VIEWPOINT CORP
Form 10-Q
November 09, 2006

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

or

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

For the transition period from ______________ to ______________

Commission file number: 0-27168

VIEWPOINT CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

As of November 6, 2006, 67,670,000 shares of $0.001 par value common stock were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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

	September 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,927	$ 6,437
Marketable securities	4,382	2,674
Accounts receivable, net of reserve of $425 and $419, respectively	2,572	4,342
Prepaid expenses and other current assets	504	510
Total current assets	9,385	13,963
Restricted cash	188	182
Property and equipment, net	1,146	1,218
Goodwill, net	14,882	25,537
Intangible assets, net	3,681	4,131
Other assets, net	92	105
Total assets	$ 29,374	$ 45,136
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,257	$ 2,834
Accrued expenses	609	635
Deferred revenues	149	207
Current portion of notes payable	389	814
Accrued incentive compensation	545	545
Current liabilities related to discontinued operations	231	231
Total current liabilities	4,180	5,266
Deferred rent	261	334
Warrants to purchase common stock	1,133	982
Subordinated notes-related party	2,357	2,090
Unicast notes	1,583	1,582
Total liabilities	9,514	10,254
Stockholders equity:		
Preferred stock, $.001 par value; 5,000 shares authorized - no shares issued and outstanding on September 30, 2006 and December 31, 2005		
Common stock, $.001 par value; 100,000 shares authorized - 67,830 shares issued and 67,670 shares outstanding at September 30, 2006, and 64,849 shares issued and 64,689 shares outstanding at December 31, 2005	68	65
Paid-in capital	305,787	301,766
Treasury stock at cost; 160 at September 30, 2006 and December 31, 2005	(1,015)	(1,015)
Accumulated other comprehensive loss	(2)	(63)
Accumulated deficit	(284,978)	(265,871)

Total stockholders equity	19,860	34,882
Total liabilities and stockholders equity	$ 29,374	$ 45,136

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues:				
Search	$ 1,460	$ 2,498	$ 4,822	$ 7,071
Advertising systems	961	566	5,569	2,461
Services	786	1,744	2,430	4,551
Related party services		154		903
Licenses	4	124	82	506
Related party licenses		873		2,618
Total revenues	3,211	5,959	12,903	18,110
Cost of revenues:				
Search	39	39	113	134
Advertising systems	399	405	3,638	1,907
Services	455	956	1,766	2,875
Licenses		8	8	11
Total cost of revenues	893	1,408	5,525	4,927
Gross profit	2,318	4,551	7,378	13,183
Operating expenses:				
Sales and Marketing	1,454	1,325	4,481	3,828
Research and development	982	1,126	3,138	3,479
General and administrative	2,102	3,224	6,687	7,965
Depreciation	113	158	337	496
Amortization of intangible assets	222	118	443	370
Restructuring charges			92	
Impairment of goodwill	10,655		10,655	
Total operating expenses	15,528	5,951	25,833	16,138
Loss from operations	(13,210)	(1,400)	(18,455)	(2,955)
Other income (expense), net:				
Interest and other income; net	95	30	264	86
Interest expense	(213)	(288)	(709)	(943)
Changes in fair values of warrants to purchase common stock	1,021	207	(151)	1,037
Total other income (expense)	903	(51)	(596)	180
Loss before provision for income taxes	(12,307)	(1,451)	(19,051)	(2,775)
Provision for income taxes	30		56	12
Net loss from continuing operations	(12,337)	(1,451)	(19,107)	(2,787)
Adjustment to net loss on disposal of discontinued operations				145

Net loss	$	(12,337)	$	(1,451)	$	(19,107)	$	(2,642)
Basic and diluted net loss per common share:	$	(0.18)	$	(0.02)	$	(0.29)	$	(0.05)
Weighted average number of shares outstanding basic and diluted		67,361		59,136		66,253		58,274

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

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

	Nine Months Ended September 30,	
	2006	**2005**
Cash flows from operating activities:		
Net loss	$ (19,107)	$ (2,642)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation charges	1,616	1,743
Depreciation and amortization	942	1,183
Impairment of goodwill and intangibles	10,655	
Provision for bad debt	27	95
Changes in fair values of warrants to purchase common stock	151	(1,037)
Amortization of debt discount and issuance costs	533	805
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	1,764	1,329
Prepaid expenses	6	(165)
Accounts payable	(693)	(2,028)
Accrued expenses	(99)	(581)
Deferred revenues	(58)	(123)
Related party deferred revenues		(3,490)
Other	34	
Net cash used in operating activities	(4,229)	(4,911)
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	7,943	9,050
Purchases of marketable securities	(9,645)	(8,232)
(Increase)/decrease in restricted cash	(6)	139
Purchases of property and equipment	(226)	(341)
Acquisition of Unicast, net of cash acquired		(512)
Purchases of patents and trademarks	(77)	(48)
Net cash (used in) provided by investing activities	(2,011)	56
Cash flows from financing activities:		
Repayment of Subordinated Notes	(450)	
Repayment of Unicast Debt	(227)	
Payment of modification fee relating to debt extension		(61)
Proceeds from issuance of common stock		2,000
Proceeds from exercise of stock options	2,407	488
Net cash provided by financing activities	1,730	2,427
Effect of exchange rates changes on cash		3
Net decrease in cash and cash equivalents	(4,510)	(2,425)
Cash and cash equivalents at beginning of period	6,437	5,804
Cash and cash equivalents at end of period	$ 1,927	$ 3,379

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

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

	Nine Months Ended September 30,	
	2006	**2005**
Supplemental disclosure of cash flow activities:		
Cash paid during the period for income taxes	56	12
Cash paid during the period for interest	178	183
Net assets acquired in Unicast acquisition:		
Accounts receivable, net		2,056
Prepaids		7
Other assets		22
Fixed assets		128
Goodwill and Intangible assets		6,547
Accounts payable and accrued expenses		(3,578)
Unicast Debt		(1,702)
Supplemental disclosure of non-cash investing and financing activities:		
Cost of Unicast acquisition		
Common stock		(1)
APIC		(2,967)
Unrealized (losses) gains on marketable securities	6	
Purchase of property and equipment accrued and not yet paid	117	

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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation

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

The year end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

These unaudited consolidated financial statements have been prepared in accordance with the instructions to Rule 10-01 of Regulation S-X and, therefore, do not include all of the information and footnotes normally provided in annual financial statements. As a result, these unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with management s discussion and analysis of financial condition and results of operations, contained in Viewpoint s Annual Report on Form 10-K for the year ended December 31, 2005. The results of operations for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the results to be expected for the year ending December 31, 2006 or other future periods.

Certain reclassifications have been made to the 2005 consolidated financial statements to conform to the 2006 presentation (See Note 3).

Liquidity

The Company had cash, cash equivalents and marketable securities of $6.3 million at September 30, 2006. During the nine months ended September 30, 2006, net cash used in operations amounted to $4.2 million. As of September 30, 2006, the Company had an accumulated deficit of $285.0 million.

The Company has incurred negative cash flows and net losses since inception. Based on current operating levels combined with limited capital resources, financing operations during 2007 will require that the Company improve operating results through cost cutting measures, increases in revenues or both, and/or raise sufficient additional equity or debt capital, including the avoidance of violating existing debt covenants. If the Company s expected revenue targets are not achieved, management would implement cost reduction measures including work force reduction as well as reduction in overhead costs and capital expenditures.

There can be no assurance that the Company will achieve or sustain positive cash flows from operations or profitability. The Company currently has no commitment for additional financing and may experience difficulty in obtaining additional financing on favorable terms, if at all. Any financing the Company obtains may contain covenants that restrict the Company s freedom to operate the business or may have rights, preferences or privileges senior to the Company s common stock and may dilute the Company s current shareholders ownership interest in Viewpoint.

Furthermore, the stock price of the Company declined below $1.00 and has not closed above $1.00 since October 13, 2006. If the Company s stock trades below a $1.00 for 30 consecutive days, NASDAQ s listing rules provide for Viewpoint to be notified that its common stock is being considered for de-listing. While the Company has not been notified that its stock has been considered for de-listing, it may receive such notification. While there are several different remediation measures that the Company may take to prevent such de-listing, if the Company s remediation measures are unsuccessful, it is possible that the Company s stock could be de-listed in approximately one year after receiving such notification from NASDAQ. If the Company is de-listed it will violate a covenant within the subordinated note agreement which would accelerate the maturity date of the $3.1 million of subordinated note currently scheduled to mature on March 31, 2008. If the Company is unable to secure adequate financing, including the avoidance of the acceleration of the maturity date of the $3.1 million subordinated note, and/or can not achieve and sustain positive cash flows from operations, it would raise substantial doubt about the Company s ability to continue as a going concern through December 31, 2007.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The most significant estimates include fair value of stock compensation, revenue, receivables, liabilities, warrants, goodwill, and intangible and fixed asset useful lives.

Stock-Based Compensation

The Company has adopted the provisions of FAS No. 123R, Share-Based Payment which replaced FAS 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees, as of January 1, 2006. The provisions of FAS 123R require a company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized in the statement of operations over the period during which an employee is required to provide service in exchange for the award. The determination of the fair value of stock-based payment awards on the date of grant using the Black-Scholes option pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the Company s expected stock price volatility over the term of the awards of 134%, actual and projected employee stock option exercise behaviors resulting in an estimated term of 4.54 years, risk-free interest rate of 4.67%, and expected dividends of zero. FAS 123R also amends FASB Statement No. 95, Statement of Cash Flows, to require that excess tax benefits, as defined, realized from the exercise of stock options be reported as a financing cash inflow rather than as a reduction of taxes paid in cash flow from operations. As the result of the uncertainty regarding the Company s ability to utilize its deferred tax assets, the impact of wind fall tax benefits on the accompanying financial statements was immaterial. A change in volatility and term could significantly increase or decrease operating expenses.

The Company elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new 2006 grants and to grants that were unvested as of the effective date. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service period using the compensation cost estimated for the FAS 123 pro forma disclosures.

The adoption of FAS 123R had a material impact on our consolidated financial position and results of operations. See Note 4 for further information regarding our stock-based compensation assumptions and expenses, including pro forma disclosures for prior periods as if we had recorded stock-based compensation expense.

Net Loss Per Common Share

Basic net loss per common share is computed using the weighted average number of shares of outstanding and diluted net loss per common share is computed using the weighted average number of shares of common and common equivalent shares outstanding. Common equivalent shares related to stock options and warrants totaling 7.2 million for the three and nine months ended September 30, 2006, and 8.2 million and 8.6 million for the three and nine months ended September 30, 2005, respectively, are excluded from the computation of diluted net loss per common share because their effect was anti-dilutive.

Common Stock Issuance

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

In December 2005, the Company sold 5.1 million shares of common stock and warrants in a private placement to several investors for $5.1 million. The warrants were to purchase an additional 1.0 million shares of common stock at an exercise price of $1.20 per share with a term of three years. In addition, as compensation to the underwriter of this private placement the Company issued warrants to purchase 0.2 million shares of common stock at an exercise price of $1.20 per share with a term of five years, and paid $0.3 million in issuance costs. For financial reporting purposes, the terms and provisions of the warrants require that the Company record the fair value of the warrant as a liability at the time of issuance. At each balance sheet date subsequent to issuance, the carrying value of warrants are adjusted to the then current fair value using the Black-Scholes Method and any changes in fair value of the warrant are included within operating results. During the three months ended September 30, 2006, the fair value of the warrants decreased by $0.7 million which is included as a gain on changes in the fair value of the warrants within the statement of operations. During the nine months ended September 30, 2006, the fair value of the warrants increased by $0.1 million, which is included as an expense within the statement of operations.

Comprehensive Income

For all periods presented, the difference between net loss and comprehensive net loss was not material.

Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB SFAS Nos. 133 and 140 . This Statement amends FASB SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities”, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities&#148. SFAS 155 resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. We do not believe the adoption of SFAS No. 155 will materially impact our consolidated financial statements.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not, of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of January 1, 2007, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. We do not believe the adoption of FIN 48 will materially impact our consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements (SAB 108), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. We will be required to adopt the provisions of SAB 108 in our annual financial statements for fiscal year 2006. We do not believe that the adoption of SAB 108 will materially impact our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (FAS 157). FAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. We will be required to adopt the provisions of FAS 157 beginning with our first quarter ending March 31, 2008. We do not believe that the adoption of the provisions of FAS 157 will materially impact our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R), (FAS 158). FAS 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit pension and other postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. We will be required to adopt the provisions of FAS 158 in our annual financial statements for fiscal year 2006. We do not believe that the adoption of the provisions of FAS 158 will materially impact our consolidated financial statements.

2. Goodwill and Intangible Assets

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

At September 30, 2006 the Company determined that, based on a decline in operating performance during the third quarter of 2006 marked by a reduction of revenues from the automotive sector and slower growth in revenues from the development of other creative products and initiatives, the Services reporting unit had experienced an impairment of its allocated goodwill. The Company then performed the second step of the impairment test in accordance with SFAS No. 142 using a discount rate of 16% and a revenue growth rate of 5%. Following the completion of that step the Company recorded an impairment expense of $10.7 million.

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

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

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

	Goodwill				
	Technology	Advertising Systems	Services	Total	Intangible Assets
Balance as of December 31, 2005	$ 10,206	$ 2,039	$ 13,292	$ 25,537	$ 4,131
Additions during period					16
Impairment					
Adjustments					
Amortization					(138)
Balance as of March 31, 2006	$ 10,206	$ 2,039	$ 13,292	$ 25,537	$ 4,009
Additions during period					44
Impairment					
Adjustments					
Amortization					(138)
Balance as of June 30, 2006	$ 10,206	$ 2,039	$ 13,292	$ 25,537	$ 3,915
Additions during period					16
Impairment			(10,655)	(10,655)	
Adjustments					
Amortization					(250)
Balance as of September 30, 2006	$ 10,206	$ 2,039	$ 2,637	$ 14,882	$ 3,681

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

Balance as of June 30, 2005	$ 10,206	$ 2,133	$ 21,070	$ 33,409	$ 4,393
Additions during period					36
Amortization					(160)
Balance as of September 30, 2005	$ 10,206	$ 2,133	$ 21,070	$ 33,409	$ 4,269

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

	September 30, 2006			December 31, 2005		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Website Partner Relationships -Unicast	$ 3,772	$ (685)	$ 3,087	$ 3,772	$ (404)	$ 3,368
Acquired Technology - Unicast	410	(271)	139	410	(187)	223
Patents and Trademarks - Unicast	326	(126)	200	326	(80)	246
Patents and Trademarks	409	(154)	255	332	(38)	294
Total Intangible Assets	$ 4,917	$ (1,236)	$ 3,681	$ 4,840	$ (709)	$ 4,131

During the quarter ended September 30, 2006, the Company reduced the useful life of its patent technology from 17 years to 8 years. The change was made to better reflect the period in which the Company expected to benefit from the use of the patented technology. As a result of this change, patent amortization expense increased by $0.1 million for the three and nine month periods ended September 30, 2006. The impact of this change in estimate on per share data was not material.

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

The Company has also reclassified depreciation expense amounts in the 2005 financial statements to conform to the 2006 presentation. The 2005 reclassification consisted of the allocation of depreciation from operating expenses into cost of sales. For the three and nine month periods ended September 30, 2006, depreciation expense amounted to $0.1 million and $0.4 million, respectively, of which less than $0.1 million was recorded in cost of sales for the three months ended September 30, 2006, and $0.1 million was recorded in cost of sales for the nine months ended September 30, 2006.

3. Long Term Debt

Convertible Notes

On December 31, 2002, the Company completed a private placement of convertible notes and warrants in which it issued to three institutional investors, 4.95% convertible notes having an aggregate principal amount of $7.0 million, and warrants to purchase 0.7 million shares of Company common stock. The warrants expire on December 31, 2006, and were initially issued at an exercise price of $2.26 per share. The number of warrants and the exercise price are subject to adjustment if the Company sells or issues securities under a dilutive issuance (as defined in the warrant to purchase common stock agreement) subject to certain conditions. As of September 30, 2006, 0.8 million warrants were outstanding related to this placement.

For the three and nine month period ended September 30, 2006, the Company recognized a gain related to the change in the valuation for the outstanding warrants of $0.3 million and a loss of less than $0.1 million, respectively. For the three and nine month period ended September 30, 2005, the Company recognized a gain from the change in the fair value of the outstanding warrants of $0.2 million and $1.0 million, respectively, resulting from a decrease in the fair market value of the Company s common stock. The fair value of these outstanding warrants amounted to $0.1 as of September 30, 2006 and December 31, 2005.

Subordinated Notes

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

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

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

Amended Notes

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

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

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

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

Unicast Notes

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

As of January 3, 2005, the date of acquisition, the fair value of the collateralized and non-collateralized notes amounted to $1.4 million and $0.3 million, respectively. The Company recorded interest expense on these notes of $0.1 million and $0.3 million for the three and nine months ended September 30, 2006, respectively and $0.1 million and $0.3 million for the three and nine months ended September 30, 2005, respectively. In March 2006, the Company began making monthly payments as required by the agreement and this resulted in a decrease of the aggregate carrying value of these notes to $2.0 million as of September 30, 2006, of which $1.6 million is long-term.

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

	September 30 2006	December 31 2005
Subordinated notes	$ 2,357	$ 2,505
Unicast notes	1,972	1,981
Total long-term debt	4,329	4,486
Less current portion	389	814
Long-term debt, net of current portion	$ 3,940	$ 3,672

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

	Subordinated Notes	Unicast Notes	Total
Book value of long-term debt	2,357	1,972	4,329
Discount on long-term debt	693	551	1,244
Face value of the long-term debt	$ 3,050	$ 2,523	$ 5,573

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

Maturity	
2006	$ 65
2007	350
2008	3,400
2009	350
2010 and thereafter	1,408

$ 5,573

The Subordinated Note contains a covenant which requires that the Company s common stock remain listed on a national stock exchange as defined. The Company s common stock declined below $1.00 and has not closed above $1.00 since October 13, 2006. While the Company has not been notified that its stock has been considered by NASDAQ for de-listing, it may receive such notification. If the Company s stock remains below a $1.00 for 30 consecutive days NASDAQ listing rules provide for Viewpoint to be notified that its common stock has been considered for delisting. While there are several different remediation measures that the Company may take to prevent such de-listing, if the Company s remediation measures are unsuccessful it is possible that the Company s stock could be de-listed approximately one year after receiving such notification from

NASDAQ. If the Company is de-listed, it will violate the loan covenant noted above which would allow the Subordinated Note holders to demand repayment immediately of the $3.1 million outstanding note balance.

4. Stock-Based Compensation

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

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

Prior to January 1, 2006, the Company disclosed compensation cost in accordance with FAS No. 123. The provisions of FAS No. 123 required the Company to disclose the assumptions used in calculating the fair value pro forma expense. Had compensation expense for the plans been determined based on the fair value of the options at the grant dates for awards under the plans consistent with FAS No. 123, the Company s net loss for the three and nine months ended September 30, 2005 would have been as follows (amounts in thousands, except per share data):

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
Net loss, as reported	$ (1,451)	$ (2,642)
Add: Stock-based employee compensation charges included in reported net loss	1,147	1,742
Deduct: Stock-based employee compensation charges determined under fair value based method for all awards	(2,550)	(5,071)
Pro forma net loss	$ (2,854)	$ (5,971)
Net loss per share:		
Basic and diluted as reported	$ (0.02)	$ (0.05)
Basic and diluted pro forma	$ (0.05)	$ (0.10)

Pro forma disclosures for the three and nine months ended September 30, 2006 are not presented because the amounts are recognized in the unaudited Consolidated Statement of Operations.

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

To determine compensation expense under FAS No. 123(R) and FAS No. 123 for the three months and nine months ended September 30, 2006 and 2005, respectively, the Company uses the Black-Scholes Option-Pricing Model with the following weighted-average assumptions:

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

In September 2006 the Company issued retention options to certain employees within the company, that vest after three years. The options were valued using the same assumptions in the above table, but due to their three year cliff vesting, the Company estimated a forfeiture rate against those options of 64% based on the history of employee s term.

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

As of September 30, 2006, total unrecognized share-based compensation cost related to unvested stock options was $4.5 million (excluding performance based awards noted above), which is expected to be recognized over a weighted average period of approximately 2.7 years. The Company has included the following amounts for share-based compensation cost, in the accompanying unaudited Consolidated Statement of Operations for the three and nine months ended September 30, 2006 (amounts in thousands):

	Three Months Ended 30-Sep-06	Nine Months Ended 30-Sep-06
Cost of revenues:		
Advertising systems	$ 10	$ 15
Services	25	126
Operating expenses:		
Sales and marketing	104	396
Research and development	67	261
General and administrative	247	818
Total	$ 453	$ 1,616

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

Stock Option Plans

1995 Stock Plan

The Company s 1995 Stock Plan (the 1995 Plan) provides for the grant to employees (including officers and employee directors) of incentive stock options and for the grant to employees (including officers and employee directors), non-employee directors and consultants of nonstatutory stock options and stock purchase rights. As of September 30, 2006, options to purchase an aggregate of 3.5 million shares of common stock were outstanding under the 1995 Plan, with vesting provisions ranging up to four years. Options granted under the 1995 Plan are exercisable for a period of up to ten years. The ability to issue options out of this plan expired in 2005, however, options currently outstanding will remain outstanding until exercised, forfeited, or expire.

1995 Director Option Plan

The Company s 1995 Director Option Plan (the Director Plan) provides for an automatic grant of options to purchase shares of common stock to each non-employee director of the Company. Options granted under the 1995 Director Plan vest over one and a half to four and a half years and are exercisable for a period of ten years. As of September 30, 2006, 0.1million options were outstanding under the 1995 Director Plan. The ability to issue options out of this plan expired in 2005, however, options currently outstanding will remain outstanding until exercised, forfeited, or expire.

1996 Nonstatutory Stock Option Plan

The Company s 1996 Nonstatutory Stock Option Plan (the 1996 Nonstatutory Plan) provides for the grant to employees (including officers and employee directors) and consultants of nonstatutory stock options and stock purchase rights. As of September 30, 2006, options to purchase an aggregate of 1.3 million shares of common stock were outstanding under the 1996 Nonstatutory Plan, with vesting provisions ranging up to four years. Options granted under the 1996 Nonstatutory Plan are exercisable for a period of up to ten years. At September 30, 2006, an aggregate of 0.2 million shares of common stock were reserved for future issuance under the 1996 Nonstatutory Plan. The ability to issue options out of this plan expire in October 2006, however, options currently outstanding will remain outstanding until exercised, forfeited, or expire.

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

2006 Equity Incentive Plan

The Company s 2006 Equity Incentive Plan (the 2006 Plan) provides for the grant to employees (including officers and employee directors) of incentive stock options and for the grant to employees (including officers and employee directors), non-employee directors and consultants of nonstatutory stock options, stock appreciation rights, restricted stock, restricted stock units and other stock awards. The 2006 Plan was adopted by the stockholders of the Company at the 2006 annual meeting of stockholders on June 21, 2006. As of September 30, 2006, an aggregate of 1.1 million shares were outstanding under the 2006 Plan and an aggregate of 3.4 million shares of common stock were reserved for future issuance under the 2006 Plan.

Options Issued Outside the Option Plans

For the nine months ended September 30, 2006, the Company issued 0.3 million, non-qualified stock options outside the Option Plans in connection with the hiring of certain personnel. All options were issued with exercise prices equal to the fair value of the Company s common stock on the grant date, which was the employees first date of employment. The terms and conditions of these grants are similar to the terms and conditions of options granted under the 1996 Nonstatutory Plan. There are 3.9 million shares outstanding outside the Option Plans.

Summary of All Outstanding Options

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

		Options Outstanding	
	Options Available for Grant	Number of Shares	Weighted Average Exercise Price
Options outstanding at December 31, 2005	363	12,566	$ 1.79
Granted exercise price equal to fair value	(1,532)	1,532	1.49
Granted non-plan options		250	1.53
Plan approved at June 30, 2006	4,500		
Exercised		(2,981)	0.81
Cancelled	393	(393)	4.47
Cancelled expired plan		(811)	2.30
Cancelled non-plan options		(249)	3.15
Options outstanding at September 30, 2006	3,724	9,914	$ 1.85

During the three and nine months ended September 30, 2006, the total intrinsic value of options exercised to purchase common stock was $0.4 million and $1.9 million, and the weighted average fair value of options to purchase common stock that were granted was $1.61 and $1.50 per share, respectively.

During the three and nine months ended September 30, 2006, financing cash generated from share-based compensation arrangements amounted to $0.5 million and $2.4 million for the purchase of shares upon exercise of options. The Company issues new shares upon exercise of options to purchase common stock.

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

	Outstanding			Exercisable	
Exercise Price Range	**Shares**	**Average Life**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**
$0.46 $0.82	2,307	6.98	$ 0.76	2,302	$ 0.76
$0.87 $1.32	2,105	5.41	1.09	1,280	1.02
$1.34 $1.62	2,946	8.15	1.48	660	1.41
$1.63 $5.03	2,052	5.58	3.35	1,700	3.61
$5.09 $12.88	504	1.81	6.07	504	6.07
Total	9,914	6.44	$ 1.85	6,446	$ 2.04

	Intrinsic Value Options Outstanding	Intrinsic Value Options Exercisable
Aggregate intrinsic value (in thousands)	$ 1,269	$ 1,223

	Outstanding Average Life	Exercisable Average Life
Weighted average remaining contractual life	6.44	6.14

The aggregate intrinsic value in the table above is based on the Company s closing stock price of $1.18 per share as of September 30, 2006, which amount would have been received by the optionees had all options been exercised on that date. The total fair value of options to purchase common stock that vested during the three and nine months ended September 30, 2006 was $0.5 million, and $1.6 million, respectively.

5. Restructuring Charges

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

6. Commitments and Contingencies

Commitments

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

The Company leased a vehicle for a former executive of the Company during 2005. The lease was terminated in the first quarter of 2006. Rent expense for office space, equipment, and the executive s vehicle totaled approximately $0.2 million, and $0.7 million, and $0.3 million and $0.8 for the three and nine months ended September 30, 2006 and 2005, respectively.

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

2006	$	253
2007		1,014
2008		855
2009		799
2010		90
	$	3,011

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.

7. Segment Information and Enterprise-Wide Disclosures

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

The Company does not allocate or analyze operating expenses by segment. There are no inter-segment sales.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues:				
Technology				
Licenses	$ 4	$ 124	$ 82	$ 506
Related party licenses		873		2,618
Search	1,460	2,498	4,822	7,071
Total technology revenue	1,464	3,495	4,904	10,195
Advertising systems	961	566	5,569	2,461
Services:				
Services	786	1,744	2,430	4,551
Related party services		154		903
Total revenues	3,211	5,959	12,903	18,110
Cost of Revenues:				
Technology				
Licenses	$	$ 8	$ 8	$ 11
Search	39	39	113	134
Total technology cost of revenues	39	47	121	145
Advertising systems	399	405	3,638	1,907
Services	455	956	1,766	2,875
Total cost of revenues	893	1,408	5,525	4,927
Gross profit	$ 2,318	$ 4,551	$ 7,378	$ 13,183
Technology				
Licenses	$ 4	$ 989	$ 74	$ 3,113
Search	1,421	2,459	4,709	6,937
Total technology gross profit	1,425	3,448	4,783	10,050
Advertising systems	562	161	1,931	554
Services	331	942	664	2,579
Total gross profit	$ 2,318	$ 4,551	$ 7,378	$ 13,183
Gross profit margin				
Technology				
Licenses	100%	99%	90%	100%
Search	97	98	98	98
Total technology gross profit	97	99	98	99
Advertising systems	58	28	35	23
Services	42	50	27	47
Total gross profit margin	72%	76%	57%	73%

	September 30, 2006	December 31, 2005
Total assets:		
Technology	$ 12,333	$ 13,369
Advertising systems	7,421	8,086
Services	3,311	14,388
Corporate (*)	6,309	9,293
Total assets	$ 29,374	$ 45,136

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

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

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

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

Overview

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

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

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

In July 2005, the Company launched version 3.0 of the Viewpoint Toolbar which includes the capability to manage digital photograph files on the user s computer and provides the ability to share the photographs at a website or get printed copies of the photographs for a fee. During October 2005, the Company released version 3.5 of the Viewpoint Toolbar and re-named it the Fotomat Toolbar. The Company has licensed the trademark and internet url Fotomat.com for its exclusive use in connection with the internet website for photograph and printing services and computer software for organization, editing, managing, sharing, and processing images and related data through the end of December 2006. Its new Fotomat Toolbar provides enhanced photograph editing capabilities and an efficient method of creating albums of photographs, which the Company believes enhances the utility of the toolbars for users, while simultaneously allowing users to use the Toolbar to search the internet.

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

In addition, Viewpoint also offers an online advertising campaign management and deployment product. In July 2005, the Company redesigned this product, incorporating the Viewpoint Creative Innovator product with Unicast s UCP ad delivery system into one system. This system, known as the Unicast Ad Platform (UAP), permits publishers, advertisers, and their agencies to manage the process of deploying online advertising campaigns. The Company charges customers on a cost per thousand (CPM) impression basis, and recognizes revenue when the impressions are served, so long as all other revenue recognition criteria are satisfied. The Company also provides another advertising services product whereby the Company purchases media space from web-site publishers and resells that space to advertisers. The Company acts as a principal party in the transaction by assuming the title to the media space purchased. In addition, the Company assumes risks of collection, and therefore recognizes the entire amount billed to the customer as revenue and the cost of the media space as cost of sales.

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

Viewpoint has a limited operating history upon which an evaluation of the Company and its prospects can be based. Viewpoint has had significant quarterly and annual operating losses since its inception, and, as of September 30, 2006, had an accumulated deficit of $285 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 for the three and nine months ended September 30, 2006 and 2005, the Company s consolidated statements of operations expressed as a percentage of total revenues for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Statements of Operations Data				
Revenues:				
Search	46%	42%	37%	39%
Advertising Systems	30	9	43	14
Services	24	29	19	25
Related party services		3		5
Licenses		2	1	3
Related party licenses		15		14
Total revenues	100	100	100	100
Cost of revenues:				
Search	1	1	1	1
Advertising Systems	13	7	28	10
Services	14	16	14	16
Licenses				
Total cost of revenues	28	24	43	27
Gross profit	72	76	57	73
Operating expenses:				
Sales and Marketing	45	22	34	21
Research and development	31	19	24	19
General and administrative	65	54	52	44
Depreciation	4	3	3	3
Amortization of intangible assets	7	2	3	2
Restructuring charges			1	
Impairment of goodwill	332		83	
Total operating expenses	484	100	200	89
Loss from operations	(412)	(23)	(143)	(17)
Other income (expense):				
Interest and other income, net	3	1	2	
Interest expense	(7)	(5)	(5)	(5)
Changes in fair values of warrants to purchase common stock and conversion feature of convertible notes	32	3	(1)	6
Total Other income (expense)	28	(1)	(4)	1
Loss before provision for income taxes	(384)	(24)	(147)	(16)
Provision for income taxes	1			

Net loss from continuing operations	(385)	(24)	(147)	(16)
Adjustment to net loss on disposal of discontinued operations				1
Net loss	(385)%	(24)%	(147)%	(15)%

Critical Accounting Policies and Estimates

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

Stock-Based Compensation

The Company has adopted the provisions of FAS No. 123R (FAS 123R), Share-Based Payment which replaced Statement of Financial Accounting Standards No. 123 (FAS 123), Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees, as of January 1, 2006. The provisions of FAS 123R require a company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized in the statement of operations over the period during which an employee is required to provide service in exchange for the award. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the Company s expected stock price volatility over the terms of the awards of 134%, actual and projected employee stock option exercise behaviors resulting in an estimated term of 4.54 years, risk-free interest rate of 4.67%, and expected dividends of zero. As the result of the uncertainty regarding the Company s ability to utilize its deferred tax assets, the impact of wind fall tax benefits on the accompanying financial statements was immaterial. A change in volatility and term could significantly increase or decrease operating expenses.

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

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

Financial Results

Viewpoint reported total revenue of $3.2 million for the third quarter 2006 compared to $6.0 million for the third quarter 2005. Operating loss for the third quarter of 2006 was $13.2 million compared to $1.4 million in the third quarter of 2005. The increase in operating loss compared to the third quarter 2005 resulted principally from a $10.7 million impairment charge the Company took for its Services segment in the third quarter when it concluded that revenue growth in this unit would take longer to develop. Additionally revenue declined $1.0 million due to the expiration of a license and services revenue arrangement with AOL in December 2005 from a contract executed in 2003. Additionally, the Company experienced a 42% or $1.0 million decline in revenue in its search business. Viewpoint s ad systems business, however experienced growth of 70% in the third quarter of 2006 as compared with the third quarter in 2005. The Company recorded $0.5 million of stock-based compensation expense in the third quarter of 2006 associated with the adoption of Statement of Financial Accounting Standards (SFAS) No. 123R Share-Based Payment on January 1, 2006 which also led to an increase in operating loss. This compared to a stock based compensation charge of $1.1 million recorded in the third quarter of 2005 associated with the departure of an executives from the Company and a corresponding extension of their stock option exercise period. Net loss for the third quarter 2006 was $12.3 million, or a loss of $0.18 per share, compared to a net loss of $1.5 million, or a loss of $0.02 per share, in the third quarter of 2005. The net loss in the third quarter of 2006 included a non-cash gain of $1.0 million to recognize the impact of the Company s decreased stock price on its outstanding warrants. The net loss in the third quarter of 2005 included a non-cash gain of $0.2 million to recognize the impact of the Company s increased stock price on its outstanding warrants.

Viewpoint reported total revenue of $12.9 million for the first nine months of 2006 compared to $18.1 million for the same period in 2005. Operating loss for the first nine months of 2006 was $18.5 million compared to $3.0 million in the same period of 2005. This increase in operating loss resulted principally from the services impairment charge of $10.7 million and lower revenues associated with the expiration of a license and services revenue arrangement with AOL in December 2005 of a contract executed in 2003. The Company experienced a 32% decline in revenue in its search business which contributed to an increase in the operating loss on a comparative basis; however its ad systems business experienced growth of 126% in revenues during the comparative period. The Company s services revenue declined 47.0% in the first nine months of 2006 compared to the same period in 2005. During March 2006, when the Company noted it was experiencing a decline in this business it announced a restructuring of this group. This restructuring streamlined the business by terminating 29% of the services employees and relocating the principal services office from New York to Los Angeles. During the first nine months of 2006, the Company also recorded $1.6 million of stock-based compensation expense associated with the adoption of Statement of Financial Accounting Standards (SFAS) No. 123R Share-Based Payment on January 1, 2006. This compared to a stock based compensation expense of $1.7 million in the same period in 2005. Net loss for the first nine months of 2006 was $19.1 million, or a loss of $0.29 per share including a non-cash charge of $0.2 million to recognize the impact of the Company s increased stock price of its outstanding warrants. Net loss for the first nine months of 2005 was $2.6 million, or a loss of $0.05 per share, including a non-cash gain of $1.0 million to recognize the impact of the Company s decreased stock price on outstanding warrants.

Viewpoint s cash, cash equivalents, and marketable securities as of September 30, 2006 were $6.3 million. This compares to cash, cash equivalents, and marketable securities of $9.1 million at December 31, 2005. The decrease in cash, cash equivalents, and marketable securities can be principally attributed to the loss from operations during the nine month period offset by proceeds from the exercise of stock options granted to current and former employees.

Revenues

	Months Ended September 30, 2006	Months Ended September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Search	$ 1,460	$ 2,498	(42)
Advertising Systems	961	566	70
Services	786	1,744	(55)
Related party services		154	(100)
Licenses	4	124	(97)
Related party licenses		873	(100)
Total revenues	$ 3,211	$ 5,959	(46)%
Nine months ended:			
Search	$ 4,822	$ 7,071	(32)%
Advertising Systems	5,569	2,461	126
Services	2,430	4,551	(47)
Related party services		903	(100)
Licenses	82	506	(84)
Related party licenses		2,618	(100)
Total revenues	$ 12,903	$ 18,110	(29)%

On March 17, 2004 Viewpoint entered the internet search business by launching the Viewpoint Toolbar on a test basis. In April 2004, the Company ended the test phase and began delivering the Viewpoint Toolbar Version 1.0. Search revenue is generated when a customer uses the Viewpoint Toolbar to search the internet, and clicks on a sponsored advertisement included in the search results. The Viewpoint Toolbar s search results are provided by Yahoo!, who collects a fee from the advertiser and remits a percentage of the fee to Viewpoint. Revenue generated is a function of the number of Viewpoint Toolbars performing searches, the number of searches that are sponsored by advertisers, the number of advertisements that are clicked on by Viewpoint Toolbar searchers, the rate advertisers pay for those advertisements, and the percentage retained by Yahoo! for providing the results.

Additionally, Viewpoint offers an online advertising campaign management and deployment product. In July 2005, the Company deployed a new product, incorporating the Viewpoint Creative Innovator product and Unicast s UCP ad delivery system into one system. This system, known as the Unicast Ad Platform (UAP), permits publishers, advertisers, and their agencies to manage the process of deploying online advertising campaigns. The Company charges customers on a cost per thousand (CPM) impression basis, and recognizes revenue when the impressions are served, so long as all other revenue recognition criteria are satisfied. The Company also provides another advertising services product whereby the Company purchases media space from web-site publishers and resells that space to advertisers. The Company acts as a principal party in the transaction, assumes the title to the media space purchased, and assumes the risks of collection and therefore recognizes the entire amount billed to the customer as revenue, and the cost of the media space as cost of sales.

Viewpoint has a creative services group that builds content in the Viewpoint format for customers. Viewpoint charges customers fees for these services based on the estimated time and materials to complete a creative project for the customer including an acceptable profit margin. Revenue is recognized on a percentage-of-completion basis if all other revenue recognition criteria are satisfied. During 2005 and 2006, the Company continued its strategy of concentrating on executing larger creative projects

The Company also generated revenues by selling licenses to the Viewpoint graphical platform principally to internet content publishers. On June 14, 2005, Viewpoint announced that for all non-special-purpose-licenses, it was discontinuing the practice of charging customers a license fee for the use of the Viewpoint Media Player and related technologies. The Viewpoint Media Player will no longer require a broadcast key to display content, thereby giving all developers a free license to the Viewpoint Distribution Network. However, Viewpoint will still charge for certain licenses requiring customization. By providing the standard license for free, the Company plans to extend the Viewpoint Media Player s reach into new channels of distribution beyond the estimated 120 million computers it currently resides within. Viewpoint believes that this strategy supports the advertising business by potentially making the player more pervasive as well as providing stronger distribution for the search business.

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

Search revenues for the three months ended September 30, 2006 amounted to $1.5 million, compared to $2.5 million in the three months ended September 30, 2005. Revenues for the nine months ended September 30, 2006 were $4.8 million compared to $7.1 million for the comparable period in 2005. The Company had installed 19 million through September 2005, and 25.3 million through September 2006. Internet users can uninstall the Viewpoint Toolbar, and through September, 2005, 8.4 million users who had accepted the installation of the Toolbar had later uninstalled it, and 12.7 million had uninstalled through September, 2006. The total of cumulative toolbars installed, net of those uninstalled was 10.6 million at September, 2005 and 12.6 million at September 2006. Though the number of toolbars is increasing, the Company is seeing a decrease in usage of bars, and a resulting decrease in search revenue. This decrease in revenue may continue unless the Company obtains new distribution partners for its toolbar, enhancements to its toolbar delivered to consumers are found to be beneficial or the revenue paid by advertisers to Yahoo! increases.

The Company recognized $1.0 million in advertising systems revenue during the three months ended September 30, 2006 compared to $0.6 million for the same period in 2005. This revenue was generated by delivering advertising impressions to websites in several different formats including video and the purchase of media space from publishers on behalf of advertisers. The revenue increase is attributable to the Company continuing to expand its customer base and types of advertising formats delivered to them.

Ad systems revenues of $5.6 million for the nine months ended September 30, 2006 increased compared with revenues of $2.5 million for the nine months ended September 30, 2005. Growth in this segment accelerated during the last six months and is expected to continue during the remainder of 2006 as the Company is able to attract more clients and websites to its various ad serving formats.

Services revenues amounted to $0.8 million for the three months ended September 30, 2006 as compared to $1.7 million for the same period in 2005. The Company experienced a decline in its number of clients during the quarter. During March 2006, in recognition of a decline in revenues for this group, the Company announced a restructuring which resulted in a reduction of its workforce and the relocation of its principal operational headquarters for this business to its Los Angeles office. The Company recognized an additional impairment of goodwill for this segment during this quarter due to a reduction of revenues from the automotive sector and slower growth in revenues from the development of other creative products and initiatives.

Services revenues amounted to $2.4 million for the nine months ended September 30, 2006 as compared to revenues of $5.5 million for the nine months ended September 30, 2005. This segment s revenues were down significantly in the first quarter of 2006 compared to the same period the prior year which led to the March 2006 restructuring. Additional decreases in subsequent quarters led to an impairment expense for this segment which was recorded in September 2006. The Company believes that it can increase revenues prospectively in this segment if customers continue to seek the Company s assistance in building more content using the Viewpoint Platform to be used at their websites, develop advertising formats, and more client contracts for private label toolbars.

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

License revenues amounted to less than $0.1 million in the nine months ended September 30, 2006, which represents a decrease of approximately $0.4 million, as compared to the same period last year. License revenues for the first quarter of 2005 represent four licenses the Company sold during 2004, which provided upgrade rights, and were therefore being recognized ratably over 12 months. The Company essentially eliminated the sale of all but special-purposes licenses in September 2005 and believes that revenues in this segment will continue to decrease in 2006.

Cost of revenues

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Search	$ 39	$ 39	%
Percentage of Search Revenues	3%	2%	
Nine months ended:			
Search	$ 113	$ 134	(16)%
Percentage of Search Revenues	2%	2%	
Three months ended:			
Advertising Systems	$ 399	$ 405	(1)%
Percentage of Advertising Systems Revenues	42%	72%	
Nine months ended:			
Advertising Systems	$ 3,638	$ 1,907	91%
Percentage of Advertising Systems Revenues	65%	77%	
Three months ended:			
Services	$ 455	$ 956	(52)%
Percentage of Services Revenues	58%	50%	
Nine months ended:			
Services	$ 1,766	$ 2,875	(39)%
Percentage of Services Revenues	73%	53%	
Three months ended:			
Licenses	$	$ 8	(100)%
Percentage of Licenses Revenues	%	1%	
Nine months ended:			
Licenses	$ 8	$ 11	(27)%
Percentage of Licenses Revenues	10%	%	

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

Cost of revenues from advertising systems were $0.4 million and $3.6 million for the three and nine month periods, respectively, ended September 30, 2006 compared to $0.4 million and $1.9 million for the same periods last year. These costs consist of the web-hosting and employee fees associated with serving advertising content, costs for media space at websites, and costs of developing certain advertisements in contracts that include a combined price for developing creative material and delivering that material. Cost of media space at websites increased by $0.0 million and $2.0 million in the three and nine month periods, respectively, in 2006, compared with the same periods last year. This increase was due to more contracts which required the Company to both purchase media and deliver ads for the advertiser.

Cost of revenues for services consists primarily of salaries, consulting fees and overhead for those who provide fee-based content creation and engineering professional services. Cost of revenues for services of $0.5 million and $1.8 million for the three and nine month periods, respectively, ended September 30, 2006 decreased by $0.5 and $1.1 million, respectively, compared to the same periods last year. The decreases in cost of revenues for services is attributable to the decrease in service revenues compared to the prior year. Additionally, due to the decline in revenues the Company initiated a restructuring which reduced the cost of revenues in the second quarter of 2006 as compared to the first quarter of 2006. The Company believes that the costs for services as a percentage of revenue will improve during the remainder of 2006.

Sales and marketing

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Sales and Marketing	$ 1,454	$ 1,325	10%
Percentage of total revenues	45%	22%	
Nine months ended:			
Sales and Marketing	$ 4,481	$ 3,828	17%
Percentage of total revenues	34%	21%	

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

Sales and marketing expenses of $1.5 million for the three months ended September 30, 2006 increased by $0.1 million compared to the same period last year. The increase was principally due to recording $0.1 million in stock-based compensation in 2006 due to the adoption of FAS 123R.

Sales and marketing expenses of $4.5 million for the nine months ended September 30, 2006 increased by $0.7 million compared to the same period last year. The increase was principally due to recording $0.4 million in stock-based compensation in 2006 due to the adoption of FAS 123R. Personnel costs including commissions increased by $0.2 million and search marketing costs increased by $0.1 million. These increases were offset by a decrease in consulting expenses of $0.1 million.

Research and development

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Research and development	$ 982	$ 1,126	(13)%
Percentage of total revenues	31%	19%	
Nine months ended:			
Research and development	$ 3,138	$ 3,479	(10)%
Percentage of total revenues	24%	19%	

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

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

Research and development expenses decreased by $0.1 million and $0.3 million for the three and nine months ended September 30, 2006 compared to the same periods last year. These changes resulted from a decrease in salaries due to fewer employees in this group during the past year.

General and administrative

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
General and Administsrative	$ 2,102	$ 3,224	(35)%
Percentage of total revenues	65%	54%	
Nine months ended:			
General and Administsrative	$ 6,687	$ 7,965	(16)%
Percentage of total revenues	52%	44%	

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

General and administrative expenses decreased by $1.1 million for the three months ended September 30, 2006 compared to the same period last year. The Company recorded $0.2 million in stock-based compensation for the three months ended September 30, 2006 due to the adoption of FAS 123R. During the same period in 2005 the Company recorded a stock based compensation expense of $1.1 million associated with a charge taken on extending the options of a former executive at September 30, 2005. Salary and fringe benefit costs decreased by $0.2 million in the three months ended September 30, 2006 due primarily to an overall reduction of employees in this department during the year.

General and administrative expenses decreased by $1.3 million, for the nine months ended September 30, 2006 compared to the same period last year. Stock based compensation charges decreased $0.9 million for the period due to the extension of options to the former executive noted above. Corporate costs including accounting fees increased by $0.2 million in the nine months ended September 30, 2006 as compared to the same period in the prior year. Salary and fringe benefit costs decreased by $0.6 million due primarily to a decrease of employees in this area during 2006.

Depreciation expense

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Depreciation	$ 113	$ 158	(28)%
Percentage of total revenues	4%	3%	
Nine months ended:			
Depreciation	$ 337	$ 496	(32)%
Percentage of total revenues	3%	3%	

Depreciation expense relating to operating expenses decreased by less than $0.1 million and $0.2 million for the three and nine month periods ended September 30, 2006, as compared with the same period last year primarily due to the Unicast assets acquired on January 3, 2005. Most of the assets acquired were depreciated over a one year life. Certain depreciation amounts were reclassed to the cost of revenue for the three and nine months ended September 30, 2005 to conform to the 2006 presentation. Refer to the consolidated financial statements for further information regarding the reclassification.

Amortization of intangible assets

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Amortization of intangible assets	$ 222	$ 118	88%
Percentage of total revenues	7%	2%	
Nine months ended:			
Amortization of intangible assets	$ 443	$ 370	20%
Percentage of total revenues	3%	2%	

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

Impairment Charge

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Impairment of goodwill and other intangible assets	$ 10,655	$	N/A%
Percentage of total revenues	332%	%	
Nine months ended:			
Impairment of goodwill and other intangible assets	$ 10,655	$	N/A%
Percentage of total revenues	83%	%	

At September 30, 2006 the Company determined that, based on a decline in operating performance during the third quarter of 2006 marked by a reduction of revenues from the automotive sector and slower growth in revenues from the development of other creative products and initiatives, the Services reporting unit had

experienced an impairment of its allocated goodwill. The Company then performed the second step of the impairment test in accordance with SFAS No. 142 using a discount rate of 16% and a revenue growth rate of 5%. Following the completion of that step the Company recorded an impairment expense of $10.7 million.

Restructuring charges

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

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

Interest and other income, net

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Interest and other income, net	$ 95	$ 30	217%
Percentage of total revenues	3%	1%	
Nine months ended:			
Interest and other income, net	$ 264	$ 86	207%
Percentage of total revenues	2%	%	

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

Interest and other income, net, increased 217% and 207% for the three and nine months ended September 30, 2006, respectively, compared to the same period last year due to an increase in average cash, cash equivalents, and marketable securities balances as well as an increase in market interest rates.

Interest expense

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Interest expense	$ (213)	$ (288)	(26)%
Percentage of total revenues	(7)%	(5)%	
Nine months ended:			
Interest expense	$ (709)	$ (943)	(25)%
Percentage of total revenues	(5)%	(5)%	

Interest expense consists of interest paid and accrued, and amortization of debt discount and debt issue costs on the Company s outstanding subordinated notes and the debt assumed based upon the Unicast acquisition on January 3, 2005. The decrease is primarily the result of an extension of the maturity period of a note from March

2006 to March 2008, resulting in lower monthly interest expense for that note based on the effective rate of interest, as well as a reduction of $0.4 million of debt in March 2006.

Changes in fair value of warrants to purchase common stock

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Changes in fair value of warrants to purchase common stock and conversion options of convertible notes	$ 1,021	$ 207	393%
Percentage of total revenues	32%	3%	
Nine months ended:			
Changes in fair value of warrants to purchase common stock and conversion options of convertible notes	$ (151)	$ 1,037	(115)%
Percentage of total revenues	(1)%	6%	

Based on the provisions of SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, and EITF Issue No. 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock, the Company records gains and losses based upon changes in the Company s common stock value and the number of common stock equivalents that the associated financial instruments may be settled in.

For the three and nine month periods ended September 30, 2006, the Company recorded a gain of $1.0 million and an expense of $0.2 million, respectively, based on the change in the fair value of warrants. For the three and nine months ended September 30, 2005, the Company recorded income of $0.2 million and $1.0 million, respectively, in the Company s consolidated statements of operations based on the change in the fair values of warrants.

Provision for income taxes

	September 30, 2006	September 30, 2005	% Change
	(dollars in thousands)		
Three months ended:			
Provision for income taxes	$ 30	$	N/A%
Percentage of total revenues	1%	%	
Nine months ended:			
Provision for income taxes	$ 56	$ 12	367%
Percentage of total revenues	%	%	

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

Adjustment to net loss on disposal of discontinued operations

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

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

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

Factors That May Affect Future Results of Operations

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

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

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

If our stock price were to remain below $1.00 we may receive notice of de-listing from NASDAQ which might reduce the value of our Company.

If our common stock were to be de-listed from NASDAQ we would be in default of certain loan covenants which could require the accelerated payment of our $3.1 million subordinated loan.

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

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

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

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

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

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

Our failure to successfully compete may hinder our growth.

Our revenues will be subject to seasonal fluctuations.

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

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

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

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

We might experience significant defects in our products.

Our technical systems are vulnerable to interruption and damage.

Our management team has only recently started working together.

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

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

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

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

We may be unable to protect our intellectual property rights.

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

Regulatory and legal uncertainties could harm our business.

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

Internet security poses risks to our entire business.

Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB SFAS Nos. 133 and 140 . This Statement amends FASB SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities . SFAS 155 resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. We do not believe the adoption of SFAS No. 155 will materially impact our consolidated financial statements.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not, of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of January 1, 2007, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. We do not believe the adoption of FIN 48 will materially impact our consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements (SAB 108), which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. We will be required to adopt the provisions of SAB 108 in our annual financial statements for fiscal year 2006. We do not believe that the adoption of SAB 108 will materially impact our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (FAS 157). FAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of this Statement relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. We will be required to adopt the provisions of FAS 157 beginning with our first quarter ending March 31, 2008. We do not believe that the adoption of the provisions of FAS 157 will materially impact our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R), (FAS 158). FAS 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit pension and other postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. We will be required to adopt the provisions of FAS 158 in our annual financial statements for fiscal year 2006. We do not believe that the adoption of the provisions of FAS 158 will materially impact our consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity and Capital Resources

Cash, cash equivalents, and marketable securities totaled $6.3 million at September 30, 2006, down from $9.1 million at December 31, 2005.

	Nine Months Ended September 30, 2006	2005
	(dollars in millions)	
Cash used in operating activities	$ (4.2)	$ (4.9)
Cash provided by (used in) investing activities	$ (2.0)	$ 0.1
Cash provided by financing activities	$ 1.7	$ 2.4

Operating activities

In the nine months ended September 30, 2006, cash used in operating activities was $4.2 million, a decrease of $0.7 million compared to the nine months ended September 30, 2005. The use of cash was mainly due to a net loss of $19.1 million, adjusted for the goodwill impairment charge of $10.7 million and non-cash stock-based compensation charges of $1.6 million, as well as a decrease in accounts payable and accrued expenses of $0.8 million, offset by a decrease in accounts receivable of $1.8 million, a change in the fair value of warrants of $0.2 million, depreciation and amortization expenses of $0.9 million and amortization of debt related costs of $0.5 million.

Investing activities

In the nine months ended September 30, 2006, cash used in investing activities was $2.0 million, primarily as a result of net purchases of marketable securities of $1.7 million and purchase of property and equipment of $0.2 million.

In the nine months ended September 30, 2005, cash provided by investing activities was $0.1 million, primarily due to net sale of marketable securities of $0.8 million offset by the cash used in the acquisition of Unicast of $0.5 million and capital expenditures of $0.3 million.

Financing activities

In the nine months ended September 30, 2006, net cash provided by financing activities was $1.7 million, resulting from the exercise of stock options of $2.4 million which was offset by cash used for the repayment of debt totaling $0.7 million.

In the nine months ended September 30, 2005, net cash provided by financing activities was $2.4 million, resulting from the issuance of common stock in connection with the company extending the maturity of a subordinated note payable. In addition, stock option exercises amounted to $0.5 million.

As of September 30, 2006, the Company had cash commitments totaling approximately $10.0 million through 2011, related mainly to long-term notes and future minimum lease payments for office space, and equipment.

	Payments Due By Period (dollars in thousands)				
	Total	**1 Year or Less**	**2-3 Years**	**4-5 Years**	**More than 5 Years**
Long-Term Debt Obligations	$ 3,050	$	$ 3,050	$	$
Operating Lease Obligations	3,011	253	1,869	889	
Interest Payments on Long-Term Debt Obligations	487	59	314	114	
Unicast Debt Obligations	3,058	97	778	2,183	
Purchase Obligations	381	381			
Total	$ 9,987	$ 790	$ 6,011	$ 3,186	$

Convertible Notes

On December 31, 2002, the Company completed a private placement of convertible notes and warrants in which it issued to three institutional investors, 4.95% convertible notes having an aggregate principal amount of $7.0 million, and warrants to purchase 0.7 million shares of Company common stock. The convertible notes were converted to Viewpoint common stock in 2004. The warrants expire on December 31, 2006, and were initially issued at an exercise price of $2.26 per share. The number of warrants and the exercise price are subject to adjustment if the Company sells or issues securities under a dilutive issuance (as defined in the warrant to purchase common stock agreement) subject to certain conditions. In 2003 and 2004, all of the convertible notes were converted into common stock or redeemed for cash, therefore, no convertible notes remained outstanding as of

September 30, 2006 and December 31, 2005. As of September 30, 2006, 0.8 million warrants were outstanding related to this placement.

Subordinated Notes

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

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

The Subordinated Note contains a covenant which requires that the Company s common stock remain listed on a national stock exchange as defined. The Company s common stock declined below $1.00 and has not closed above $1.00 since October 13, 2006. While the company has not been notified that its stock has been considered by NASDAQ for de-listing, it may receive such notification. If the Company s stock remains below a $1.00 for 30 consecutive days NASDAQ listing rules provide for Viewpoint to be notified that its common stock has been considered for delisting. While there are several different remediation measures that the Company may take to prevent such de-listing, if the Company s remediation measures are unsuccessful it is possible that the Company s stock could be de-listed approximately one year after receiving such notification from NASDAQ. If the Company is de-listed, it will violate the loan covenant noted above which would allow the Subordinated Note holders to demand repayment immediately of the $3.1 million outstanding note balance.

Other Transactions

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

Liquidity

The Company had cash, cash equivalents and marketable securities of $6.3 million at September 30, 2006. During the nine months ended September 30, 2006, net cash used in operations amounted to $4.2 million. As of September 30, 2006, the Company had an accumulated deficit of $285.0 million.

The Company has incurred negative cash flows and net losses since inception. Based on current operating levels combined with limited capital resources, financing operations during 2007 will require that the Company improve operating results through cost cutting measures, increases in revenues or both, and/or raise sufficient additional equity or debt capital, including the avoidance of violating existing debt covenants. If the Company s expected revenue targets are not achieved, management would implement cost reduction measures including work force reduction as well as reduction in overhead costs and capital expenditures.

There can be no assurance that the Company will achieve or sustain positive cash flows from operations or profitability. The Company currently has no commitment for additional financing and may experience difficulty in obtaining additional financing on favorable terms, if at all. Any financing the Company obtains may contain covenants that restrict the Company s freedom to operate the business or may have rights, preferences or privileges senior to the Company s common stock and may dilute the Company s current shareholders ownership interest in Viewpoint.

Furthermore, the stock price of the Company declined below $1.00 and has not closed above $1.00 since October 13, 2006. If the Company s stock trades below a $1.00 for 30 consecutive days, NASDAQ s listing rules provide for Viewpoint to be notified that its common stock is being considered for de-listing. While the Company has not been notified that its stock has been considered for de-listing, it may receive such notification. While there are several different remediation measures that the Company may take to prevent such de-listing, if the Company s remediation measures are unsuccessful, it is possible that the Company s stock could be de-listed in approximately one year after receiving such notification from NASDAQ. If the Company is de-listed it will violate a covenant within the subordinated note agreement which would accelerate the maturity date of the $3.1 million of subordinated note currently scheduled to mature on March 31, 2008. If the Company is unable to secure adequate financing, including the avoidance of the acceleration of the maturity date of the $3.1 million subordinated note, and/or can not achieve and sustain positive cash flows from operations, it would raise substantial doubt about the Company s ability to continue as a going concern through December 31, 2007.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

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

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

The Company has incurred negative cash flows and net losses since inception. Based on current operating levels combined with limited capital resources, financing operations during 2007 will require that the Company improve operating results through cost cutting measures, increases in revenues or both, and/or raise sufficient additional equity or debt capital, including the avoidance of violating existing debt covenants. If the Company’s expected revenue targets are not achieved, management would implement cost reduction measures including work force reduction as well as reduction in overhead costs and capital expenditures.

There can be no assurance that the Company will achieve or sustain positive cash flows from operations or profitability. The Company currently has no commitment for additional financing and may experience difficulty in obtaining additional financing on favorable terms, if at all. Any financing the Company obtains may contain covenants that restrict the Company’s freedom to operate the business or may have rights, preferences or privileges senior to the Company’s common stock and may dilute the Company’s current shareholders’ ownership interest in Viewpoint.

Furthermore, the stock price of the Company declined below $1.00 and has not closed above $1.00 since October 13, 2006. If the Company’s stock trades below a $1.00 for 30 consecutive days, NASDAQ’s listing rules provide for Viewpoint to be notified that its common stock is being considered for de-listing. While the Company has not been notified that its stock has been considered for de-listing, it may receive such notification. While there are several different remediation measures that the Company may take to prevent such de-listing, if the Company’s remediation measures are unsuccessful, it is possible that the Company’s stock could be de-listed in approximately one year after receiving such notification from NASDAQ. If the Company is de-listed it will violate a covenant within the subordinated note agreement which would accelerate the maturity date of the $3.1 million of subordinated note currently scheduled to mature on March 31, 2008. If the Company is unable to secure adequate financing, including the avoidance of the acceleration of the maturity date of the $3.1 million subordinated note, and/or can not achieve and sustain positive cash flows from operations, it would raise substantial doubt about the Company’s ability to continue as a going concern through December 31, 2007.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits

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

SIGNATURES

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

	VIEWPOINT CORPORATION
Dated: November 9, 2006	By: /s/ PATRICK VOGT
	Patrick Vogt President and Chief Executive Officer
Dated: November 9, 2006	By: /s/ WILLIAM H. MITCHELL
	William H. Mitchell Chief Financial Officer
Dated: November 9, 2006	By: /s/ CHRISTOPHER C. DUIGNAN
	Christopher C. Duignan Chief Accounting Officer