

VIEWPOINT CORP  
Form 10-Q  
August 09, 2006

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

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2006

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-27168

**VIEWPOINT CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**95-4102687**

(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  No

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  Accelerated filer  Non-accelerated filer

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

As of August 1, 2006, 67,232,000 shares of \$0.001 par value common stock were outstanding.



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## PART I - FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements

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

	June 30, 2006	December 31, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,802	\$ 6,437
Marketable securities	5,718	2,674
Accounts receivable, net of reserve of \$410 and \$419, respectively	2,895	4,342
Prepaid expenses and other current assets	536	510
	<u>10,951</u>	<u>13,963</u>
Total current assets	10,951	13,963
Restricted cash	185	182
Property and equipment, net	1,164	1,218
Goodwill, net	25,537	25,537
Intangible assets, net	3,915	4,131
Other assets, net	95	105
	<u>41,847</u>	<u>45,136</u>
Total assets	\$ 41,847	\$ 45,136
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,177	\$ 2,834
Accrued expenses	820	635
Deferred revenues	151	207
Current portion of notes payable	389	814
Accrued incentive compensation	545	545
Current liabilities related to discontinued operations	231	231
	<u>4,313</u>	<u>5,266</u>
Total current liabilities	4,313	5,266
Deferred rent	286	334
Warrants to purchase common stock	2,154	982
Subordinated notes	2,263	2,090
Unicast notes	1,625	1,582
	<u>10,641</u>	<u>10,254</u>
Total liabilities	10,641	10,254
Stockholders' equity:		
Preferred stock, \$.001 par value; 5,000 shares authorized - no shares issued and outstanding on June 30, 2006 and December 31, 2005		
Common stock, \$.001 par value; 100,000 shares authorized - 67,171 shares issued and 67,011 shares outstanding at June 30, 2006, and 64,849 shares issued and 64,689 shares outstanding at December 31, 2005	67	65
Paid-in capital	304,811	301,766
Treasury stock at cost; 160 at June 30, 2006 and December 31, 2005	(1,015)	(1,015)
Accumulated other comprehensive loss	(16)	(63)
Accumulated deficit	(272,641)	(265,871)
	<u>67</u>	<u>65</u>

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Total stockholders' equity	31,206	34,882
	<u>          </u>	<u>          </u>
Total liabilities and stockholders' equity	\$ 41,847	\$ 45,136
	<u>          </u>	<u>          </u>

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>Revenues:</b>				
Search	\$ 1,573	\$ 2,393	\$ 3,362	\$ 4,573
Advertising systems	3,013	1,163	4,608	1,895
Services	1,091	1,564	1,644	2,807
Related party services		354		749
Licenses	32	227	78	382
Related party licenses		872		1,745
<b>Total revenues</b>	<b>5,709</b>	<b>6,573</b>	<b>9,692</b>	<b>12,151</b>
<b>Cost of revenues:</b>				
Search	38	49	74	95
Advertising systems	2,199	909	3,239	1,498
Services	648	1,055	1,311	1,923
Licenses	2	1	8	3
<b>Total cost of revenues</b>	<b>2,887</b>	<b>2,014</b>	<b>4,632</b>	<b>3,519</b>
<b>Gross profit</b>	<b>2,822</b>	<b>4,559</b>	<b>5,060</b>	<b>8,632</b>
<b>Operating expenses:</b>				
Sales and marketing	1,449	1,228	3,027	2,503
Research and development	1,068	1,147	2,156	2,353
General and administrative	2,226	2,654	4,585	4,741
Depreciation	107	182	224	338
Amortization of intangible assets	111	126	221	252
Restructuring charges			92	
<b>Total operating expenses</b>	<b>4,961</b>	<b>5,337</b>	<b>10,305</b>	<b>10,187</b>
<b>Loss from operations</b>	<b>(2,139)</b>	<b>(778)</b>	<b>(5,245)</b>	<b>(1,555)</b>
<b>Other income (expense), net:</b>				
Interest and other income; net	90	32	169	56
Interest expense	(209)	(339)	(496)	(655)
Changes in fair values of warrants to purchase common stock	(544)	648	(1,172)	830
<b>Total other income (expense)</b>	<b>(663)</b>	<b>341</b>	<b>(1,499)</b>	<b>231</b>
<b>Loss before provision for income taxes</b>	<b>(2,802)</b>	<b>(437)</b>	<b>(6,744)</b>	<b>(1,324)</b>
Provision for income taxes	19	9	26	12
<b>Net loss from continuing operations</b>	<b>(2,821)</b>	<b>(446)</b>	<b>(6,770)</b>	<b>(1,336)</b>

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Adjustment to net loss on disposal of discontinued operations				145
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net loss	\$ (2,821)	\$ (446)	\$ (6,770)	\$ (1,191)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Basic and diluted net loss per common share:	\$ (0.04)	\$ (0.01)	\$ (0.10)	\$ (0.02)
Weighted average number of shares outstanding basic and diluted	<u>66,505</u>	<u>58,014</u>	<u>65,689</u>	<u>57,835</u>

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

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

	Six Months Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Net loss	\$ (6,770)	\$ (1,191)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation charges	1,163	595
Depreciation and amortization	555	810
Provision for bad debt	13	62
Changes in fair values of warrants to purchase common stock	1,172	(830)
Amortization of debt discount and issuance costs	381	563
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	1,455	527
Prepaid expenses	(26)	(43)
Accounts payable	(665)	(1,300)
Accrued expenses	137	(410)
Deferred revenues	(56)	(38)
Related party deferred revenues		(2,463)
Other	34	
	<u>          </u>	<u>          </u>
Net cash used in operating activities	(2,607)	(3,718)
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	5,480	6,980
Purchases of marketable securities	(8,532)	(5,307)
Net decrease in restricted cash	(3)	100
Purchases of property and equipment	(215)	(285)
Acquisition of Unicast, net of cash acquired		(512)
Purchases of patents and trademarks	(61)	(12)
	<u>          </u>	<u>          </u>
Net cash (used in) provided by investing activities	(3,331)	964
Cash flows from financing activities:		
Repayment of Subordinated Notes	(450)	
Repayment of Unicast Debt	(130)	
Proceeds from exercise of stock options	1,883	386
	<u>          </u>	<u>          </u>
Net cash provided by financing activities	1,303	386
Effect of exchange rates changes on cash		3
Net decrease in cash and cash equivalents	(4,635)	(2,365)
Cash and cash equivalents at beginning of period	6,437	5,804
	<u>          </u>	<u>          </u>
Cash and cash equivalents at end of period	\$ 1,802	\$ 3,439
	<u>          </u>	<u>          </u>

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



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

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
Supplemental disclosure of cash flow activities:		
Cash paid during the period for income taxes	26	12
Cash paid during the period for interest	116	136
Net assets acquired in Unicast acquisition:		
Accounts receivable, net		2,056
Prepays		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:		
Cost of Unicast acquisition		
Common stock		(1)
APIC		(2,967)
Unrealized (losses) gains on marketable securities	(8)	2
Purchase of property and equipment accrued and not yet paid	9	

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 and six month periods ended June 30, 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 \$7.5 million at June 30, 2006. During the six months ended June 30, 2006, net cash used in operations amounted to \$2.6 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 June 30, 2006, had an accumulated deficit of \$272.6 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, anticipated capital expenditures and financing activity requirements at least through June 30, 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.

**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 the Black-Scholes 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 134%, actual and projected employee stock option exercise behaviors resulting in an estimated term of 4.52 years, risk-free interest rate of 5.07%, 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 windfall 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 2006 grants and to grants that were unvested as of the effective date. 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 and results of operations. 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.

**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 7.9 million and 6.4 million, for the three and six months ended June 30, 2006, respectively, and 7 million and 7.1 million for the three and six months ended June 30, 2005, respectively, are excluded from the computation of diluted net loss per common share because their effect was anti-dilutive.

*Common Stock Issuance*

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 June 30, 2006 the aggregate value of warrants to purchase the 1.2 million shares of common stock amounted to \$1.7 million. During the three and six months ended June 30, 2006, the fair value of the warrants increased by \$0.3 million and \$0.8 million respectively, which is included as an expense within the statement of operations.

**Comprehensive Income**

Other comprehensive income amounted to less than \$0.1 million in the three and six month period ending June 30, 2006. Other comprehensive income amounted to less than \$0.1 million in the three and six month period ending June 30, 2005.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**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 occurring 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.

In July 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ( FIN 48 ). FIN 48 clarifies the recognition threshold and measurement of a tax position taken on a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. FIN 48 also requires expanded disclosure with respect to the uncertainty in income taxes. We are currently evaluating the requirements of FIN 48 and the impact this interpretation may have on our financial statements.

**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 collateralized 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 June 30, 2006 no contingencies had occurred. All unpaid principal and interest on the collateralized note is payable in 60 equal monthly installments from March 2006 through March 2011 amounting to \$2.2 million. In March 2006, the Company began making its monthly payments under the secured promissory note. Principal and interest on the unsecured debt in the amount of \$1.4 million is due and payable in March 2011.

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

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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, excluding goodwill, were determined to have a life of 5-10 years. Goodwill has an indefinite life. 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.

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

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

### 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.

At December 31, 2005 the Company determined that, based upon a decline in operating performance during the fourth quarter of 2005, the Services reporting unit had experienced an impairment of its allocated goodwill. At that time, the Company recorded an impairment expense of \$7.8 million.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As stated in Note 1, the Company has reclassified amortization expense amounts in the 2005 financial statements to conform to the 2006 presentation. The 2005 reclassification consisted of the allocation of amortization from operating expenses into cost of sales. For the three and six month periods ended June 30, 2006, amortization amounted to \$0.1 million and \$0.3 million, respectively, of which less than \$0.1 million was recorded in cost of sales for the three months ended June 30, 2006, and \$0.1 million was recorded in cost of sales for the six months ended June 30, 2006.

The changes in the carrying amounts of goodwill by reporting unit, and intangible assets during the three and six months ended June 30, 2006 and 2005, by aggregated segments are as follows (amounts in thousands):

**Goodwill**

	Technology	Advertising Systems	Services	Total	Intangible Assets
Balance as of December 31, 2005	\$ 10,206	\$ 2,039	\$ 13,292	\$ 25,537	\$ 4,131
Additions during period	—	—	—	—	16
Impairment	—	—	—	—	—
Adjustments	—	—	—	—	—
Amortization	—	—	—	—	(138)
Balance as of March 31, 2006	\$ 10,206	\$ 2,039	\$ 13,292	\$ 25,537	\$ 4,009
Additions during period	—	—	—	—	44
Impairment	—	—	—	—	—
Adjustments	—	—	—	—	—
Amortization	—	—	—	—	(138)
Balance as of June 30, 2006	\$ 10,206	\$ 2,039	\$ 13,292	\$ 25,537	\$ 3,915

**Goodwill**

	Technology	Advertising Systems	Services	Total	Intangible Assets
Balance as of December 31, 2004	\$ 10,206	\$ —	\$ 21,070	\$ 31,276	\$ 230
Additions during period	—	2,101	—	2,101	5,179
Adjustments	—	—	—	—	—
Amortization	—	—	—	—	(178)
Balance as of March 31, 2005	\$ 10,206	\$ 2,101	\$ 21,070	\$ 33,377	\$ 5,231
Additions during period	—	32	—	32	2
Adjustments	—	—	—	—	(662)
Amortization	—	—	—	—	(178)
Balance as of June 30, 2005	\$ 10,206	\$ 2,133	\$ 21,070	\$ 33,409	\$ 4,393

As of June 30, 2006 and December 31, 2005, the Company's intangible assets and related accumulated amortization consisted of the following (in thousands):

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	June 30, 2006			December 31, 2005		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Website Partner Relationships - Unicast	\$ 3,772	\$ (591)	\$ 3,181	\$ 3,772	\$ (404)	\$ 3,368
Acquired Technology - Unicast	410	(243)	167	410	(187)	223
Patents and Trademarks - Unicast	326	(111)	215	326	(80)	246
Patents and Trademarks	392	(40)	352	332	(38)	294
<b>Total Intangible Assets</b>	<b>\$ 4,900</b>	<b>\$ (985)</b>	<b>\$ 3,915</b>	<b>\$ 4,840</b>	<b>\$ (709)</b>	<b>\$ 4,131</b>

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

The Company has also reclassified depreciation expense amounts in the 2005 financial statements to conform to the 2006 presentation. The 2005 reclassification consisted of the allocation of depreciation from operating expenses into cost of sales. For the three and six month periods ended June 30, 2006, depreciation expense amounted to \$0.1 million and \$0.2 million, respectively, of which less than \$0.1 million was recorded in cost of sales for the three months ended June 30, 2006, and \$0.1 million was recorded in cost of sales for the six months ended June 30, 2006.

#### 4. 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 June 30, 2006, 0.8 million warrants were outstanding related to this placement.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For the three and six month period ended June 30, 2006, the Company recognized a loss related to the change in the valuation for the outstanding warrants of \$0.2 million and \$0.3 million, respectively, resulting from an increase in the fair market value of the Company's common stock. For the three and six month period ended June 30, 2005, the Company recognized a gain from the change in the fair value of the outstanding warrants of \$0.6 million and \$0.8 million, respectively resulting from a decrease in the fair market value of the Company's common stock. As of June 30, 2006 and December 31, 2005, the fair value of these outstanding warrants amounted to \$0.4 million and \$0.1 million, respectively.

*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.

On March 31, 2006, the Company redeemed notes with a principal amount of \$0.4 million pursuant to the agreement. The maturity date for the remaining notes with a principal amount of \$3.1 million was extended in July, 2005. (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.



**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*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.

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 and \$0.2 million for the three and six months ended June 30, 2006 and \$0.1 and \$0.2 for the three and six months ending June 30, 2005. In March 2006, the Company began making monthly payments as required by the agreement and this resulted in a decrease of the aggregate carrying value of these notes to \$2.0 million as of June 30, 2006, of which \$1.6 million is long-term.

The Company's total carrying value by note at June 30, 2006 and December 31, 2005 is as follows (amounts in thousands):

	<b>June 30</b>	<b>December 31</b>
	<b>2006</b>	<b>2005</b>
Subordinated notes	\$ 2,263	\$ 2,505
Unicast notes	2,014	1,981
<b>Total long-term debt</b>	<b>4,277</b>	<b>4,486</b>
Less current portion	389	814
<b>Long-term debt, net of current portion</b>	<b>\$ 3,888</b>	<b>\$ 3,672</b>

The reconciliation of the carrying value to the face value of each note as of June 30, 2006, is as follows (amounts in thousands):

	<b>Subordinated Notes</b>	<b>Unicast Notes</b>	<b>Total</b>
Book value of long-term debt	2,263	2,014	4,277
Discount on long-term debt	787	606	1,393
<b>Face value of the long-term debt</b>	<b>\$ 3,050</b>	<b>\$ 2,620</b>	<b>\$ 5,670</b>

The maturity schedule for the Company's debt subsequent to June 30, 2006 is as follows (amounts in thousands):

<b>Maturity</b>	
2006	\$ 162
2007	350
2008	3,400
2009	350
2010 and thereafter	1,408

\$ 5,670

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**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

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 and six months ended June 30, 2005 would have been as follows (amounts in thousands, except per share data):

	<b>Three Months Ended June 30,</b>	<b>Six Months Ended June 30,</b>
	<b>2005</b>	<b>2005</b>
Net income (loss), as reported	\$ (446)	\$ (1,191)
Add: Stock-based employee compensation charges included in reported net loss, net of related tax effects	581	595
Deduct: Stock-based employee compensation charges determined under fair value based method for all awards, net of related tax effects	(945)	(1,926)
Pro forma net income (loss)	<u>\$ (810)</u>	<u>\$ (2,522)</u>
Net income (loss) per share:		
Basic and diluted as reported	<u>\$ (0.01)</u>	<u>\$ (0.02)</u>
Basic and diluted pro forma	<u>\$ (0.01)</u>	<u>\$ (0.04)</u>

Pro forma disclosures for the three and six months ended June 30, 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 windfall 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 and the compensation cost that was recognized under FAS No. 123(R) for the six months and three months ended June 30, 2006 and 2005, the Company uses the Black-Scholes option-pricing model with the following weighted-average assumptions by the ranges specified for equity awards granted:

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Three and Six Months Ended	
	June 30,	
	2006	2005
Risk-free interest rate	4.72-5.07%	3.73-4.04%
Dividend yield		
Volatility factor	1.34-1.35	1
Weighted average expected life in years	4.52-4.58	3.75

The Company will recognize the estimated compensation cost of performance awards, net of estimated forfeitures, when it becomes probable that the performance criteria will be met. The Company currently has outstanding performance awards with a fair value of \$0.3 million which will vest if certain operating performance is achieved by December 31, 2006. As of June 30, 2006, management's current estimate is that these awards will not vest and accordingly no provision has been made in the accompanying financial statements.

As of June 30, 2006, total unrecognized share-based compensation cost related to unvested stock options was \$4.0 million (excluding performance based awards noted above), which is expected to be recognized over a weighted average period of approximately 2.7 years. The Company has included the following amounts for share-based compensation cost, in the accompanying unaudited Consolidated Statement of Operations for the three and six months ended June 30, 2006 (amounts in thousands):

	Three Months Ended	Six Months Ended
	June 30, 2006	June 30, 2006
Cost of revenues:		
Advertising systems	\$ 2	\$ 5
Services	46	101
Operating expenses:		
Sales and marketing	119	291
Research and development	84	193
General and administrative	243	572
	494	1,162
Total	\$ 494	\$ 1,162

Share-based compensation expense recognized during the three and six months ended June 30, 2006 included (1) compensation expense for awards granted prior to, but not yet fully vested as of January 1, 2006, and (2) compensation expense for the share-based payment awards granted subsequent to December 31, 2005, based on the grant date fair values estimated in accordance with the provisions of SFAS No. 123R.

### Stock Option Plans

#### *1995 Stock Plan*

The Company's 1995 Stock Plan (the "1995 Plan") provides for the grant to employees (including officers and employee directors) of incentive stock options and for the grant to employees (including officers and employee directors), non-employee directors and consultants of nonstatutory stock options and stock purchase rights. As of June 30, 2006, options to purchase an aggregate of 4.1 million shares of common stock were outstanding under the 1995 Plan, with vesting provisions ranging up to four years. Options granted under the 1995 Plan are exercisable for a period of up to ten years. The ability to issue options out of this plan expired in 2005, however, options currently outstanding will remain outstanding until exercised, forfeited, or expire.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*1995 Director Option Plan*

The Company's 1995 Director Option Plan (the Director Plan) provides for an automatic grant of options to purchase shares of common stock to each non-employee director of the Company. Options granted under the 1995 Director Plan vest over one and a half to four and a half years and are exercisable for a period of ten years. As of June 30, 2006, 4.1 million options were outstanding under the 1995 Director Plan. The ability to issue options out of this plan expired in 2005, however, options currently outstanding will remain outstanding until exercised, forfeited, or expire.

*1996 Nonstatutory Stock Option Plan*

The Company's 1996 Nonstatutory Stock Option Plan (the 1996 Nonstatutory Plan) provides for the grant to employees (including officers and employee directors) and consultants of nonstatutory stock options and stock purchase rights. As of June 30, 2006, options to purchase an aggregate of 1.3 million shares of common stock were outstanding under the 1996 Nonstatutory Plan, with vesting provisions ranging up to four years. Options granted under the 1996 Nonstatutory Plan are exercisable for a period of up to ten years. At June 30, 2006, an aggregate of 0.2 million shares of common stock were reserved for future issuance under the 1996 Nonstatutory Plan.

The 1995 Plan, the Director Plan, and the 1996 Nonstatutory Plan are collectively referred to as Option Plans.

*2006 Equity Incentive Plan*

The Company's 2006 Equity Incentive Plan (the 2006 Plan) provides for the grant to employees (including officers and employee directors) of incentive stock options and for the grant to employees (including officers and employee directors), non-employee directors and consultants of nonstatutory stock options, stock appreciation rights, restricted stock, restricted stock units and other stock awards. The 2006 Plan was adopted by the stockholders of the Company at the 2006 annual meeting of stockholders on June 21, 2006. As of June 30, 2006, no grants were outstanding under the 2006 Plan and an aggregate of 4.5 million shares of common stock were reserved for future issuance under the 2006 Plan.

*Options Issued Outside the Option Plans*

For the three and six months ended June 30, 2006, the Company issued 0.2 million and 0.3 million, respectively, non-qualified stock options outside the Option Plans in connection with the hiring of certain personnel. All options were issued with exercise prices equal to the fair value of the Company's common stock on the grant date, which was the employees first date of employment. The terms and conditions of these grants are similar to the terms and conditions of options granted under the 1996 Nonstatutory Plan. There are 4.2 million shares outstanding outside the Option Plans.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Summary of All Outstanding Options**

Activity and pricing information regarding all options to purchase shares of common stock are summarized as follows, (in thousands, except per share data):

	<b>Options Outstanding</b>		
	<b>Options Available for Grant</b>	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>
Options outstanding at December 31, 2005	363	12,566	\$ 1.79
Granted exercise price equal to fair value	(418)	418	1.17
Granted non-plan options		250	1.53
Plan approved at June 30, 2006	4,500		
Exercised		(2,323)	0.81
Cancelled	388	(388)	1.68
Cancelled expired plan		(633)	4.91
Cancelled non-plan options		(221)	3.15
<b>Options outstanding at June 30, 2006</b>	<b>4,833</b>	<b>9,669</b>	<b>\$ 1.82</b>

During the three and six months ended June 30, 2006, the total intrinsic value of options exercised to purchase common stock was \$1.1 million and \$1.5 million, and the weighted average fair value of options to purchase common stock that were granted was \$1.80 and \$1.31 per share.

During the three and six months ended June 30, 2006, financing cash generated from share-based compensation arrangements amounted to \$1.1 million and \$1.9 million for the purchase of shares upon exercise of options. The Company issues new shares upon exercise of options to purchase common stock.

Additional information regarding options outstanding for all plans as of June 30, 2006, is as follows (in thousands except per share data):

Exercise Price Range	<b>Outstanding</b>			<b>Exercisable</b>	
	<b>Shares</b>	<b>Average Life (a)</b>	<b>Weighted Average Exercise Price</b>	<b>Shares</b>	<b>Weighted Average Exercise Price</b>
\$0.46 \$0.77	2,035	7.19	\$ 0.73	2,035	\$ 0.73
\$0.78 \$0.87	2,028	5.61	0.90	1,614	0.85
\$0.93 \$1.36	2,546	8.05	1.31	906	1.29
\$1.40 \$4.35	1,994	7.13	2.68	1,318	3.01
\$4.40 \$25.13	1,066	2.86	5.29	1,065	5.29
<b>Total</b>	<b>9,669</b>	<b>6.59</b>	<b>1.82</b>	<b>6,938</b>	<b>1.97</b>
	<b>Intrinsic Value Options Outstanding</b>			<b>Intrinsic Value Options Exercisable</b>	
Aggregate intrinsic value (in thousands)	\$ 4,996			\$ 3,961	

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	<b>Outstanding Average Life</b>	<b>Exercisable Average Life</b>
	<u>                    </u>	<u>                    </u>
Weighted average remaining contractual life	6.59	6.09

The aggregate intrinsic value in the table above is based on the Company's closing stock price of \$1.75 per share as of June 30, 2006, which amount would have been received by the optionees had all options been exercised on that date. The total fair value of options to purchase common stock that vested during the three and six months ended June 30, 2006 was \$0.5 million, and \$1.2 million, respectively.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**7. Restructuring Charges**

In March of 2006, the Company implemented a restructuring plan designed to streamline the services business. Under this plan the Company eliminated 10 positions in the services group and relocated the management of the group from its New York office to its existing Los Angeles office. The Company incurred a restructuring charge of \$0.1 million related to severance arrangements which has been recorded separately on the statement of operations. This restructuring plan was completed by June 30, 2006 and all payments have been made.

**8. Commitments and Contingencies***Commitments*

The Company leases its primary office space in New York City pursuant to various lease agreements with terms through February of 2010. The Company also leases office space in Los Angeles, California, with a lease term through December of 2009.

The Company leased a vehicle for a former executive of the Company during 2005. The lease was terminated in the first quarter of 2006. Rent expense for office space, equipment, and the executive's vehicle totaled approximately \$0.3 million, and \$0.5 million, and \$0.3 million and \$0.6 for the three and six months ended June 30, 2006 and 2005, respectively.

Future minimum lease payments under non-cancelable operating leases for each year subsequent to June 30, 2006 are as follows (amounts in thousands):

2006	\$ 511
2007	1,014
2008	855
2009	799
2010	90
	<u>          </u>
	\$ 3,269
	<u>          </u>

*Legal Proceedings*

The Company is engaged in certain legal actions arising in the ordinary course of business. The Company believes it has adequate legal defenses in legal actions in which it is the defendant and believes that the ultimate outcome of such actions will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.



**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. Segment Information and Enterprise-Wide Disclosures**

As discussed in more detail in Notes 1 and 2 in the Company's 2005 Form 10-K, the Company has four revenue streams which are analyzed under three segments consisting of the technology-based segment, which includes two revenue streams licensing and search, the services segment, and the advertising systems segment. In determining reportable segments, management considered the nature of the business activity whose operations are regularly reviewed by the Company's chief operating decision maker and for which there is discrete financial information. Licensing revenue and search revenue are aggregated within the Technology-based segment as both revenue streams give customers the same access to the Viewpoint Media Player and the distributed network and have similar economic characteristics. Upon the acquisition of Unicast in 2005 it was determined that Unicast goodwill solely benefited Advertising Systems, and accordingly all of the acquired goodwill was allocated to that reporting unit.

The Company does not allocate or analyze operating expenses by segment. During 2004 the Company commenced operations within the advertising systems segment. There are no inter-segment sales.

Revenues in the Technology segment are generated based upon providing customers access to the Company's distributed network of Viewpoint Media Players. Advertising systems revenue is generated by charging customers to host advertising campaigns based on CPM impressions. The Services segment provides creative and support services to customers who generally have purchased or received licenses to use the Viewpoint software platform. The accounting policies for the segments are the same as the consolidated accounting policies disclosed in the Company's 2005 Form 10-K.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>Revenues:</b>				
<b>Technology</b>				
Licenses	\$ 32	\$ 227	\$ 78	\$ 382
Related party licenses	—	872	—	1,745
Search	1,573	2,393	3,362	4,573
	<u>1,605</u>	<u>3,492</u>	<u>3,440</u>	<u>6,700</u>
Total technology revenue	1,605	3,492	3,440	6,700
Advertising systems	3,013	1,163	4,608	1,895
<b>Services:</b>				
Services	1,091	1,564	1,644	2,807
Related party services	—	354	—	749
	<u>1,091</u>	<u>1,918</u>	<u>1,644</u>	<u>3,556</u>
Total revenues	<u>5,709</u>	<u>6,573</u>	<u>9,692</u>	<u>12,151</u>
<b>Cost of Revenues</b>				
<b>Technology</b>				
License	2	1	8	3
Search	38	49	74	95
	<u>40</u>	<u>50</u>	<u>82</u>	<u>98</u>
Total technology cost of revenues	40	50	82	98
Advertising systems	2,199	909	3,239	1,498
Services	648	1,055	1,311	1,923
	<u>2,847</u>	<u>2,014</u>	<u>4,550</u>	<u>3,421</u>
Total cost of revenues	<u>2,887</u>	<u>2,014</u>	<u>4,632</u>	<u>3,519</u>
Gross profit	<u>2,822</u>	<u>4,559</u>	<u>5,060</u>	<u>8,632</u>
<b>Technology</b>				
Licenses	30	1,098	70	2,124
Search	1,535	2,344	3,288	4,478
	<u>1,565</u>	<u>3,442</u>	<u>3,358</u>	<u>6,602</u>
Total technology gross profit	1,565	3,442	3,358	6,602
Advertising systems	814	254	1,369	397
Services	443	863	333	1,633
	<u>1,257</u>	<u>1,117</u>	<u>1,702</u>	<u>1,630</u>
Total gross profit	<u>\$ 2,822</u>	<u>\$ 4,559</u>	<u>\$ 5,060</u>	<u>\$ 8,632</u>
<b>Gross profit margin</b>				
<b>Technology</b>				
Licenses	94%	100%	90%	100%
Search	98	98	98	98
	<u>98</u>	<u>99</u>	<u>98</u>	<u>99</u>
Total technology gross profit	98	99	98	99
Advertising systems	27	22	30	21
Services	41	45	20	46
	<u>68</u>	<u>67</u>	<u>50</u>	<u>67</u>
Total gross profit	<u>49%</u>	<u>69%</u>	<u>52%</u>	<u>71%</u>

	<u>June 30,</u> <u>2006</u>	<u>December 31,</u> <u>2005</u>
Total assets:		
Technology	\$ 12,416	\$ 13,369
Advertising systems	7,189	8,086
Services	14,537	14,388
Corporate (*)	7,705	9,293
	<u>          </u>	<u>          </u>
Total assets	\$ 41,847	\$ 45,136

\* Corporate assets consists solely of cash, cash equivalents, marketable securities and restricted cash as the Company does not allocate such amounts to the individual reporting units.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with the consolidated financial statements and notes thereto.*

*In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from the results implied by the forward looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Factors That May Affect Future Results of Operations." You should carefully review the risks described in other documents we file from time to time with the Securities and Exchange Commission, including any future reports to be filed in 2006 and our Annual Report on Form 10-K for 2005. When used in this report, the words will, expects, anticipates, intends, plans, believes, seeks, targets, estimates, and similar expressions are generally intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to publicly release any revisions to the forward looking statements or reflect events or circumstances after the date of this document.*

**Overview**

Viewpoint Corporation ( Viewpoint or the Company ) is an internet marketing technology company that focuses on using its technical capabilities to help marketers effectively promote their products online. Viewpoint provides a full suite of digital products, services and consulting for internet marketers. Viewpoint employs its visualization technology to drive powerful customer-facing marketing tools that enable marketers to showcase complex products as advertising or content at websites, and allows for user interaction. Since 2003 the Company has extended the historical imaging capabilities of its proprietary graphics technology to develop a search business that provides internet consumers a flexible graphical searching experience and an advertising delivery system that specializes in deploying video and rich media advertising. The company supplements its revenues in these product segments by using its in-house services team to build sophisticated content that is used by customers in each product segment. Finally, the Company previously licensed its platform to internet publishers enabling them to deploy graphical sophisticated content at their websites. However, in June 2005, the Company began offering free use of its platform to facilitate growth in its search and advertising systems segments.

On March 17, 2004, Viewpoint entered the internet search business by launching a toolbar search product (the Viewpoint Toolbar ). The Viewpoint Toolbar attaches to the Internet Explorer browser, enabling web surfers to conduct internet searches without leaving the web page they are viewing. When a user enters a term or phrase in the search field of the Viewpoint Toolbar, search results appear not only as text links listed on a search results page but also as thumbnail icons of the web pages themselves in a tray that descends from the Viewpoint Toolbar. Additionally, if a user visits certain internet search engine sites the Viewpoint Toolbar will simultaneously receive a user's search request and provide the user comparative thumbnail search results in the Viewpoint Toolbar search results tray.

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 exclusive right 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. The agreement also provides the Company the ability to create, distribute and market private label toolbars for third parties.

In July 2005, the Company launched version 3.0 of the Viewpoint Toolbar which includes the capability to manage digital photograph files on the user's computer and provides the ability to share the photographs at a website

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

or get printed copies of the photographs for a fee. During October 2005, the Company released version 3.5 of the Viewpoint Toolbar and re-named it the Fotomat Toolbar. The Company has licensed the trademark and internet url Fotomat.com for its exclusive use in connection with the internet website for photograph and printing services and computer software for organization, editing, managing, sharing, and processing images and related data through the end of December 2006, with the ability to renew such license. Its new Fotomat Toolbar provides enhanced photograph editing capabilities and an efficient method of creating albums of photographs, which the Company believes enhances the utility of the toolbars for users, while simultaneously allowing users to use the Toolbar to search the internet.

Prior to launching the Search product the Company principally leveraged its distributed base of VMP's by licensing access to use the Viewpoint Platform for display of content on a website. Viewpoint initiated internet activities with the release of a beta version of the Viewpoint Media Player in 1999. Simultaneously, Viewpoint released a suite of free content authoring tools specifically designed to enable customers who published digital content on their websites to create material that can be read or played back by the VMP. With the VMP residing on the web consumer's computer and interpreting instructions delivered by its customers' web sites, web sites can transmit relatively small files that can yield rich media on the end user's computer. In this way, website owners can deploy digital content representing three-dimensional views of their products, include pre-set animations, and provide high-resolution two-dimensional views, video, audio, text, and other media types. For example, the Company has licensing customers who are auto manufacturers that deploy from their websites 3D representations of their vehicles which viewers can interact with by opening doors, zooming in on features, configuring accessories, or swapping colors. Its licensees helped facilitate the growth of its distributed base of VMP's that the Company used to launch its Search Toolbar business.

In addition, Viewpoint also offers an online advertising campaign management and deployment product. In July 2005, the Company redesigned this product, incorporating the Viewpoint Creative Innovator product with Unicast's UCP ad delivery system into one system. This system, known as the Unicast Ad Platform (UAP), 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 provides another advertising services product whereby the Company purchases media space from web-site publishers and resells that space to advertisers. The Company acts as a principal party in the transaction by assuming the title to the media space purchased. In addition, the Company assumes 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.

The Company provides fee-based professional services for creating content and implementing visualization systems. Clients include both content-related licensees and advertisers who use UAP as well as internal services provided to its marketing team. Its professional services group uses the Viewpoint platform, as well as a spectrum of tools and other technologies to create enhanced rich media solutions for a client's particular purpose, whether over the web, intranet systems or offline media and applications. The Company provides the support its clients need to implement the rich media content, to fully utilize the enhanced software, or to maximize the branding potential of the advertising opportunity. Clients supported during 2005 and 2006 include America Online, Toyota Motor Services, General Electric and Honda.

Viewpoint has a limited operating history upon which an evaluation of the Company and its prospects can be based. Viewpoint has had significant quarterly and annual operating losses since its inception, and, as of June 30, 2006, had an accumulated deficit of \$272.6 million. Viewpoint's prospects must be considered in light of the risks and difficulties frequently encountered by early stage technology companies. There can be no assurance that Viewpoint will achieve or sustain profitability.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**RESULTS OF OPERATIONS**

The following table sets forth for the three and six months ended June 30, 2006 and 2005, the Company's consolidated statements of operations expressed as a percentage of total revenues for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
<b>Statements of Operations Data</b>				
Revenues:				
Search	27%	37%	35%	38%
Advertising Systems	53	18	47	16
Services	19	24	17	23
Related party services		5		6
Licenses	1	3	1	3
Related party licenses		13		14
	_____	_____	_____	_____
Total revenues	100	100	100	100
	_____	_____	_____	_____
Cost of revenues:				
Search	1	1	1	1
Advertising Systems	39	14	33	12
Services	11	16	14	16
Licenses				
	_____	_____	_____	_____
Total cost of revenues	51	31	48	29
	_____	_____	_____	_____
Gross profit	49	69	52	71
	_____	_____	_____	_____
Operating expenses:				
Sales and marketing	25	19	31	21
Research and development	19	17	22	19
General and administrative	38	40	48	39
Depreciation	2	3	2	3
Amortization of intangible assets	2	2	2	2
Restructuring charges			1	
Impairment of goodwill and other intangible assets				
	_____	_____	_____	_____
Total operating expenses	87	81	106	84
	_____	_____	_____	_____
Gain/Loss from operations	(38)	(12)	(54)	(13)
Other income (expense):				
Interest and other income, net	2		1	
Interest expense	(4)	(5)	(5)	(5)
Changes in fair values of warrants to purchase common stock and conversion feature of convertible notes	(10)	10	(12)	7
	_____	_____	_____	_____
Total Other income (expense)	(12)	5	(16)	2
	_____	_____	_____	_____

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Loss before provision for income taxes	(49)	(7)	(70)	(11)
Provision for income taxes	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net loss from continuing operations	(49)	(7)	(70)	(11)
Adjustment to net loss on disposal of discontinued operations	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
				1
Net loss	<u>(49)%</u>	<u>(7)%</u>	<u>(70)%</u>	<u>(10)%</u>

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Critical Accounting Policies and Estimates**

Viewpoint's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The Company bases its estimates on historical experience and on various other assumptions that the Company believes to be reasonable under the circumstances though actual results may differ from these estimates under different assumptions or conditions. For a complete description of the Company's critical accounting policies and estimates refer to the Company's 2005 Form 10-K and Stock-Based Compensation discussed below.

*Stock-Based Compensation*

The Company has adopted the provisions of FAS No. 123R ( FAS 123R ), Share-Based Payment which replaced Statement of Financial Accounting Standards No. 123 ( 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 terms of the awards of 134%, actual and projected employee stock option exercise behaviors resulting in an estimated term of 4.52 years, risk-free interest rate of 5.07%, and expected dividends of zero. As the result of the uncertainty regarding the Company's ability to utilize its deferred tax assets, the impact of windfall 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 SFAS 123 pro forma disclosures.

The adoption of SFAS 123R had a material impact on our consolidated financial position, results of operations and cash flows.

**Financial Results**

Viewpoint reported total revenue of \$5.7 million for the second quarter 2006 compared to \$6.6 million for the second quarter 2005. Operating loss for the second quarter of 2006 was \$2.1 million compared to \$0.8 million in the second quarter of 2005. The increase in operating loss compared to the second quarter 2005 resulted principally from lower revenues associated with the expiration of a license and services revenue arrangement with AOL in December 2005 from a contract executed in 2003. The Company experienced a 34% decline in revenue in its search business, however its ad systems business experienced growth of 159% in the second quarter of 2006 as compared with the second quarter in 2005. The Company recorded \$0.5 million of stock-based compensation expense in the second quarter of 2006 associated with the adoption of Statement of Financial Accounting Standards (SFAS) No. 123R Share-Based Payment on January 1, 2006 which also led to an increase in operating loss. This compared to a stock based compensation charge of \$0.6 million recorded in the second quarter of 2005 associated with the departure of an executive from the Company and corresponding extension of the exercise period. Net loss for the second quarter 2006 was \$2.8 million, or a loss of \$0.04 per share, compared to a net loss of \$0.4 million, or a loss of \$0.01 per share, in the second quarter of 2005. The net loss in the second quarter of 2006 included a non-cash charge of \$0.5 million to recognize the impact of the Company's increased stock price on its outstanding warrants. The net loss in the second quarter of 2005 included a non-cash gain of \$0.6 million to recognize the impact of the Company's decreased stock price on its outstanding warrants.



**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Viewpoint reported total revenue of \$9.7 million for the first six months of 2006 compared to \$12.2 million for the same period in 2005. Operating loss for the first six months of 2006 was \$5.2 million compared to \$1.6 million in the same period of 2005. This increase in operating loss resulted principally from lower revenues associated with the expiration of a license and services revenue arrangement with AOL in December 2005 of a contract executed in 2003. The Company experienced a 34% decline in revenue in its search business which contributed to an increase in the operating loss on a comparative basis; however its ad systems business experienced growth of 159%, as stated above. The Company's services revenue declined 41% in the first six months of 2006 compared to the same period in 2005. During March 2006, when the Company noted it was experiencing a decline in this business it announced a restructuring of this group. This restructuring streamlined the business by terminating 29% of the services employees and relocating the principal services office from New York to Los Angeles. During the first six months of 2006, the Company also recorded \$1.1 million of stock-based compensation expense associated with the adoption of Statement of Financial Accounting Standards (SFAS) No. 123R Share-Based Payment on January 1, 2006. This compared to a stock based compensation expense of \$0.6 million in the same period in 2005. Net loss for the first six months of 2006 was \$6.8 million, or a loss of \$0.10 per share including a non-cash charge of \$1.2 million to recognize the impact of the Company's increased stock price of its outstanding warrants. Net loss for the first six months of 2005 was \$1.2 million, or a loss of \$0.02 per share, including a non-cash charge of \$0.8 million to recognize the impact of the Company's decreased stock price on outstanding warrants.

Viewpoint's cash, cash equivalents, and marketable securities as of June 30, 2006 were \$7.5 million. This compares to cash, cash equivalents, and marketable securities of \$9.1 million at December 31, 2005. The decrease in cash, cash equivalents, and marketable securities can be principally attributed to the loss from operations during the six month period offset by proceeds from the exercise of stock options granted to current and former employees.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Revenues**

	Months Ended June 30,		%
	2006	2005	Change
(dollars in thousands)			
Three months ended:			
Search	\$ 1,573	\$ 2,393	(34)
Advertising Systems	3,013	1,163	159
Services	1,091	1,564	(30)
Related party services		354	(100)
Licenses	32	227	(86)
Related party licenses		872	(100)
	<u>5,709</u>	<u>6,573</u>	<u>(13)%</u>
Total revenues	\$ 5,709	\$ 6,573	(13)%
Six months ended:			
Search	\$ 3,362	\$ 4,573	(26)%
Advertising Systems	4,608	1,895	143
Services	1,644	2,807	(41)
Related party services		749	(100)
Licenses	78	382	(80)
Related party licenses		1,745	(100)
	<u>9,692</u>	<u>12,151</u>	<u>(20)%</u>
Total revenues	\$ 9,692	\$ 12,151	(20)%

On March 17, 2004 Viewpoint entered the internet search business by launching the Viewpoint Toolbar on a test basis. In April 2004, the Company ended the test phase and began delivering the Viewpoint Toolbar Version 1.0. Search revenue is generated when a customer uses the Viewpoint Toolbar to search the internet, and clicks on a sponsored advertisement included in the search results. 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.

Additionally, Viewpoint offers an online advertising campaign management and deployment product. In July 2005, the Company deployed a new product, incorporating the Viewpoint Creative Innovator product and Unicast's UCP ad delivery system into one system. This system, known as the Unicast Ad Platform (UAP), 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 provides another advertising services product whereby the Company purchases media space from web-site publishers and resells that space to advertisers. 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 the estimated time and materials to complete a creative project for the customer including an acceptable profit margin. Revenue is recognized on a percentage-of-completion basis if all other revenue recognition criteria are satisfied. During 2005 and 2006, the Company continued its strategy of concentrating on executing larger creative projects.

The Company also generated revenues by selling licenses to the Viewpoint graphical platform principally to internet content publishers. 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 Media Player will no longer require a broadcast key to display content, thereby



**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

giving all developers a free license to the Viewpoint Distribution Network. However, Viewpoint will still charge for certain licenses requiring customization. By providing the standard license for free, the Company plans to extend the Viewpoint Media Player's reach into new channels of distribution beyond the estimated 120 million computers it currently resides within. Viewpoint believes that this strategy supports the advertising business by potentially making the player more pervasive as well as providing stronger distribution for the search business.

Prior to 2004, licenses were generally 15 months in duration. Revenues were recognized upon the completion of the sales and delivery process so long as all other revenue recognition criteria were satisfied. The Company supplemented its license revenue by providing content development services to licensees. The service revenues were recognized on a percentage of completion basis as computed by comparing the incurred costs of the project to the total estimated project cost and applying this percentage against the total contracted revenue.

During the first five months of 2005, prior to the discontinuation of standard broadcast license fees, the Company recognized license sales upon delivery so long as all other revenue recognition criteria were satisfied. Since January 2004, licenses had generally been sold for a 12 month term.

During October 2003, the Company entered into an amended license agreement with America Online, Inc. ( AOL ) which provided for payments by AOL of \$10.0 million which were received in 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 revenue from this agreement ratably as license and services revenue through December 2005 which represents the duration of the Company's obligation for post-contract support of the source code element, including quarterly upgrades and maintenance requirements. Approximately \$0.9 million was recognized each quarter from October 2003 to December 2005 as related party license revenue and \$0.2 million as related party services revenue. There will be no future revenue earned subsequent to December 31, 2005 related to this License.

During 2004, the Company began to focus more resources on its search and advertising systems products. License revenue was relatively constant through 2005, as twelve month licenses that contained upgrades when and if available that were entered into prior to the change in license fee structure in June 2005 were recognized. The Company believes that, consistent with the new business model, license revenue will be minimal in 2006.

Search revenues amounted to \$1.6 million for the three months ended June 30, 2006 as compared to \$2.4 million in the three months ended June 30, 2005. Search revenues are generated when users of the Viewpoint Toolbar are provided search results from advertisers that they click on to view. These advertisers then pay a fee to Yahoo!, who remits a percentage of the fee to Viewpoint. The Company had installed 8.7 million Viewpoint Toolbars through December 2004, 12.4 million through March 2005, 16.1 million throughout June 2005, 21.4 million through December 2005, 22.6 million through March 2006 and 23.9 million through June 2006. Internet users can uninstall the Viewpoint Toolbar, and through December 2004, 3.3 million users who had accepted the installation of the Toolbar had later uninstalled it during 2004. The total of cumulative toolbars installed, net of those uninstalled was 11.6 million at December 2005 and 12.0 million at June 2006.

Search revenues of \$3.4 million for the six months ended June 30, 2006 decreased compared with revenues of \$4.6 million for the six months ended June 30, 2005. The Company believes that search revenues may increase in the second half of 2006 as compared to the first half of 2006 if it is able to continue to increase the number of Viewpoint Toolbars that are distributed and remain installed. The ability of the Company to obtain distribution from private label toolbars in the second half of 2006 will be critical to this growth.

The Company recognized \$3.0 million in advertising systems revenue during the three months ended June 30, 2006 compared to \$1.2 million for the same period in 2005. This revenue was generated by delivering advertising impressions to websites in several different formats including video and the purchase of media space from publishers on behalf of advertisers. The revenue increase is attributable to the Company continuing to expand its customer base and types of advertising formats delivered to them.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Ad systems revenues of \$4.6 million for the six months ended June 30, 2006 increased compared with revenues of \$1.9 million for the six months ended June 30, 2005. Growth in this segment accelerated during the second quarter and is expected to continue to increase during the remainder of 2006 as the Company is able to attract more clients and websites to its various ad serving formats.

Services revenues amounted to \$1.1 million for the three months ended June 30, 2006 as compared to \$1.6 million for the same period in 2005. The Company experienced a decline in its number of clients during the quarter. During March 2006, in recognition of a decline in revenues for this group, the Company announced a restructuring which resulted in a reduction of its workforce and the relocation of its principal operational headquarters for this business to its Los Angeles office.

Services revenues amounted to \$1.6 million for the six months ended June 30, 2006 as compared to revenues of \$2.8 million for the six months ended June 30, 2005. This segment's revenues were down significantly in the first quarter of 2006 compared to the same period the prior year which led to the March 2006 restructuring. The Company believes that it can increase revenues in the second half of 2006 in this segment if customers continue to seek the Company's assistance in building more content using the Viewpoint Platform to be used at their websites, develop advertising formats, and more client contracts for private label toolbars.

There were no related party services or license revenues for the three months ended June 30, 2006, as the October 2003 AOL contract expired on December 31, 2005.

License revenues amounted to less than \$0.1 million in the six months ended June 30, 2006, which represents a decrease of approximately \$0.2 million, as compared to the same period last year. License revenues for the first quarter of 2005 represent four licenses the Company sold during 2004, which provided upgrade rights, and were therefore being recognized ratably over 12 months. The Company essentially eliminated the sale of all but special-purposes licenses in June 2005 and believes that revenues in this segment will continue to decrease in 2006.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Cost of revenues*

	June 30,		%
	2006	2005	Change
(dollars in thousands)			
Three months ended:			
Search	\$ 38	\$ 49	(22)%
Percentage of Search Revenues	2%	2%	
Six months ended:			
Search	\$ 74	\$ 95	(22)%
Percentage of Search Revenues	2%	2%	
Three months ended:			
Advertising Systems	\$ 2,199	\$ 909	142%
Percentage of Advertising Systems Revenues	73%	78%	
Six months ended:			
Advertising Systems	\$ 3,239	\$ 1,498	116%
Percentage of Advertising Systems Revenues	70%	79%	
Three months ended:			
Services	\$ 648	\$ 1,055	(39)%
Percentage of Services Revenues	59%	55%	
Six months ended:			
Services	\$ 1,311	\$ 1,923	(32)%
Percentage of Services Revenues	80%	54%	
Three months ended:			
Licenses	\$ 2	\$ 1	100%
Percentage of Licenses Revenues	6%	%	
Six months ended:			
Licenses	\$ 8	\$ 3	167%
Percentage of Licenses Revenues	10%	0%	

The Company incurs cost of revenues related to search revenue for the hosting services associated with providing search results. Bandwidth costs utilized in providing results has been minimal. The Company believes that as search revenue increases, the hosting services associated with this revenue will increase. Additionally, as the Company is able to obtain private label distribution agreements there may be costs associated with that distribution. This may lead to an increase in the costs as a percentage of revenues.

Cost of revenues from advertising systems were \$2.2 million and \$3.2 million for the three and six month periods, respectively, ended June 30, 2006 compared to \$0.9 million and \$1.5 million for the same periods last year. These costs consist of the web-hosting and employee fees associated with serving advertising content, costs for media space at websites, and costs of developing certain advertisements in contracts that include a combined price for developing creative material and delivering that material. Cost of media space at websites increased by \$1.4 million and \$2.0 million in the three and six month periods, respectively, in 2006, compared with the same periods last year. This increase was due to more contracts which required the Company to both purchase media and deliver ads for the advertiser.

Cost of revenues for services consists primarily of salaries, consulting fees and overhead for those who provide fee-based content creation and engineering professional services. Cost of revenues for services of \$0.6 million and \$1.3 million for the three and six month periods, respectively, ended June 30, 2006 decreased by \$0.4 and \$0.6 million, respectively, compared to the same periods last year. The decreases in cost of revenues for services is attributable to the decrease in service revenues compared to the prior year. Additionally, due to the decline in revenues the Company initiated a restructuring which reduced the cost of revenues in the second quarter

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

of 2006 as compared to the first quarter of 2006. The Company believes that the costs for services as a percentage of revenue will improve during the remainder of 2006.

***Sales and marketing***

	June 30,		
	2006	2005	% Change
(dollars in thousands)			
Three months ended:			
Sales and Marketing	\$ 1,449	\$ 1,228	18%
Percentage of total revenues	25%	19%	
Six months ended:			
Sales and Marketing	\$ 3,027	\$ 2,503	21%
Percentage of total revenues	31%	21%	

Sales and marketing expenses include salaries and benefits, sales commissions, stock-based compensation charges, consulting fees, and travel and entertainment expenses for its sales and marketing personnel. Sales and marketing expenses also include the cost of programs aimed at increasing revenue, such as advertising, trade shows, and public relations.

Sales and marketing expenses of \$1.4 million for the three months ended June 30, 2006 increased by \$0.2 million compared to the same period last year. The increase was principally due to recording \$0.1 million in stock-based compensation in 2006 due to the adoption of FAS 123R.

Sales and marketing expenses of \$3.0 million for the six months ended June 30, 2006 increased by \$0.5 million compared to the same period last year. The increase was principally due to recording \$0.3 million in stock-based compensation in 2006 due to the adoption of FAS 123R. Personnel costs including commissions increased by \$0.1 million and search marketing costs increased by \$0.2 million. These increases were offset by a decrease in consulting expenses of \$0.1 million.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Research and development**

	June 30,		
	2006	2005	% Change
(dollars in thousands)			
Three months ended:			
Research and development	\$ 1,068	\$ 1,147	(7)%
Percentage of total revenues	19%	17%	
Six months ended:			
Research and development	\$ 2,156	\$ 2,353	(8)%
Percentage of total revenues	22%	19%	

Research and development expenses consist primarily of salaries and benefits for software developers, contracted development efforts, and stock-based compensation charges related to the Company's product development efforts. The Company expenses as incurred research and development costs necessary to establish the technological feasibility of its internally developed software products and technologies. To date, the establishment of technological feasibility of the Company's products and general release has substantially coincided. As a result, the Company has not capitalized any software development costs since costs qualifying for such capitalization have not been significant. Additionally, the Company capitalizes costs of software, consulting services, hardware and payroll-related costs incurred to purchase or develop internal-use software, if technological feasibility has been established, it is probable that the project will be completed and the software will be used as intended. The Company expenses costs incurred during preliminary project assessment, research and development, re-engineering, training and application maintenance.

Beginning in 2004, the Company expanded its research and development efforts beyond changes in the overall quality of the Viewpoint Media Player to efforts to build the Viewpoint Toolbar for searching. During 2005, efforts in this area focused on the development of a more flexible frame for the Toolbar which would facilitate adding different software tools to its capabilities and the development of a photosharing capability. In addition, during 2004 the Company expanded its efforts to build its advertising system product by expanding the creative assembly capability of its product. During 2005, efforts were focused on building an ad delivery system that combined the capabilities of Unicast's and Viewpoint's products. During 2006 the Company has been working on a new type of toolbar which can be easily branded for a customer. Additionally the Company has been developing a personalization tool that can be used in the toolbar or ad systems business and a new reporting module that will more effectively determine returns on types of advertising formats for its ad systems platform.

Research and development expenses decreased by \$0.2 million and \$0.1 million for the six and three months ended June 30, 2006 compared to the same periods last year. These changes resulted from a decrease in salaries due to fewer employees in this group during the past year.



**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*General and administrative*

	June 30,		
	2006	2005	% Change
(dollars in thousands)			
Three months ended:			
General and Administrative	\$ 2,226	\$ 2,654	(16)%
Percentage of total revenues	38%	40%	
Six months ended:			
General and Administrative	\$ 4,585	\$ 4,741	(3)%
Percentage of total revenues	48%	39%	

General and administrative expenses primarily consist of corporate overhead of the Company, which includes salaries and benefits related to finance, human resources, MIS, legal, and executive personnel along with other administrative costs such as facilities costs, legal, accounting and investor relations fees, insurance expense, and bad debt expense.

General and administrative expenses decreased by \$0.4 million for the three months ended June 30, 2006 compared to the same period last year. The Company recorded \$0.2 million in stock-based compensation for the three months ended June 30, 2006 due to the adoption of FAS 123R. During the same period in 2005 the Company recorded a stock based compensation expense of \$0.6 million associated with a charge taken on extending the options of a former executive at June 30, 2005. Salary and fringe benefit costs decreased by \$0.2 million in the three months ended June 30, 2006 due primarily to an overall reduction of employees in this department during the year.

General and administrative expenses decreased by \$0.1 million, or 3%, for the six months ended June 30, 2006 compared to the same period last year. Stock based compensation charges were \$0.6 million for both periods. Accounting fees increased by \$0.2 million in the six months ended June 30, 2006 as compared to the same period in the prior year. Salary and fringe benefit costs decreased by \$0.4 million due primarily to a decrease of employees in this area during 2006.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Depreciation expense*

	June 30,		
	2006	2005	% Change
(dollars in thousands)			
Three months ended:			
Depreciation	\$ 107	\$ 182	(41)%
Percentage of total revenues	2%	3%	
Six months ended:			
Depreciation	\$ 224	\$ 338	(34)%
Percentage of total revenues	2%	3%	

Depreciation expense relating to operating expenses decreased by less than \$0.1 million for the three and six month periods ended June 30, 2006, as compared with the same period last year primarily due to the Unicast assets acquired on January 3, 2005. Most of the assets acquired were depreciated over a one year life. Certain depreciation amounts were reclassified to the cost of revenue for the three and six months ending June 30, 2005 to conform to the 2006 presentation. Refer to the consolidated financial statements for further information regarding the reclassification.

*Amortization of intangible assets*

	June 30,		
	2006	2005	% Change
(dollars in thousands)			
Three months ended:			
Amortization of intangible assets	\$ 111	\$ 126	(12)%
Percentage of total revenues	2%	2%	
Six months ended:			
Amortization of intangible assets	\$ 221	\$ 252	(12)%
Percentage of total revenues	2%	2%	

Amortization of intangible assets relates to the amortization of patents, trademarks and other intangible assets acquired in the Unicast acquisition. Intangible assets, excluding Goodwill, determined to have been acquired included trademarks, and website partner relationships. Viewpoint will be amortizing these values over an effective 7.5 year life principally due to the longer life estimated for the more valuable website partner relationships. Certain amortization amounts were reclassified to cost of revenue for the three and six months ending June 30, 2005 to conform to the 2006 presentation. Refer to the consolidated financial statements for further information regarding the reclassification.

At December 31, 2005 the Company determined that, based upon a decline in operating performance during the fourth quarter of 2005, the Services reporting unit had experienced an impairment of its allocated goodwill. At that time, the Company recorded an impairment expense of \$7.8 million.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Restructuring charges**

	June 30, 2006	2005	% Change
(dollars in thousands)			
Three months ended:			
Restructuring charges	\$	\$	N/A%
Percentage of total revenues		%	%
Six months ended:			
Restructuring charges	\$	92	\$ N/A%
Percentage of total revenues		1%	%

The Company implemented a restructuring plan in March 2006 designed to streamline the services business. Under this plan the Company eliminated 10 positions in the services group and relocated the management of the group from its New York office to its existing Los Angeles office. The Company incurred a restructuring charge of \$0.1 million related to severance arrangements which has been recorded separately on the income statement. This restructuring plan was completed by March 31, 2006 and the severance was paid in the second quarter of 2006.

**Interest and other income, net**

	June 30, 2006	2005	% Change
(dollars in thousands)			
Three months ended:			
Interest and other income, net	\$	90	\$ 32 181%
Percentage of total revenues		2%	%
Six months ended:			
Interest and other income, net	\$	169	\$ 56 202%
Percentage of total revenues		1%	%

Interest and other income, net, primarily consists of interest and investment income on cash, cash equivalents and marketable securities. As a result, interest and other income, net, fluctuates with changes in the Company's cash, cash equivalents and marketable securities balances and market interest rates.

Interest and other income, net, increased 181% and 202% for the three and six months ended June 30, 2006, respectively, compared to the same period last year due to an increase in average cash, cash equivalents, and marketable securities balances as well as an increase in market interest rates.

**Interest expense**

	June 30, 2006	2005	% Change
(dollars in thousands)			
Three months ended:			
Interest expense	\$	(209)	\$ (339) (38)%
Percentage of total revenues		(4)%	(5)%
Six months ended:			
Interest expense	\$	(496)	\$ (655) (24)%
Percentage of total revenues		(5)%	(5)%

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Interest expense consists of interest paid and accrued, and amortization of debt discount and debt issue costs on the Company's outstanding subordinated notes and the debt assumed based upon the Unicast acquisition on January 3, 2005. The decrease is primarily the result of an extension of the maturity period of a note from March 2006 to March 2008, resulting in lower monthly interest expense for that note based on the effective rate of interest, as well as a reduction of \$0.4 million of debt in March 2006.

*Changes in fair value of warrants to purchase common stock*

	June 30,		% Change
	2006	2005	
(dollars in thousands)			
Three months ended:			
Changes in fair value of warrants to purchase common stock and conversion options of convertible notes	\$ (544)	\$ 648	(184)%
Percentage of total revenues	(10)%	10%	
Six months ended:			
Changes in fair value of warrants to purchase common stock and conversion options of convertible notes	\$ (1,172)	\$ 830	(241)%
Percentage of total revenues	(12)%	7%	
	35		

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**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Based on the provisions of 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, the Company records gains and losses based upon changes in the Company's common stock value and the number of common stock equivalents that the associated financial instruments may be settled in.

For the three and six month periods ended June 30, 2006, the Company recorded an expense of \$0.5 million and \$1.2 million, respectively, based on the change in the fair value of warrants. For the three and six months ended June 30, 2005, the Company recorded income of \$0.6 million and \$0.8 million, respectively, in the Company's consolidated statements of operations based on the change in the fair values of warrants.

***Provision for income taxes***

	2006	June 30, 2005	% Change
(dollars in thousands)			
Three months ended:			
Provision for income taxes	\$ 19	\$ 9	111%
Percentage of total revenues	%	%	
Six months ended:			
Provision for income taxes	\$ 26	\$ 12	117%
Percentage of total revenues	%	%	

Provision for income taxes consists primarily of certain minimum state and city income taxes.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Adjustment to net loss on disposal of discontinued operations*

	2006	June 30, 2005	% Change
(dollars in thousands)			
Three months ended:			
Adjustment to net loss on disposal of discontinued operations, net of tax	\$	\$	N/A%
Percentage of total revenues		%	%
Six months ended:			
Adjustment to net loss on disposal of discontinued operations, net of tax	\$	\$ 145	(100)%
Percentage of total revenues		%	1%

In December 1999, the Board of Directors of the Company approved a plan to focus exclusively on its interactive media technologies and digital content creation services and to correspondingly divest itself of its prepackaged software graphics business. Accordingly, these operations are reflected as discontinued operations for all periods presented in the accompanying consolidated statements of operations.

There were no adjustments to net loss on disposal of discontinued operations for the three and six month periods ended June 30, 2006. The adjustment to net loss on disposal of discontinued operations for the six month ended June 30, 2005 represents a settlement of a lawsuit in the Company's favor related to discontinued operations.

**Factors That May Affect Future Results of Operations**

We believe that in the future our results of operations could be affected by various factors including:

We have a history of losses and expect to incur losses in the future, which may cause our share price to decline.

Our business is difficult to evaluate because we have a limited operating history and have only relatively recently launched our search toolbar and UAP products.

Our competitors in the search business include much larger companies such as Google, Microsoft, Yahoo! and others that have significantly greater resources than we do to build a business.

Our efforts to distribute our graphically enhanced search toolbar may experience setbacks limiting or reducing our search revenue.

The success of our graphically enhanced search operations depends on users' satisfaction with search results supplied by Yahoo!.

We may be unable to successfully replace our search results vendor when our distribution contract with Yahoo! expires in March 2008.

Our software products may be improperly labeled as spyware or adware which might lead to its uninstallation causing a decrease in our revenues.

Our business may not grow if the internet advertising market does not continue to develop or if we are unable to successfully implement our business model.

Our failure to successfully compete may hinder our growth.

Our revenues will be subject to seasonal fluctuations.

We may enter into business combinations and strategic alliances which could be difficult to integrate and may disrupt our business.

We may need to develop new products or other untested methods of increasing sales with our existing products or distribution network to generate sales and if we are unsuccessful the growth of our business may cease or decline.

We will need to keep pace with rapid technological change in the internet search and advertising industries.

Our ad campaign management and deployment solution may not be successful and may cause business disruption.

We might experience significant defects in our products.

Our technical systems are vulnerable to interruption and damage.

Our management team has only recently started working together.

We may have to obtain financing on less favorable terms, which could dilute current stockholders' ownership interests in the company.

Our stock price is volatile, which could subject us to class action litigation.

Our charter documents could make it more difficult for an unsolicited third party to acquire us.

The market for digital visualization solutions is characterized by rapidly changing technology, and if we do not respond in a timely manner, our products and technologies may not succeed in the marketplace.

We may be unable to protect our intellectual property rights.

We may be liable for infringing the intellectual property rights of others.

Regulatory and legal uncertainties could harm our business.

Changes in regulations or user concerns regarding privacy and protection of user data could adversely affect our business.

Internet security poses risks to our entire business.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**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 occurring 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.

In July 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ( FIN 48 ). FIN 48 clarifies the recognition threshold and measurement of a tax position taken on a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. FIN 48 also requires expanded disclosure with respect to the uncertainty in income taxes. We are currently evaluating the requirements of FIN 48 and the impact this interpretation may have on our financial statements.

**LIQUIDITY AND CAPITAL RESOURCES**

**Liquidity and Capital Resources**

Cash, cash equivalents, and marketable securities totaled \$7.5 million at June 30, 2006, down from \$9.1 million at December 31, 2005.

	<b>Six Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>
	<b>(dollars in millions)</b>	
Cash used in operating activities	\$ (2.6)	\$ (3.7)
Cash provided by (used in) investing activities	(3.3)	1.0
Cash provided by financing activities	\$ 1.3	\$ 0.4



**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Operating activities**

In the six months ended June 30, 2006, cash used in operating activities was \$2.6 million, a decrease of \$1.1 million compared to the six months ended June 30, 2005. The use of cash was mainly due to a net loss of \$6.8 million as well as a decrease in accounts payable of \$0.7 million, offset by a decrease in accounts receivable of \$1.5 million, a change in the fair value of warrants of \$1.2 million, stock-based compensation charges of \$1.2, depreciation and amortization expenses of \$0.6 million and amortization of debt related costs of \$0.4 million.

**Investing activities**

In the six months ended June 30, 2006, cash used in investing activities was \$3.3 million, primarily as a result of net purchases of marketable securities of \$3.1 million.

In the six months ended June 30, 2005, cash provided by investing activities was \$1.0 million, primarily due to net sale of marketable securities of \$1.7 million offset by the cash used in the acquisition of Unicast of \$0.5 million and capital expenditures of \$0.3 million.

**Financing activities**

In the six months ended June 30, 2006, net cash provided by financing activities was \$1.3 million, resulting from the exercise of stock options of \$1.9 million which was offset by cash used for the repayment of debt totaling \$0.6 million.

In the six months ended June 30, 2005, net cash provided by financing activities was \$0.4 million resulting solely from the exercise of stock options.

As of June 30, 2006, the Company had cash commitments totaling approximately \$10.7 million through 2011, related mainly to long-term notes and future minimum lease payments for office space, and equipment.

	<b>Payments Due By Period</b>				
	(dollars in thousands)				
	<b>Total</b>	<b>1 Year or Less</b>	<b>2-3 Years</b>	<b>4-5 Years</b>	<b>More than 5 Years</b>
Long-Term Debt Obligations	\$ 3,050	\$	\$ 3,050	\$	\$
Operating Lease Obligations	3,269	511	1,869	889	
Interest Payments on Long-Term Debt Obligations	547	119	314	114	
Employee Agreement	30	30			
Unicast Debt Obligations	3,155	194	778	2,183	
Purchase Obligations	609	609			
<b>Total</b>	<b>\$ 10,660</b>	<b>\$ 1,463</b>	<b>\$ 6,011</b>	<b>\$ 3,186</b>	<b>\$</b>

**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.

Long-term debt issued by Unicast ( Unicast notes ) remain 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 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 million. This promissory note bears interest of 5% per annum and is secured by substantially all of the Unicast subsidiary's assets. Concurrently with the closing of the Unicast acquisition,



**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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. All unpaid principal and interest is payable in 60 equal monthly installments from March 2006 through March 2011. In March 2006, the Company made the first installment under the secured promissory note.

*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 convertible notes were converted to Viewpoint common stock in 2004. 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. In 2003 and 2004, all of the convertible notes were converted into common stock or redeemed for cash, therefore, no convertible notes remained outstanding as of June 30, 2006 and December 31, 2005. As of June 30, 2006, 0.8 million warrants were outstanding related to this placement.

*Subordinated Notes*

On March 26, 2003, Viewpoint Corporation entered into a Securities Purchase Agreement with three other 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. 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.

On March 31, 2006, the Company redeemed notes with a principal amount of \$450,000 pursuant to the agreement. The maturity date was extended to March 31, 2008 for the remaining notes with a principal amount of \$3.1 million and these notes remain outstanding as of June 30, 2006.

*Other Transactions*

In March of 2006, the Company implemented a restructuring plan designed to streamline the services business. Under this plan the Company eliminated 10 positions in the services group and relocated the management of the group from its New York office to its existing Los Angeles office. The Company incurred a restructuring charge of \$0.1 million related to severance arrangements which has been recorded separately on the statement of operations.

*Liquidity*

The Company had cash, cash equivalents and marketable securities of \$7.5 million at June 30, 2006. During the six months ended June 30, 2006, net cash used in operations amounted to \$2.6 million. As of June 30, 2006, the Company had an accumulated deficit of \$272.6 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 provided by expected future operations are sufficient to meet its operating cash flow needs and anticipated capital expenditure requirements through June 30, 2007.

The Company has contingency plans for 2006 if expected revenue targets are not achieved. These plans include further 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

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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. If the Company is unable to achieve profitable operations and/or raise additional capital, future operations will need to be scaled back further or discontinued.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company is subject to concentration of credit risk and interest rate risk related to cash, cash equivalents and marketable securities. Credit risk is managed by limiting the amount of 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. The majority of the Company's portfolio, which is classified as available-for-sale, is comprised of fixed income securities that are subject to the risk of market interest rate fluctuations, and all of the Company's securities are subject to risks associated with the ability of the issuers to perform their obligations under the instruments. The Company may suffer losses in principal if forced to sell securities, which have declined in market value due to changes in interest rates.

**Item 4. Controls and Procedures**

As required by Rule 13a-15(b), Viewpoint management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of the Company's disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. As required by Rule 13a-15(d), Viewpoint management, including the Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of the Company's internal control over financial reporting to determine whether any changes occurred during the quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during the quarter covered by this report.

**VIEWPOINT CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company is engaged in certain legal actions arising in the ordinary course of business. The Company believes it has adequate legal defenses in legal actions in which it is the defendant and believes that the ultimate outcome of such actions will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows.

**Item 1A. Risk Factors**

We have previously disclosed the risk factors in Part I Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005, which was filed with the Securities and Exchange Commission on March 20, 2006. A summary of these risk factors is provided in Item 2 of Part 1.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

The Annual Meeting of Stockholders of Viewpoint Corporation was held on June 21, 2006. A proposal to elect five (5) members of the Board of Directors to serve for a one-year term expiring at the annual meeting of stockholders in 2007 was approved by the stockholders with the nominees receiving the following votes:

	<b>For</b>	<b>Withheld</b>
Stephen Duff	59,694,036	1,915,540
Samuel H. Jones, Jr.	60,584,957	1,024,619
Dennis R. Raney	60,599,313	1,010,263
Patrick Vogt	60,597,319	1,012,257
Harvey D. Weatherson	60,600,181	1,009,395

**Item 5. Other Information**

None.

**Item 6. Exhibits**

(a) Exhibits

<b>Exhibit Number</b>	<b>Exhibit Title</b>
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

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

VIEWPOINT CORPORATION

Dated: August 9, 2006

By: /s/ PATRICK VOGT

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Patrick Vogt  
President and Chief Executive Officer

Dated: August 9, 2006

By: /s/ WILLIAM H. MITCHELL

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William H. Mitchell  
Chief Financial Officer

Dated: August 9, 2006

By: /s/ CHRISTOPHER C. DUIGNAN

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Christopher C. Duignan  
Chief Accounting Officer