Company will issue one share of Series B Preferred Stock and 55 shares of common stock.
- Authorized the issuance of up to 125,000 shares of Series B Preferred Stock for consideration of $16.00 per share to accredited investors only.
- Authorized the Company to hold a stockholders meeting following completion of the review by the Securities and Exchange Commission of the Company's proxy statement to be submitted to stockholders in connection with the stockholders meeting. The purpose of the stockholders meeting will be to approve the amendment to the articles of incorporation as substantially set forth in the preliminary proxy and Schedule 13E-3 filed with the Securities and Exchange Commission on July 24, 2007.
- Authorized the Company, upon approval by the stockholders of the amendment to the articles of incorporation as substantially set forth in the proxy, to terminate its registration with the Securities and Exchange Commission by filing Form 15.

On July 20, 2007, the Company cancelled $10,792,922 in debt owed to the Company by stockholders and officers in exchange for the issuance of 539,643 shares of Series B Preferred Stock, par value $1.00, and the issuance of 29,680,531 shares of common stock, par value $0.0005. The Series B Preferred Stock converts to common stock at a ratio of 20 shares of common stock for each share of Series B Preferred Stock.

On July 20, 2007, the Company issued 4,500 shares of Series B Preferred Stock, par value $1.00, for a total of $45,000 to a stockholder who is also an accredited investor. The Series B Preferred Stock converts to common stock at a ratio of 20 shares of common stock for each share of Series B Preferred Stock.

On July 20, 2007, the Company entered into a demand note with Keith Guevara, the Company's Chairman, President and CEO for $75,000 to meet general operating capital needs. The note bears interest at an annual rate of 10%.

On August 1, 2007, the Company entered into a demand note with Keith Guevara, the Company's Chairman, President and CEO for $15,000 to meet general operating capital needs. The note bears interest at an annual rate of 10%.

On August 1, 2007, the Company entered into a secured promissory note with Christopher Foley, the Company's CFO, Director and Secretary & Treasurer for $30,000 to meet general operating capital needs. The note bears interest at an annual rate of 10% and is payable upon receipt of certain receivables from vendors anticipated on or about August 3, 2007. The note was retired in full on August 3, 2007.

The Company's fulfillment contract with GMRI ("Darden") has been extending on a month-to-month basis since February 2007. The Company anticipated a reduction in revenue as a result of a change in the contract structure with Darden. As of August 3, 2007, the Company is no longer fulfilling gift cards for Darden.

NBO SYSTEMS, INC.
**RISK FACTORS**

*Investing in our common stock and/or preferred stock involves a high degree of risk. Before purchasing our common stock, you should carefully consider the risks described below in addition to the other information in this Report. Our business prospects, results of operations, liquidity or financial position may be materially and adversely affected due to any of the following risks. The risks described below are not the only ones we face. Additional risks of which we are not presently aware or that we currently believe are immaterial may also impair our business prospects, results of operations, liquidity or financial position. The value of our common stock could decline due to any of these risks, and you could lose all or part of your investment. In assessing these risks, you should also refer to the other information contained or incorporated by reference in this Report, including our financial statements and related notes. This Report contains forward-looking statements based on management's current expectations, assumptions, estimates and projections about our industry and us. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements as a result of certain factors, as more fully described in this section and elsewhere in this Report. We do not undertake to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.*

**Our independent registered public accounting firm has issued a report emphasizing there is substantial doubt about our ability to continue as a going concern.**

Our independent registered public accounting firm has added an explanatory paragraph to its opinion on our financial statements as of December 31, 2006 and 2005, emphasizing there is substantial doubt about our ability to continue as a going concern. This opinion may be viewed unfavorably by the investment community. This explanatory paragraph provided by the independent registered public accounting firm may be a significant impediment to our ability to raise additional capital or seek financing from entities that will not conduct such transactions in the face of such increased level of risk of insolvency and loss, increased difficulty in attracting talent, and the diversion of the attention of our executive officers and other key employees to raising capital or financing rather than devoting time to the day-to-day operations of our business. We are behind in our payments to note holders and trade creditors. We have been unable to attract any additional equity capital in 2007 on terms that we find acceptable. We urge potential investors to review our financial statements and related notes contained in this Report, and to seek independent advice concerning the substantial risks related thereto before making a decision to invest in us.

**Since inception, we have incurred net losses and negative cash flows from operating activities.**

Since inception of operations in June 1994, we have incurred net losses and negative cash flows from operating activities. As of June 30, 2007, we have incurred cumulative losses of approximately $49.4 million. In recent years, we have been financing our operations, in part, through loans extended by existing stockholders, in exchange for which we have issued promissory notes providing for interest at annual rates of between 10 and 50 percent. These loans aggregate to approximately $7.74 million as of June 30, 2007. We need to raise additional funds to continue to operate our business. We may not be able to obtain such financing on terms favorable to us, if at all. Any additional capital raised through the sale of equity or convertible debt securities would dilute the ownership interests of our then-existing stockholders. Any additional capital raised through debt financing would result in increased interest expense and would likely subject us to financial and other covenants that restrict our ability to operate our business. If financing is unavailable when required or is not available upon acceptable terms, we may not be able to develop or enhance our products and services, marketing efforts or operational infrastructure, which may, in turn, prevent us from achieving profitability and/or continuing in business.

**If we are not successful in marketing our products and services, our results of operations will suffer.**

We have not expended what we consider optimal resources on marketing and advertising to date. We have not developed or tested any targeted, integrated, multi-media marketing program that would include print, radio, television or on-line components to build brand awareness and drive sales. Our future growth and profitability will depend in large part upon our ability to:

- create greater awareness of our products and services and the ways in which consumers and businesses may purchase them;
- identify the most effective and efficient level of spending for each product in each market;
- determine the appropriate creative message and media mix for marketing expenditures;
- effectively manage marketing costs (including creative and media) in order to maintain acceptable operating margins and return on marketing investment;
- select the right markets in which to market; and
- convert consumer awareness into actual store visits, on-line visits and product purchases.

If we are not successful in implementing our marketing program, our results of operations will be adversely affected. If we do not raise additional capital, we will not be able to implement these programs.

**At present, we have a limited number of customers. To continue in business and achieve profitability, we need to expand our customer base.**

There are a limited number of shopping mall properties in the United States that would likely have sufficient gift card and gift certificate volume for us to be able to establish profitable gift card/certificate programs at such properties. Our target market for gift card/certificate programs is further limited as a result of owners/operators of some of the largest malls in the United States developing their own gift card and/or gift certificate programs, as have many large retailers. Further, there has been a significant amount of consolidation in the shopping mall commercial real estate industry. The prospect of further consolidation creates the risk that we may lose some of our existing mall owner/operator customers.

We maintain a non-compete agreement with First Data Commercial Services ("FDCS"), limiting the customer base available for fulfillment contract services. At this time, we are unable to offer fulfillment services to direct FDCS clients or competitors.

**Existing and/or proposed federal and state laws and regulations regarding gift certificates, gift cards and other prepaid stored-value cards have limited (and may further limit) the manner in which we operate our gift, incentive and fund-raising card programs and our revenues.**

Existing and/or proposed federal and state laws and regulations have limited and may in the future further limit the manner in which we are able to operate our gift and incentive card programs. For example, a bill has been introduced in the U.S. Senate and referred to the Committee on Banking, Housing and Urban Affairs. This proposed legislation, referred to as the Fair Gift Card Act, would, if adopted, preclude us from being able to impose fees, such as the monthly maintenance fees we charge, for non-use or inactivity of gift certificates or gift cards, except in limited circumstances. Further, the proposed legislation would make it unlawful for gift certificates or gift cards to have an expiration date of less than five years from the date of purchase. Some states have already enacted legislation eliminating expiration dates or maintenance fees, and additional states may enact similar legislation in the future. In other states, the statute of limitations before a gift certificate expires is minimally three years from the date of issuance of the gift certificate. We cannot recognize revenue from unused gift certificates until the expiration date or the statute of limitations expires. Accordingly, if the statute of limitations is increased or expiration dates are eliminated then this would extend the time before we would be able to recognize revenue from unused gift certificates and gift cards, which would negatively affect our results of operations.

We currently recognize revenue from the funds underlying unused gift certificates and gift cards, known in our industry as "breakage." Through their unclaimed property laws (also known as abandoned property or escheat laws), some states seek to claim as abandoned property the funds associated with the obligation related to gift certificates and gift cards that remain unclaimed or unused for a legally specified amount of time. According to the leading U.S. Supreme Court case, Texas v. New Jersey, 379 U.S. 674 (1965), a state may escheat the unclaimed property held by a company if either (1) that company keeps records indicating that the addresses of the property owners are located in that state, or (2) the company does not keep such records, but is domiciled in that state. As a Maryland corporation, we are subject to Maryland's unclaimed property laws, which expressly exempt gift certificates from its abandoned property laws. We have relied on the ruling in Texas v. New Jersey and our Maryland domicile to determine that the breakage we hold is exempt from delivery to the states.

However, approximately 14 states have enacted unclaimed property laws that both provide for the escheat or the delivery of funds underlying the obligation related to gift certificates or gift cards and contain so-called "transactional jurisdiction" provisions. Such "transactional jurisdiction" provisions authorize a state to escheat unclaimed property that was initially sold or distributed within such state. The legal validity of "transactional jurisdiction" provisions is in question given the ruling in Texas v. New Jersey. One federal district court has held that transactional jurisdiction is invalid to the extent it conflicts with Texas v. New Jersey. However, the state courts in two states have upheld the validity of transactional jurisdiction. In future years, as the dormancy periods for the years in which the gift cards and gift certificates were issued expire, the potential escheatment amount might become material.

We face the risk that some of the states that have enacted "transactional jurisdiction" provisions will attempt to enforce such provisions and claim the funds associated with the unused gift certificates and gift cards that we hold. If such states are successful in applying such laws, our business prospects, results of operations, liquidity, and financial position would be adversely affected. Furthermore, some of the states which have not enacted "transactional jurisdiction" provisions might enact such provisions in the future. If additional states enact "transactional jurisdiction" provisions and the unclaimed property laws of such states provide for the delivery to the state of funds associated with unused gift certificates or gift cards, our business prospects, results of operations, liquidity, and financial position may further be adversely affected. The potential amount subject to delivery to the states that have transactional jurisdiction statutes that do not exempt gift cards and gift certificates at the end of our last fiscal year is not material.

On August 1, 2006, a federal judge ruled that New Hampshire could not impose state laws restricting gift-card fees on Simon Property Group's gift cards, because the bank-issued cards are governed by federal banking laws that supercede state laws. Simon's Gift Card is issued by U.S. Bank National Association, MetaBank and Bank of America, which collect and keep the fees.

Our programs are similar in nature to Simon's gift card programs and we operate under the same premises regarding collection of fees. We also use MetaBank as the issuing bank for our gift cards. We are continually reviewing legislation enacted from time to time by the various states and we attempt to monitor material instances of litigation affecting gift certificates and gift cards. We make a concerted effort to comply with the laws of the various states and to adapt our business practices from time to time in response to changes in the laws and the results of litigation.

**Since we do not have long-term agreements with our vendors and suppliers, we may not be able to secure adequate supplies, which could disrupt our operations and have an adverse affect on our business prospects, liquidity, financial position and results of operations.**

We purchase 100% of our materials used for our products and services from outside vendors. These vendors, in turn, contract for our orders with multiple factories for the production of our certificate and card stock. Our relationships with our vendors generally are on a purchase order basis and do not provide a contractual obligation to provide adequate supply, quality or acceptable pricing on a long-term basis. Our vendors could discontinue sourcing products for us at any time. If the vendors were to discontinue their relationship with us, or if the factories with which they contract were to suffer a disruption in their production, we may be unable to replace the vendors in a timely manner, which could result in short-term disruption to our inventory flow as we transition our orders to new vendors or factories. Disruption in inventory could, in turn, disrupt our operations and have an adverse effect on our business, financial condition and results of operations.

**Our field of business is highly competitive and our customers may choose services from our competitors.**

Our field of business contains numerous competitors, many of whom are larger and better capitalized than we are. MidAmerica Gift Certificate Company, owned by BB&T Corp., the nation's 10th largest full-service financial-holding company, directly competes with us and has the advantage of a well-capitalized corporate parent. We compete with large mall developers and owners who maintain their own in-house gift card programs. Numerous transactions have recently resulted in the consolidation of the ownership of numerous shopping malls, and we have lost customers when large mall owners acquired our customers and implemented their own in-house gift card programs. In addition, national retailers have implemented their own gift card programs, thus removing themselves from the universe of potential customers for us.

**Our success is highly dependent on general economic conditions since consumer gifts are highly discretionary.**

Our business is subject to changes in general economic conditions. Since purchases of our products and services are dependent upon discretionary spending by the users of our gift cards, our financial performance is sensitive to changes in overall economic conditions that affect consumer spending. Consumer spending habits are affected by, among other things, prevailing economic conditions, levels of employment, salaries and wage rates, consumer confidence and consumer perception of economic conditions. A general or perceived slowdown in the United States economy or uncertainty to the economic outlook could reduce discretionary spending or cause a shift in consumer discretionary spending to other products or services. Any of these factors would likely cause us to delay or slow our expansion plans, result in lower transaction volumes and revenues and adversely affect our liquidity and profitability. A nationwide economic downturn could adversely impact our busiest selling season and reduce the expected revenues and other income we expect to receive to fund our operations.

**The execution of our growth strategy depends on our ability to retain key personnel, including our executive officers, and to attract qualified personnel.**

The successful implementation of our business model and growth strategy depends on the continued contributions of our senior management and other key personnel, including Keith A. Guevara, our President and Chief Executive Officer. We carry $2,000,000 in key man life insurance on Mr. Guevara. We believe future success will also depend, in part, upon the ability to attract, retain and motivate qualified personnel. Christopher Foley, our Chief Financial Officer, has a three-year employment agreement with a term through December 31, 2009. Christopher McGee, our Senior Vice President of Sales and Marketing, has a three-year employment agreement with a term through March 26, 2009.

**If we are unable to protect our intellectual property, which is essential to our business, we may not be able to compete effectively.**

We believe our copyrights, service marks, trademarks, trade secrets, and similar intellectual property are critical to our success. In a highly competitive industry with relative ease of entry into the marketplace, we rely on trademark, copyright and other intellectual property laws to protect our proprietary rights and maintain our product differentiation. We also depend on trade secret protection through confidentiality and license agreements with our employees, licensees, licensors and others. We may not have agreements containing adequate protective provisions in every case, and the contractual provisions that are in place may not provide us with adequate protection in all circumstances. The unauthorized reproduction or other misappropriation of our intellectual property could diminish the value of our brands, products and services and competitive advantages and result in decreased revenues.

Despite our efforts to protect our intellectual property rights, intellectual property laws afford us only limited protection. A third party could copy or otherwise obtain information from us without authorization. Accordingly, we may not be able to prevent misappropriation of our intellectual property or to deter others from developing similar products and services. Further, monitoring the unauthorized use of our intellectual property rights is difficult. Litigation may be necessary to enforce our intellectual property rights or to determine the validity and scope of the proprietary rights of others. Litigation of this type could result in further substantial costs and diversion of resources, may result in counterclaims or other claims against us and could negatively impact our financial position, liquidity, business prospects, and results of operations. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States.

**Damage or long-term disruption to our information systems would substantially harm our business.**

We depend heavily on our communications and information systems, which, despite our adoption of industry-standard security measures, are vulnerable to potential systems failures, unauthorized file access, telecommunications provider failures, and power failures. Any damaging failure or long-term interruption of our systems, including those associated with new systems implementations or system upgrades, will significantly harm our business, including our sales, distribution, purchasing, inventory control, merchandising and financial controls.

**Consumer-information privacy regulations could subject us to state penalties or litigation, damage our reputation, and deter current and potential users from using our products and services.**

Under certain circumstances, we currently obtain and retain personal information about consumers who purchase cards on our websites, phone in orders to our call center, or register cards on our websites for theft-cancellation or loss-replacement services. Federal, state and foreign governments have enacted or may enact laws or regulations regarding the collection and use of personal information, possibly including enforcement and redress provisions. We have implemented programs and procedures designed to protect the privacy of consumers and have established security features to protect our user database and websites. However, our security measures may not prevent all possible security breaches. If third persons were able to penetrate our network security and gain access to, or otherwise misappropriate, our users' personal information, it could harm our reputation and, therefore, our business, and we could be subject to liability. Such liability could include claims for misuse of personal information. These claims could result in litigation, our involvement in which, regardless of the outcome, could require us to expend financial resources and limit our operational growth.

**Increased accounting and financial reporting requirements, as an SEC reporting entity, could stress our internal accounting system and system of internal controls sufficient to potentially impair the accuracy of our financial results or impair our ability to prevent fraud.**

The risks associated with financial reporting have come to the forefront in recent years. Any failure to effectively implement adequate controls or meet the growing systems and staffing needs of our accounting and finance functions could result in errors in our published financial reports or in other failures to comply with our obligations as a public company, including the requirements of the Sarbanes-Oxley Act of 2002. Based upon our size and scope of operations, we are not required to comply with Sarbanes-Oxley Section 404 until the Company's first fiscal year ending on or after July 15, 2007, which would require a Company assessment by December 31, 2007, and our full compliance by December 31, 2008. Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud within the Company. Our intent is to operate within the confines of the requirement to ensure effective internal controls within the organization. As we have been a non-listed public company, we have had limited accounting personnel and other resources with which to address our internal controls and procedures. Our reporting obligations will increase significantly should we become a listed public company, placing a considerable strain on our management, operational and financial resources and systems for the foreseeable future. We are currently developing and improving our internal accounting systems, particularly our operational, financial, communications and management controls and our reporting systems and procedures. We expect to devote significant resources to ensure that our administrative infrastructure and system of internal controls remain adequate for a listed public company. We cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial processes and reporting. Non-compliance with the Sarbanes-Oxley Act can result in litigation, public scrutiny, and/or lost revenues, significantly limiting opportunities for future growth.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

*Note Regarding Forward – Looking Statements*

*The following discussion of our financial condition and results of operations should be read in conjunction with our financial statements and the related notes to such financial statements included in our 2006 Form 10-KSB and our 2007 Forms 10-QSB. This discussion should be read in conjunction with our unaudited condensed financial statements and accompanying notes presented in Part I, Item 1 of this report. This item discusses our results of operations for the three-month and six-month periods ended June 30, 2007, and compares these periods with the same periods of the previous year. In addition, the discussion describes the significant changes in our financial position at June 30, 2007, as compared to December 31, 2006, our fiscal year end. The following discussion contains forward-looking statements that involve risks and uncertainties. Readers should not place undue reliance on these forward-looking statements. These forward-looking statements are based on management's current expectations and actual results could differ materially from those discussed herein. Our actual results could differ materially from those predicted in these forward-looking statements, and the events anticipated in the forward-looking statements may not actually occur. Although we believe the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this Form 10-QSB to conform these statements to actual results or to reflect the occurrence of unanticipated events, unless required by law.*

### Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires the appropriate application of various accounting policies, many of which require us to make estimates and assumptions about future events and their impact on amounts reported in our financial statements and related notes. Since future events and their impact cannot be determined with certainty, the actual results will inevitably differ from our estimates, and those differences could be material to the financial statements.

We believe the application of accounting policies, and the estimates inherently required in connection with the application of those policies, are reasonable. These accounting policies and estimates are periodically reevaluated, and adjustments are made when facts and circumstances dictate a change. Historically, we have found that our financial results have not differed materially from those expected based on our estimates.

#### How We Generate Revenues and Other Income

With respect to our various gift card programs, we derive revenue and other income from a number of sources, including:

- Enrollment or point of sale fees charged to purchasers of cards issued in connection with one of our card programs. These fees are an additional expense to the consumer and are deposited with the proceeds from the card sales regularly in accounts swept by us.
- Payment system interchange and transaction fees in connection with card transactions.
- Interest on funds held in reserve for the payment of transactions with the prepaid, stored-value cards.
- Monthly administrative fees and renewal fees charged on inactive prepaid, stored-value cards.
- Remaining amount inquiry fees.
- Fees charged to sponsors of employee incentive and customer rewards programs.
- "Breakage" resulting from prepaid, stored-valued cards that expire or are never used.

Historically, we expect to receive between 8% and 10% of the value loaded on our consumer-based prepaid stored-value cards back in the form of maintenance fees, expiration fees, remaining amount inquiry fees and other administrative fees.

With respect to our various gift certificate programs, we derive revenue and other income from a number of sources, including:

- Interest income on funds held in reserve until utilized for gift certificate transactions by the customer.
- Breakage resulting from unused or unusable gift certificates.

We also record revenue from the sale of third-party closed-end gift cards and gift certificates. We purchase these gift cards and gift certificates at a discount as inventory and in turn resell them to customers at full face value through our call center and internet fulfillment website. We record revenue equal to the sales price of the gift cards and gift certificates sold plus shipping and handling charges.

We also provide gift card fulfillment services to clients of FDCS (also referred to as "ValueLink" – ValueLink changed it's name to "FDCS" in 2006) through our call center and internet fulfillment website. We record revenue equal to the fulfillment fee paid to us by FDCS and the shipping and handling charges.

**Revenue Recognition/Cost of Goods**

*Gift Card Fees*

We recognize several different types of fees related to our gift card programs. The timing of the revenue recognition varies depending on the type of fee being charged.

Point of Sale Fees

In most circumstances, we charge an up-front point of sale convenience fee on the sale of gift cards in retail establishments. We charge this fee to the customer at the time the purchaser purchases the gift card. We recognize revenue from the point of sale convenience fee ratably over the life of the gift card or gift certificate. If the gift card or gift certificate is fully used, any remaining balance of deferred point of sale convenience fee is recognized as revenue at that time.

Interchange and Transaction Fees

We record interchange transaction or processing fees earned in connection with card usage transactions as revenues when received. The issuing bank and card processor calculate the fees owed to us and submit the fee revenue to us from the restricted bank accounts on a regular basis, typically monthly. We receive a point of sale fee upon activation of the card. However, we recognize revenue on the point of sale transaction fee ratably as the card is used or at the expiration of the card if the funds on the card are not redeemed. The issuing bank and card processor calculate the fees owed to us and submit the fee revenue to us from the restricted bank accounts on a regular basis, typically monthly.

Monthly Administrative Fees, Renewal Fees, and Expiration Fees

Our cards are governed by the rules of, and approved by, the member bank associations (Visa and MasterCard) and Discover. The member bank associations and their related issuing financial institutions require us to fund the value of the prepaid stored-value cards within 24 hours from the sale of the card. We sweep the depository funds from the mall owner/operator depository accounts and hold the funds in restricted bank accounts. The issuing bank or financial institution sweeps the funds reserved for gift card redemptions from our restricted cash accounts to be held for future card redemptions. We show the funds on our balance sheet as restricted cash. We record an offsetting liability labeled gift certificates/gift cards payable on our balance sheet. The card-issuing bank makes a daily reconciliation to net new sales against usage and fees owed to us.

The average life of all cards is approximately 3 to 6 months. Consumers use most prepaid stored-value cards (approximately 85% to 90%) before any maintenance fees or expiration fees are imposed. For those cards that are not fully used by a particular date (which may vary from mall to mall), we charge a monthly administrative maintenance fee (typically $2.50 per month) to the card per the Terms and Conditions (imprinted on the prepaid stored-value card and in a separate document provided at the point of sale) until the remaining amount on the card is zero or until the card reaches the expiration date, subject to the requirements of local law which might place restrictions on fees. Our experience shows that approximately 8% of the face value of all prepaid stored value cards sold will be returned to us in the form of maintenance fees. We record revenue from monthly administrative fees in the month in which they are charged. Cardholders may check the remaining balance on their card or reload amounts on an existing card by calling us at the phone number listed on the back of the card or through our website. We charge a fee to the cardholder to check the remaining card balance or to reload funds on the existing card. Such inquiry fees and renewal fees are recognized at the time the balance inquiry is made or an amount is reloaded on the existing card.

The card has a maximum life of 18 to 36 months based on the "Valid thru" (or other similar phrase) date imprinted on the face of the card. The issuing banks mandate this expiration date. Incentive and loyalty cards typically have a shorter expiration date of 3 to 6 months and are typically exempted from laws governing fees on gift cards. Upon expiration of the card, the issuing bank holding the funds for our cards remits to us the funds remaining as an expiration fee, which we record as revenue when received. Our experience shows that less than 2% of the face value of all cards sold will be returned to us in the form of expiration fees.

The up front convenience fees, monthly administrative maintenance fees and the expiration fees enable us to provide the prepaid stored-value card service to consumers and cover our up-front costs. We record gift card maintenance and expiration fees as revenue in the period earned.

Incentive and Customer Reward Program Fees

We contract with third-party providers of incentive, promotion and loyalty programs for a wide variety of entities, including financial institutions, subscription-based services, and membership clubs, to provide the prepaid stored-value cards and associated administration of the cards. Generally, we charge an up front fee per card issued in the incentive programs. Revenue from the up front fees is recognized ratably over the life of the card. If the prepaid stored-value card is fully used, any remaining balance of deferred up front fee is recognized as revenue at that time. These cards typically have an expiration date of six months and are typically exempt from regulations regarding the imposition of fees.

*Other Income – Gift Certificate Breakage*

For gift certificates, we record the gross transaction volume on our balance sheet as restricted cash. We adjust the restricted cash liability as we offset new gift certificate sales against our payment to retailers of gift certificates they present to us for payment. We earn and retain all of the interest income from the restricted bank accounts. With interest rates at their current levels, revenue from interest income is not material.

We do not record the full amount of the mall gift certificate sale as revenue. We recognize the majority of our other income from unused or unusable gift certificates, known in the industry as "breakage". We classify breakage as "Other Income" in our statement of operations. We recognize income from breakage upon expiration of the gift certificate, or when no expiration date exists, upon the extinguishment of the liability per the applicable state statute of limitations, for which we use an average of three years from the date of issuance. We have tracked usage and breakage patterns since inception. Our historical analysis indicates that we receive less than 4% of the gift certificate gross transaction volume in the form of breakage. This breakage income is deferred a minimum of 12 months from the sale date to several years from the sale date, based on the existence or non-existence of an expiration date on the gift certificate. As we record breakage income in the statement of operations in the applicable period, we record a corresponding decrease in gift certificate liability.

*Gift Certificate Processing Fees*

Our sales history shows that typically 70% to 80% of the gift certificates are purchased with a credit or debit card, with the remainder being purchased with either cash or check. Each credit or debit card transaction is assessed a processing fee, which we show as a cost of revenue shown as merchant fees and charges in our statement of operations. We pay the processing fees and subsequently invoice the mall operator for the processing fees in the following month. We record revenue from the credit and debit card processing fees as merchant fees earned from retailers in our statement of operations.

*Sale of Third-Party Gift Certificates and Gift Cards and Related Fulfillment Services*

Because we pre-purchase third-party gift certificate and gift card inventory, we bear all the financial risk associated with that inventory. Therefore, we record the entire transaction volume sold as revenue in our statements of operations. The associated cost of revenue is the discounted price we pay to the seller of the gift certificates and gift cards we purchase for re-sale.

We record the pre-purchased inventory fulfillment business transaction volume conducted for third parties as revenue. We derive the majority of the revenue from this channel from our Darden relationship. We expect the percentage of revenues in future periods to be reduced as we generate other revenue from new products and services that we anticipate selling through other business channels in 2007. Additionally, at some point in 2007, the Darden relationship and the subsequent revenues received from selling Darden gift cards will shift from a pre-purchased inventory scenario where we recognize the full face value of the gift card sold as revenue, to a fee per card fulfilled basis similar to our relationship with FDCS. Although this change will significantly impact our revenues in 2007 and periods going forward from this client, we expect an immaterial change in operating profit as a result. We anticipate this change to become effective in the third quarter of 2007.

FDCS, our leading fulfillment customer, pays us on a per card fulfilled basis, which we record as revenue in the appropriate period. Typically, we ship FDCS consumer orders from our facilities in Salt Lake City. Most orders are placed by consumers and corporations via our website or call center operators. We retain any shipping and handling margins from the fulfillment of the FDCS products.

**Stock Based Compensation**

In accordance with Statement of Financial Accounting Standards (SFAS) No. 123(R), we measure compensation cost for stock-based awards at fair value and recognize compensation over the service period for awards expected to vest. The estimation of stock-based awards that will ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We consider many factors when estimating expected forfeitures, including types of awards, employee roles, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.

**Restricted Cash**

Restricted cash consists of funds held for the payment of issued and outstanding gift certificates and gift cards to customers. We maintain these funds at several financial institutions in demand deposit accounts and associated sweep accounts. We are restricted from withdrawing the funds except for the redemption payment of issued and outstanding gift certificates and gift cards. We may not transfer the funds into our operating accounts until such time that the unredeemed gift certificates and gift cards qualify as breakage or estimated breakage. We determine breakage based on (1) expiration, (2) legal statute of limitations, or (3) the accumulation of sufficient historical data upon which to make reliable estimates. We record breakage by expiration or legal statute of limitations as income, and we remove a corresponding amount from gift certificates and gift cards payable. We remove the same amount from restricted cash and record it as unrestricted cash. We base estimated unredeemed gift certificates and gift cards ("estimated breakage") on our historical breakage data and we do not record it as income until the expiration date or the legal statute of limitations passes. However, we may transfer all or a portion of estimated breakage from restricted cash to unrestricted cash upon issuance of the gift certificate or gift card. Any estimated breakage amount transferred to unrestricted cash decreases the restricted cash balance but remains in gift certificates payable, until we recognize such estimated breakage as income. At such time, we reduce the amount of gift certificates and gift cards payable by a corresponding amount.

**Our Primary Business Channels**

*The Shopping Mall Channel*

Industry sources, such as the Mercator Advisory Group, estimate over 21 million prepaid cards were issued in 2004. This number more than doubled to over 45 million cards in 2005, representing $165 billion in open loop and closed loop prepaid transaction volume. Growth in the open loop prepaid card market is predicted to be the fastest growing segment within the burgeoning prepaid card space over the next few years. Although gift certificate sales have been growing at an annual rate of 11% to 15% since 1993 and reached 20% annual growth in 2004, gift cards are rapidly replacing traditional paper gift certificates because of their greater flexibility and convenience. We anticipate by 2008, gift cards will represent 80% of the total amount of sales of gifts that are given in the form of gift cards and gift certificates.

Approximately 3,800 covered or indoor shopping malls and 37,000 outdoor shopping centers or outlets (often referred to as strip centers), exist in the United States. Approximately 15 major commercial property developers own about 1,500, or 42.9%, of the indoor malls. Smaller commercial property developers or independent owner/operators own or manage the remaining mall properties. Several of the larger indoor-mall property owners/developers, with interests in roughly half of the indoor malls, manage their own gift certificate/card programs. The owner/operators of the remaining indoor malls either outsource their gift certificate/card programs or do not currently have such programs.

We intend to grow our mall gift card business as we have done over the last several years. However, as a percentage of total transaction volume and total revenues, we expect the mall channel percentages to decrease as other business channels produce higher transaction volumes and revenues. We also anticipate a decrease in mall gift certificate business as the industry shifts to mall stored-value gift cards.

We have been marketing our gift card programs, and related fulfillment services, to targeted mall owner/operators since October 2001. Our typical mall owner/operator does gift certificate/card volume averaging $500,000 per year. We currently service 73 mall properties in 28 states across the nation. We have serviced in excess of 100 malls in 38 states in recent years; however, the commercial real estate market, particularly shopping malls, experienced a significant amount of consolidation. The largest mall developers are buying even more shopping mall properties from large to mid-size owner/operators. Typically, the largest mall developers have the resources to manage their gift certificate or gift card programs in-house. That consolidation has resulted in a loss of business for us each of the last several years. We have been able to make up some of the losses by adding new shopping mall clients to our portfolio. The industry consolidation is outside of our control. We typically collect termination fees when our contracts are not renewed due to consolidation. Typically, we are contractually unable to force an acquiring mall company to continue with our gift certificate or gift card program.

As a result of our efforts to convert our gift certificate customers to gift cards, our gift certificate business has been declining, both in terms of volume and in terms of the percentage of our business. We anticipate 2007 gift certificate gross transaction volume will decrease compared to 2006 due to the number of our mall owner/developer customers converting from paper gift certificate programs to gift card programs. Our gift card programs may be tailored specifically to the owners/developers of one or more shopping malls, as well as individual and multiple retailers.

Early in 2005, we changed the economic structure of our mall gift card contracts to become less reliant on monthly maintenance fees and focus more on up-front point of sale fees to consumers, which is sometimes paid for by the mall owner/operator. We recognize point of sale fee revenue ratably over the life of the cards. Up front fees improve our cash flow as we do not have to wait for a period of time to charge fees to the card. Generally, monthly maintenance or administrative fees are not charged until approximately 13 months after the sale of the card, whereas the up front fees are charged at the time the card is sold to the customer. Up front fees also help to mitigate some of the risk being imposed by various state legislatures in attempting to restrict the use of monthly maintenance fees as a method of recouping our cost of administrating the gift card programs. In some cases, the point of sale fees have resulted in decreased sales as consumers may be reluctant or unwilling to pay for the gift card services. However, we have found that this approach reduces our legal liability and makes our programs more consumer friendly.

Up front fees for stored-value card services, versus monthly maintenance fees, are becoming the norm in the industry as more consumer advocate groups lobby their legislators to enact gift card fee changes. We have provided mechanisms for gift card registration; thereby enabling us with the ability to notify consumers that their card is nearing expiration and that replacement, for a fee, is an option. This helps to protect consumers from losing the full value on the gift card. We have also added reloadability as an option to consumers who wish to continue using their gift card as a debit card.

If federal, state or local legislation is enacted that exposes us to increased liability, we are prepared to exit the mall gift card business to focus on our other stored-value products that do not have such onerous restrictions. Our new contracts now provide us with the ability to renegotiate or terminate the contract if the economics are unfavorable to us, based on legislative changes enacted into law. On August 1, 2006, a federal judge ruled that New Hampshire could not impose state laws restricting gift-card fees on Simon Property Group's gift cards, because the bank-issued cards are governed by federal banking laws that preempt state laws. Simon's Gift Cards are issued by U.S. Bank National Association, MetaBank and Bank of America, which collect and keep the fees. Our programs are similar in nature to Simon's gift card programs and we operate under the same premises regarding collection of fees. We also use MetaBank as the issuing bank for our gift cards. We are continually reviewing legislation enacted from time to time by the various states and we attempt to monitor material instances of litigation affecting gift certificates and gift cards. We make a concerted effort to comply with the laws of the various states and to adapt our business practices from time to time in response to changes in the laws and the results of litigation.

*Fulfillment Services*

We are the exclusive provider for Internet and call-center order processing and fulfillment services for dedicated closed network gift cards for FDCS. We also fulfill on an exclusive basis, third-party gift certificates and gift cards acquired through our own direct marketing efforts. We anticipate an increase in FDCS clients in 2007 and a corresponding increase in revenues. We also plan to pursue fulfillment opportunities on our own that do not infringe upon our non-compete agreement with FDCS. We have developed and introduced re-loadable card options as well as gift card and greeting card personalization options to consumers purchasing gift cards via the Internet, supplementing our fulfillment revenue streams. We will continue to focus our efforts on business which produces acceptable margins while discontinuing unprofitable operations. Our fulfillment contract with GMRI ("Darden") had been extending on a month-to-month basis since February 2007. We anticipated a reduction in revenue as disclosed in this Form 10-QSB and previous filings as a result of a change in the contract structure with Darden. As of August 3, 2007, we are no longer fulfilling gift cards for Darden

*Incentive Cards*

According to a 2006 Mercator Advisory Group industry survey, gift cards and certificates are used by over 80% of companies in the United States as part of their overall incentive programs. Uses include recognizing performance, as sales incentives, as business gifts and as consumer promotions. Gift cards are being used as incentive tools across all types of organizations, including manufacturers, wholesalers, retailers and service providers. We believe a significant portion of our sales and revenues going forward will be derived from business-to-business prepaid card programs. We believe we can significantly improve the number of new programs we bring on board in 2007 based on new direct sales and marketing efforts being directed at this channel. These types of gift card programs are typically exempt from general gift card legislation as these programs are funded by corporations, not consumers, and are given to employees or consumers free of charge. We intend to shift more of our focus on these products going forward. We expect to add a number of new programs with modest volume increases in 2007 based on new agreements signed in the first and second quarter of 2007.

**Results of Operations**

***Transaction Volume***

We include the following figures for informational purposes only. We do not include them in our statements of operations. Transaction volume does not represent our revenues or other income. Rather, transaction volume represents the face value amount of the gift certificates and gift cards that we sell through our various business channels. Transaction volume is sometimes referred to as "sales."

| | Three Months Ended June 30, 2007 | Three Months Ended June 30, 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Mall gift cards | $ 3,349,000 | $ 4,730,000 | $ (1,381,000) | -29.2% |
| NBO fulfillment [excluding FDCS ("ValueLink")] | 1,212,000 | 1,342,000 | (130,000) | -9.7% |
| FDCS ("ValueLink") | 900,000 | 800,000 | 100,000 | 12.5% |
| Mall gift certificates | 218,000 | 403,000 | (185,000) | -45.9% |
| B2B loyalty/incentive cards | 130,000 | 243,000 | (113,000) | -46.5% |
| B2C loyalty/incentive cards | 51,000 | - | 51,000 | na |
| NBO issued theme cards | 1,000 | - | 1,000 | na |
| | $ 5,861,000 | $ 7,518,000 | $ (1,657,000) | -22.0% |

| | Six Months Ended June 30, 2007 | Six Months Ended June 30, 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Mall gift cards | $ 5,952,000 | $ 8,098,000 | $ (2,146,000) | -26.5% |
| NBO fulfillment [excluding FDCS ("ValueLink")] | 2,155,000 | 2,284,000 | (129,000) | -5.6% |
| FDCS ("ValueLink") | 1,581,000 | 1,257,000 | 324,000 | 25.8% |
| Mall gift certificates | 413,000 | 685,000 | (272,000) | -39.7% |
| B2B loyalty/incentive cards | 249,000 | 318,000 | (69,000) | -21.7% |
| B2C loyalty/incentive cards | 93,000 | - | 93,000 | na |
| NBO issued theme cards | 5,000 | - | 5,000 | na |
| | $ 10,448,000 | $ 12,642,000 | $ (2,194,000) | -17.4% |

Over the last several years, we experienced a major shift from mall gift certificate sales to mall gift card sales. This was primarily a result of consolidation in the commercial real estate sector – specifically shopping malls, as well as a reflection of the overall trend in the industry towards stored-value gift card products, versus paper gift certificates. We anticipate a further reduction in gift certificate sales as more properties convert to stored-value mall gift cards. With the decline in gift certificate sales (-45.9% and -39.7%, respectively, for the three- and six-month periods ended June 30, 2007), we have developed new products and services to provide diversification away from the mall channel. We will continue to grow our mall gift card business, but anticipate less of a reliance on the mall channel for future growth in sales and revenue. Gift cards are now of a ubiquitous nature, for sale at almost any retail location. The ease with which consumers can purchase gift cards outside the shopping mall is having a negative impact on the number of cards being sold within the shopping mall. Many mall cards are closed-loop cards only redeemable at the mall property. Our research confirms that consumers are interested in purchasing both the mall gift cards as well as open-loop gift cards that can be redeemed anywhere. We are now selling both open and closed-looped cards side by side to offer consumers more choices. The amount of gift card sales is also directly attributable to the marketing and advertising budget of the mall owner/operator. We are stressing the importance of the allocation of sales and marketing resources to our mall partners. While our mall gift card transaction volume is down from a year ago (-29.2% and -26.5%, respectively, for the three- and six-month periods ended June 30, 2007) for the reasons just stated, our gross profit margins, as discussed further below, have increased due to a change in economic model that relies less on monthly maintenance fees and expiration fees, and more on up-front point of sale fees. We see this as a continuing industry trend. We experienced a decline in the number of third-party gift certificates and gift cards fulfilled (-9.7% and -5.6%, respectively, for the three- and six-month periods ended June 30, 2007). The majority of this transaction volume resulted from year-over-year declines in Darden sales (Red Lobster, Olive Garden, Bahama Breeze and Seasons 52). We expect a decrease of approximately $4 million to $5 million in total transaction volume and revenue through the remainder of 2007 as a result of the termination of our fulfillment relationship with Darden. FDCS ("ValueLink") transaction volume increased 12.5% and 25.8%, respectively, for the three- and six-month periods ended June 30, 2007. We expect full year 2007 FDCS transaction volume to exceed 2006 volumes. We are just beginning concerted efforts to increase our B2B and B2C loyalty/incentive card businesses. Overall transaction volume decreased 22.0% and 17.4%, respectively, for the three- and six-month periods ended June 30, 2007 for the reasons just described.

***Revenues and Other Income***

We recorded revenues and other income from the various channels as follows:

| | Three Months Ended June 30, 2007 | Three Months Ended June 30, 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Sale of third party gift certificates/cards | $ 1,209,000 | $ 1,340,000 | $ (131,000) | -9.8% |
| Fees earned from customers | 285,000 | 360,000 | (75,000) | -20.8% |
| Merchant fees earned from retailers | 122,000 | 183,000 | (61,000) | -33.3% |
| Miscellaneous income | 165,000 | 156,000 | 9,000 | 5.8% |
| Interest on restricted cash | 40,000 | 47,000 | (7,000) | -14.9% |
| Gift certificate breakage | 46,000 | 69,000 | (23,000) | -33.3% |
| Total revenues and other income | $ 1,867,000 | $ 2,155,000 | $ (288,000) | -13.4% |

| | Six Months Ended June 30, 2007 | Six Months Ended June 30, 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Sale of third party gift certificates/cards | $ 2,131,000 | $ 2,271,000 | $ (140,000) | -6.2% |
| Fees earned from customers | 837,000 | 850,000 | (13,000) | -1.5% |
| Merchant fees earned from retailers | 280,000 | 362,000 | (82,000) | -22.7% |
| Miscellaneous income | 276,000 | 262,000 | 14,000 | 5.3% |
| Interest on restricted cash | 108,000 | 112,000 | (4,000) | -3.6% |
| Gift certificate breakage | 62,000 | 66,000 | (4,000) | -6.1% |
| Total revenues and other income | $ 3,694,000 | $ 3,923,000 | $ (229,000) | -5.8% |

Our business is subject to typical retail seasonality. We sell the majority of our gift certificates and gift cards between Thanksgiving and Christmas every year. We have specific holiday spikes such as Easter, Mother's Day and Father's Day, but the first six calendar months of the year typically represent approximately only 20% of our transaction volume and revenues and other income. Approximately 65% of our full year revenues and other income are represented by activity in the fourth quarter of each calendar year. As noted in the transaction volume table above, we have shifted from gift certificates to gift cards. We earned the majority of fees from the monthly maintenance fees and expiration fees from unused gift cards sold in prior periods. We have also been able to negotiate with malls to retain all or a portion of the point-of-sale fees assessed by malls upon the sale of the gift cards. In contrast, in our past contracts we generally allowed the malls to retain these point-of-sale fees. We expect the trend of increased fees to continue as we complete new mall contracts going forward and as we sell more gift cards than gift certificates. Revenues and other income decreased 13.4%, or $288,000, and 5.8%, or $229,000 in the three- and six-months ended June 30, 2007, respectively, compared to the three- and six-months ended June 30, 2006. Other income is comprised solely of gift certificate breakage (down 33.3%, or $23,000, and 6.1%, or $4,000 in the three- and six-months ended June 30, 2007, respectively, compared to the three- and six-months ended June 30, 2006). Sales of third-party gift certificates/cards decreased, as Darden sales were down in the three- and six-months ended June 30, 2007 compared to the three- and six-months ended June 30, 2006. Revenues and other income will decline substantially in the remainder of 2007 as a result of the termination of our Darden fulfillment relationship. The fees we earned from customers in the form of maintenance fees and expiration fees on gift cards decreased 20.8%, or $75,000, and 1.5%, or $13,000 in the three- and six-months ended June 30, 2007, respectively, compared to the three- and six-months ended June 30, 2006 due to the extension of the waiting period before we begin to collect monthly maintenance fees from six months to thirteen months to make our programs more consumer friendly regarding fees. Gift certificate sales are expected to decline. Gift certificate breakage income will likely decrease in future periods due to our shift in focus from gift certificate sales to gift card sales. Miscellaneous income is comprised primarily of postage and handling as well as equipment and lease of our counter top units ("CTU's").

***Cost of Revenues and Other Income***

We recorded cost of revenues for the various revenue channels as follows:

| | Three Months Ended June 30, 2007 | Three Months Ended June 30, 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Third-party gift certificates/cards | $ 1,124,000 | $ 1,247,000 | $ (123,000) | -9.9% |
| Merchant fees and charges | 287,000 | 400,000 | (113,000) | -28.3% |
| Other | 139,000 | 139,000 | - | 0.0% |
| Commissions paid to mall owner/operators | 10,000 | 28,000 | (18,000) | -64.3% |
| Total cost of revenues and other income | $ 1,560,000 | $ 1,814,000 | $ (254,000) | -14.0% |

NBO SYSTEMS, INC.

| | Six Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Third-party gift certificates/cards | $ 1,979,000 | $ 2,109,000 | $ (130,000) | -6.2% |
| Merchant fees and charges | 650,000 | 809,000 | (159,000) | -19.7% |
| Other | 206,000 | 248,000 | (42,000) | -16.9% |
| Commissions paid to mall owner/operators | 14,000 | 51,000 | (37,000) | -72.5% |
| Total cost of revenues and other income | $ 2,849,000 | $ 3,217,000 | $ (368,000) | -11.4% |

Cost of revenues and other income decreased 14.0%, or $254,000, and 11.4%, or $368,000 in the three- and six-months ended June 30, 2007, respectively, compared to the three- and six-months ended June 30, 2006, as our transaction volume and our revenues and other income decreased as described above. Cost of revenues associated with third-party gift certificates and cards represents the costs associated with providing outside gift certificates and gift cards to our fulfillment customers. We purchase our inventory of cards and certificates directly from the vendors at a discount and then resell the inventory at full face value. As noted above, we experienced declining sales and declining revenues associated with those sales, and experienced a corresponding decrease in the cost of revenues associated with third-party cards and certificates. Merchant fees and charges decreased as a result of decreased sales, further resulting in less mall gift cards and gift certificates purchased by consumers with credit/debit cards. We pay a commission on some mall gift cards sold (based on transaction volume and the number of cards sold) to mall owner/operators as an incentive to use our card programs. We accumulate these commissions and pay the commissions to the malls approximately one year following the completion of the card transaction year. However, in 2005 and 2006, we changed our economic models to rely less upon monthly maintenance fees on gift cards and more on point of sale fees. Concurrently, we reduced the commission payouts due on expiration of the gift cards. These factors, along with the significant reduction in gift certificate sales, resulted in a decrease in commissions paid in the three- and six-months ended June 30, 2007 compared to the three- and six-months ended June 30, 2006 of 64.3%, or $18,000, and 72.5%, or $37,000, respectively. The category of "Other costs" is comprised primarily of postage and handling costs associated with providing gift cards and certificates to our mall clients, and the cost of gift card and gift certificate stock. The largest change in these accounts from the prior year is due to the "hard costs" associated with providing our mall gift card products. We incur all of the up-front costs of the raw plastic, the embossing and encoding of the gift cards. As the number of gift cards issued increases or decreases annually, these hard costs increase or decrease proportionately.

**Gross Profit**

Gross profit for the three- and six-month periods ended June 30, 2007 is as follows:

| | Three Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Revenues and other income | $ 1,867,000 | $ 2,155,000 | $ (288,000) | -13.4% |
| Cost of revenues and other income | (1,560,000) | (1,814,000) | 254,000 | -14.0% |
| Gross profit | $ 307,000 | $ 341,000 | $ (34,000) | -10.0% |
| Gross margin % | 16.4% | 15.8% | | |

| | Six Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Revenues and other income | $ 3,694,000 | $ 3,923,000 | $ (229,000) | -5.8% |
| Cost of revenues and other income | (2,849,000) | (3,217,000) | 368,000 | -11.4% |
| Gross profit | $ 845,000 | $ 706,000 | $ 139,000 | 19.7% |
| Gross margin % | 22.9% | 18.0% | | |

Transaction volume decreased in the three- and six-month periods ended June 30, 2007 as described above. Correspondingly, revenues and other income also decreased in the three- and six-month periods ended June 30, 2007 as described above. Cost of revenues and other income also decreased in the three- and six-month periods ended June 30, 2007 as described above. Collectively, gross profit decreased 10.0%, or $34,000 in the three-month period ended June 30, 2007 compared to the three-month period ended June 30, 2006. However the decrease in cost of revenue and other income exceeded the decrease in revenue and other income in the six moth period ended June 30, 2007 compared to the six-month period ended June 30, 2006. Collectively, gross profit increased 19.7%, or **$**139,000 in the six-month period ended June 30, 2007 compared to the six-month period ended June 30, 2006. Gross margins increased to 16.4%, and 22.9%, in the three- and six-month periods ended June 30, 2007, respectively, from 15.8%, and 18.0%, respectively, in the three- and six-month periods ended June 30, 2006. We anticipate gross margins will be maintained at approximately 20% to 30% throughout 2007. Our shift in revenues away from gift certificates, which carried a lower gross margin is reflected in the increase in gross profit. We expect our non-mall programs that we are introducing to carry higher gross margins, which we believe will increase gross profit as well. We must increase our volumes generated by all programs to become cash-flow positive.

***Selling, General and Administrative Expenses***

We recorded selling, general and administrative expenses for the three- and six-month periods ended June 30, 2007 as follows:

| | Three Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Personnel | $ 752,000 | $ 779,000 | $ (27,000) | -3.5% |
| Rent and office expense | 172,000 | 146,000 | 26,000 | 17.8% |
| Depreciation and amortization | 30,000 | 33,000 | (3,000) | -9.1% |
| Professional fees | 151,000 | 126,000 | 25,000 | 19.8% |
| Other selling, general and administrative expenses | 66,000 | 63,000 | 3,000 | 4.8% |
| | $ 1,171,000 | $ 1,147,000 | $ 24,000 | 2.1% |

| | Six Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Personnel | $ 1,557,000 | $ 1,592,000 | $ (35,000) | -2.2% |
| Rent and office expense | 324,000 | 313,000 | 11,000 | 3.5% |
| Depreciation and amortization | 60,000 | 67,000 | (7,000) | -10.4% |
| Professional fees | 320,000 | 296,000 | 24,000 | 8.1% |
| Other selling, general and administrative expenses | 107,000 | 114,000 | (7,000) | -6.1% |
| | $ 2,368,000 | $ 2,382,000 | $ (14,000) | -0.6% |

Selling, general and administrative expenses increased 2.1% and decreased 0.6% in the three- and six-month periods ended June 30, 2007, respectively, compared to the three- and six-month periods ended June 30, 2006. Personnel expenses were slightly reduced mainly due to attrition. Rent expenses decreased slightly as a result of a renegotiated lease agreement for less office space. However, office expenses increased due to moving costs. Professional fees increased due to the cost in preparation of additional filings with the Securities and Exchange Commission as described in the notes to the financial statements. These fees will likely increase in connection with our capital restructuring. We cannot predict how federal and state regulatory activity may affect us, especially as state governments address the legal requirements associated with unclaimed property. We expect additional expenditures to protect and further our interests in this area. Management remains committed to controlling our costs and minimizing selling, general and administrative expenses.

**Operating Loss**

Operating losses for the three- and six-month periods ended June 30, 2007 are as follows:

| | Three Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Revenues and other income | $ 1,867,000 | $ 2,155,000 | $ (288,000) | -13.4% |
| Operating expenses | | | | |
| Cost of revenues | (1,560,000) | (1,814,000) | 254,000 | -14.0% |
| Selling, general & admin. expenses | (1,171,000) | (1,147,000) | (24,000) | 2.1% |
| Operating loss | $ (864,000) | $ (806,000) | $ (58,000) | 7.2% |
| Operating margin | -46.3% | -37.4% | | |

| | Six Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Revenues and other income | $ 3,694,000 | $ 3,923,000 | $ (229,000) | -5.8% |
| Operating expenses | | | | |
| Cost of revenues | (2,849,000) | (3,217,000) | 368,000 | -11.4% |
| Selling, general & admin. expenses | (2,368,000) | (2,382,000) | 14,000 | -0.6% |
| Operating loss | $ (1,523,000) | $ (1,676,000) | $ 153,000 | -9.1% |
| Operating margin | -41.2% | -42.7% | | |

Collectively, our operating loss increased 7.2%, or $58,000, in the three months ended June 30, 2007 as compared to the three months ended June 30, 2006. However, our operating loss improved 9.1%, or $153,000, in the six months ended June 30, 2007 as compared to the six months ended June 30, 2006. Operating negative margins worsened to (46.3%) in the three-month period ended June 30, 2007 from (37.4%) in the three-month period ended June 30, 2006. However, operating negative margins improved to (41.2%) in the six-month period ended June 30, 2007 from (42.7%) in the six-month period ended June 30, 2006. We will continue to market our products and services to gain market share, while focusing on higher margin products and shifting our focus to more "up-front" revenue streams. We have consistently decreased our selling, general and administrative expenses, and will continue to be vigilant in minimizing our spending for overhead items. Increasing volumes generated by all programs is necessary to become cash-flow positive.

***Interest Expense***

We recorded interest expenses for the three- and six-month periods ended June 30, 2007 as follows:

| | Three Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Interest expense | $ 890,000 | $ 910,000 | $ (20,000) | -2.2% |

| | Six Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Interest expense | $ 1,721,000 | $ 1,517,000 | $ 204,000 | 13.4% |

As of June 30, 2007, we had notes payable to stockholders of totaling $7.74 million compared to $8.29 million as of June 30, 2006. Our interest expense decreased 2.2% for the three-month period ended June 30, 2007 due primarily to the retirement of some loans. However, our interest expense increased 13.4% for the six-month period ended June 30, 2007 due primarily to raising additional working capital through debt to stockholders at unfavorable rates to us. While our debt has been reduced, our interest expense is up as a result of default provisions in certain notes to stockholders at significantly higher interest rates as well as the amortization of discounts over the prior year. Until such time that we achieve positive cash flows from operating activities, we will continue our efforts to raise working capital from debt and equity financings. We may sell certain assets or a portion or all of the Company to pay down some or all of the debt and restructure the capitalization of our debt to help eliminate interest expense as further described in the notes to the financial statements. As of July 20, 2007, approximately $10.4 million in debt including accrued interest from notes to stockholders has been eliminated in exchange for shares of Series B Preferred Stock and shares of common stock. Additionally, as of July 20, 2007, approximately $403,000 in debt, including accrued interest from notes to officers has been eliminated in exchange for shares of Series B Preferred Stock and shares of common stock. As a result, our interest expense will decrease significantly going forward.

All of the working capital needed in excess of cash generated from operating activities has been provided by loans from existing stockholders or additional equity investments that are discussed below. We sometimes elect to enter into debt agreements with interest rates that are not favorable to us, or loans with dilutive warrants to purchase common stock attached. Notes to stockholders as of June 30, 2007 bear interest at rates between 10% and 50%. In addition, the debt agreements have generally provided for the issuance of warrants to purchase our common stock and provisions to convert the debt to our common stock. In some cases, the conversion price has been less than the fair market value of our common stock, resulting in a non-cash beneficial conversion interest expense feature. In addition, the warrants issued in connection with debt financings and re-financings have been recorded as debt discounts or deferred financing costs. The debt discounts and deferred financing costs are recognized as interest expense over the life of the note. A significant portion of the interest expense recorded resulted from the issuance of warrants as payment of interest, the amortization of debt discounts and deferred financing costs, and the beneficial conversion features. The following table details interest expense during the three-month and six-month periods ended June 30, 2007 and 2006.

| | 2007 | 2006 | Change | Change |
|---|---|---|---|---|
| Interest paid in cash plus change in accrued interest | $ 883,000 | $ 446,000 | $ 437,000 | 98.0% |
| Interest expense recorded due to beneficial conversion features and amortization of debt discounts and deferred finance costs | 7,000 | 464,000 | (457,000) | -98.5% |
| Total interest expense | $ 890,000 | $ 910,000 | $ (20,000) | -2.2% |

| | Six Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Interest paid in cash plus change in accrued interest | $ 1,699,000 | $ 841,000 | $ 858,000 | 102.0% |
| Interest expense recorded due to beneficial conversion features and amortization of debt discounts and deferred finance costs | 22,000 | 676,000 | (654,000) | -96.7% |
| Total interest expense | $ 1,721,000 | $ 1,517,000 | $ 204,000 | 13.4% |

***Net Loss***

Net loss for the three- and six-month periods ended June 30, 2007 is as follows:

| | Three Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Net loss | $ (1,752,000) | $ (1,709,000) | $ (43,000) | -2.5% |

| | Six Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Net loss | $ (3,234,000) | $ (3,190,000) | $ (44,000) | -1.4% |

During the three months ended June 30, 2007 compared to the three months ended June 30, 2006:

- Our transaction volume decreased 22.0%;
- Our revenues and other income decreased 13.4%;
- Our cost of revenues and other income decreased 14.0%;
- Our gross profit decreased 10.0%;
- Our gross margin percentage increased by 3.8%, from 15.8% to 16.4%;
- Our selling, general and administrative expenses increased 2.1%;
- Our operating loss increased 7.2%;
- Our interest expense decreased 2.2%; and
- Our net loss increased 2.5%

During the six months ended June 30, 2007 compared to the six months ended June 30, 2006:

- Our transaction volume decreased 17.4%;
- Our revenues and other income decreased 5.8%;
- Our cost of revenues and other income decreased 11.4%;
- Our gross profit increased 19.7%;
- Our gross margin percentage increased by 27.2%, from 18.0% to 22.9%;
- Our selling, general and administrative expenses decreased 0.6%;
- Our operating loss decreased 9.1%;
- Our interest expense increased 13.4%; and
- Our net loss increased 1.4%

However, the positive changes were overshadowed by the high cost of capital for operating purposes as evidenced by the increase in interest expense related to fund raising activities. In order to obtain operating profitability, we must reduce general and administrative expenses and increase the transaction volume of gift cards sold. We have taken significant positive steps to minimize interest expense as described above and will continue in our cost-cutting efforts as well as expansion of new business.

***EBITDA (Earnings before interest, taxes, depreciation and amortization)***

Our EBITDA for the three- and six-month periods ended June 30, 2007 is as follows:

| | Three Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Net loss | $ (1,752,000) | $ (1,709,000) | $ (43,000) | -2.5% |
| Add interest expense | 890,000 | 910,000 | (20,000) | -2.2% |
| Add income taxes | - | 2,000 | (2,000) | -100.0% |
| Add depreciation and amortization | 30,000 | 33,000 | (3,000) | -9.1% |
| Negative EBITDA | $ (832,000) | $ (764,000) | $ (68,000) | -8.9% |

| | Six Months Ended June 30, 2007 | 2006 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| Net loss | $ (3,234,000) | $ (3,190,000) | $ (44,000) | -1.4% |
| Add interest expense | 1,721,000 | 1,517,000 | 204,000 | 13.4% |
| Add income taxes | 4,000 | 5,000 | (1,000) | -20.0% |
| Add depreciation and amortization | 60,000 | 67,000 | (7,000) | -10.4% |
| Negative EBITDA | $ (1,449,000) | $ (1,601,000) | $ 152,000 | 9.5% |

EBITDA is a non-GAAP measure and should not be used as a replacement for the GAAP measures of net loss or cash flows from operating activities. EBITDA is a common metric used by management, investors and others to normalize financial results in an effort to make comparisons of companies easier. It is a measure of controllable operating costs incurred by a company and is considered a useful additional measure by which the Company can be evaluated. Management believes that EBITDA, reflects operating results after excluding interest expense and certain other non-cash items, which significantly contribute to the overall net loss. EBITDA comparisons provide measurements for management to assess the impacts of re-capitalizing the balance sheet and reducing or eliminating the Company's debt in its efforts to bring the Company's operations profitable. EBITDA is commonly used by investment bankers to evaluate the financial strength of a company and to establish a valuation for the company based on comparable companies in similar industries. Our EBITDA results decreased 8.9%, or $68,000, in the three-month period ended June 30, 2007 compared to the three-month period ended June 30, 2006. Our EBITDA results improved 9.5%, or $152,000, in the six-month period ended June 30, 2007 compared to the six-month period ended June 30, 2006.

## Liquidity and Capital Resources

Our independent registered public accounting firm added an explanatory paragraph to its opinion on our financial statements as of December 31, 2006 and 2005 emphasizing that substantial doubt exists about our ability to continue as a going concern. This opinion may be viewed unfavorably by the investment community. This explanatory paragraph provided by the independent registered public accounting firm may be a significant impediment to our ability to raise additional capital or seek financing from entities that will not conduct such transactions in the face of such increased level of risk of insolvency and loss, increased difficulty in attracting talent, and the diversion of the attention of our executive officers and other key employees to raising capital or financing rather than devoting time to the day-to-day operations of our business. We are in default on some of our payments to note holders and trade creditors as described in the notes to the financial statements. We have been unable to attract any additional equity capital in 2007 on terms that we find acceptable. We urge potential investors to review the report of the independent registered public accounting firm and our financial statements and related notes contained in this Report, and to seek independent advice concerning the substantial risks related thereto before making a decision to invest in us.

Our total costs and expenses are currently greater than revenues and other income. In addition, our operating activities have used cash rather than provided cash. We have had a history of losses and our accumulated deficit (since inception June 23, 1994) through June 30, 2007 was approximately $49.4 million. During the six months ended June 30, 2007, we utilized approximately $1.8 million in cash from operating activities. We have deferred payments to certain trade creditors in the amount of approximately $3.3 million and these amounts are currently past due. At June 30, 2007, we had a deficit in working capital of approximately $16.2 million. Our ability to meet our obligations as they come due is dependent upon obtaining additional financing. Our net losses increased by 2.5% and 1.4%, respectively, for the three- and six-months ended June 30, 2007, respectively, as compared to the three- and six-months ended June 30, 2006. We will continue our efforts to raise capital through private equity or debt financings, as well as institutional investors, until our operations provide sufficient cash to meet our needs. We are taking steps to improve profitability and sales. We have recapitalized our balance sheet as described above. We can give no assurance that we will be successful in executing our plans to improve operations or obtain additional debt or equity financing. If we are unable to improve operations or obtain additional debt or equity financing, we may be required to further restructure operations during 2007. We may be able to sell all or a portion of our assets to reduce debt and provide working capital. We currently operate without a line of credit and we occasionally enter into short and long-term promissory notes with accredited investors, typically existing stockholders. These promissory notes often have conversion privileges into our common stock, easing debt service requirements. However, conversion privileges and warrants issued in conjunction with the notes dilute existing stockholders and increase our net losses.

### *Liquidity and Financing Arrangements*

- On January 3, 2007, February 8, 2007, February 11, 2007, April 3, 2007 and May 9, 2007, we collectively issued 76,666 warrants to purchase common stock with an exercise price of $2.00 with a combined fair value of $12,128 as payment of interest in connection with note agreements to a stockholder. The note agreements call for the quarterly issuance of a specified number of warrants. We recorded the fair value of the warrants issued as interest expense as the warrants are issued.
- On January 16, 2007, we redeemed 25,000 shares of common stock from a stockholder, as a decrease in common stock of $12, a decrease in additional paid-in capital of $49,988 and general and administrative expenses of $2,500. In connection with this redemption we rescinded 8,334 shares of common stock that were previously issued under the terms of a September 2005 offering agreement. We recognized rescinded preferential dividends paid in common stock of $16,668.
- On January 18, 2007, we reinstated, to a previous debt holder of the Company, warrants to purchase 39,063 shares of common stock that had previously expired unexercised. The warrants have an exercise price of $2.00 per share. We recorded the warrants at fair value as a deemed dividend of $7,082.
- On January 22, 2007, we issued 312,500 shares of common stock to our President upon exercise of 312,500 stock options at $0.35 per option, in exchange for a decrease of $188 of accrued interest, a decrease of $37,187 of notes to officer and a decrease of $72,000 of accrued liabilities. The decrease in accrued liabilities is a net after tax amount based on a pre-tax amount of $120,190 in accrued paid time off.

- On January 23, 2007, we re-priced 57,500 options held by our independent director to $2.00 from an exercise price of $4.00. The fair value of the re-priced options was $24,477. Options already vested, with a fair value of $22,391 were recognized as general and administrative expense. We will recognize options not vested, with a fair value of $2,086, as general and administrative expense as the options vest.
- On April 1, 2007, we defaulted on accounts payable due to GMRI for fulfillment services for GMRI's gift cards. GMRI extended credit to us at an annual rate of 10%. The secured note totals $3,263,338 as of June 30, 2007 and is due as certain fee income from MetaBank is payable to us, after our secured long-term note to MetaBank is retired.
- On May 18, 2007, we borrowed $1,000,000 from MetaBank of Sioux Falls, South Dakota, the primary issuer of our gift cards. This loan is secured by certain future revenue streams to us from fees assessed to gift cards in the form of monthly maintenance fees and breakage when the gift cards expire. The term of the loan is 24 months and bears interest at an annual rate of 9.75%. Until this loan is retired, certain fees due to us from MetaBank will first be applied to the outstanding principal and interest balance.

## ITEM 3. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized, and reported within the required time periods, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding disclosure.

a. Evaluation of disclosure controls and procedures.

Our management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) as of June 30, 2007, the end of the period covered by this report (the "Evaluation Date"). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective.

b. Changes in internal controls.

During the first two quarters of 2007 covered by this report, we made no change in our internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not a party to any material threatened or pending legal proceedings, which if adversely determined, would have an adverse material effect on the financial condition or results of operations of the Company. From time to time, however, the Company may become subject to legal proceedings, claims, and litigation arising in the ordinary course of business, including, but not limited to, employee, customer and vendor disputes.

Item 2. Unregistered Sales of Equity Securities

During the six-month period ended June 30, 2007, the Company:

- Issued 312,500 shares of common stock to the Company's President upon exercise of 312,500 stock options at $0.35 per share, in payment of $188 of accrued interest, $37,187 of principal on notes payable to officer, and $72,000 of accrued liabilities for paid time off (net of tax).
- Issued 76,666 warrants to purchase common stock with an exercise price of $2.00 per share with an aggregate fair value of $12,128 as payment of interest in connection with note agreements. The note agreements call for the quarterly issuance of a specified number of warrants. The fair value of the warrants issued is recorded as interest expense.
- In connection with previously issued debt, reinstated, to an existing stockholder of the Company, warrants to purchase 39,063 shares of common stock that had previously expired unexercised. The warrants have an exercise price of $2.00 per share. The warrants were recorded at fair value as a deemed dividend of $7,082.
- Re-priced 57,500 options held by the Company's independent director to $2.00 per share. These options previously had an exercise price of $4.00 per share. The fair value of the re-priced options was $24,477, of which $22,391 was expensed for vested options and $2,086 will be expensed as the unvested options vest in accordance with the option terms.

All of the investors are accredited investors. We relied upon the exemption from registration set forth in section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D thereunder. All investors are also existing stockholders. All stockholders are financially sophisticated. We have had a long relationship with the investors in our securities. We did not engage in any public solicitation or advertising. All of the securities are restricted by legends and stop-transfer instructions.

Item 3. Defaults upon Senior Securities.

None.

Item 4. Submission of matters to a vote of Security Holders.

No matters were submitted to a vote of security holders in the quarter ended June 30, 2007.

Item 5. Other Information.

None.

Item 6. Exhibits

Remainder of this page intentionally left blank.

| Exhibit Number | Description |
|---|---|
| 3.1 | Articles of Incorporation for a Stock Corporation in the State of Maryland (Filed as Exhibit 2(a) to the Registrant's Form 10-SBA filed on April 26, 2002, and incorporated herein by reference.) |
| 3.2 | Certificate of Ownership and Merger (Filed as Exhibit 2(b) to the Registrant's Form 10-SBA filed on April 26, 2002, and incorporated herein by reference.) |
| 3.3 | Bylaws of NBO Systems, Inc. (Filed as Exhibit 2(c) to the Registrant's Form 10-SBA filed on April 26, 2002, and incorporated herein by reference.) |
| 3.4 | Articles of Amendment of Articles of Incorporation (Filed as Exhibit 3.4 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 4.1 | See Exhibits 3.1, 3.2, 3.3 and 3.4 for provisions of the Articles of Incorporation, as amended, and Bylaws for NBO Systems, Inc. defining the rights of holders of common stock of NBO Systems, Inc. |
| 4.2 | Amended 1997 Stock Option Plan (Filed as Exhibit 4.2 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 4.3 | Warrant Agreement. The form of warrant agreement is substantially the same for all outstanding warrants consisting of Class A Warrants; Class B Incentive Warrants; Other Warrants (Filed as Exhibit 6(c) to the Registrant's Form 10-SB filed on August 2, 2005 and incorporated herein by reference. |
| 10.1 | Master Agreement dated October 10, 2002, with Metavante Corporation (Filed as Exhibit 10.3 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 10.2 | Stored Value Card Service Agreement Dated As Of April 1, 2003, With First Data Resources Inc. (Filed as Exhibit 10.6 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 10.3 | Card Sponsorship Agreement between Registrant and BankFirst dated April 9, 2003 (Filed as Exhibit 10.7 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 10.4 | ODFI Originator Agreement dated as of March 19, 2004, with BANKFIRST (Filed as Exhibit 10.11 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 10.5 | Marketer Agreement dated September 2, 2004, with First Federal Savings Bank of the Midwest dba Meta Payment Systems (Filed as Exhibit 10.14 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 10.6 | Originating Depository Financial Institution Originator Agreement dated September 13, 2004, with First Federal Savings Bank of the Midwest dba Meta Payment Systems (Filed as Exhibit 10.15 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference). |
| 10.7 | First Amendment to Contract Services Agreement with Glimcher Properties Limited Partnership dated September 9, 2004 (Filed as Exhibit 10.16 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 10.8 | Merchant Processing Agreement dated October 14, 2004, with NOVA Information Systems, Inc., and U.S. Bank, N.A. (Filed as Exhibit 10.17 to the Registrant's Form 10KSB filed on May 2, 2005 and incorporated herein by reference.) |
| 10.9 | Amendment to the Development and Consulting Services Agreement with First Data Corporation dated March 24, 2005 (Filed as Exhibit 10.22 to the Registrant's Form 10KSB filed on March 31, 2006 and incorporated herein by reference). |
| 10.10 | Amendment to Master Services Agreement with IPS Card Solutions, Inc., effective April 22, 2005 (Filed as Exhibit 10.23 to the Registrant's Form 10KSB filed on March 31, 2006 and incorporated herein by reference). |
| 10.11 | Amendment 3 to Internet Gift Card Agreement dated July 22, 2005 (Filed as Exhibit 10.24 to the Registrant's Form 10KSB filed on March 31, 2006 and incorporated herein by reference). |
| 10.12 | Lease Amendment #2 with 5B Bangerter, L.L.C. dated September 22, 2005 (Filed as Exhibit 10.25 to the Registrant's Form 10KSB filed on March 31, 2006 and incorporated herein by reference). |
| 10.13 | Employer Services Agreement with A Plus Benefits dated October 13, 2005 (Filed as Exhibit 10.26 to the Registrant's Form 10KSB filed on March 31, 2006 and incorporated herein by reference). |
| 10.14 | Second Amendment to Cash Card Issuer Agreement with Discover Financial Services LLC dated January 23, 2006 (Filed as Exhibit 10.28 to the Registrant's Form 10KSB filed on March 31, 2006 and incorporated herein by reference). |
| 10.15 | First Amendment to Marketer Agreement with MetaPayment Systems dated May 31, 2006 (Filed as Exhibit 10.15 to the Registrant's Form 10-QSB filed on July 15, 2006 and incorporated herein by reference). |
| 10.16 | Consent to Assignment to MetaPayment Systems of the Cash Card Issuer Agreement with Discover Financial Services LLD dated June 1, 2006 (Filed as Exhibit 10.16 to the Registrant's Form 10-QSB filed on July 15, 2006 and incorporated herein by reference). |
| 10.17 | Contract Services Agreement with Glimcher Properties dated July 24, 2006 (Filed as Exhibit 10.17 to the Registrant's Form 10-QSB filed on July 15, 2006 and incorporated herein by reference). |
| 31.1 | Section 302 Certification of Keith A. Guevara, Chairman, President and CEO |
| 31.2 | Section 302 Certification of Christopher Foley, Board Member and CFO |
| 32 | Certification pursuant to 18 U.S.C. Section 1350 of Keith A. Guevara and Christopher Foley |
| | |

## SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant caused this Form 10-QSB to be signed on its behalf by the undersigned, thereunto duly authorized.

NBO Systems, Inc.

By: /s/ Keith A. Guevara
Keith A. Guevara
Chairman/President/CEO

Dated: August 14, 2007

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signatures | Title | Date |
|---|---|---|
| /s/ Keith A. Guevara<br>Keith A. Guevara<br>*Principal Executive Officer | President, Chief Executive Officer and Chairman of the Board of Directors | August 14, 2007 |
| /s/ Christopher Foley<br>Christopher Foley<br>*Principal Financial and Accounting Officer | Chief Financial Officer, Director, Secretary and Treasurer | August 14, 2007 |
| /s/ Andrew Boyd-Jones<br>Andrew Boyd-Jones | Director | August 14, 2007 |

Exhibit 31.1

I, Keith A. Guevara, certify that:

1. I have reviewed this interim report on Form 10-QSB for the three- and six-months ended June 30, 2007 of NBO SYSTEMS, INC.;

2. Based on my knowledge, this 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 periods covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. The small business issuer's other certifying officer(s) and I, are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15e)) for the small business issuer and have:

    a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, is made known to us by others, particularly during the period in which this report is being prepared;

    b) evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;

    c) disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):

    a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and

    b) any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: August 14, 2007

/s/ Keith A. Guevara

Chairman of the Board of Directors, Chief Executive Officer and President
(Principal Executive Officer)

Exhibit 31.2

I, Christopher Foley, certify that:

1. I have reviewed this interim report on Form 10-QSB for the three- and six-months ended June 30, 2007 of NBO SYSTEMS, INC.;

2. Based on my knowledge, this 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 periods covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;

4. The small business issuer's other certifying officer(s) and I, are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15e)) for the small business issuer and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, is made known to us by others, particularly during the period in which this report is being prepared;

   b) evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;

   c) disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. The small business issuer's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: August 14, 2007

/s/ Christopher Foley

Chief Financial Officer, Director, Corporate Secretary & Treasurer
(Principal Financial and Accounting Officer)

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

Keith A. Guevara, as Chief Executive Officer of NBO Systems, Inc. (the "Company"), and Christopher Foley, as Chief Financial Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) the Company's interim report on Form 10-QSB for the period ended June 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), fully complies with the applicable requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 14, 2007

/s/ Keith A. Guevara
Chief Executive Officer
of NBO Systems, Inc.

Dated: August 14, 2007

/s/ Christopher Foley
Chief Financial Officer
(Principal Financial and Accounting Officer)
of NBO Systems, Inc.