

VIEWPOINT CORP
Form 10-K
March 16, 2005

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

F_{ORM} 10-K

(Mark One)

**S ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR FISCAL YEAR ENDED DECEMBER 31, 2004
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 **95-4102687**
(State or other jurisdiction of (I.R.S. Employer
incorporation of organization) Identification Number)
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)

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, \$0.001 par value

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 such 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 S No £

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K. £

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2 of the Act) Yes No

Aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2004	\$ 107,850,000
Number of shares of common stock outstanding as of February 28, 2005	57,652,000

DOCUMENTS INCORPORATED BY REFERENCE:

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the annual meeting of stockholders to be held in 2005, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

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PART I

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from the results stated, implied, or suggested 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 "Management's Discussion and Analysis of Financial Condition and Results of Operations—Factors That May Affect Future Results of Operations." You should carefully review these factors as well as the risks described in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q to be filed in 2005. When used in this report, the words "will," "expects," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," and similar expressions generally intended to identify forward-looking statements. You should not place undue reliance on the forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. 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.

Item 1. Business

Viewpoint Corporation ("Viewpoint" or the "Company") is an internet advertising company that focuses on using its graphical platform's capabilities to provide consumers, advertisers, and website publishers an enhanced internet experience. Since 2003, we have extended the historical imaging capabilities of our 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. Our revenues in these product segments are supplemented by our in-house services team which builds sophisticated content that is used by customers in each product segment. Finally, we license our platform to internet publishers enabling them to deploy sophisticated graphically content at their websites.

All of our four product segments have their roots in our core software offering, the Viewpoint Media Player ("VMP"). The VMP is a free software product installed by internet consumers on their computers to view specialized digital content displayed by websites. (See discussion of "Licensing" below.) We have been distributing the VMP since 2000 and estimate that it has been installed on more than 120 million computers in the United States. We base this estimate on independent surveys commissioned by us and by other industry participants as well as information we've received from our publishing clients who report to us the frequency with which visitors to their sites have the VMP installed before arriving at their sites.

The VMP has an "automatic update" feature that enables new functions and features to be easily and efficiently added. Whenever an internet consumer visits a website deploying content that is built using the Viewpoint platform, or encounters online advertising content delivered by our ad-delivery product, the VMP is activated. When the VMP is activated it communicates with our servers to check for recent improvements and automatically updates itself when necessary. This activation provides a unique opportunity for us to communicate with internet consumers and to offer them the latest version of the VMP as well as other valuable features and products, such as our internet search toolbar.

Internet Search

On March 17, 2004, we entered the internet search business by launching a Graphically Enhanced Search toolbar product that we call the "Viewpoint Toolbar." The Viewpoint Toolbar works within 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 into 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 images of the web pages themselves in a horizontal "tray" that descends from the Viewpoint Toolbar. Search results delivered to users of the Viewpoint Toolbar are supplied by Yahoo! Inc. and its wholly-owned subsidiary, Overture Services,

Inc. (“Yahoo!”) Under our Agreement with Yahoo! we receive a share of the fees advertisers pay to Yahoo! to be listed in the search results as “sponsored links.”

The Viewpoint Toolbar technology incorporates methods for “rendering”, streaming, updating, and “skinning” that were first developed for the VMP. Like other offerings of its type, the Viewpoint Toolbar enables consumers to search the Internet for goods, services and information. Unlike other toolbars, however, the Viewpoint Toolbar's architecture enables features such as visual representations of search results and “bookmarked” internet sites, automatic updating, generation of desktop animations, and a “Pop-Up” blocker that intercepts pop-up advertisements and holds them in a “tray” of the Viewpoint Toolbar. This tray can be accessed if and when a user desires. Viewpoint is in the process of applying for patent protection on several of these features and processes.

In July 2004, we launched version 2.0 of the Viewpoint Toolbar which includes more efficient deployment of search results and a feature we call “Comparative Search.” When the Comparative Search feature is operating and a consumer uses a search method other than the Viewpoint Toolbar to conduct an internet search, a web page listing the search results of the search engine selected will appear and the tray from the Viewpoint Toolbar will simultaneously populate with thumbnail images of the search results supplied by Yahoo!.

We have been offering the Viewpoint Toolbar to internet users who have the most recent version of the VMP installed on their computer. We present those users with notice of the availability of the Viewpoint Toolbar and an opportunity to install it without charge. Through March 1, 2005, we have offered over 33 million VMP users the opportunity to install the Viewpoint Toolbar and 10 million have accepted. Consumers can uninstall the Viewpoint Toolbar either through their operating system or through an option on the Viewpoint Toolbar. Over 6 million remain installed as of March 1, 2005. We also make the Viewpoint Toolbar available for download from our website.

We generate revenue from the Viewpoint Toolbar when an internet consumer uses the Viewpoint Toolbar to conduct an internet search, or when they have the Viewpoint Toolbar installed and conduct a search at an internet site. We also generate revenue, although a very small percentage, when a user conducts a search from our search homepage, www.viewpointsearch.com. Revenue is generated when the consumer clicks on results provided by Yahoo! that have been provided because an advertiser has paid to be included in Yahoo!'s search results. Yahoo! receives the fee from the advertiser and pays Viewpoint a percentage of this fee 45 days after the end of the month in which the advertisement is clicked.

In 2004, we recognized \$2.7 million in revenue from our Internet Search business segment. For more information regarding the financial performance of this and our other segments, please see Note 15 in the financial statements.

Advertising Systems

We also offer an online advertising campaign management and deployment product known as “Creative Innovator.” Creative Innovator permits publishers, advertisers, and their agencies to manage the complex process of deploying online advertising campaigns. This process includes creating the advertising assets, selecting the sites on which the advertisements will be deployed, setting the campaign parameters (ad rotation, the frequency with which an ad may be deployed, and others), deployment, and tracking of campaign results.

We designed Creative Innovator to be the first management system to integrate creative assembly with campaign management and detailed performance analysis. In addition, we believe it has the broadest capabilities of any deployment system to deliver ad formats and media types, including several different video formats, 3D content, and all major “rich media” units.

Creative Innovator is “technology agnostic”, meaning it delivers advertisements that utilize all major technologies and formats, not just those exploiting the special capabilities of the VMP. Importantly, however, video and other “rich media” ads that typically involve large file sizes and,

therefore, higher bandwidth costs, can be deployed at significantly lower rates when utilizing the Viewpoint format by taking advantage of the VMP residing on the internet consumer's computer.

We delivered over 1 billion ad impressions through Creative Innovator in 2004. Many of the campaigns were delivered to help advertisers and publishers use Creative Innovator on a trial basis and did not generate revenue. The campaigns that were delivered as “pilots” or test campaigns served to provide publishers and advertisers with practical hands-on experience with the system and provided a practical basis of comparison with other ad-serving technologies. Following trial campaigns, certain advertisers and publishers elected to use Creative Innovator on a fee basis, including America Online and CBS Sportsline.

On January 3, 2005, we acquired Unicast Communications Corp. (“Unicast”), a leader in the delivery of internet video advertisements that play interstitially when a web surfer moves between pages at a web publisher's site, adding another video ad delivery mechanism to our solution. We believe the addition of Unicast will help accelerate the growth of our advertising systems segment both because of its past relationship with over 240 advertisers and 280 web publishers in 2004, and as a result of the addition of key personnel in the marketing, technology, sales, and customer support areas.

Following the acquisition of Unicast, we integrated all of our product offerings into one suite of products called Viewpoint's Unicast Online Advertising Suite. This suite of products includes Unicast Transitional (full screen and partial screen video and interactive ads that are shown to consumers as they navigate between pages), Unicast In-Page (video and interactive ads embedded within web pages including standard and expandable banners, pre-roll and post-roll ads), and Unicast Over-the-Page (video and interactive ads that “float”/play over the top of an internet site page). The suite of products is delivered using Creative Innovator.

We offer these advertising formats delivered through Creative Innovator to customers, charging in the standard manner for the industry with fees based on the number of times an advertisement is deployed (*i.e.*, on a “CPM”, or cost per thousand impression basis). CPM fees vary by type of advertisement, with static ads realizing relatively low fees and rich media ads—particularly video ads—realizing higher fees. Rates charged for advertising ranged from \$0.18 to \$4.00 per thousand advertisements in 2004.

Ad delivery via Creative Innovator also contributes to our overall strategy in that ads served through Creative Innovator cause older VMPs to be updated (as described above) regardless of whether the advertisement served relies on the VMP or uses other standard formats. At some later time, the user can be offered the Viewpoint Toolbar. Thus, we have experienced an increase in offers of Viewpoint Toolbars when we have an increase in advertising impressions delivered using Creative Innovator.

Creative Services

We provide fee-based professional services for creating content and implementing visualization solutions. Our professional services group uses the Viewpoint platform, as well as a spectrum of tools and other technologies to create enhanced rich media solutions for our clients' particular purposes, whether over the web, intranet systems or offline media and applications. We provide the support our 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 2004 include America Online, Inc., Toyota Motor Services, General Electric and Sony Electronic.

Our professional services group plays an integral role in our overall strategy. Aside from generating significant revenues, the group increases our ability to sell licenses (as described below) to clients who are impressed by the advantages of the Viewpoint platform but who do not wish to create Viewpoint content themselves. Also, the group's work keeps us on the cutting-edge of the industry, giving us hands-on experience with the design and development problems faced by our own clients. We are not totally reliant on our own content creation services, however, as we have cultivated a network of independent content developers trained to provide those services as well.

Licensing

Viewpoint launched a business in 1987 as a software maker focused primarily on products that enabled content authors to create images in three dimensions and to “paint” artistic images digitally. 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 our 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, several of our licensing and creative services customers 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.

We charge web site owners licensing fees for the right to display content in the Viewpoint format from their sites. Our technology is designed so that content in the Viewpoint format that is deployed from a website or otherwise distributed without a valid license or “key” can be spoiled by a “watermarking” image.

We make available on our web site, without charge, the core software necessary to create content in the Viewpoint format, as well as extensive tutorials and related materials. However, we are currently developing a content authoring software product that we expect will improve upon the currently available tools and make the process of authoring content in the Viewpoint format easier. We anticipate that this product will be available in 2005. We intend to license the product for a one-time fee and include with the price of the software the right to deploy an unlimited quantity of most types of Viewpoint content from an unlimited number of websites for an unlimited period of time.

During 2004, we generated \$4.2 million in License revenues including \$3.5 million from an agreement with America Online signed in 2003. While rights to use the software are perpetual, maintenance and upgrades associated with the agreement will cease in December 2005.

The Licensing segment represents an increasingly smaller portion of our revenues. While we anticipate that license revenues may actually decrease in the future, it remains an important aspect of our business because the increase of content in the Viewpoint format deployed on the internet—and therefore, the increase in the number of VMP's in use and up-to-date—benefits our other business segments by enabling us to offer additional Viewpoint products and to sell advertising campaign management solutions that involve Viewpoint content.

Competition

We have competitors in all four of our product segments. Competitors in the Search business include Google Inc., Yahoo! (who offers its own search toolbar in addition to supplying search results for use with the Viewpoint Toolbar), MSN, AskJeeves, Inc., FindWhat, and InfoSpace. Competitors of our Creative Innovator product include full service advertising delivery companies like DoubleClick, ValueClick, Aquantive, 24/7 Media, AOL (through its recently purchased Advertising.com subsidiary) and MSN. Additionally, certain companies specialize in delivering rich media and video advertisements although these companies are generally smaller and are not publicly listed. Competitors in the Services sector include advertising agencies, online agencies and independent creative talent that can build content in the Viewpoint format or in other rich media formats. Our software licensing competitors (and their products) include: Macromedia, Inc. (Flash and Shockwave) and Cycore AB (Cult3D).

Some of our competitors have longer operating histories and significantly greater financial, management, technology, development, sales, marketing and other resources than we have. As we compete with larger competitors across a broader range of products and technologies, we may face

increasing competition from such companies. If these or other competitors develop products, technologies or solutions that offer significant performance, price or other advantages over our products, our business would be harmed.

A variety of other possible actions by our competitors could also have a material adverse effect on our business, including increased promotion or the introduction of new or enhanced products and technologies. Moreover, new personal computer platforms and operating systems may provide new entrants with opportunities to obtain a substantial market share in the markets in which we compete.

Our competitors may be able to develop products or technologies comparable or superior to ours, or may be able to develop new products or technologies more quickly. We also face competition from developers of personal computer operating systems such as Microsoft and Apple Computer, Inc., as well as from open-source operating systems such as Linux. These operating systems may incorporate functions that could be superior to or incompatible with our products and technologies. Such competition would adversely affect our business.

See the section headed "Factors That May Affect Future Results of Operations" below for additional information regarding competition.

Product Development

The continual development of new products and enhancements to our existing products is critical to our success. Our principal current product development efforts are focused on the development of the Viewpoint platform and other technologies like Creative Innovator and Graphically Enhanced Search. From time to time, we may also acquire basic software technologies that we considers complementary to our offerings.

Our growth will, in part, be a function of the introduction of new products, technologies and services and future enhancements to existing products and technologies. Any such new products, technologies or enhancements may not achieve market acceptance. In addition, we have historically experienced delays in the development of new products, technologies and enhancements, and such delays may occur in the future. If we were unable, due to resource constraints or technological or other reasons, to develop and introduce such products, technologies or enhancements in a timely manner, this inability could have a material adverse effect on our business.

Our research and development expenses were approximately \$3.4 million, \$3.4 million and \$3.6 million for 2004, 2003, and 2002 respectively, excluding charges for non-cash stock based compensation. We have added additional engineers in connection with our recent acquisition of Unicast and expanded efforts in the advertising systems business which will result in increased research and development expenses during 2005.

Employees

As of February 25, 2005, Viewpoint had 126 full time employees, including 40 related to cost of revenues in creative services and advertising systems; 20 in sales and marketing; 39 in research, development and quality assurance; and 27 in administration. This compares to 95 full-time employees at March 5, 2004 including 16 in sales and marketing, 29 in creative services, 29 in research, development and quality assurance and 21 in administration. The employees and the Company are not parties to any collective bargaining agreements, and the Company believes that its relationships with its employees are good.

Executive Officers of the Registrant

The following table sets forth certain information regarding the Company's executive officers as of March 5, 2005:

Name	Age	Position
Jerry S. Amato	45	President and Chief Executive Officer
William H. Mitchell	47	Chief Financial Officer
Brian J. O'Donoghue	41	Senior Vice President and General Counsel
Robert E. Rice	50	Executive Chairman

Jerry S. Amato, President and Chief Executive Officer

Mr. Amato has been a director of the Company and its Chief Executive Officer since August 2003. From July 1995 through September 1998, Mr. Amato served as President and Chief Operating Officer of Vanstar Corporation, a leading provider of services and products designed to build, manage and enhance personal computer network infrastructures with 1998 revenues exceeding \$2.8 billion. From September 1998 until joining the Company in August 2003, Mr. Amato served as a principal of the Flatiron Group in New York, a business strategy and planning advisory service. In March 1998, Mr. Amato led the formation of Technology Access Action Coalition/ACT, a Washington-based organization promoting innovation and growth in the technology sector, and served as its Chairman until November 1999.

William H. Mitchell, Chief Financial Officer

Mr. Mitchell has served as Chief Financial Officer of the Company since August 2003. From July 2002 to August 2003, Mr. Mitchell served as Chief Financial Officer of MaxWorldwide, Inc., an Internet-based provider of marketing solutions for advertisers and web publishers. From January 2001 to July 2002, Mr. Mitchell served as Chief Financial Officer for Tally Systems, Inc., a software development company. He served as Executive Vice President and Chief Financial Officer of Bigfoot Interactive, an Internet advertising company, from July 1999 to January 2001, and as Chief Operating Officer of Bigfoot International from October 1998 to July 1999. Mr. Mitchell graduated with an A.B. from Dartmouth College, MS and MS/M.B.A. degrees from Northeastern University and obtained his certified public accountant license in 1982.

Brian O'Donoghue, Senior Vice President and General Counsel

Mr. O'Donoghue was an attorney at Milbank, Tweed, Hadley, and McCloy LLP, specializing in corporate and litigation matters from 1995 until joining the Company as General Counsel in May 2000. Mr. O'Donoghue received his Juris Doctorate from Fordham University School of Law in 1995.

Robert E. Rice, Executive Chairman

Mr. Rice has been Executive Chairman since August 2003. Prior to that Mr. Rice served as President and Chief Executive Officer of Viewpoint since March 2000 and Chairman of the Company's Board of Directors since November 2000. At the Company, he served as Vice President of Strategic Affairs until September 1999. He served as the President and a Director of Metastream since its formation in June 1999. Mr. Rice co-founded Real Time Geometry Corporation and served as its chairman until its sale to the Company in 1996. Before founding Real Time Geometry, Mr. Rice was a partner at the law firm of Milbank, Tweed, Hadley and McCloy LLP, where he advised on various corporate, tax, and intellectual property issues.

Item 2. Properties

The Company leases approximately 17,000 square feet of space on the 18th floor of a 24-story office building in New York City, New York. This space houses approximately 90 personnel,

including substantially all of the Company's general and administrative and research and development personnel as well as a significant portion of the sales and marketing and creative services personnel. The primary lease agreement expires in February 2010, if not renewed. The Company believes that this office space is adequate for its current needs and that additional space is available in the building or in the New York City area to provide for anticipated growth.

The Company also leases approximately 12,000 square feet of office space in Los Angeles, California, pursuant to a lease that expires in December 2009. This space houses approximately 18 personnel principally engaged in sales, marketing and production for the services segment.

The Company also leased approximately 12,000 square feet of office space in Draper, Utah, pursuant to a sublease agreement that expired in April 2010. This space housed approximately 29 personnel in 2002 principally engaged in sales and marketing, creative services, and management information systems services. In February 2003, the Company closed this office and reached an agreement with the Lessor to terminate the lease in October, 2004. The Company recorded a partial impairment for the costs associated with maintaining this facility in 2003 and adjusted this impairment to reflect the final settlement in 2004.

Item 3. 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 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for Registrant's Common Stock, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Viewpoint Corporation's ("Viewpoint" or the "Company") common stock, \$0.001 par value, began trading over the counter in December 1995. The common stock is traded on The NASDAQ National Market under the symbol "VWPT." On February 28, 2005, there were 321 holders of record of our common stock. Some of the holders of record of Viewpoint common stock are brokers and other institutions that hold stock on behalf of their customers. We estimate that approximately 10,000 stockholders hold shares of Viewpoint common stock through the brokers and other institutions. The following table sets forth, for the periods indicated, the range of high and low closing sales prices per share of our common stock:

	High	Low
2004		
4th Quarter	\$ 3.30	\$ 2.38
3rd Quarter	2.34	1.03
2nd Quarter	3.99	1.97
1st Quarter	3.50	0.75
2003		
4th Quarter	\$ 1.01	\$ 0.68
3rd Quarter	1.64	0.72
2nd Quarter	1.37	0.43

1st Quarter

1.83

0.30

The Company has not paid any cash dividends on its common stock to date. The Company currently anticipates that it will retain all future earnings, if any, for use in its business and does not anticipate paying any cash dividends on its common stock in the foreseeable future.

In March 2004, the Company sold 1.5 million shares of common stock, in a private placement to an institutional investor, for \$3.7 million or \$2.45 per share.

In December 2004 the company sold 1.9 million shares of common stock in a private placement to an investor for \$5.0 million or \$2.65 per share.

Information with respect to securities authorized for issuance under equity compensation plans is included in our Proxy Statement relating to our 2004 annual meeting of stockholders and is incorporated herein by reference.

Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with “Management's Discussion and Analysis of Financial Condition and Results of Operations” and the Consolidated Financial Statements and related notes thereto appearing elsewhere in this Annual Report on Form 10-K.

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	Years Ended December 31,				
	2004	2003	2002	2001	2000
(In thousands, except per share data)					
Statements of Operations Data					
Revenues:					
Search	\$ 2,698	\$ —	\$ —	\$ —	\$ —
Advertising systems	305	—	—	—	—
Services	4,822	4,291	3,302	3,500	1,659
Related party services	2,468	5,226	2,244	827	500
Licenses	704	2,283	5,039	8,148	1,421
Related party licenses	3,535	1,729	7,554	1,533	—
Total revenues	14,532	13,529	18,139	14,008	3,580
Cost of Revenues:					
Search	45	—	—	—	—
Advertising systems	132	—	—	—	—
Services	3,074	5,776	3,587	3,283	1,467
Licenses	6	97	353	309	76
Total cost of revenues	3,257	5,873	3,940	3,592	1,543
Gross profit	11,275	7,656	14,199	10,416	2,037
Operating expenses:					
Sales and marketing	3,732	8,723	16,682	17,521	18,616
Research and development	3,432	4,209	4,348	9,846	10,559
General and administrative	7,220	11,549	10,334	10,423	9,814
Depreciation	853	1,543	1,962	1,804	801
Amortization of intangible assets (1),(2)	17	10	664	3,325	1,258
Amortization of goodwill (1)	—	—	—	14,128	1,767
Restructuring charges (3)	(106)	2,023	—	—	—
Impairment of goodwill and other intangible assets (2)	—	—	6,275	7,925	—
Compensation charge related to forgiveness of an officer loan	—	—	—	—	2,322
Non-cash sales and marketing charges (4)	—	—	—	—	19,998
Acquired in-process research and development costs (1)	—	—	—	—	963
Total operating expenses	15,148	28,057	40,265	64,972	66,098
Loss from operations	(3,873)	(20,401)	(26,066)	(54,556)	(64,061)
Other income (expense):					
Interest and other income, net	60	254	153	1,064	2,180
Interest expense (5)	(936)	(958)	—	—	—
Changes in fair values of warrants to purchase common stock and conversion options of convertible notes (5)	(4,180)	1,209	—	—	—
Loss on conversion of debt	(810)	—	—	—	—
Loss on early extinguishment (5)	—	(1,682)	—	—	—

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Other income (expense):	(5,866)	(1,177)	153	1,064	2,180
Loss before provision for income taxes	(9,739)	(21,578)	(25,913)	(53,492)	(61,881)
Provision for income taxes	90	81	107	—	—
Loss before minority interest in loss of subsidiary	(9,829)	(21,659)	(26,020)	(53,492)	(61,881)
Minority interest in loss of subsidiary	—	—	—	—	4,429
Net loss from continuing operations	(9,829)	(21,659)	(26,020)	(53,492)	(57,452)
Net income (loss) from discontinued operations (4)	129	157	127	1,122	1,496
Net loss	(9,700)	(21,502)	(25,893)	(52,370)	(55,956)
Accretion of mandatorily redeemable preferred stock of subsidiary	—	—	—	—	(438)
Net loss applicable to common shareholders	\$ (9,700)	\$ (21,502)	\$ (25,893)	\$ (52,370)	\$ (56,394)
Basic and diluted net loss per common share:					
Net loss per common share from continuing operations	\$ (0.18)	\$ (0.47)	\$ (0.64)	\$ (1.37)	\$ (2.01)
Net income (loss) per common share from discontinued operations	0.00	0.00	0.00	0.03	0.05
Net loss per common share	\$ (0.18)	\$ (0.47)	\$ (0.64)	\$ (1.34)	\$ (1.96)
Weighted average number of shares outstanding—basic and diluted	52,955	45,280	40,759	39,077	28,718

	December 31,				
	2004	2003	2002	2001	2000
	(In thousands)				
Balance Sheet Data (In thousands)					
Cash, cash equivalents and marketable securities (4) (7)	\$ 8,662	\$ 9,488	\$ 11,568	\$ 15,122	\$ 29,033
Working capital (3) (5) (7)	4,416	3,324	9,051	11,765	34,313
Total assets (1) (2) (5)	45,273	45,743	53,352	61,917	102,349
Convertible notes, subordinated notes and warrants (6)	3,674	4,748	7,000	—	—
Stockholders' equity (1) (4) (7)	33,958	27,467	38,352	52,737	96,339

- (1) Effective January 1, 2002, the Company adopted Statements of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets.” As required by SFAS No. 142, the Company discontinued amortizing the remaining balances of goodwill as of January 1, 2002. All remaining and future acquired 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 continue to be amortized over their estimated useful lives and assessed for impairment under SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.”
- (2) During 2002, due to the persistence of unfavorable economic conditions along with lower-than-expected revenues generated to date and reduced estimates of future performance of the Viewpoint Digital assets, the Company performed an impairment analysis on the goodwill and other intangible asset balances recorded upon the acquisition of Viewpoint Digital. In accordance with the provisions of SFAS No. 142 and SFAS No. 144, the Company recorded impairment charges totaling \$6.3 million.
- (3) In fiscal 2003, the Company implemented three restructuring plans. The first plan, implemented and completed in 2003, reduced operating expenses by closing the Company's Utah office. In accordance with SFAS No. 146 “Accounting for Costs Associated with Exit or Disposal Activities,” the Company recorded restructuring charges of \$1.4 million, which was recorded on our income statement as restructuring charges. During October 2004 the Company signed an agreement releasing it from any additional obligation under the remaining lease commitment after a payment of \$0.3 million. As a result of this release the Company reversed the remaining accrued amount of \$0.1 million as the Company completed its obligations under the release agreement. The second plan was implemented in 2003, and was designed to streamline the business. The Company incurred a restructuring charge of \$0.6 million related to severance arrangements, on the income statement. In January 2004 the Company recorded a non-cash adjustment less than \$0.1 million to the restructuring accrual to reflect payments that were less than originally contemplated under the plan. The third plan was implemented and completed in 2003, and was designed to consolidate international operations to the New York office. The Company incurred a restructuring charge of \$0.1 million related to severance arrangements on the income statement.
- (4) In December 1999, the Board of Directors of the Company approved a plan to focus exclusively on the Company's 3D and rich media visualization and marketing technologies, and to correspondingly divest itself of all its prepackaged graphics software business. Consequently, the results of operations of the prepackaged graphics software business have been classified as net income (loss) from discontinued operations for all periods presented.
- (5) On December 31, 2002, the Company completed a debt financing in which it issued to three investors, 4.95% convertible notes having an aggregate principle amount of \$7 million, and warrants to purchase 0.7 million shares of Company common stock. On March 25, 2003 the Company redeemed an aggregate of \$3.3 million principal amount of the outstanding convertible notes, exchanged an aggregate of \$1 million principal amount of the outstanding convertible notes for shares of the Company's common stock, and exchanged the remaining \$2.7 million principal amount of outstanding convertible notes for \$2.7 million principal amount of new convertible notes.

(footnotes continued on next page)

(footnotes continued from previous page)

In connection with the redemption of the convertible notes the Company recorded a \$1.7 million loss on the early extinguishment of debt.

On March 26, 2003, the Company 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 subordinated notes and 3.6 million shares of Viewpoint common stock.

On March 17, 2004, one of the institutional investors holding the convertible notes converted \$0.9 million of outstanding notes for shares of the Company's common stock. In the first quarter of 2004, the Company recorded a loss of \$1.4 million related to the change in the fair value of the conversion feature from January 1, 2004 through the date of the conversion. For the three months ended March 31, 2004 the Company also recorded a loss related to a change in the fair value of the conversion feature and warrants of \$3.7 million and \$1.3 million, respectively.

In addition, on the same day as the conversion, the Company sold 1.5 million shares of common stock in a private placement to the institutional investor, for \$3.7 million or \$2.45 per share. The Company recorded a loss on conversion of debt in the amount of \$0.6 million, which represented the write-off of unamortized loan discount and debt issuance costs of \$0.1 million and the difference between the proceeds received from the private placement and the fair value of the common stock issued based upon the closing price of the Company's stock on the day of the sale of \$0.5 million. The remaining noteholders chose not to exercise their right to redeem their notes in amount up to 20% of the \$3.7 million received by the Company within 10 days of the Company's public announcement of the closing of the private placement.

During the period beginning on April 15, 2004 and May 20, 2004—a period which covered 25 consecutive trading days—the dollar volume-weighted average price of the Company's common stock exceeded 150% of the conversion price applicable to the outstanding convertible notes and the Company determined to exercise its right to convert the outstanding notes into shares of Company common stock. Accordingly, on May 20, 2004, the Company informed the institutional investors holding the outstanding convertible notes that it would exercise its right to convert that debt. On June 18, 2004, the Company completed the conversion of the remaining outstanding convertible notes of \$1.8 million and the related outstanding interest into 1.7 million shares of Viewpoint common stock. In the second quarter of 2004, the Company recorded a gain of \$3.0 million related to the change in the fair value of the conversion feature during the period from April 1, 2004 through June 18, 2004, the date of the conversion.

In addition, the Company recorded a loss on conversion which represented the difference between the fair value of the common stock issued in exchange for the notes and the carrying value of the convertible notes on the date of conversion. This change was primarily comprised of the write-off of unamortized loan discount and debt issuance costs.

- (6) In November 2003, the Company sold 3.1 million shares of common stock, in a private placement to Federal Partners, L.P., an affiliate of The Clark Estates, Inc. for \$2.5 million or \$0.80 per share. Under the terms of the investment, the Company was obliged to file a registration statement covering the resale of the shares within 45 days of the closing date, which occurred on November 12, 2003. The Company filed the registration statement on December 27, 2003.

In March 2004, the Company sold 1.5 million shares of common stock, in a private placement to an institutional investor, for \$3.7 million or \$2.45 per share.

In December 2004 the company sold 1.9 million shares of common stock in a private placement to an investor for \$5.0 million or \$2.65 per share.

Item 7. 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 Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially. 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 the Quarterly Reports on Form 10-Q to be filed in 2004. When used in this report, the words "wills," "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 the forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. 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

Overview. Viewpoint Corporation ("Viewpoint" or the "Company") is a leading internet advertising company that focuses on using its graphical platform's capabilities to provide consumers, advertisers, and website publishers an enhanced internet experience. Since 2003 we have extended the historical imaging capabilities of our 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 licenses its platform to internet publishers enabling them to deploy graphical sophisticated content at their websites.

On March 17, 2004, Viewpoint entered the internet search business by launching a toolbar search product which the Company calls 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. Search results delivered to users of the Viewpoint Toolbar are supplied by Yahoo! Inc. and its wholly-owned subsidiary, Overture Services, Inc. ("Yahoo!") Under its Agreement with Yahoo!, Viewpoint receives a share of the fees advertisers pay to Yahoo! to be listed in the search results as a "sponsored link".

Viewpoint also offers an online advertising campaign management and deployment product known as "Creative Innovator". Creative Innovator permits publishers, advertisers, and their agencies to manage the process of deploying online advertising campaigns. This process includes creating the advertising assets, selecting the sites on which the advertisements will be deployed, setting the metrics (ad rotation, the frequency with which an ad may be deployed, and others) associated with the campaign, ad deployment, and tracking of campaign results. Creative Innovator enables users to manage advertising campaigns across many sites. In March 2004, Viewpoint announced the availability of "AirTime", an extension of Creative Innovator that permits users to manage and deploy online video advertising campaigns.

On January 3, 2005 Viewpoint purchased all the outstanding stock of Unicast Corporation ("Unicast"), a leader in the delivery of interstitial and superstitial video internet advertisements. Unicast delivered video advertisements for its customers using a format that complements Viewpoint's in-page and in-stream video advertising provided by AirTime. Additionally, Unicast

generated monthly revenues from dozens of advertisers who purchased advertising on some of the internet's most active websites including Microsoft's MSN, Yahoo! and America Online. Viewpoint believes that the addition of Unicast will significantly accelerate the Company's growth in its advertising systems segment.

We provide fee-based professional services for creating content and implementing visualization solutions. Clients include both content-related licensees and advertisers who use Creative Innovator as well as internal services provided to our marketing team. Our 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. We provide the support our 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 2004 include America Online, Toyota Motor Services, General Electric and Sony.

Viewpoint began business in 1987 as a software maker focused primarily on products that enabled content authors to create images in three dimensions and to "paint" artistic images digitally. 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 our 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, several of our licensing and creative services customers 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.

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 December 31, 2004, had an accumulated deficit of \$255.3 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.

RESULTS OF OPERATIONS

The following table sets forth certain selected financial information expressed as a percentage of revenues for the periods indicated:

	Years Ended December 31,		
	2004	2003	2002
Statements of Operations Data			
Revenues:			
Search	19%	—%	—%
Advertising systems	2	—	—
Services	33	32	18
Related party services	17	38	12
Licenses	5	17	28
Related party licenses	24	13	42
	<u> </u>	<u> </u>	<u> </u>
Total revenues	100	100	100
	<u> </u>	<u> </u>	<u> </u>
Cost of revenues:			
Search	—	—	—
Advertising systems	1	—	—
Services	21	42	20
Licenses	—	1	2
	<u> </u>	<u> </u>	<u> </u>
Total cost of revenues	22	43	22
	<u> </u>	<u> </u>	<u> </u>
Gross profit	78	57	78
	<u> </u>	<u> </u>	<u> </u>
Operating expenses:			
Sales and marketing	26	64	92
Research and development	25	32	24
General and administrative	48	86	56
Depreciation	6	11	11
Restructuring charges related to office closure	(1)	15	—
Amortization of intangible assets	—	—	4
Impairment of goodwill and other intangible assets	—	—	35
	<u> </u>	<u> </u>	<u> </u>
Total operating expenses	104	208	222
	<u> </u>	<u> </u>	<u> </u>
Loss from operations	(26)	(151)	(144)
Other income (expense):			
Interest and other income, net	—	2	1
Interest expense	(6)	(7)	—
Changes in fair values of warrants to purchase common stock and conversion options of convertible notes	(29)	9	—
Loss on conversion of debt	(6)	—	—
Loss on early extinguishment	—	(12)	—

Other income	(41)	(8)	1
Loss before provision for income taxes	(67)	(159)	(143)
Provision for income taxes	1	1	1
Net loss from continuing operations	(68)	(160)	(144)
Adjustment to net loss on disposal of discontinued operations, net of tax	1	1	1
Net loss	(67)	(159)	(143)
Net loss applicable to common shareholders	(67)%	(159)%	(143)%

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. We base our estimates on historical experience and on various other assumptions that we believe 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 significant accounting policies, see Note 2 to the consolidated financial statements included in this Annual Report on Form 10-K.

Described below are the areas where we believe that the estimates, judgments or assumptions that we have made, if different, would have yielded the most significant differences in our financial statements:

Revenue Recognition

The Company recognizes revenue in accordance with Statement of Position (“SOP”) 97-2, “Software Revenue Recognition,” as amended, Emerging Issues Task Force (“EITF”) No. 00-21 “Revenue Arrangements with Multiple Deliverables,” and Staff Accounting Bulletin (“SAB”) No. 104 “Revenue Recognition”. Per SOP 97-2 and SAB No. 104, the Company recognizes revenue when the following criteria are met: (a) persuasive evidence of an arrangement exists, (b) delivery has occurred or services have been rendered, (c) the Company's fee is fixed or determinable, and (d) collectibility is reasonably assured.

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

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.

Viewpoint also offers an online advertising campaign management and deployment product. This advertising system permits publishers, advertisers, and their agencies to manage the process of deploying online advertising campaigns. The Company charges customer 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.

Fee-based professional services for customized software development are performed on a fixed-fee or time-and-materials basis under separate service arrangements. Revenues for fixed-fee arrangements are recognized over the pattern of performance in accordance with the provisions of SAB No. 104. The pattern of performance for service arrangements is measured by the percentage of costs incurred and accrued to date for each contract, which primarily consist of direct labor costs, cost of outsourcing, and overhead, to the estimated total cost for each contract at completion. The percentage approximates the percentage of a customer's contract that has been completed and would be available for the customer to use at that point in time. Use of this method is based on the availability of reasonably dependable estimates. If reasonably dependable estimates are not available due to the complexity of the services to be performed, the Company defers recognition of any revenues for the project until the project is completed, delivered and accepted by the customer, provided all other revenue recognition criteria are met and no further

significant obligations exist. Revenues from customer support services are recognized ratably over the term of the contract. Revenues from training services are recognized as services are performed.

License revenues from direct customers include sales of perpetual and term-based licenses for broadcasting digital content in the Viewpoint format. License revenues are recognized up-front provided no further significant obligations exist and the resulting receivable is deemed collectible by management. Arrangements with VARs require (i) an up-front, non-refundable payment, (ii) a percentage royalty based on sell-through, or (iii) both as consideration for the right to resell the Viewpoint technology. Up-front, non-refundable payments are recognized as license revenues when the VARs right to resell the company's technology begins and the technology has been delivered to the VAR, which is upon contract signing, provided all other revenue recognition criteria are met and no further significant obligations exist. For arrangements that do not call for an up-front, non-refundable payment, revenues are recognized as the royalties are earned, which is upon notification of sell-through by the VAR, provided all other revenue recognition criteria are met and no further significant obligations exist. Term-based licenses that include upgrades, when and if available, over the term of the contract are recognized ratably over the term that the upgrades are provided.

Fees from licenses sold together with fee-based professional services are generally recognized upon delivery of the software, provided that the payment of the license fees are not dependent upon the performance of the services, and the services are not essential to the functionality of the licensed software. If the services are essential to the functionality of the software, or payment of the license fees are dependent upon the performance of the services, both the software license and service fees are recognized in accordance with SOP 81-1 "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." The percentage of completion method is used for those arrangements in which reasonably dependable estimates are available. If reasonably dependable estimates are not available due to the complexity of the services to be performed, the Company defers recognition of any revenues for the project until the project is completed, delivered and accepted by the customer, provided all other revenue recognition criteria are met and no further significant obligations exist.

For arrangements involving multiple elements, the Company defers revenue for the undelivered elements based on their relative fair value and recognizes the difference between the total arrangement fee and the amount deferred for the undelivered elements as revenue. The determination of fair value of each undelivered element in multiple element arrangements is based on the price charged when the same element is sold separately. For maintenance and technical support elements, the Company uses renewal rates to determine the price when sold separately. The Company accounts for multiple element arrangements which involve only fee-based professional services in accordance with EITF 00-21. For licenses sold that include updates over a period of time the Company recognizes the license revenue over the period in which updates are provided.

Standard terms for license arrangements require payment within 90 days of the contract date, which typically coincides with delivery. Standard terms for service arrangements, which are typically billed and collected on an installment basis, require final payment within 90 days of completion of the services. Standard terms for Advertising systems arrangements require payment within 30 days of billing which is generally at the end of each month. Standard terms for payment of Search revenue by Yahoo! requires payment within 45 days of the end of a month. Probability of collection is based upon the assessment of the customer's financial condition through the review of their current financial statements and/or credit reports. For follow-on sales to existing customers, prior payment history is also used to evaluate probability of collection. The Company's arrangements with customers do not contain product return rights. If the fee is not fixed or determinable, revenue is recognized as payments become due or as cash is received from the customer. If a nonstandard acceptance period is required, revenues are recognized upon the earlier of customer acceptance or the expiration of the acceptance period.

Percentage of Completion

The Company recognizes revenue in accordance with Statement of Position (“SOP”) 97-2, “Software Revenue Recognition,” as amended, Emerging Issues Task Force (“EITF”) Issue No. 00-21 “Revenue Arrangements with Multiple Deliverables,” Staff Accounting Bulletin (“SAB”) No. 101 “Revenue Recognition in Financial Statements” and SAB No. 104 “Revenue Recognition.” Per SOP 97-2 and SAB No. 101, the Company recognizes revenue when the following criteria are met: (a) persuasive evidence of an arrangement exists, (b) delivery has occurred or services have been rendered, (c) the Company's fee is fixed or determinable, and (d) collectibility is reasonably assured.

Fee-based professional services for customized software development are performed on a fixed-fee or time-and-materials basis under separate service arrangements. Revenues for fixed-fee arrangements are recognized over the pattern of performance in accordance with the provisions of SAB No. 101. The pattern of performance for service arrangements is measured by the percentage of costs incurred and accrued to date for each contract, which primarily consist of direct labor costs, cost of outsourcing, and overhead, to the estimated total cost for each contract at completion. The percentage approximates the percentage of a customer's contract that has been completed and would be available for the customer to use at that point in time. Use of this method is based on the availability of reasonably dependable estimates. If reasonably dependable estimates are not available due to the complexity of the services to be performed, the Company defers recognition of any revenues for the project until the project is completed, delivered and accepted by the customer, provided all other revenue recognition criteria are met and no further significant obligations exist.

Reserve for Bad Debt

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by a review of their current credit information. The company regularly monitors collections and payments from our customers and maintains a provision for estimated credit losses based upon historical experience and any specific customer collection issues that have been identified.

Valuation of goodwill and intangible assets

The Company adopted SFAS No. 142, “Goodwill and Other Intangible Assets” and SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” SFAS 142 eliminates the amortization of goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with finite lives and addresses impairment testing and recognition for goodwill and intangible assets. SFAS No. 144 establishes a single model for the impairment of long-lived assets.

We assess goodwill for impairment annually unless events occur that require more frequent reviews. Long-lived assets, including amortizable intangibles, are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Discounted cash flow analyses are used to assess goodwill impairment while undiscounted cash flow analyses are used to assess long-lived asset impairment. If an assessment indicates impairment, the impaired asset is written down to its fair market value based on the best information available. Estimated fair market value is generally measured with discounted estimated future cash flows. Considerable management judgment is necessary to estimate undiscounted and discounted future cash flows. Assumptions used for these cash flows are consistent with internal forecasts.

On an on-going basis, management reviews the value and period of amortization or depreciation of long-lived assets, including goodwill and other intangible assets. During this review, we re-evaluate the significant assumptions used in determining the original cost of long-lived assets. Although the assumptions may vary from transaction to transaction, they generally include revenue growth, operating results, cash flows and other indicators of value. Management then determines whether there has been an impairment of the value of long-lived assets based upon events or

circumstances that have occurred since acquisition. The impairment policy is consistently applied in evaluating impairment for each of our wholly owned subsidiaries and investments.

Investments

We record an impairment charge when we believe an investment asset has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future.

Derivatives

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

Contingencies and Litigation

We evaluate contingent liabilities including threatened or pending litigation in accordance with SFAS No. 5, "Accounting for Contingencies" and record accruals when the outcome of these matters is deemed probable and the liability is reasonably estimable. We make these assessments based on the facts and circumstances and in some instances based in part on the advice of outside legal counsel.

Restructuring Activities

Restructuring activities are accounted for in accordance with SFAS No. 146 "Accounting for Costs Associated With Exit or Disposal Activities". SFAS No. 146 requires, with respect to the recognition of severance expenses, management approval of the restructuring plan, the determination of the employees to be terminated, communication of benefit arrangements to employees and, with respect to costs associated with lease terminations, an estimation of sublease payments.

Financial Performance Summary

Viewpoint reported total revenue of \$14.5 million for 2004, compared to \$13.5 million for 2003. Gross profit for the year ended December 31, 2004 was \$11.3 million, compared to \$7.7 million for the twelve months ended December 31, 2003. The improvement in gross profit in 2004 compared to 2003 was due to the addition of revenues from our higher margin search products of \$2.7 million, and higher margin professional services contracts during 2004.

Operating loss for the year ended December 31, 2004 was \$3.9 million compared to \$20.4 million for the year ended December 31, 2003. The lower level of operating losses came from a reduction in operating expenses due to steps management implemented in 2003 to reduce costs, primarily in payroll. Additionally, in 2003 the Company

recognized \$2.0 million in restructuring

costs that had a small net positive adjustment in 2004 and experienced a \$2.4 million decrease in non-cash stock based compensation charges in 2004 compared to 2003.

The Company recognized a net loss of \$9.7 million, or \$(0.18) per share in 2004, compared to a net loss of \$21.5 million, or \$(0.47) per share in 2003. The lower level of net loss was principally due to reduced operating losses, offset by an increase in other expenses principally due to the \$5.4 million expense associated with its obligation to convertible debt and warrant holders attributable to its March 2003 financing. This obligation increased in 2004 due to an increase in the Company's stock price during the year, and represents a non-cash expense to Viewpoint. Additionally, 6.7 million additional common shares were outstanding during 2004 when compared to the prior year due to two private placements, the conversion of debt to equity and the exercise of stock options that occurred during the year. These additional shares had the impact of reducing the net loss per share.

From March through June, 2004 Viewpoint converted \$2.7 million of convertible debt to equity. Additionally, in March 2004 the Company sold 1.5 million shares of stock in a private placement for \$3.7 million or \$2.45 per share. Finally, in December 2004, the Company sold 1.9 million shares of common stock in a private placement for \$5.0 million or \$2.65 per share.

Viewpoint's cash, cash equivalents, and marketable securities as of December 31, 2004 were \$8.7 million compared to cash, cash equivalents, and marketable securities of \$9.5 million at December 31, 2003. This decrease can be attributed to the Company's operating loss less the recognition of deferred revenue, which was a non-cash item during the year ended December 31, 2004, offset by the first and fourth quarter's private placements. The Company believes that its current cash, cash equivalents, and marketable securities balances and cash provided by future operations, if any, are sufficient to meet its operating cash flow needs and anticipated capital expenditure requirements through at least the next twelve months. The Company may seek additional funds before that time through public or private equity financing or from other sources to fund our operations and pursue our growth strategy. We have no commitment for additional financing, and we may experience difficulty in obtaining additional financing on favorable terms, if at all. Any financing we obtain may contain covenants that restrict our freedom to operate our business or may have rights, preferences or privileges senior to our common stock and may dilute our current shareholders' ownership interest in Viewpoint. In the event the company is unable to obtain adequate financing or profitable operations in future periods, operations will need to be scaled back or activity in certain segments discontinued.

Revenues

	<u>2004</u>	<u>% Change</u>	<u>2003</u>	<u>% Change</u>	<u>2002</u>
	(Dollars in thousands)				
Search	\$ 2,698	N/A %	\$ —	N/A %	\$ —
Advertising systems	305	N/A	—	N/A	—
Services	4,822	12	4,291	30	3,302
Related party services	2,468	(53)	5,226	133	2,244
Licenses	704	(69)	2,283	(55)	5,039
Related party licenses	3,535	104	1,729	(77)	7,554
	<u> </u>		<u> </u>		<u> </u>
Total revenues	\$ 14,532	7 %	\$ 13,529	(25)%	\$ 18,139

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.

Viewpoint also offers an online advertising campaign management and deployment product. The product permits publishers, advertisers, and their agencies to manage the process of deploying online advertising campaigns. The Company charges customers on a cost per thousand impression ("CPM") basis, and recognizes revenue when the impressions are served, so long as all other revenue recognition criteria are satisfied. The Company expects revenues from advertising systems to continue to grow in future quarters.

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 2004 the Company concentrated on executing larger creative projects which improved overall financial performance of the segment.

The Company also generates revenues by selling licenses to the Viewpoint graphical platform principally to internet content publishers. 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 2004 the Company continues to recognize license sales upon delivery so long as all other revenue recognition criteria are satisfied. Since January 2004, licenses are generally sold for a 12 month term. The Company also adopted a new licensing price structure in 2004 whereby larger license sales, that are made less frequently, contain product upgrades when and if available for a period of 12 months. These license sales will be amortized over a 12 month period, due to the inclusion of when and if available upgrades.

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 was 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 is recognizing 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.

During 2004, the Company began to focus more resources on its Search and Advertising systems segments. While the Company was successful in selling some licenses during 2004 it is likely that License revenue will continue to decline relative to total revenues.

Search revenues of \$2.7 million for 2004 represent fees earned by Viewpoint since its introduction of the Viewpoint Toolbar in March 2004. Search revenues are generated when users of the Viewpoint Toolbar are provided search results from advertisers that they click on to see. These advertisers then pay a fee to Yahoo!, who remits a percentage of the fee to Viewpoint. The Company had installed 1.2 million Viewpoint Toolbars through June 30, 2004 and 4.7 million through September 30, 2004 and 8.7 million through December 31, 2004. Internet users can uninstall the Viewpoint Toolbar, and through December 31, 2004, 3.3 million users who had accepted the installation of the Toolbar had later uninstalled it during 2004. During 2004 the Company delivered search results to consumers over 400 million times. The Company believes that search revenues will continue to increase in 2005 if it is able to continue to increase the number of Viewpoint Toolbars that are distributed and remain installed.

The Company recognized \$0.3 million in advertising systems revenue during 2004. This revenue was generated by delivering advertising impressions to websites in several different formats

including video, principally during the fourth quarter of the year. While growth in this product revenue has been slower than anticipated, the Company expects growth to continue to increase during 2005 since the Company had more success selling its advertising systems products during the fourth quarter of 2004. Viewpoint purchased Unicast Corporation (“Unicast”) on January 3, 2005. Unicast recognized advertising systems revenue in excess of \$6.0 million during 2004. The Company believes it will be able to increase advertising systems revenues in 2005 due to the Unicast acquisition as well as an increase in spending by advertisers in the rich media advertising delivery market. Revenue increases may be negatively impacted by lower CPM rates if more competitors enter this market or website publishers develop delivery systems similar to those used by the Company.

Service revenues of \$4.8 million increased approximately \$0.5 million or 12% for the year ended December 31, 2004 compared to the same period last year. The Company's revenues during 2004 included \$0.5 million from a service project that was completed in the third quarter of 2003 for which the Company received a final payment and recognized revenue in February 2004. The Company recorded \$1.2 million in revenue, along with all associated expenses, for this same service project during 2003. The \$0.7 million decrease in revenue from this client was offset by the Company selling more services to other clients in 2004 who had purchased licenses during 2003 and 2004. Approximately \$0.8 million in service revenues from AOL are also included in this category in 2004 as they ceased being a related party in December 2003 and two contracts underlying these service revenues were executed in 2004. The Company believes that it will be able to increase revenues in this segment if licensees continue to ask the Company for assistance in building more content using the Viewpoint Platform to be used at their websites.

Related party service revenues of \$2.5 million for the year ended December 31, 2004, decreased by approximately \$2.8 million or 53% compared to the same period last year. This decrease is due to AOL use of the Company's engineering professional services extensively in 2003 which amounted to \$2.1 million in revenue. These services were not used in 2004. In addition, revenues included in 2004 as related party service revenues relate to contracts that were entered into prior to December 2003. The Company believes that revenue in this segment will be significantly lower in 2005 since there is only one remaining agreement for the Company to provide services to AOL that was executed in 2003.

License revenues of \$0.7 million decreased approximately \$1.6 million or 69% for the twelve months ended December 31, 2004, compared to the same period last year. License revenues in 2004 were essentially generated from licenses sold with upgrades offered when and if available over the term of the license. Conversely, during 2003, the Company generated license revenue from licenses sold without upgrades offered over the term of the contract. These licenses met the revenue recognition requirements and were therefore recognized upon delivery of the software. These licenses included three licenses purchased by international Value Added Resellers (“VAR”s), two international sales through its London office and two multi-year licenses. The Company has ceased pursuing sales through reseller channels and closed the department that supported this process at its headquarters. It has also closed its London office in December 2003 due to costs involved in supporting that location. One of the multi-year licenses remains in place and another was subsequently modified. The Company believes that revenues in this segment will continue to decrease as the Company focuses on increasing distribution of licenses through lower rates and focus efforts on other segments.

Related party license revenues increased approximately \$1.8 million, or 104% to \$3.5 million, for the year ended December 31, 2004 compared to the same period last year. The increase is attributable to the difference in the agreements AOL was working under. In 2004, AOL was working under one agreement the whole year which amounted to \$3.5 per year in license revenue. In 2003, this agreement was only outstanding for approximately 3 months, prior to which the Company recognized \$1 million in license revenue. Revenues in this segment will remain constant in 2005 and will be eliminated in 2006.

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Service revenues increased \$1.0 million, or 30%, for 2003 compared to 2002. The increase was caused by an expanded use of our services group by long term licensees and companies licensing our software on a project basis.

Related party service revenues increased by approximately \$3.0 million, or 133%, for 2003 compared to 2002. The increase was caused by an increased demand by AOL to utilize our services group to produce creative material for use by AOL in part due to their launch of new software in 2003, as well as post-contract customer support for software licensed by AOL in 2002 and 2003.

Total related party revenues for the year ended December 31, 2003 were \$7.0 million and were for services and licenses provided to AOL. The Company considered AOL a related party from November 2000 through December 10, 2003 because an employee of AOL served on the Company's board of directors during that time and AOL held 1.8 million shares of Company common stock.

License revenues decreased by \$2.8 million, or 55%, for 2003 compared 2002. The decrease was principally due to the successful sale of licenses for extended periods for certain customers during 2002 that did not require renewal during 2003, and a decrease in the number of new customers we were able to sell our software licenses to during the year. In addition, in 2003 there was a sharp decline in the sales to VARs of the rights to license our software to third parties as compared to the prior year.

Related party license revenues decreased by \$5.8 million, or 77% for 2003 compared with 2002. The decrease was caused by a 2002 amendment to an AOL contract that originated in 2001. The 2002 amendment resulted in the Company recording revenues when payments were due, as compared to the partial deferral of those payments which would have otherwise occurred. This amendment resulted in the Company recognizing \$5.8 million in license revenues in 2002 as opposed to \$2.7 million if the contract had not been amended. In October 2003, the Company entered into an amended license agreement with AOL which provided for payments by AOL of \$10.0 million which were all received during the fourth quarter of 2003. The agreement contains multiple elements consisting of a perpetual broadcast license, a perpetual source code license, quarterly updates to the source code through December 2005, and maintenance and consulting services. In 2003, the Company recognized license revenue of \$0.7 million, and service revenue of \$0.1 million related to this contract. The Company is recognizing the remaining revenue from this agreement ratably as License and Services revenue, through December 31, 2005, which represents the duration of the Company's obligation for post-contract customer support of the source code element including quarterly upgrades and maintenance requirements.

Cost of revenues

	2004	% Change	2003	% Change	2002
(Dollars in thousands)					
Search	\$ 45	N/A %	\$ —	N/A %	\$ —
Advertising systems	132	N/A	—	N/A	—
Services	3,074	(47)	5,776	61	3,587
Licenses	6	(94)	97	(73)	353
Total cost of revenues	\$ 3,257	(45)%	\$ 5,873	49 %	\$ 3,940
Percentage of total revenues	22%		43%		22%

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 although we do not anticipate an increase in the costs as a percentage of revenues.

Cost of revenues from advertising systems consists of the web-hosting fees associated with serving advertising content and costs of developing certain advertisements in contracts that included a combined price for developing creative material and delivering that material. The

Company is continually evaluating pricing for hosting services in order to reduce the delivery expenses to the greatest extent practicable. During the third quarter of 2004 the Company separated creative development from delivery contracts which will separate the creative development revenues and costs into services revenues and costs in the future. The Company believes that as advertising system revenue increases, expenses for bandwidth will increase. However, the Company believes that costs as a percentage of revenue will decrease since it will receive improved pricing efficiencies for hosting and delivery services and it does not anticipate bundling the costs of developing creative advertising with contracts for delivery of such advertising impressions.

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 decreased by \$2.7 million for the year ended December 31, 2004 as compared to the same period last year. The decrease in cost of revenues for services is attributable to the decrease in service revenues. Services expenses as a percentage of services revenues decreased from 61% to 42% because of the \$0.5 million payment made in February 2004, which was recognized as revenue in 2004 against which the cost had been recognized in cost of revenues in 2003, and due to more effective cost controls, including a reduced reliance on outside contractors, by the services group. The Company believes that the costs for services as a percentage of revenue will remain fairly constant in 2005.

Cost of revenues for licenses consists primarily of commissions to VARs. The decrease in cost of license revenues for 2004 is attributable to a decrease in sales to VARs that require commission payments, as compared to the same periods last year. The Company believes these costs will not change significantly in 2005.

Cost of revenues-service in 2003 increased by \$2.2 million or 61%, compared to 2002. This increase was directly attributable to an increase in service revenues of 72%. Cost of revenues-license in 2003 decreased by \$0.3 million or 73% compared to 2002. The reduction in cost of revenues-licenses was due to the reduction in license sales made to VARs during 2003.

Sales and marketing

	<u>2004</u>	<u>% Change</u>	<u>2003</u>	<u>% Change</u>	<u>2002</u>
	(Dollars in thousands)				
Sales and Marketing	\$ 3,732	(57)%	\$ 8,723	(48)%	\$ 16,682
Percentage of total revenues	26%		64%		92%

Sales and marketing expenses include salaries and benefits, sales commissions, non-cash stock-based compensation charges, consulting fees and travel and entertainment expenses for our 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 decreased by \$5.0 million, or 57%, for the year ended December 31, 2004 compared to the same period last year due to a decrease in personnel in the sales and marketing area. Personnel costs including fringe benefits decreased by \$3.7 million due to a reduction in sales staff associated with slower license sales, and a change in marketing emphasis and support. Travel and entertainment expenses decreased by \$0.4 million due to a reduction in sales staff and a decrease in the number of trade events attended by the Company. Consulting expenses, including marketing expenses such as trade shows, decreased by \$0.7 million related to decreases in marketing efforts for certain products compared to the same period last year. Non-cash stock-based compensation charges decreased \$0.5 million due to headcount reductions in sales and marketing personnel who had received option grants in the past where the exercise price was lower than the market value of the Company's common stock on the date of grant, or whose options became fully vested. Currently, the Company issues stock options to new personnel with an exercise price equal to the market value of the common stock on the date of grant. These decreases were offset by an increase in marketing expense related to launching and building the Company's search business of \$0.9 million. The Company

believes that sales and marketing

expenses will increase in 2005 primarily due to the net addition of 4 employees in this area related to the Unicast acquisition as well as increased commission and marketing costs associated with increases in revenues and generating revenues in search and advertising systems for a full year in 2005. However, the Company believes that costs as a percentage of revenue will decrease in 2005.

Sales and marketing expenses decreased \$8.0 million, or 48%, in 2003 compared to 2002. This decrease was principally attributable to a decrease in salaries and related fringes of approximately \$4.7 million due to a decreased demand for our products and a corresponding reduction in our sales and marketing efforts. An additional \$2.7 million reduction in sales and marketing expenses was due to a decrease in non-cash stock-based compensation as employees associated with these charges either left the company before their options fully vested or the options became fully vested in 2003; a \$0.6 million decrease due to bad debt expense associated with certain officer loans that were written off in 2002, and a \$0.5 million reduction was due to a curtailment of marketing efforts stemming from the slowdown in demand for our products. A quarterly reduction in total expense of approximately \$0.5 million in sales and marketing costs were realized in the fourth quarter of 2003 compared to the third quarter of 2003 largely resulting from the Company's office consolidation and workforce reductions which occurred during the third quarter of 2003.

Research and development

	<u>2004</u>	<u>% Change</u>	<u>2003</u>	<u>% Change</u>	<u>2002</u>
	(Dollars in thousands)				
Research and development	\$ 3,432	(18)%	\$ 4,209	(3)%	\$ 4,348
Percentage of total revenues	25%		32%		24%

Research and development expenses consist primarily of salaries and benefits for software developers, contracted development efforts, and non-cash 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, when 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.

The Company's research and development efforts are primarily directed at improving the overall quality of the Viewpoint Media Player and its proprietary software tools for creating digital content as well as development of the Viewpoint Toolbar and advertising systems products. During 2003, the Company developed significant enhancements to the video playback functionality of Viewpoint Media Player (which the Company made available in June 2003), an authoring tool for clients publishing advertising content, Computer Aided Design ("CAD") workflow solutions and technology for converting CAD data into Viewpoint content, expanded capability of the Video Media Player onto new platforms, developed new configuration capabilities for user interfaces, and enhancements to the Viewpoint Media Player that allow print quality images to be generated from interactive online content. Additionally, the Company began to build an ad serving system, Creative Innovator, which is capable of deploying advertising on internet websites. Beginning in 2004 the Company expanded its efforts to build the Viewpoint Toolbar for searching and related advertising efforts. It also developed a creative assembly capability for the advertising systems product that is used to deploy advertising to publisher sites on the internet. Additionally, it developed the capability of delivering video advertising using its advertising system. The Company has also been building a software development kit that will simplify the creation of graphical content to be deployed on the Viewpoint platform that should be available to the market in 2005.

Research and development expenses decreased by \$0.8 million or 18% for the year ended December 31, 2004 compared to the same period last year. The most significant decrease came in non-cash stock-based compensation which decreased \$0.8 million due to headcount reductions in research and development personnel who had received option grants in the past where the exercise price was lower than the market value of the Company's common stock on the date of grant, or whose options became fully vested. These decreases were off-set by an increase in salaries and benefits of \$0.3 million. Salaries and benefits increased due to specific engineering salaries and benefits that were classified as cost of revenues as a result of revenue generating customer specific development work during the first three quarters of 2003. Such contracts did not exist in the same period of 2004. This was offset by a reduction in bonuses of \$0.2 million for payments made during 2003 for the completion of certain projects were not paid in 2004. Travel and entertainment expenses decreased by \$0.1 million due to a reduction in travel associated with reductions in staffing levels during the year. The Company believes that costs in this area will increase due to the net addition of 10 employees during the year, due to the Unicast acquisition, however costs relative to revenues should decrease.

Research and development expenses decreased \$0.1 million or 3% in 2003 compared to 2002 due to a \$0.3 million decrease in compensation and fringes associated with a reduction of employees in the research and development area as the company narrowed its focus on research and development efforts and certain employees were assigned to other departments. This decrease was offset by an increase of \$0.1 million in non-cash stock-based compensation charges associated with the re-assignment of certain employees from other departments into research and development.

General and administrative

	<u>2004</u>	<u>% Change</u>	<u>2003</u>	<u>% Change</u>	<u>2002</u>
	(Dollars in thousands)				
General and Administrative	\$ 7,220	(37)%	\$ 11,549	12%	\$ 10,334
Percentage of total revenues	48%		86%		56%

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

General and administrative expenses decreased by \$4.3 million or 37% for the year ended December 31, 2004 compared to the same period last year. Non-cash stock-based compensation decreased by \$1.1 million due to headcount reductions in general and administrative personnel who had received option grants in the past where the exercise price was lower than the market value of the Company's common stock on the date of grant, or whose options became fully vested. Bad debt expense decreased by \$1.2 million due in part to the collection of accounts written off during 2003. Facility costs decreased by \$0.4 million associated with the closing of a facility in Utah in a restructuring completed in 2003. Total compensation costs including fringe benefits decreased by \$0.6 million associated with the reduction in executive staff associated with the cost reduction programs implemented by management in 2003. Corporate costs were reduced by \$0.6 million from 2003 due to costs incurred with outside counsel and accountants offset by additional costs associated with implementing the requirements of Sarbanes Oxley's Section 404 in 2004. The Company believes that costs in this area will increase in 2005 due to the net addition of 7 employees during the year, due to the Unicast acquisition, however costs relative to revenues should decrease.

General and administrative expenses increased \$1.2 million in 2003 compared to 2002 due to a \$0.8 million increase in severance costs related to an unfavorable legal decision regarding an officer loan, bad debt expense of \$0.4 million associated with an increase in the number of large license receivables that were written off, and \$0.2 million of internal use software that was determined to

be obsolete after a review of future utility in the third quarter of 2003. These were offset by a decrease of \$0.2 million in facilities costs associated with the closure of our Utah office.

Depreciation

	2004	% Change	2003	% Change	2002
	(Dollars in thousands)				
Depreciation	\$ 853	(45)%	\$ 1,543	(21)%	\$ 1,962
Percentage of total revenues	6%		11%		11%

Depreciation expense decreased \$0.7 million or 45% in 2004 compared to 2003 due to a reduction in depreciable equipment used in our Company stemming from our restructurings in 2003 and the retirement of equipment at the conclusion of its useful life. Depreciation expense decreased \$0.4 million or 21% in 2003 compared to 2002 due to the reduction of depreciable equipment associated with the reduction in staffing stemming from our restructurings and the retirement of equipment at the conclusion of its useful life.

Amortization of intangible assets

	2004	% Change	2003	% Change	2002
	(Dollars in thousands)				
Amortization of intangible assets	\$ 17	70%	\$ 10	(98)%	\$ 664
Percentage of total revenues	—%		0%		4%

Amortization of intangible assets relates to the amortization of patents and trademarks. Amortization of intangible assets decreased \$0.7 million or 98% in 2003 compared to 2002 as all intangible assets acquired in the Viewpoint Digital transaction were either fully amortized or written off in accordance with SFAS No. 144 during 2002.

Restructuring charges

	2004	% Change	2003	% Change	2002
	(Dollars in thousands)				
Restructuring charges	\$ (106)	(105)%	\$ 2,023	N/A%	\$ —
Percentage of total revenues	(1)%		15%		—%

In 2003, the Company implemented three restructuring plans. The first plan, implemented in February 2003, reduced operating expenses by closing the Company's Utah office and related to the termination of 28 employees in that office who were primarily engaged in sales and marketing activities. In accordance with SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities," the Company recorded restructuring charges of \$1.2 million. This charge is recorded on our income statement as restructuring charges. The restructuring charges represent the present value of remaining lease commitments discounted by 20% and reduced by estimated sublease rental income, employee severance and termination benefits, the write-off of the net book value of certain fixed assets used in the Utah office, and other miscellaneous charges. Subsequent to the restructuring, the Company re-evaluated market conditions surrounding its efforts to sub-lease the Utah office space and increased the restructuring charge by \$0.2 million related to the fair value of the remaining lease commitment reduced by estimated sublease rental income. During October 2004 the Company signed an agreement releasing it from any additional obligation under the remaining lease commitment after a payment of \$0.3 million. As a result of this release the Company reversed the remaining accrued amount of \$0.1 million as the Company completed its obligations under the release agreement.

The second plan was implemented in September 2003, and was designed to streamline the business. Under the plan the Company eliminated 24 sales and marketing, research and development, and general and administrative positions. The Company incurred a restructuring charge of \$0.5 million related to severance arrangements. The charge is recorded on the income statement as a restructuring and impairment charge. The second restructuring plan was completed

by September 30, 2003. In November 2003, however, the Company increased the restructuring charge by \$0.1 million in settlement of an action brought by one of the terminated employees. In January 2004 the Company recorded a non-cash adjustment to the restructuring accrual to reflect payments that were less than originally contemplated under the plan.

The third plan was implemented in December 2003, and was designed to consolidate international operations to the New York office. Accordingly, the Company closed the London, England office, incurring a restructuring charge of \$0.1 million related to severance arrangements. This severance payment was made in January 2004. As the lease relating to this office terminated in February 2004 the Company did not incur a charge related to rent expense. The severance charge is recorded on the income statement as a restructuring charge. The third restructuring plan was completed by December 31, 2003.

Impairment of goodwill and other intangible assets

	<u>2004</u>	<u>% Change</u>	<u>2003</u>	<u>% Change</u>	<u>2002</u>
	(Dollars in thousands)				
Impairment of goodwill and other intangible assets	\$ —	N/A	\$ —	(100)%	\$ 6,275
Percentage of total revenues	—%		—%		35%

In the first and second quarter of the year ended December 31, 2003, the market value of the Company's equity securities declined below the Company's carrying value indicating the existence of a potential goodwill impairment. In accordance with SFAS No. 142, the Company performed the first step of the goodwill impairment test as of March 31, 2003. The fair value of the Company was determined to exceed its carrying value using a market-based approach with selected multiples ranging from 1.5 to 2.0 times revenues and 1.8 to 2.5 times gross profit. In accordance with SFAS No. 142, the second step of the impairment test was unnecessary, and no goodwill impairment charges were recorded. Subsequent to March 31, 2003, the market value of the Company recovered and increased to a value in excess of its carrying value through December 2003.

In conjunction with the implementation of SFAS No. 142, the Company completed a goodwill impairment review as of January 1, 2002 and found no impairment on that date. As of March 31, 2002, due to the persistence of unfavorable economic conditions, lower-than-expected revenues generated to date and reduced estimates of future performance of the Viewpoint Digital assets, the Company performed an additional impairment analysis on the goodwill and other intangible asset balances recorded upon the acquisition of Viewpoint Digital. In accordance with the provisions of SFAS No. 142 and SFAS No. 144, the Company recorded impairment charges totaling \$6.3 million during the three months ended March 31, 2002. The fair value of the Viewpoint Digital assets was estimated using the expected present value of future cash flows. The assumptions supporting the cash flows, including the discount rate, were determined using the Company's best estimates as of the date the impairment was recorded.

Interest and other income, net

	<u>2004</u>	<u>% Change</u>	<u>2003</u>	<u>% Change</u>	<u>2002</u>
	(Dollars in thousands)				
Interest and other income, net	\$ 60	(76)%	\$ 254	66%	\$ 153
Percentage of total revenues	%		2%		1%

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

Interest and other income decreased \$0.2 million or 76%, in 2004 compared to 2003 and increased \$0.1 million or 66%, in 2003 compared to 2002 based on the change in average cash, cash equivalents and marketable securities balances as well as the change in interest rates.

Interest expense

	<u>2004</u>	<u>% Change</u>	<u>2003</u>	<u>% Change</u>	<u>2002</u>
	(Dollars in thousands)				
Interest Expense	\$ (936)	(2)%	\$ (958)	N/A	\$ —
Percentage of total revenues	(6)%		(7)%		—%

Interest expense consists of interest paid and accrued, and amortization of debt discount and debt issue costs on the Company's outstanding convertible and subordinated notes. The Company issued convertible notes with a principal balance of \$7.0 million on December 31, 2002, then subsequently redeemed \$3.3 million of the notes at par, exchanged \$1.0 million of the notes for common stock and exchanged \$2.7 million of the notes for new notes on March 25, 2003. Additionally, the Company issued \$3.5 million of subordinated notes on March 26, 2003. The \$6.2 million aggregate principal balances of the convertible and subordinated notes, which were outstanding at December 31, 2003, bear interest at a rate of 4.95%.

In March 2004, one of the institutional investors holding the convertible notes converted three \$0.3 million convertible notes into Company common stock at \$1.00, \$1.00, and \$1.10, respectively. In connection with this conversion, the Company issued the investor 0.9 million shares of Company common stock.

During the period beginning on April 15, 2004 and ending on May 20, 2004, a period which covered 25 consecutive trading days, the dollar volume-weighted average price of the Company's common stock exceeded 150% of the conversion price applicable to the outstanding convertible notes and the Company determined to exercise its right to convert the outstanding notes into shares of Company common stock. Accordingly, on May 20, 2004, the Company informed the institutional investors holding the outstanding convertible notes that it would exercise its right to convert that debt. On June 18, 2004, the Company completed the conversion of the remaining outstanding convertible notes of \$1.8 million and the related outstanding interest into 1.7 million shares of Viewpoint common stock. In addition, the Company recorded a loss on conversion which represented the difference between the fair value of the common stock issued in exchange for the notes and the carrying value of the convertible notes on the date of conversion. This change was primarily comprised of the write-off of unamortized loan discount and debt issuance costs.

The Company believes that interest expense will increase in 2005 as the Company assumed \$2.8 million of debt in the Unicast acquisition.

Loss on conversion of debt

	<u>2004</u>	<u>% Change</u>	<u>2003</u>	<u>% Change</u>	<u>2002</u>
	(Dollars in thousands)				
Loss on conversion of debt	\$ (810)	N/A	\$ —	N/A	\$ —
Percentage of total revenues	(6)%		—%		—%

On March 17, 2004, one of the institutional investors holding the convertible notes converted \$0.9 million of outstanding notes for shares of the Company's common stock. In the first quarter of 2004, the Company recorded a loss of \$1.4 million related to the change in the fair value of the conversion feature from January 1, 2004 through the date of the conversion. For the three months ended March 31, 2004 the Company also recorded a loss related to a change in the fair value of the conversion feature and warrants of \$3.7 million and \$1.3 million, respectively.

In addition, on the same day as the conversion, the Company sold 1.5 million shares of common stock in a private placement to the institutional investor, for \$3.7 million or \$2.45 per share. The Company recorded a loss on

conversion of debt in the amount of \$0.6 million, which represented the write-off of unamortized loan discount and debt issuance costs of \$0.1 million and the difference between the proceeds received from the private placement and the fair value of the common stock issued based upon the closing price of the Company's stock on the day of the sale of \$0.5 million. The remaining noteholders chose not to exercise their right to redeem their notes

in amount up to 20% of the \$3.7 million received by the Company within 10 days of the Company's public announcement of the closing of the private placement.

During the period beginning on April 15, 2004 and ending on May 20, 2004, a period which covered 25 consecutive trading days, the dollar volume-weighted average price of the Company's common stock exceeded 150% of the conversion price applicable to the outstanding convertible notes and the Company determined to exercise its right to convert the outstanding notes into shares of Company common stock. Accordingly, on May 20, 2004, the Company informed the institutional investors holding the outstanding convertible notes that it would exercise its right to convert that debt. On June 18, 2004, the Company completed the conversion of the remaining outstanding convertible notes of \$1.8 million and the related outstanding interest into 1.7 million shares of Viewpoint common stock. In addition, the Company recorded a loss on conversion which represented the difference between the fair value of the common stock issued in exchange for the notes and the carrying value of the convertible notes on the date of conversion. This change was primarily comprised of the write-off of unamortized loan discount and debt issuance costs.

Changes in fair value of warrants to purchase common stock and conversion options of convertible notes

	2004	% Change	2003	% Change	2002
	(Dollars in thousands)				
Changes in fair value of warrants to purchase common stock and conversion options of convertible notes	\$(4,180)	(446)%	\$1,209	N/A	\$ —
Percentage of total revenues	(29)%		9%		—%

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 recorded a loss for 2004 based on the changes in fair values of the conversion options of the convertible notes of \$3.0 million and warrants to purchase common stock of \$1.2 million and a gain for 2003 based on the changes in fair values of the conversion options of the convertible notes of \$1.0 million and warrants to purchase common stock of \$0.2 million. Gains and losses are calculated 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.

The Company believes that expenses in this area will decrease in 2005 since it only has to account for the impact of the change in its common stock price on the outstanding stock warrants. The amount of the decrease, if, any, however, will be driven by changes in the Company's common stock price that is partially beyond the control of the Company.

Loss on early extinguishment of debt

	2004	% Change	2003	% Change	2002
	(Dollars in thousands)				
Loss on early extinguishment of debt	\$ —	(100)%	\$ (1,682)	N/A	\$ —
Percentage of total revenues	—%		(12)%		—%

On March 25, 2003, the Company entered into Redemption, Amendment and Exchange Agreements with the three institutional investors with whom it had completed a \$7.0 million private placement of convertible notes and warrants on December 31, 2002. Pursuant to these agreements, the Company redeemed an aggregate of \$3.3 million principal amount of the outstanding convertible notes, exchanged an aggregate of \$1.0 million principal amount of the

outstanding convertible notes for shares of Viewpoint common stock at \$0.74 per share, and exchanged the remaining \$2.7 million principal amount of outstanding convertible notes for \$2.7 million principal amount of new convertible notes. The warrants to purchase 0.7 million shares of Company common stock, which were issued to these investors on December 31, 2002, remain outstanding.

In accordance with the provisions of Accounting Principals Board (“APB”) Opinion No. 26 “Early Extinguishment of Debt,” and EITF 96-19 “Debtor's Accounting for a Modification or Exchange of Debt Instruments”, the Company recorded a loss on the early extinguishment of the original convertible notes in the amount of \$1.7 million of which \$0.7 million related to the write-off of deferred loan costs. The carrying value of the convertible notes at the time of the exchange was \$5.6 million, inclusive of \$0.1 million, which represented the fair value of the conversion options. In conjunction with the extinguishment, the Company paid \$3.3 million, issued new convertible notes in the principal amount of \$2.7 million and issued 1.4 million shares of its common stock with a market value of \$0.7 million. The difference between (i) the carrying value of the outstanding convertible notes exchanged and (ii) cash paid and the fair value of the common stock and new convertible notes issued, amounted to \$1.0 million and was included in the loss on early extinguishment of debt.

Adjustment to net loss on disposal of discontinued operations, net of tax

	2004	%	2003	%	2002
	Change	Change			
	(Dollars in thousands)				
Adjustment to net loss on disposal of discontinued operations, net of tax	\$129	(18)%	\$157	24%	\$127
Percentage of total revenues	1%		1%		1%

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

During the years ended December 31, 2004, 2003 and 2002, the Company recorded an adjustment to net loss on disposal of discontinued operations, net of tax, of \$0.1 million, \$0.2 million and \$0.1 million respectively, as a result of changes in estimates related to accounts receivable and liabilities of the discontinued business. Changes in estimates, which are not expected to be significant, will be accounted for prospectively and included in adjustment to net loss on disposal of discontinued operations.

FACTORS THAT MAY AFFECT FUTURE RESULTS OF OPERATIONS

An investment in Viewpoint involves a high degree of risk. You should consider carefully the following information about these risks, before you decide to invest in Viewpoint. If any of the following risks actually occur, our business, financial condition or results of operations would likely suffer. In this case, the market price of our common stock could decline, and you could lose all or part of your investment.

WE HAVE A HISTORY OF LOSSES AND EXPECT TO INCUR LOSSES IN THE FUTURE, WHICH MAY CAUSE OUR SHARE PRICE TO DECL