VIEWPOINT CORP
Form 10-Q
May 10, 2006

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2006

or

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

For the transition period from ____________ to ____________

Commission file number: 0-27168

VIEWPOINT CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**95-4102687**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

498 Seventh Avenue, Suite 1810, New York, NY 10018
(Address of principal executive offices and zip code)

(212) 201-0800
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check One): Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

As of May 2, 2006, 66,320,000 shares of $0.001 par value common stock were outstanding.

TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

VIEWPOINT CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)
(Unaudited)

	March 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,779	$ 6,437
Marketable securities	3,818	2,674
Accounts receivable, net of reserve of $420 and $419, respectively	2,583	4,342
Prepaid expenses and other current assets	1,341	510
Total current assets	11,521	13,963
Restricted cash	184	182
Property and equipment, net	1,126	1,218
Goodwill	25,537	25,537
Intangible assets, net	4,009	4,131
Other assets	97	105
Total assets	$ 42,474	$ 45,136
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,341	$ 2,834
Accrued expenses	663	635
Deferred revenues	181	207
Current portion of warrants to purchase common stock	264	
Current portion of notes payable	476	814
Accrued incentive compensation	545	545
Current liabilities related to discontinued operations	231	231
Total current liabilities	4,701	5,266
Deferred rent	310	334
Warrants to purchase common stock	1,347	982
Subordinated notes	2,174	2,090
Unicast notes	1,581	1,582
Total liabilities	10,113	10,254
Stockholders equity:		
Preferred stock, $.001 par value; 5,000 shares authorized - no shares issued and outstanding at March 31, 2006 and December 31, 2005		
Common stock, $.001 par value; 100,000 shares authorized - 65,804 shares issued and 65,644 shares outstanding at March 31, 2006, and 64,849 shares issued and 64,689 shares outstanding at December 31, 2005	66	65
Paid-in capital	303,195	301,766
Treasury stock at cost; 160 at March 31, 2006 and December 31, 2005	(1,015)	(1,015)
Accumulated other comprehensive loss	(65)	(63)

Accumulated deficit	(269,820)	(265,871)
Total stockholders equity	32,361	34,882
Total liabilities and stockholders equity	$ 42,474	$ 45,136

VIEWPOINT CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(Unaudited)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Revenues:		
Search	$ 1,789	$ 2,180
Advertising systems	1,595	732
Services	553	1,243
Related party services		395
Licenses	46	155
Related party licenses		873
Total revenues	3,983	5,578
Cost of revenues:		
Search	36	46
Advertising systems	1,005	518
Services	642	810
Licenses	6	2
Total cost of revenues (exclusive of depreciation and amortization shown seperately below)	1,689	1,376
Gross profit	2,294	4,202
Operating expenses:		
Sales and marketing	1,578	1,275
Research and development	1,088	1,206
General and administrative	2,359	2,087
Depreciation	145	233
Amortization of intangible assets	138	178
Restructuring charges	92	
Total operating expenses	5,400	4,979
Loss from operations	(3,106)	(777)
Other income (expense), net:		
Interest and other income; net	79	24
Interest expense	(287)	(316)
Changes in fair values of warrants to purchase common stock	(628)	182
Total other income (expense)	(836)	(110)
Loss before provision for income taxes	(3,942)	(887)
Provision for income taxes	7	3
Net loss from continuing operations	(3,949)	(890)

Adjustment to net loss on disposal of discontinued operations, net of tax		145
Net loss	$ (3,949)	$ (745)
Basic and diluted net loss per common share:		
Net loss per common share from continuing operations	$ (0.06)	$ (0.01)
Net loss per common share	$ (0.06)	$ (0.01)
Weighted average number of shares outstanding basic and diluted	64,864	57,655

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

VIEWPOINT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Cash flows from operating activities:		
Net loss	$ (3,949)	$ (745)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation charges	668	14
Depreciation and amortization	283	411
Provision for bad debt	1	3
Changes in fair values of warrants to purchase common stock	628	(182)
Amortization of debt discount and issuance costs	236	271
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	1,758	219
Prepaid expenses	(831)	(198)
Accounts payable	(491)	(2,277)
Accrued expenses	4	299
Deferred revenues	(26)	100
Related party deferred revenues		(1,226)
Other	(1)	
Net cash used in operating activities	(1,720)	(3,311)
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	3,645	3,250
Purchases of marketable securities	(4,790)	(3,088)
Decrease (Increase) in restricted cash	(2)	101
Purchases of property and equipment	(53)	(160)
Acquisition of Unicast, net of cash acquired		(512)
Purchases of patents and trademarks	(16)	(9)
Net cash used in investing activities	(1,216)	(418)
Cash flows from financing activities:		
Repayment of Subordinate Notes	(450)	
Monthly repayment of Unicast Debt	(33)	
Proceeds from exercise of stock options	761	147
Net cash provided by financing activities	278	147
Net decrease in cash and cash equivalents	(2,658)	(3,582)
Cash and cash equivalents at beginning of year	6,437	5,804
Cash and cash equivalents at end of year	$ 3,779	$ 2,222

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

VIEWPOINT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	Three Monthe Ended March, 31	
	2006	**2005**
Supplemental disclosure of cash flow activities:		
Cash paid during the year for income taxes	$ 7	$ 3
Cash paid during the year for interest	53	89
Net assets acquired in Unicast acquisition :		
Accounts receivable, net		2,056
Prepaids		7
Other assets		22
Fixed assets		128
Goodwill and Intangible assets		6,547
Accounts payable and accrued expenses		(3,578)
Unicast Debt		(1,702)
Supplemental disclosure of non-cash investing and financing activities:		
Non-cash cost of Unicast acquisition		
Common stock		(1)
APIC		(2,967)
Unrealized (loss) on marketable securities	(1)	(8)

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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, consistent in all material respects with those applied in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. The interim financial information is unaudited, but reflects all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results of Viewpoint Corporation (Viewpoint or the Company) for the interim periods.

These unaudited consolidated financial statements have been prepared in accordance with the instructions to Rule 10-01 of Regulation S-X and, therefore, do not include all of the information and footnotes normally provided in annual financial statements. As a result, these unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with management s discussion and analysis of financial condition and results of operations, contained in Viewpoint s Annual Report on Form 10-K for the year ended December 31, 2005. The results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results to be expected for the year ending December 31, 2006 or other future periods.

Certain reclassifications have been made to the 2005 consolidated financial statements to conform to the 2006 presentation.

Liquidity

The Company had cash, cash equivalents and marketable securities of $7.6 million at March 31, 2006. During the quarter ended March 31, 2006, net cash used in operations amounted to $1.7 million. In July 2005, the Company extended the maturity date of $3.1 million in subordinated debt to March 2008, however, it has had significant quarterly and annual operating losses since its inception, and as of March 31, 2006, had an accumulated deficit of $269.8 million. There can be no assurance that Viewpoint will achieve or sustain positive cash flows from operations or profitability.

The Company believes that its current cash, cash equivalents, and marketable securities balances and cash flows from operations are sufficient to meet its operating cash flow needs and anticipated capital expenditure and financing activity requirements at least through March 31, 2007. In the event that the Company is unable to reach profitable operations or raise additional capital in the future, operations will need to be scaled back or discontinued.

If the Company s expected revenue targets are not achieved management would consider implementing cost reduction measures including workforce reductions as well as reductions in overhead and capital expenditures. The Company may seek additional funds when necessary through public or private equity financing or from other sources to fund operations and pursue growth, although there are no assurances that the Company can obtain such financing with reasonable terms.

The Company currently has no commitment for additional financing and may experience difficulty in obtaining additional financing on favorable terms, if at all. Any financing the Company obtains may contain covenants that restrict the Company s freedom to operate the business or may have rights, preferences or privileges senior to the Company s common stock and may dilute the Company s current shareholders ownership interest in Viewpoint.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

significant estimates include fair value of stock compensation, revenue, receivables, liabilities, warrants, goodwill, and intangible and fixed asset useful lives.

Cash Equivalents and Marketable Securities

The Company considers all highly liquid investments purchased with an original maturity of three months or less at date of acquisition to be cash equivalents.

The Company considers its marketable securities portfolio available-for-sale as defined in Statement of Financial Accounting Standards (FAS) No. 115 Accounting for Certain Investments in Debt and Equity Securities. These available-for-sale securities are accounted for at their fair value, and unrealized gains and losses on these securities are reported as a separate component of stockholders equity. The cost of an investment is determined based on specific identification. Realized gains or losses on marketable securities were not material for all periods presented.

The Company invests its cash in accordance with a policy that seeks to maximize returns while ensuring both liquidity and minimal risk of principal loss. The policy limits investments principally to certain types of instruments issued by institutions with investment grade credit ratings, and places restrictions on maturities and concentration by type and issuer. The majority of the Company s portfolio is composed of fixed income securities that are subject to the risk of market interest rate fluctuations, and all of the Company s marketable securities are subject to risks associated with the ability of the issuers to perform their obligations under the instruments although the Company expects all issuers to perform their obligations.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted Cash

The balance of $0.2 in restricted cash at March 31, 2006 and December 31, 2005 represents funds which were pledged as collateral to secure a letter of credit used for a security deposit on the Company s New York facility.

Goodwill and Intangible Assets

Goodwill is subject to impairment tests annually, or earlier, if indicators of potential impairment exist, using a fair-value-based approach in order to estimate the reporting unit s enterprise value. When evaluating goodwill for potential impairment, the Company first compares the fair value of each reporting unit, based on market comparables or discounted cash flow using a discount rate of 18%, with its carrying amount. If the estimated fair value of the reporting unit is less than its carrying amount, an impairment loss calculation is prepared. The impairment loss calculation compares the implied fair value of the reporting unit goodwill with the carrying amount of that goodwill. An impairment loss is recognized in an amount equal to the excess of the carrying amount of the reporting unit goodwill over the implied fair value of that goodwill. In determining fair value of the reportable units and the impairment amount, we consider estimates and judgments that affect the future cash flow projections as well as comparable companies. Actual results may differ from these estimates under different assumptions or conditions. See Note 3 for more information regarding goodwill and goodwill impairment.

All other intangible assets continue to be amortized over their estimated useful lives and are assessed for impairment under FAS No.144, Accounting for the Impairment or Disposal of Long-Lived Assets.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Assets are depreciated on the straight-line method over their estimated useful lives, which range from 3 to 5 years. Computer hardware and software is depreciated over 3 years, while furniture is depreciated over 5 years. Leasehold improvements are amortized over the shorter of the life of the lease or the life of the asset. Upon sale, any gain or loss is included in the consolidated statements of operations. Maintenance and minor replacements are expensed as incurred.

Software Development Costs

In accordance with FAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed, the Company provides for capitalization of certain software development costs once technological feasibility is established. To date, the establishment of technological feasibility of the Company s products and general release have substantially coincided. As a result, the Company has not capitalized any internal software development costs since costs qualifying for such capitalization have not been significant.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Software Developed for Internal Use

In accordance with Statement of Position (SOP) No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, and Emerging Issues Task Force (EITF) 00-02 Accounting for Web Site Development Costs, the Company capitalizes certain costs for software, consulting services, hardware and payroll-related costs incurred to purchase or develop internal-use software or website development, during the application development stage. The Company expenses costs incurred during preliminary project assessment, research and development, re-engineering, training, and application maintenance.

Stock-Based Compensation

The Company has adopted the provisions of FAS No. 123R, Share-Based Payment which replaced FAS 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees, as of January 1, 2006. The provisions of FAS 123R require a company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized in the statement of operations over the period during which an employee is required to provide service in exchange for the award. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the Company s expected stock price volatility over the term of the awards of 135%, actual and projected employee stock option exercise behaviors resulting in an estimated term of 4.58 years, risk-free interest rate of 4.72%, and expected dividends of zero. FAS 123R also amends FASB Statement No. 95, Statement of Cash Flows, to require that excess tax benefits, as defined, realized from the exercise of stock options be reported as a financing cash inflow rather than as a reduction of taxes paid in cash flow from operations. As the result of the uncertainty regarding the Company s ability to utilize its deferred tax assets, the impact of wind fall tax benefits on the accompanying financial statements was immaterial.

The Company elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding as of the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service period using the compensation cost estimated for the FAS 123 pro forma disclosures.

The adoption of FAS 123R had a material impact on our consolidated financial position, results of operations and cash flows. See Note 6 for further information regarding our stock-based compensation assumptions and expenses, including pro forma disclosures for prior periods as if we had recorded stock-based compensation expense.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Revenue Recognition

The Company recognizes revenue in accordance with Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended, and Staff Accounting Bulletin (SAB) No. 101 Revenue Recognition in Financial Statements as amended by SAB No. 104 Revenue Recognition. Per SOP 97-2 and SAB No. 101, as amended by SAB No. 104, the Company recognizes revenue when the following criteria are met: (a) persuasive evidence of an arrangement exists, (b) delivery has occurred or services have been rendered, (c) the Company s fee is fixed or determinable, and (d) collectibility is reasonably assured.

Viewpoint generates revenues through four sources: (a) search advertising, (b) advertising systems, (c) services, and (d) software licenses. Search Advertising revenue is an extension of the Company s licensing revenue, and is derived from a share of the fees charged by Yahoo! to advertisers who pay for sponsored links when a customer clicks on the paid link on the results provided by the Viewpoint Toolbar. Advertising systems revenue is generated by charging customers to host and/or deliver advertising campaigns based on a cost per thousand (CPM) impressions. Service revenues are generated from fee-based professional services, customer support services (maintenance arrangements), and training services performed for customers that license the Company s products. License revenues are generated from licensing the rights to use products directly to customers.

The Company executed a search advertising agreement in 2004, and amended it in 2006, with Yahoo!. The agreement provides that Yahoo! is the exclusive provider of search results for the Viewpoint Toolbar through March 2008. Yahoo! pays a variable fee per month for the access to the Company s distribution and the ability to display search results to the Viewpoint Toolbar. This variable fee is based on users clicks on sponsored advertisements included in the search results provided by Yahoo!, through the Viewpoint Toolbar. The Viewpoint Toolbar s search results are provided by Yahoo!, who collects a fee from the advertiser and remits a percentage of the fee to Viewpoint. Revenue generated is a function of the number of Viewpoint Toolbars performing searches, the number of searches that are sponsored by advertisers, the number of advertisements that are clicked on by Viewpoint Toolbar searchers, the rate advertisers pay for those advertisements, and the percentage retained by Yahoo! for providing the results.

In addition, Viewpoint also offers an online advertising system campaign management and deployment product. This system permits publishers, advertisers, and their agencies to manage the process of deploying online advertising campaigns. The Company charges customers on a cost per thousand (CPM) impression basis, and recognizes revenue when the impressions are served, so long as all other revenue recognition criteria are satisfied. The Company also purchases media space from web-site publishers and re-sells that space to its advertising customers. The Company acts as a principal party in the transaction, assumes the title to the media space purchased, and assumes the risks of collection and therefore recognizes the entire amount billed to the customer as revenue, and the cost of the media space as cost of sales.

Viewpoint has a creative services group that builds content in the Viewpoint format for customers. Viewpoint charges customers fees for these services based on time and materials to complete a project for the customer. Revenue is recognized on a percentage-of-completion basis if all other revenue recognition criteria are satisfied. Those estimates are reviewed quarterly, and differences are adjusted in the period they are found. If the actual cost to complete is not consistent with the original estimates, revenues may be materially different than initially recorded. Historically, the Company s estimates have been consistent with actual costs.

On June 14, 2005, Viewpoint announced that for all non-special purpose licenses, it was discontinuing the practice of charging customers a license fee for the use of the Viewpoint Media Player and related technologies. The

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Viewpoint Media Player will no longer require a broadcast key to display content, thereby giving all developers free access to the Viewpoint Distribution Network. However, Viewpoint will still charge for certain licenses requiring customization. Software license revenues from direct customers included sales of perpetual and term-based licenses for broadcasting digital content in the Viewpoint format. Fees from licenses sold together with fee-based professional services were generally recognized as revenue upon delivery of the software, provided that the payment of the license fees were not dependent upon the performance of the services, and the services were not essential to the functionality of the licensed software. If the services were essential to the functionality of the software, or payment of the license fees were dependent upon the performance of the services, both the software license and service fees were recognized in accordance with SOP 81-1 Accounting for Performance of Construction-Type and Certain Production-Type Contracts. The percentage of completion method were used for those arrangements in which reasonably dependable estimates were available. If reasonably dependable estimates were not available due to the complexity of the services to be performed, the Company deferred recognition of any revenues for the project until the project was completed, delivered and accepted by the customer, provided all other revenue recognition criteria were met and no further significant obligations exist. For arrangements involving multiple elements, the Company defers revenue for the undelivered elements based on vendor specific objective evidence (VSOE) of the fair value of the undelivered elements and recognizes the difference between the total arrangement fee and the amount deferred for the undelivered elements as revenue. The determination of VSOE in multiple element arrangements is based on the price charged when the same element is sold separately. For maintenance and technical support elements, the Company uses renewal rates to determine the price when sold separately.

Standard terms for service arrangements, which are typically billed and collected on an installment basis, require final payment within 90 days of completion of the services. Standard terms for license arrangements required payment within 90 days of the contract date, which typically coincided with delivery. Probability of collection is based upon the assessment of the customer s financial condition through the review of their current financial statements and/or credit reports. For follow-on sales to existing customers, prior payment history is also used to evaluate probability of collection. The Company s arrangements with customers do not contain product return rights. If the fee is not fixed or determinable, revenue is recognized as payments become due or as cash is received from the customer assuming all other revenue recognition requirements have been met. If a nonstandard acceptance period is required, revenues are recognized upon the earlier of customer acceptance or the expiration of the acceptance period.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes

The Company accounts for income taxes using the liability method as required by SFAS No. 109, Accounting for Income Taxes. Deferred income taxes are determined based on the differences between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Concentration of Risk

The Company is subject to concentration of credit risk and interest rate risk related to cash, cash equivalents, marketable securities, accounts receivable, and restricted cash. Credit risk is managed by limiting the amount of marketable securities placed with any one issuer, investing in high-quality marketable securities and securities of the U.S. government and limiting the average maturity of the overall portfolio. At March 31, 2006, the Company has maintained balances with various financial institutions in excess of the federally insured limits.

Carrying amounts of financial instruments held by the Company, which include cash and cash equivalents, marketable securities, accounts receivable, accounts payable, long-term debt, and accrued expenses, approximate fair value.

Net Loss Per Common Share

Basic net loss per common share is computed using the weighted average number of shares of outstanding and diluted net loss per common share is computed using the weighted average number of shares of common and common equivalent shares outstanding. Common equivalent shares related to stock options and warrants totaling 5.5 million and 8.3 million, for the three months ended March 31, 2006 and 2005, respectively, are excluded from the computation of diluted net loss per common share because their effect was anti-dilutive.

Common Stock Issuance

In November 2003, the Company sold 3.1 million shares of common stock in a private placement to an institutional investor for $2.5 million or $.80 per share.

In March 2004, the Company sold 1.5 million shares of common stock, in a private placement to an institutional investor for $3.7 million or $2.45 per share. The institutional investor was one of the holders of convertible notes. Prior to the closing of the March 2004 private placement the institutional investor converted $0.9 million of outstanding notes and received 0.9 million shares of Company common stock in exchange.

In June 2004, the Company exercised its right to convert the remaining outstanding convertible notes of $1.8 million and the related outstanding interest into 1.7 million shares of Viewpoint common stock.

In July 2005, the Company sold 1.3 million shares of common stock in a private placement to a holder of the Company s subordinated debt for aggregate gross proceeds of $2.0 million.

In December 2005 the Company sold 5.1 million shares of common stock and warrants in a private placement to several investors for $5.1 million. The warrants were to purchase an additional 1.0 million shares of common stock at an exercise price of $1.20 per share with a term of three years. In addition, pursuant to this private placement the Company issued warrants to purchase 0.2 million shares of common stock at an exercise price of $1.20 per share with a term of five years, and paid $0.3 million in issuance costs. As of March 31, 2006 the aggregate value of warrants to purchase the 1.2 million shares of common stock amounted to $1.3 million. During the quarter ended March 31, 2006, the fair value of the warrants increased by $0.4 million which is included as an expense within the statement of operations.

Derivatives

In 2002 and 2003, the Company issued convertible notes and warrants which would require Viewpoint to issue shares of common stock upon conversion of these securities. The Company accounts for the fair values of the outstanding warrants to purchase common stock and the conversion options of its convertible notes in accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, and EITF Issue No. 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock, which requires the Company to bifurcate and separately account for the conversion option and warrants as derivatives. The convertible notes and warrants are accounted for as derivatives as under certain situations the Company could be forced to net cash settle. The Company is required to carry these derivatives on its balance sheet at fair value and the unrealized changes in the value of these derivatives are reflected in net loss as changes in fair values of warrants to purchase common stock and conversion options of convertible notes. Such changes in fair value are recorded as an adjustment to reconcile net loss to net cash used in operating activities in the consolidated statement of cash flows. In 2004, the convertible notes were converted into common stock.

The Company was also required to carry the warrants associated with the December 2005 private placement on its balance sheet at fair value. The unrealized changes in the value of these warrants are reflected in the net loss as changes in fair values of warrants to purchase common stock. Such changes in fair value are recorded as an adjustment to reconcile net loss to net cash used in operating activities in the consolidated statement of cash flows.

The Company determines the value of the warrants by using the Black Scholes Method using the actual term of the warrants, and assumptions that are consistent with the Black-Scholes option-pricing model.

Comprehensive Loss

All components of comprehensive income (loss), including net income (loss), are reported in the financial statements in the period in which they are recognized. Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Net income (loss) and other comprehensive income (loss), are reported net of their related tax effect, to arrive at comprehensive income (loss).

Recent Accounting Pronouncements

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155 (SFAS 155), Accounting for Certain Hybrid Financial Instruments which amends Statement of Financial Accounting Standards No. 133 (SFAS 133), Accounting for Derivative Instruments and Hedging Activities and Statement of Financial Accounting Standards No. 140 (SFAS 140), Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS 155 simplifies the accounting for certain derivatives embedded in other financial instruments by allowing them to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis. SFAS 155 also clarifies and amends certain other provisions of SFAS 133 and SFAS 140. SFAS 155 is effective for all financial instruments acquired, issued or subject to a remeasurement event occuring in fiscal years beginning after September 15, 2006. Earlier adoption is permitted, provided the Company has not yet issued financial statements, including for interim periods, for that fiscal year. We do not expect the adoption of SFAS 155 to have a material impact on our consolidated financial position, results of operations or cash flows.

2. Unicast Acquisition

On December 1, 2004, Viewpoint Corporation entered into an agreement to acquire all of the outstanding capital stock of Unicast Communications Corp. (Unicast). The transaction closed on January 3, 2005, and Viewpoint assumed ownership of Unicast as a wholly owned subsidiary at that date. The aggregate purchase price for the acquisition was $3.5 million.

Under the terms of the agreement, Viewpoint issued an aggregate of 1.1 million shares of Viewpoint common stock, with a fair value of $3.0 million to the selling stockholders of Unicast and paid $0.4 million in cash and acquisition costs of $0.1 million. Viewpoint also assumed negative net working capital from Unicast of $1.8 million. Based upon the working capital calculation during the period following the acquisition Viewpoint has no additional obligation to issue shares or pay cash to the seller.

Additionally, long-term debt issued by Unicast (Unicast notes) remains outstanding at the Unicast subsidiary level following the closing. This debt is comprised primarily of two notes. Unicast issued an unsecured promissory note dated February 27, 2004 in the principal amount of $1.0 million. This promissory note bears interest at 5% per annum, compounding annually, and matures in February 2011. No payments of principal or interest are due until the maturity date. In addition, Unicast issued an amended and restated secured promissory note dated February 27, 2004 in the principal amount of $2.0 million. This promissory note bears interest of 5% per annum and is collateralized by substantially all of the Unicast subsidiary s assets. Concurrently with the closing of the Unicast acquisition, Viewpoint made a payment of $0.3 million to the secured note holder which was applied towards reducing the amount outstanding under the promissory note. Viewpoint will become an additional obligor under the promissory note and Viewpoint s assets will become additional collateral to secure the obligations if certain contingencies occur, such as Viewpoint s failure to operate the Unicast ad-serving business through the Unicast subsidiary or the ad-serving business fails to achieve certain revenue targets. As of March 31, 2006 no contingencies had occurred. All unpaid principal and interest is payable in 60 equal monthly installments from March 2006 through March 2011 amounting to $2.2 million. In March 2006, the Company made the first installment under the secured promissory note.

Viewpoint recorded all working capital assets and liabilities at their fair market value on the date of the acquisition.

Tangible equipment value was determined based on fair market value at the date of acquisition. The remaining useful life of this equipment was predominantly determined to be one year. Intangible values acquired included trademarks, acquired technology, website partner relationships and goodwill. Acquired technology was determined to have a life of three years while the other intangible values were determined to have a life of 5-10 years. Unicast had no in-process research and development.

Goodwill was determined based upon the residual value based upon fair value of the common stock issued, the cash paid plus the liabilities assumed less the identifiable asset values. None of the goodwill will be tax deductible. Consideration paid for the acquisition amounted to $3.5 million, made up of cash consideration of $0.4 million, acquisition costs of $0.1 million and the issuance of 1.1 million shares of common stock valued at $3.0 million. The following table summarizes amounts recorded associated with the Unicast transaction, based upon the consideration paid.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

		(in thousands)
Current assets	$	2,097
Property and equipment		128
Intangible assets		4,508
Goodwill		2,039
Total assets acquired		8,772
Less: liabilities assumed		(5,280)
Total purchase price	$	3,492

The results of operations of Unicast are included in the Company s Consolidated Statement of Operations beginning January 3, 2005.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Goodwill and Intangible Assets

Goodwill is subject to impairment tests annually, or earlier if indicators of potential impairment exist, using a fair-value-based approach. All other intangible assets are amortized over their estimated useful lives and are assessed for impairment under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

A summary of changes in the Company s goodwill by reporting unit and intangible assets during the quarter ended March 31, 2006 by aggregated segment are as follows (amounts in thousands):

	Goodwill	Intangible Assets	Total
Balance as of December 31, 2005	$ 25,537	$ 4,131	$ 29,668
Additions during period		16	16
Amortization		(138)	(138)
Balance as of March 31, 2006	$ 25,537	$ 4,009	$ 29,546

The changes in the carrying amounts of goodwill by reporting unit, and intangible assets for the quarter ended March 31, 2005, are as follows (in thousands):

	Goodwill	Intangible Assets	Total
Balance as of December 31, 2004	$ 31,276	$ 230	$ 31,506
Additions during period		9	9
Additions during period related to Unicast acquisition	2,101	5,170	7,271
Amortization		(1)	(1)
Amortization related to Unicast acquisition		(177)	(177)
Balance as of March 31, 2005	$ 33,377	$ 5,231	$ 38,608

As of March 31, 2006 and December 31, 2005, the Company s intangible assets and related accumulated amortization consisted of the following (in thousands):

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	March 31, 2006			December 31, 2005		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Website Partner Relationships - Unicast	$ 3,772	$ (497)	$ 3,275	$ 3,772	$ (404)	$ 3,368
Acquired Technology - Unicast	410	(215)	195	410	(187)	223
Patents and Trademarks - Unicast	326	(95)	231	326	(80)	246
Patents and Trademarks	348	(40)	308	332	(38)	294
Total Intangible Assets	$ 4,856	$ (847)	$ 4,009	$ 4,840	$ (709)	$ 4,131

Amortization of intangible assets is estimated to be $0.6 million a year for the next five years.

4. Related Party Transactions

In 2003, the Company entered into an amended license agreement with AOL which provided for payments by AOL of $10.0 million which were all received during the fourth quarter of 2003. The agreement contains multiple elements consisting of a perpetual broadcast license, a perpetual source code license, quarterly updates to the source code through December 2005, and maintenance and consulting services. The Company recognized $1.2 million in related party revenue for the three months ended March 31, 2005. The contract relating to this agreement expired on December 31, 2005.

In July 2005, the Company and a related party debt holder amended a note in the principal amount of $3.1 million (see Note 5).

5. Long Term Debt

Convertible Notes

On December 31, 2002, the Company completed a private placement of convertible notes and warrants in which it issued to three institutional investors, 4.95% convertible notes having an aggregate principal amount of $7.0 million, and warrants to purchase 0.7 million shares of Company common stock. The warrants expire on December 31, 2006, and were initially issued at an exercise price of $2.26 per share. The number of warrants and the exercise price are subject to adjustment if the Company sells or issues securities under a dilutive issuance (as defined in the warrant to purchase common stock agreement) subject to certain conditions. As of March 31, 2006, 0.8 million warrants were outstanding related to this placement.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On March 25, 2003, the Company entered into Redemption, Amendment and Exchange Agreements with the three institutional investors with whom it had completed the private placement of convertible notes and warrants on December 31, 2002, extinguishing the original convertible notes. In conjunction with the extinguishment, the Company paid $3.3 million, issued new convertible notes in the principal amount of $2.7 million and issued 1.4 million shares of its common stock with a market value of $0.9 million. The original convertible notes and new convertible notes are collectively referred to as the Notes .

Pursuant to SFAS No. 133, the Company was required to bifurcate the fair value of the conversion options from the new convertible notes. In addition, pursuant to EITF Issue No. 00-19, the Company was required to record the fair value of the conversion options as long-term liabilities.

The Company recorded income or loss based on the decrease or increase, respectively, in the fair values of the new conversion feature of the notes and original warrants in the Company s consolidated statements of operations. The amortization of discount on the new convertible notes and debt issue costs were accounted for using the effective interest method.

On March 17, 2004, one of the institutional investors holding the new convertible notes converted $0.9 million of outstanding notes for 0.9 million shares of the Company s common stock. In addition, on the same day as the conversion, the Company sold 1.5 million shares of common stock in a private placement to the institutional investor, for $3.7 million or $2.45 per share. The Company recorded a loss on conversion of debt in the amount of $0.6 million, which represented the write-off of unamortized loan discount and debt issuance costs of $0.1 million and the difference between the proceeds received from the private placement and the fair value of the common stock issued based upon the closing price of the Company s stock on the day of the sale of $0.5 million.

On June 18, 2004, the Company completed the conversion of the remaining outstanding convertible notes of $1.8 million and the related outstanding interest into 1.7 million shares of Viewpoint common stock. The Company recognized $0.2 million related to the loss on conversion of the notes.

As a result of the conversion of the outstanding notes into 2.6 million shares during 2004, the Company recorded additional paid in capital of $6.1 million which was comprised of 2.7 million of cash paid upon the conversion and $3.4 million of the carrying value of the outstanding convertible notes upon conversion.

For the quarter ended March 31, 2006, the Company recognized a loss from the change in the fair value of the outstanding warrants of $0.2 million, resulting from an increase in the fair market value of the Company s common stock. For the quarter ended March 31, 2005, the Company recognized a gain related to the change in valuation of the outstanding warrants of $0.2 million, resulting from the decrease in the fair market value of the Company s common stock.

Subordinated Notes

On March 26, 2003, Viewpoint Corporation entered into a Securities Purchase Agreement with three accredited investors, pursuant to which it received $3.5 million in exchange for an aggregate of $3.5 million principal amount of 4.95% subordinated notes and 3.6 million shares of Viewpoint common stock. Prior to the amendment discussed below (see Amended Notes), the subordinated notes were scheduled to mature on March 31, 2006. Interest on these notes is payable quarterly in arrears in cash. The Company has the right at any time to redeem up to all of the outstanding notes at par plus accrued and unpaid interest.

The $3.5 million of proceeds was allocated to subordinated notes in the amount of $1.7 million, common stock for the par value of $0.001 for the shares issued, and additional paid in capital of $1.8 million based on the market value of the Company s common stock on March 26, 2003. Debt issuance costs, which amounted to $0.2 million, were recorded as other assets in the Company s consolidated balance sheet.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

On March 31, 2006, the Company redeemed notes with a principal amount of $0.4 million pursuant to the agreement. The maturity date was extended for the remaining notes with a principal amount of $3.1 million (see Amended Notes).

Amended Notes

On July 27, 2005, the Company and a holder of the subordinated debt amended the 4.95% subordinated note in the principal amount of $3.1 million (referred to herein as the Holder) to extend the maturity date from March 31, 2006 to March 31, 2008 in exchange for the payment by Viewpoint of $0.1 million to the Holder of the subordinated note. As discussed in more detail below, the $0.1 million was accounted for as a reduction in the carrying value of the subordinated debt.

The Company accounted for the amended and restated note as a nontroubled debt transaction in accordance with EITF Issue No. 96-19 Debtor s Accounting for a Modification or Exchange of Debt Instruments. Pursuant to EITF 96-19, the Company is required to account for the modification as a debt extinguishment if it is determined that the terms have changed substantially. Per EITF 96-19, an indication of the existence of substantially different terms is whether the cash flows have changed by more than 10%. In calculating the present value of the cash flows, the Company used its current effective interest rate of 23% (incremental borrowing rate) and determined that the cash flows changed by more than 10% as a result of the extension of the maturity date on the note. Since the terms of the old and new notes were determined to be substantially different, the new debt instrument was recorded at fair value.

In addition to the amendment of the note, the Company and the Holder entered into a Stock Purchase Agreement, dated as of July 27, 2005, under which the Company issued 1.3 million shares of Company common stock in a private placement to the Holder at a purchase price of $1.55 per share resulting in aggregate gross proceeds of $2.0 million. The closing price of the Company s common stock on the date of the share purchase was $1.59.

Since the Holder of the subordinated note owned 13% of Viewpoint s outstanding common stock and also had a position on the Company s Board of Directors, the Holder of the note is considered a related party, therefore, the underlying amendment of the note was accounted for as a capital transaction. The Company recognized the difference between the carrying value of the subordinated note and the fair value of the amended and restated substituted note in the amount of $0.6 million offset by the modification fee paid of $0.1 million as an increase to the stockholders equity.

Unicast Notes

On January 3, 2005, as disclosed in Note 2, Viewpoint purchased Unicast and, as a result, assumed debt which included an unsecured note with a principal amount of $1.0 million due in December 2011 at an interest rate of 5% per annum and a collateralized note with a principal balance of $1.8 million which matures in March 2011 and interest rate of 5% per annum. This note is collateralized by the assets of Unicast. The debt was discounted to its fair value based upon the prevailing interest rates at the date of the acquisition, the term of the debt, the interest provisions of the debt and the credit risk associated with repayment. Viewpoint will accrete the notes based upon the interest-method, including interest payment requirements through maturity.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of January 3, 2005, the date of acquisition, the fair value of the collateralized and non-collateralized notes amounted to $1.4 million and $0.3 million, respectively. The Company recorded interest expense on these notes of $0.1 million for each of the three months ended March 31, 2006 and 2005, which increased the aggregate carrying value of these notes to $2.1 million as of March 31, 2006, of which $1.6 million is long-term.

The Company s total carrying value by note at March 31, 2006 and December 31, 2005 is as follows (amounts in thousands):

	March 31 2006	December 31 2005
Subordinated notes	$ 2,174	$ 2,505
Unicast notes	2,057	1,981
Total long-term debt	4,231	4,486
Less current portion	476	814
Long-term debt, net of current portion	$ 3,755	$ 3,672

The reconciliation of the carrying value to the face value of each note as of March 31, 2006, is as follows (amounts in thousands):

	Subordinated Notes	Unicast Notes	Total
Book value of long-term debt	2,174	2,057	4,231
Discount on long-term debt	876	661	1,537
Face value of the long-term debt	$ 3,050	$ 2,718	$ 5,768

The maturity schedule for the Company s debt subsequent to March 31, 2006 is as follows (amounts in thousands):

Maturity	
2006	$ 260
2007	350
2008	3,400
2009	350
2010 and thereafter	1,408
	$ 5,768

6. Stock-Based Compensation

Beginning with the first quarter of 2006, the Company adopted FAS 123R. See Note 1 for a description of the adoption of FAS 123R. The Company currently uses the Black-Scholes option pricing model to determine the fair value of stock options. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the Company s expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends.

Prior to the adoption of FAS No. 123(R) the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with APB No. 25 as allowed under FAS No. 123, *Accounting for Stock-Based Compensation*. Under the intrinsic value method, share-based compensation expense was recognized by the Company if the exercise price of the grant was less than the fair market value of the underlying stock at the date of grant.

Prior to January 1, 2006, the Company disclosed compensation cost in accordance with FAS No. 123. The provisions of FAS No. 123 required the Company to disclose the assumptions used in calculating the fair value pro forma expense. Had compensation expense for the plans been determined based on the fair value of the options at the grant dates for awards under the plans consistent with FAS No. 123, the Company s net loss for the three months ended March 31, 2005 would have been as follows (amounts in thousands, except per share data):

	Three Months Ended March, 31
	2005
Net loss, as reported	$ (745)
Add: Non-cash stock-based employee compensation charges included in reported net loss, net of related tax effects	14
Deduct: Non-cash stock-based employee compensation charges determined under fair value based method for all awards, net of related tax effects	(1,051)
Pro forma net loss	$ (1,782)
Net loss per share:	
Basic and diluted as reported	$ (0.01)
Basic and diluted pro forma	$ (0.03)

Pro forma disclosures for the three months ended March 31, 2006 are not presented because the amounts are recognized in the unaudited Consolidated Statement of Operations.

The Company estimated the expected term of options granted in accordance with the Staff Accounting Bulletin (“SAB”) 107. The Company estimated the volatility of the Company s common stock by using the historical volatility of the Company s common stock over the expected term. The Company based the risk-free interest rate used in the option valuation model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options. The Company does not anticipate paying cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. As the result of the uncertainty regarding the Company s ability to utilize its deferred tax assets, the impact of wind fall tax benefits on the accompanying financial statements was immaterial. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are the vesting periods.

To estimate compensation expense which would have been recognized under FAS No. 123 for the three months ended March 31, 2005 and the compensation cost that was recognized under FAS No. 123(R) for the three months ended March 31, 2006, the Company uses the Black-Scholes option-pricing model with the following weighted-average assumptions for equity awards granted:

	Three Months Ended March 31,	
	2006	2005
Risk-free interest rate	4.72%	4.04%
Dividend yield		
Volatility factor	1.35	1.00
Weighted average expected life in years	4.58	