

VIEWPOINT CORP/NY/
Form 10-K/A
June 05, 2003

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**Form 10-K/A
Amendment No. 2**

(Mark One)

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

For the fiscal year ended December 31, 2002

or

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

For the transition period from to

Commission file number: 0-27168

Viewpoint Corporation

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

95-4102687

*(I.R.S. Employer
Identification No.)*

498 Seventh Avenue, Suite 1810, New York, NY 10018

(Address of principal executive offices and zip code)

(212) 201-0800

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$0.001 par value

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

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

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Form 10-K or any amendment to the Form 10-K.

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

Aggregate market value of voting stock held by non-affiliates of the registrant as of June 28, 2002	197,477,449
Number of shares of common stock outstanding as of April 28, 2003	45,985,507

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PART I

In addition to historical information, this Annual Report on Form 10-K/A 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 Management's Discussion and Analysis of Financial Condition and Results of Operations-Factors That May Affect Future Results of Operations. You should carefully review the risks described in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q to be filed in 2003. When used in this report, the words expects, anticipates, intends, plans, believes, seeks, targets, es, similar expressions are generally intended to identify forward-looking statements. You should not place undue reliance on the forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K/A. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

Item 1. Business
General

Viewpoint Corporation provides interactive media technologies and digital content creation services for website marketing, online advertising, and embedded applications. Our graphics operating system has been licensed by Fortune 500 companies and others for use in online, offline and embedded applications serving a wide variety of needs, including: interactive marketing campaigns, rich media advertising and product presentations, and business process visualizations.

Until December 1999, the Company (which was then known as MetaCreations) was primarily engaged in the development, marketing, and sales of prepackaged software graphics products. Its principal products were computer graphics painting tools, photo editing, and 3D graphics software. With its acquisition of Real Time Geometry Corporation in December 1996, the Company became involved, on a limited basis, in the development of technologies designed to make practical the efficient display and deployment of interactive media on the Internet. In June 1999, the Company increased its commitment to the development of interactive Internet technologies and formed Metastream.com Corporation to operate a business exploiting these technologies. In December 1999, the Board of Directors of the Company approved a plan to focus exclusively on the Internet technologies of Metastream and to correspondingly divest the Company of all its prepackaged software business. In September 2000, the Company acquired Viewpoint Digital, Inc., a company primarily involved in the licensing of a catalog of three-dimensional digital models and providing digital content creation services. In November 2000, the Company changed its name to Viewpoint Corporation and changed its ticker symbol from MCRE to VWPT.

Viewpoint Experience Technology and the Viewpoint Media Player

Our technology, which we refer to as Viewpoint Experience Technology, or VET, enables Websites and other media publishers to integrate many interactive graphics media technologies onto regular Web pages or other digital formats. Available media types include: photo-realistic 3D, high-resolution two-dimensional images, text annotations and animations, Macromedia®Flash™-compatible vector graphics animations, object movies, immersive surround pictures, and digital audio and video. Interactive digital media can add dimension, contextual information, animation, realistic color, shadows and real-time reflections, movement, and robust interactivity to otherwise static digital objects. Our technology enables websites to publish content that mixes the narrative drive of more traditional media with the interaction of the Web. End-users can be invited to rotate and re-position objects, view extended, narrowband-friendly presentations, and configure colors and patterns.

VET involves the publication of digital content created in the Viewpoint format from a web server or other digital format and the playback of that content by Viewpoint Media Player, our software that operates on the end-user's computer, i.e., on the client-side.

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Viewpoint's client-side software exploits the abundant processing power available on the end user's computer to perform most of the functions of displaying and processing information so that a server need only transmit relatively small files to communicate complex messages. For example, in the absence of client-side software, each end-user interaction with a digital three-dimensional model served from a website would involve a separate communication between the end-user's computer and the server. In contrast, Viewpoint's client-side software can process instructions served by a web server to instantaneously assemble a digital three-dimensional model on the end-user's computer. Once the model is displayed on the end-user's screen, the user can interact with the model without communicating further with the web server. As computer processing capacities on personal computers have grown at a much more rapid rate than that of connection speeds in recent years, the Company believes VET's use of this speed advantage is of significant competitive importance.

Unlike many client-server systems, Viewpoint's technology does not involve special server software.

Content that is interpreted by Viewpoint Media Player can be created with most graphics industry standard prepackaged software products, such as Adobe's Photoshop and Autodesk's 3D Studio Max products. We also make software applications for creating content in the Viewpoint format available for free from our website.

Viewpoint Media Player software is automatically updateable. As we develop and release new features and functionality of the software, we update an end-user's existing version when the end user next views a web page which contains content in the Viewpoint format. We do not ship new versions of Viewpoint Media Player in the same way that traditional software manufacturers do and, therefore, we avoid the costs and delays associated with the typical software product cycle. Moreover, the ability to update an end user's copy of a Viewpoint Media Player as it encounters content in the Viewpoint format assures content publishers that their content can exhibit the latest features and improvements without requiring end-users to endure a lengthy download process.

Like Microsoft's .NET platform, Viewpoint's technology employs extensible mark-up language (or XML), an increasingly popular language for describing data and enabling it to communicate with other forms of data. Since content in the Viewpoint format is able to instantaneously exchange data with other platforms and programming languages, deep integration between interactive media in our format and other data systems can be achieved.

Our technology is not dependent on any particular platform; it can be deployed to provide efficient visualization techniques not only on personal computers but also on cable television set-top boxes, in personal digital assistant devices, within and beyond browser environments, and on compact disks, and other media formats. As a method of providing efficient visual communication, we believe the commercial applications of VET are virtually unlimited. However, we are primarily focused at this time on licensing our technology for use in enhancing website offerings. Recently we have begun to focus on licensing our technology for online advertising purposes. We also market our technology, albeit to a lesser extent, for use in custom developed applications.

Viewpoint Professional Services

We provide fee-based professional services for implementing visualization solutions. Encompassing both digital content creation and application enhancing services, our strategic, creative and consulting services bring together our teams of experts in rich media, content creation and technology implementation in order to identify the ideal Viewpoint solution for each client's unique needs and to ensure the timely, successful implementation of those solutions. Our professional services groups use VET as well as a spectrum of tools and other technologies to create enhanced rich media solutions for our clients' particular purposes, whether over the Web, intranet systems or offline media applications. Our professional services groups provide the support our clients need to implement the rich media content, to fully utilize the enhanced softwares and/or to maximize the branding potential of the advertising opportunity.

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Viewpoint's Business Model

The Company's business model differs from that of many other companies that have developed Website design and content-creation software for sale or license to a target market of Internet professionals—that is, Website developers, interactive agencies, solutions integrators, application service providers and content developers, as well as professionals working in-house at e-merchants and other Website owners. Instead of selling pre-packaged software products to Internet professionals—a relatively small market—we endeavor primarily to license technology to the audience where the value is created: the much larger market of e-commerce merchants, Website owners and others who can harvest benefits from communicating visually in the digital domain. Moreover, as described below, we generally license the use of our technology in a way that encourages repetitive payments, instead of the one-time fees associated with prepackaged software tools sales.

We earn fees by licensing the right to publish or broadcast content that can be read by Viewpoint Media Player. We issue to our customers keys that enable their websites to display content in the Viewpoint format. We offer these keys through a variety of broadcast license arrangements tailored to the specific needs of the client. Examples of typical arrangements include:

Licenses which are time-based and generally limited to specific Web site addresses or specific content;

Licenses which are perpetual and generally limited to specific types or amounts of content;

Licenses which permit a narrowcast only to a local area network or intranet; and

Licenses that permit the client to distribute content by means of CDs, DVDs and other portable storage media.

We believe that this revenue model, if successful, should produce a recurring stream of revenues from existing clients with the opportunity to scale income substantially as new customers are acquired.

To view content in the Viewpoint format, an end-user must have Viewpoint Media Player software installed on their computer. Like most makers of Internet-browsing plug-in software, we do not charge end-users to download or use Viewpoint Media Player. If content in the Viewpoint format is displayed from a web server to an end-user who does not have Viewpoint Media Player installed, the end-user will be afforded the opportunity to download the player. Once the player is installed, the end-user can view and interact with the content.

Many end-users browsing through the Internet are reluctant to download software, such as Viewpoint Media Player, to view specialized content. Therefore, broad distribution of the Viewpoint Media Player to computers is important to our success. In September 2002, Ipsos-NPD, a world-leading market research firm, conducted a quantitative online study to evaluate the penetration of various media players across the U.S., including Viewpoint Media Player. The survey found that 55.7% of Internet users in the United States have Viewpoint Media Player installed and active on their machines.

A key aspect of our business model is an open tools philosophy. We believe the long-term success of our platform will be fueled by having the most popular content creation tools able to output content in the Viewpoint format, rather than requiring design professionals to use Viewpoint's own proprietary toolset. This approach eliminates much of the very large cost associated with development and support of proprietary commercial toolsets. Another advantage of this strategy is that software tools companies that do incorporate Viewpoint functionality, such as Adobe Systems Incorporated and Autodesk Incorporated, have natural incentives to promote the Viewpoint platform. More than 50 companies are developing or have developed support for the Viewpoint format within their tools. In addition, we make available on our Website, without charge, the core software necessary to develop Viewpoint content, as well as extensive tutorials and related materials.

Our professional services groups play an integral role in our overall strategy. Professional services provide a significant revenue opportunity, through the sale of complete solutions comprising technology and content creation services to customers desiring a single vendor solution. At the same time, the groups increase our ability to sell broadcast licenses, by enabling us to offer Viewpoint content to clients who are impressed by the

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advantages of VET but who do not wish to create Viewpoint content themselves or trust that creation to others. Also, the groups' work keeps us on the cutting-edge of the industry, giving us hands-on experience with the design and development problems faced by our own clients, and enabling us to provide thorough, up-to-date training for other industry professionals. Nonetheless, we are not reliant on our own content creation services. We have cultivated a network of thousands of independent content developers trained to provide those services because we do not want a limited pool of content creators to become an obstacle to expanding the more profitable licensing business.

In response to encouragement from several customers, we began in 2001, and continued throughout most of 2002, to market engineering services to enhance existing or create new software applications meant to perform a specific task or set of tasks or assist in communicating through visualization. While content creation services focus on creating interactive digital objects and enhancing Websites, engineering services create or alter software to enable clients to design products, improve process workflow or enhance customer service experiences. The Company's engineering services leverage off of the existing engineering staff and the Company's growing engineering application developers network. Although the Company continues to perform custom engineering services in some cases, we are not actively marketing these services but rather focusing our sales and marketing efforts more narrowly on website marketing and online advertising.

As of April 30, 2003 and 2002, the Company had services revenues remaining to be recognized under the percentage-of-completion method of approximately \$2,435,000 and \$322,000, respectively. Future payments due under licensing agreements where extended payment terms were granted, were \$1,000,000 and \$4,500,000 as of April 30, 2003 and 2002, respectively. The Company will recognize these payments as license revenues when they become due.

Market Opportunity

The market for interactive media technologies is relatively small. However, the number of Internet users continues to increase rapidly as does the number of commercial applications that are based on digital technology. We believe that these patterns will result in continuing the trend of increasing expenditures for online marketing, advertising, branding, and e-commerce, and that such communications will increasingly utilize interactive media technologies.

We initially focused our business on Website licensing for marketing and direct selling. We believe our technology meets this market's demand for:

Effective merchandising to build brand awareness and drive sales.

Realistic product presentation and interaction.

Interoperability of major media types required for compelling product displays (including, for example, interactive 3D, vector graphics, character animation, object movies, high resolution 2D images, digital sound and video).

Compression and streaming delivery at narrowband and broadband data rates.

Client-side data logging of the use of downloaded rich media.

Ease of deployment and integration into Web, hyper-text mark-up language and IT infrastructures.

Continual advancement and refresh of features (through the automatic update function of Viewpoint Media Player).

Consistent and high quality playback across browser and non-browser environments and all major playback platforms.

In the third quarter of 2002, the Company began marketing its technology and services for use in online advertising. The Company believes that the web lacks compelling advertising formats and that numerous additional digital advertising formats are emerging, such as those for television's new digital set-top boxes. We

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further believe that our technology enables advertisers to deliver compelling and interactive ads, tapping into a large selection of media types. We also believe that Viewpoint's potential for providing client-side tracking as well as high playback quality and consistency across advertising platforms should provide strong defensibility in this space.

In the third and fourth quarters of 2002, a total of three advertisers deployed advertisements using content in the Viewpoint format. Since January 1, 2003, six advertisers have launched advertisements from websites using content in the Viewpoint format. Reports we have received from publishers indicate that end-users are interacting with ads in the Viewpoint format at rates that are more than ten times higher than the average rate at which Internet users interact with or click-through static banner ads. Although these higher interactivity rates may be due in part to the novelty of encountering interactive ads in the Viewpoint format, we believe that advertisers utilizing the Viewpoint format will consistently achieve higher recognition than otherwise results from advertisements published in standard formats.

Viewpoint also provides custom engineering services in the development of enterprise applications of our technology. The Company believes that, as data becomes more complicated and is communicated over wider geographic distances, providing efficient and effective visualization will become critical to publishers' success and that the market for custom visualization applications will grow. We are currently providing custom engineering services for several clients and expect to continue to perform these services for additional customers. However, we are not currently devoting substantial sales and marketing resources to pursue these opportunities so that we can focus on the more saleable markets for e-commerce, marketing and online advertising.

Major Customer

America Online, Inc. (AOL) was our largest customer in 2002, accounting for 51% of our revenue. We entered into a licensing and services agreement with AOL in July 2001 that provides for a three-year initial term, with three one-year renewal terms. The majority of the license fees for the initial term were received in 2002. In 2002, we entered into a master consulting agreement under which we provide content creation services to AOL from time to time for additional fees which are negotiated at the time the projects to be performed are identified and documented. We expect to continue to perform such services in 2003.

Under two additional licensing and service agreements we entered into with AOL in 2002, we performed custom engineering services and provided limited license rights on a project basis. We may be entering into similar arrangements with AOL in 2003.

Competition

The Company's competitors (and some of their products) include: Macromedia, Inc. (Shockwave and Flash); Kaon (Activate!3D); Cycore AB (Cult3D); and Rich FX (Examine-FX). Some of the Company's competitors and potential competitors have longer operating histories and significantly greater financial, management, technology, development, sales, marketing and other resources than the Company. As the Company competes with larger competitors across a broader range of products and technologies, the Company may face increasing competition from such companies. If these or other competitors develop products, technologies or solutions that offer significant performance, price or other advantages over those of the Company, the Company's business would be harmed.

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

The Company also faces competition from developers of personal computer operating systems such as Microsoft and Apple Computer, Inc., as well as from open-source operating systems such as Linux. These operating systems may incorporate functions that could be superior to or incompatible with the Company's products and technologies.

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Most companies that offer enhanced visualization products for use on the Internet target a single media type. For example, Cult 3D provides a client-server based system for predominantly viewing three-dimensional images. Some of our potential customers use the technologies afforded by these companies because their offerings are less expensive.

Macromedia, Inc. produces and markets Flash, a popular pre-packaged software product that enables design professionals to create animated content. Macromedia sells copies of Flash to design professionals, employing a business model that Viewpoint abandoned in early 2000. The prevalence of Flash means that Website publishers seeking to add animated content to their sites are able to tap into a large population of content creators to obtain animated content. This method of obtaining and deploying content is typically less expensive for website publishers than obtaining and deploying content in the Viewpoint format.

Nonetheless, we believe that VET offers significant advantages over many of our competitors' products:

Greater visual realism We believe that 3D and other digital rich media objects created in the Viewpoint format offer higher quality and a more true-to-life online experience than competitors' formats.

Interactivity VET lets a customer interact with and examine our clients' products in ways not possible with our competitors' formats. The variety of media types available in instances of content in the Viewpoint format and the integration of these media types affords end-users an opportunity to interact with content to a degree not available through our competitors' offerings. Viewpoint lets consumers pick up/put down, zoom in/out, see how parts move, add/remove components, turn products on/off, change colors/fabrics/textures, instantly receive key data (e.g. compare pricing).

Narrowband friendly Viewpoint's compression technology greatly reduces download time of 3D objects to almost what is expected from ordinary 2D images, so that even consumers with slow connections to the Internet can see Viewpoint content quickly and can interact with them in real time. The client-side rendering makes this possible as only a small file of instructions are communicated to the end-user's computer, where the object is actually rendered. Many of the Company's competitors render objects on the server-side which is more taxing on servers and connections and leads to poorer user interoperability.

Many media/One player Viewpoint includes and integrates seamlessly with many rich media types like IPIX Panoramas, high quality 3D, text annotations, Flash's vector graphics, audio and more, enabling clients to create more compelling Web experiences in a concise and integrated fashion.

No pop-up windows Viewpoint's transparent windowless rendering allows 3D images to share space on the page with text, graphics, and even buttons and hyperlinks. Our browser-less rendering allows 3D objects and vector graphics animation to play right over open windows. 2D images can hyper zoom from traditional thumbnails into images that utilize the entire screen's desktop area. The XML capabilities of the technology allow a seamless and immediately updateable data integration with back-end servers without generating additional windows.

Automatic updates Once users download the Viewpoint Media Player, they can automatically receive all releases and upgrades when next viewing a web page containing content in the Viewpoint format. Because new releases and additional functionality can be sent automatically, in the background, the user's online experience is never interrupted.

Lack of dependence on Java The Company's technology is not based upon the Java software language, which is inconsistently supported in the current and recent version of Microsoft's browser, Internet Explorer. In addition, it is not clear whether future versions of Internet Explorer will provide Java support. Some of Viewpoint's competitors base their technology on the Java language and the Company feels its lack of dependence on Java technology is an advantage.

Seamless integration VET technology requires no special server side software to deploy, and integrates easily with existing hyper-text mark-up language pages and back end database systems.

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Viewpoint is currently a leading provider of interactive media technologies and services, as noted by several trade publications. In September 2002, Ipsos-NPD, a world-leading market research firm, conducted a quantitative online study to evaluate the penetration of various media players across the U.S., including Viewpoint Media Player. The survey found that 55.7% of Internet users in the United States have Viewpoint Media Player installed and active on their machines. This was exceeded only by version 5 of Macromedia's Flash player which had a 98.5% penetration level. Viewpoint Media Player penetration exceeded that of Real Networks RealPlayer (47.7%), Apple QuickTime (52.5%), and version 6 of Macromedia's Flash player (47.1%) and was on par with Macromedia Shockwave.

Product Development

Continuous development of new products and enhancements of our existing products is critical to our success. The Company's principal current product development efforts are focused on the development of Viewpoint Experience Technology and other complementary technologies. From time to time, the Company may also acquire rights or licenses to basic software technologies that it considers complementary to its Viewpoint solution.

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

The Company's research and development expenses, exclusive of non-cash stock compensation charges, were approximately \$4,836,000, \$6,926,000 and \$6,366,000, for 2002, 2001, and 2000, respectively. The Company may hire additional engineers in connection with its continued product development efforts, which would result in increased research and development expenses.

Intellectual Property

The Company regards its patents, copyrights, service marks, trademarks, trade dress, trade secrets, propriety technology and similar intellectual property as critical to its success, and relies on trademark, copyright and patent law, trade secret protection and confidentiality and/or license agreements with its employees, partners, customers and others to protect its proprietary rights. The Company has applied for the registration of certain of its trademarks and service marks in the United States and internationally. We have nine patents that expire on varying dates between 2016 and 2020. In addition, the Company has filed U.S. and international patent applications covering certain of its proprietary technology. Effective trademark, service mark, copyright, patent and trade secret protection may not be available in every country in which the Company's products and services are made available online. The Company has licensed in the past, and expects that it may license in the future, certain of its proprietary rights, such as patents, trademarks, technology or copyrighted material, to third parties.

Employees

As of March 28, 2003, Viewpoint had 141 full time employees, including 40 in sales and marketing; 37 in creative services; 49 in research, development and quality assurance; and 15 in administration. The Company also employs independent contractors. The employees and the Company are not parties to any collective bargaining agreements, and the Company believes that its relationships with its employees are good.

In our continuing efforts to achieve efficiencies, we consolidated our U.S. offices and reduced by forty-eight the number of our employees during the first quarter of 2003. Most of these employees were involved in the content-creation process, a function which we have increasingly outsourced to third parties.

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The continued development, enhancement, and maintenance of our technology is contingent on our ability to attract and retain experienced and talented software engineers. While we do not currently anticipate a short-term need for additional software engineers, recruiting qualified personnel has sometimes been difficult and time-consuming.

Item 2. *Properties*

The Company leases approximately 17,000 square feet of space on the 18th floor of a 24-story office building in New York City, New York. This space houses approximately 108 personnel, including substantially all of the Company's general and administrative and research and development personnel as well as a significant portion of the sales and marketing and creative services personnel. The primary lease agreement expires in March 2010, if not renewed. The Company believes that this office space is adequate for its current needs and that additional space is available in the building or in the New York City area to provide for anticipated growth.

The Company also leases approximately 12,000 square feet of office space in Los Angeles, California, pursuant to a lease that expires in December 2004. This space houses approximately 17 personnel principally engaged in sales and marketing, creative services, and management information systems services.

The Company also leases approximately 12,000 square feet of office space in Draper, Utah, pursuant to a sublease agreement that expires in April 2010. This space housed approximately 29 personnel principally engaged in sales and marketing, creative services, and management information systems services. In February 2003 the Company closed this office and is currently in the process of subleasing the property.

Item 3. *Legal Proceedings*

The Company is engaged in certain legal actions arising in the ordinary course of business. The Company believes it has adequate legal defenses in legal actions in which it is the defendant and believes that the ultimate outcome of such actions will not have a material adverse effect on the Company's consolidated financial position, results of operations, or cash flows. None of the proceedings or group of similar proceedings involve a claim for damages that exceeds ten percent of our current assets.

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

None.

PART II

Item 5. *Market for Registrant's Common Stock and Related Stockholder Matters*

Viewpoint Corporation's (Viewpoint or the Company) common stock, \$0.001 par value, began trading over the counter in December 1995. The common stock is traded on The Nasdaq National Market under the symbol VWPT. On March 28, 2003, there were 318 holders of record of our common stock. Because brokers and other institutions on behalf of stockholders hold many of such shares, we are unable to

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estimate the total number of stockholders represented by these record holders. The following table sets forth, for the periods indicated, the range of high and low closing sales prices per share of our commons stock:

	<u>High</u>	<u>Low</u>
2002		
4th Quarter	\$3.30	\$1.65
3rd Quarter	4.83	2.18
2nd Quarter	6.25	4.82
1st Quarter	6.99	5.09
2001	\$8.50	\$2.75
4th Quarter	7.11	3.00
3rd Quarter	7.65	2.86
2nd Quarter	8.50	3.94
1st Quarter	7.69	2.75

The Nasdaq National Market notified us on March 20, 2003 that our common stock may be delisted from Nasdaq for failure to maintain a minimum bid price of \$1.00 and that we will be provided until September 16, 2003 to regain compliance with National Market standards. If we are unable to regain compliance with the minimum bid price we may be eligible to transfer our common stock to listing on The Nasdaq SmallCap Market if we meet applicable listing standards and thereby gain an additional 180 days to regain compliance with the minimum bid price requirement. In response to the potential delisting of our common stock due to the failure to meet the Nasdaq National Market's minimum bid price requirement, we may ask our stockholders to authorize a reverse stock split at our annual meeting in 2003. If the reverse stock split is approved by our stockholders and we effect the reverse stock split, we would reduce the number of outstanding shares of common stock. With fewer shares outstanding, we would expect our stock price to increase. While a reverse stock split may enable us to cure the minimum bid price deficiency, share prices of companies effecting reverse stock splits often decline and we cannot assure you that our stock price would not decline after a reverse stock split.

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

Information with respect to securities authorized for issuance under equity compensation plans is included in Item 12 on page 82.

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 in an aggregate principal amount of \$7,000,000, and warrants to purchase 726,330 shares of Company common stock. The convertible notes mature on December 31, 2007, unless earlier converted into shares of Company common stock at a price of \$2.26 per share. The warrants expire on December 31, 2006, and are exercisable at a price of \$2.26 per share. For this transaction, we relied upon the exemptions from registration afforded by Sections 4(2) of the Securities Act and Rule 506 promulgated thereunder based upon (i) representations from each investor that it is an accredited investor as that term is defined in Rule 501(a) under the Securities Act; (ii) that no general solicitation of the securities was made by us; (iii) each investor represented to us that it was acquiring the securities for its own account and not with a view towards further distribution; (iv) the securities issued were restricted securities as that term is defined under Rule 144 promulgated under the Securities Act; (v) we placed appropriate restrictive legends on the certificates representing the securities regarding the restricted nature of these securities; and (vi) a Form D was filed with the Commission and in each state where the individual investors reside.

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

	Years Ended December 31,				
	2002	2001	2000	1999	1998
(In thousands, except per share data)					
Statements of Operations Data					
Revenues:					
Licenses	\$ 5,039	\$ 8,148	\$ 1,421	\$ 1,868	\$ 3,001
Related party licenses	7,554	1,533		950	
Services	3,302	3,500	1,659	25	
Related party services	2,244	827	500	250	
Total revenues	<u>18,139</u>	<u>14,008</u>	<u>3,580</u>	<u>3,093</u>	<u>3,001</u>
Cost of Revenues:					
Licenses	353	309	76		
Services	3,587	3,283	1,467		
Total cost of revenues	<u>3,940</u>	<u>3,592</u>	<u>1,543</u>		
Gross profit	<u>14,199</u>	<u>10,416</u>	<u>2,037</u>	<u>3,093</u>	<u>3,001</u>
Operating expenses:					
Sales and marketing (including non-cash stock-based compensation charges totaling \$3,187 in 2002, \$2,335 in 2001, and \$5,122 in 2000)	16,682	17,521	18,616	3,000	981
Research and development (including non-cash stock-based compensation charges totaling \$712 in 2002, \$2,920 in 2001, and \$4,193 in 2000)	5,548	9,846	10,559	5,055	1,434
General and administrative (including non-cash stock-based compensation charges totaling \$1,523 in 2002, \$1,918 in 2001, and \$3,026 in 2000)	9,134	10,423	9,814	6,993	4,010
Depreciation	1,962	1,804	801	406	399
Amortization of intangible assets(1)(2)	664	3,325	1,258	75	150
Amortization of goodwill(1)		14,128	1,767		
Impairment of goodwill and other intangible assets(2)	6,275	7,925			
Compensation charge related to forgiveness of an officer loan			2,322		
Non-cash sales and marketing charges(3)			19,998		
Acquired in-process research and development costs(1)			963		
Total operating expenses	<u>40,265</u>	<u>64,972</u>	<u>66,098</u>	<u>15,529</u>	<u>6,974</u>
Loss from operations	(26,066)	(54,556)	(64,061)	(12,436)	(3,973)
Other income	153	1,064	2,180	2,286	2,618
Loss before provision for income taxes	<u>(25,913)</u>	<u>(53,492)</u>	<u>(61,881)</u>	<u>(10,150)</u>	<u>(1,355)</u>
Provision (benefit) for income taxes	107			5,481	(353)

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Loss before minority interest in loss of subsidiary	(26,020)	(53,492)	(61,881)	(15,631)	(1,002)
Minority interest in loss of subsidiary			4,429	1,048	
Net loss from continuing operations	(26,020)	(53,492)	(57,452)	(14,583)	(1,002)
Discontinued operations:					
Loss from discontinued operations				(14,811)	(18,829)
Adjustment to net loss on disposal of discontinued operations	127	1,122	1,496	(21,260)	
Net income (loss) from discontinued operations(4)	127	1,122	1,496	(36,071)	(18,829)
Net loss	(25,893)	(52,370)	(55,956)	(50,654)	(19,831)
Accretion of mandatorily redeemable preferred stock of subsidiary			(438)		
Net loss applicable to common shareholders	\$ (25,893)	\$ (52,370)	\$ (56,394)	\$ (50,654)	\$ (19,831)
Basic and diluted net loss per common share:					
Net loss per common share from continuing operations	\$ (0.64)	\$ (1.37)	\$ (2.01)	\$ (0.59)	\$ (0.04)
Net income (loss) per common share from discontinued operations	(0.00)	0.03	0.05	(1.47)	(0.79)
Net loss per common share	\$ (0.64)	\$ (1.34)	\$ (1.96)	\$ (2.06)	\$ (0.83)
Weighted average number of shares outstanding basic and diluted	40,759	39,077	28,718	24,581	23,779

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	December 31,				
	2002	2001	2000	1999	1998
	(In thousands)				
Balance Sheet Data					
Cash, cash equivalents and marketable securities	\$ 11,568	\$ 15,122	\$ 29,033	\$ 37,247	\$ 46,335
Working capital	8,680	11,765	34,313	33,638	55,439
Total assets(1)	53,352	61,917	102,349	50,574	79,116
Convertible notes and warrants(5)	7,000				
Stockholders' equity	38,352	52,737	96,339	29,901	70,181

- (1) In November 2000, the Company consummated a share exchange with Computer Associates International, Inc. (Computer Associates) and another shareholder of Metastream Corporation (Metastream), pursuant to which the Company issued 1.15 shares of the Company's common stock in exchange for each outstanding share of common stock of Metastream. The share exchanges were accounted for as acquisitions of minority interest under the purchase method of accounting, and goodwill of \$42,892,000 was recorded.

In September 2000, the Company purchased all the outstanding capital stock of Viewpoint Digital, Inc. (Viewpoint Digital). The total purchase price including contingent consideration was \$26,850,000 of which \$24,517,000 was recorded as goodwill and other intangible assets.

Effective January 1, 2002, the Company completed the adoption of Statements of Financial Accounting Standards (SFAS) No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting. As required by SFAS No. 142, the Company discontinued amortizing the remaining balances of goodwill as of January 1, 2002. All remaining and future acquired goodwill will be subject to impairment tests annually, or earlier if indicators of potential impairment exist, using a fair-value-based approach. All other intangible assets will continue to be amortized over their estimated useful lives and assessed for impairment under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

- (2) During 2002, due to the persistence of unfavorable economic conditions along with lower-than-expected revenues generated to date and reduced estimates of future performance of the Viewpoint Digital assets, the Company performed an additional impairment analysis on the goodwill and other intangible asset balances recorded upon the acquisition of Viewpoint Digital. In accordance with the provisions of SFAS No. 142 and SFAS No. 144, the Company recorded impairment charges totaling \$6,275,000.

During 2001, the Company performed impairment assessments on the goodwill and other intangibles recorded upon the acquisition of Viewpoint Digital and the acquisition of Computer Associates' minority interest in Metastream. As a result of continuing poor economic conditions, which resulted in a decrease in estimated undiscounted future cash flows, the Company recorded a \$7,925,000 goodwill impairment charge on the Viewpoint Digital goodwill during the fourth quarter of 2001.

- (3) In connection with the issuance of mandatorily redeemable preferred stock in Metastream to America Online, Inc. (AOL) and Adobe Systems Incorporated (Adobe), the Company recorded one-time non-cash sales and marketing charges of approximately \$19,998,000 during the year ended December 31, 2000. These charges represented the difference between the fair market value of the Company's common shares into which AOL and Adobe could have converted the Metastream shares on the date of issuance, and the \$20,000,000 aggregate cash consideration received from both AOL and Adobe. These charges were recorded as sales and marketing, as the incremental value of the equity over the cash consideration received was deemed to be the fair value of the license and distribution agreements simultaneously entered into with AOL and Adobe.
- (4) In December 1999, the Board of Directors of the Company approved a plan to focus exclusively on the Company's interactive media technologies and digital content creation services, and to correspondingly divest itself of all its prepackaged software graphics business. Consequently, the results of operations of the prepackaged software graphics business have been classified as net income (loss) from discontinued operations for the years ended December 31, 1998 through 2002.
- (5) 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 \$7,000,000, and warrants to purchase 726,330 shares of Company common stock.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

In addition to historical information, this Annual Report on Form 10-K/A 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 the Quarterly Reports on Form 10-Q to be filed in 2003. When used in this report, the words "expects," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," and similar expressions are generally intended to identify forward-looking statements. You should not place undue reliance on the forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K/A. 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 provides interactive media technologies and digital content creation services for website marketing, online advertising, and embedded applications. Our graphics operating system has been licensed by Fortune 500 companies and others for use in online, offline and embedded applications serving a wide variety of needs, including, interactive marketing campaigns, rich media advertising and product presentations, and business process visualization.

History. Until December 1999, the Company (which was then known as MetaCreations) was primarily engaged in the development, marketing, and sales of prepackaged software graphics products. Its principal products were computer graphics painting tools, photo editing software, and 3D graphics software. With its acquisition of Real Time Geometry Corporation in December 1996, the Company became involved, on a limited basis, in the development of technologies designed to make practical the efficient display and deployment of interactive media on the Internet. In June 1999, the Company increased its commitment to the development of interactive Internet technologies and formed Metastream Corporation to increase the pace of development of an internet-based product and a business model to exploit these technologies.

In December 1999, the Board of Directors of the Company approved a plan to focus exclusively on the Internet technologies of Metastream and to correspondingly divest the Company of all its prepackaged software business. Since then, our primary goal has been to establish the Viewpoint Media Player as the standard platform for the display of interactive media content, particularly on the Internet.

Business Model. We earn revenues by charging companies a license fee for deploying content in the Viewpoint format. We do not charge end-users to download or use the Viewpoint Media Player.

We also earn revenues by creating content in the Viewpoint format for our customers. However, we do not desire to be the only source for publishers to obtain content in the Viewpoint format. Indeed, an important underpinning of our business model is to make it easy for content creation professionals to create content in the Viewpoint format, as this provides us with a larger base of customers who require a license to display content in our format, and because revenue earned from licensing is generally higher margin revenue than that earned from content creation services.

To fuel adoption of our technology by the professional creative community, we provide on our website, free of charge, software tools that enable professional content providers to create digital content in the Viewpoint format and training in their use. We also provide software development kits and support to third party software tools makers to encourage them to produce tools that can create content in our format. Thus, we are not in competition with the graphics software tools providers; rather, we believe that by enabling their products to output to the Viewpoint format, we are increasing the usefulness of their products and the likelihood that content creation professionals will recommend to their clients that content be created and deployed in our format.

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We believe that performing content creation services ourselves in this, the early stage of our business, rather than depending on third party content creators, helps to expand the market for our technology by providing our customers with a one stop solution. As the content creation community becomes more familiar with creating content in our format, our customers will be able to more easily tap into a wide array of options for content creation solutions.

Growth of the Company. In December 1999, when the Board determined to focus exclusively on the Metastream technologies and to correspondingly divest the Company of its prepackaged software products, only approximately 15 employees of the Company were committed on a full-time basis to the development of both the internet-based product and business model while over 230 employees were committed to the Company's historical business. By March 2000, we had moved our headquarters from California to New York City, eliminated approximately 210 positions filled by persons dedicated to the historical business, and increased to 55 the number of employees devoted solely to the internet-based business. We launched the first fully-functional version of the Viewpoint Media Player in June 2000 and continued to add personnel in pursuit of exploiting the new business model. By August 2000, we employed approximately 110 people.

With our acquisition of Viewpoint Digital, Inc., a company primarily engaged in providing digital content creation services and in licensing a catalog of pre-existing 3D models, we added 88 employees, primarily involved in the performance of content creation services. We continued to provide content creation services that did not involve the Viewpoint format to Viewpoint Digital's customer base in 2000 and 2001.

In November 2000, we changed our name to Viewpoint Corporation.

Between September 2000 and December 31, 2002, the number of our employees fluctuated between 185 and 228. As of December 31, 2002, we had 189 employees.

We had sales of licenses and services in 2000 of \$3.6 million. In 2001 and 2002, we had sales of licenses and services of \$14.0 million (including \$1.5 million from AOL) and \$18.1 million (including \$9.3 million from AOL), respectively. Revenues have primarily been from the sale of technology licenses and fee-based content creation and software engineering services.

Since launching our new product and business in June 2000, the overall global economy has been in decline and our target customers have substantially diminished budgets for online marketing and advertising. We believe that these factors have tended to cause a slower rate of growth for our products and services than might otherwise have been achieved.

Distribution of the Viewpoint Media Player to end users' computers is important to the success of our business because the presence of the Viewpoint Media Player on an end user's computer enables the end user to immediately view content in the Viewpoint format without having to wait for a download. As our business has developed since June 2000, we have spent considerable resources pursuing relationships and business arrangements that lead to the distribution of the Viewpoint Media Player. The Viewpoint Media Player is currently distributed along with versions 7 and 8 of AOL's internet access software and version 5 of AOL's stand-alone instant messaging software, AIM. We expect distribution of the Viewpoint Media Player to continue in the next versions of both the AOL client and AIM.

Expense Structure and Current Sales Effort. The majority of our expenditures since launching the new business in 2000 have been compensation related, with a large portion of our employees devoted to performing content creation services. As part of our ongoing efforts to maximize efficiencies, we began in July 2002 to aggressively pursue the development of a network of third-party content creation providers to serve as subcontractors for us. Success in developing this network enabled us to eliminate the need for our facility in Utah and substantially reduce our staff. We currently employ 141 people.

Throughout 2001 and the first three quarters of 2002, the Company's sales and marketing efforts were directed at the broad spectrum of businesses with a presence on the internet, including customers in the apparel, real estate, consumer electronics, sporting goods, and luxury goods industries. In addition, early unsolicited success in licensing our technology for use in custom configuration systems and in computer

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assisted design applications encouraged us to broaden the focus of our sales efforts in late-2001 to pursue sales of our technology for such purposes.

Beginning in the third quarter of 2002, however, we narrowed the focus of our direct sales and marketing efforts to companies in the automotive and consumer electronics industries and we introduced our online advertising product. We believe that by narrowing our focus, we are better able to tailor our offerings to meet the specific desires of customers in fewer sectors which, in turn, increases the likelihood of sale. We have also reduced our efforts to license our technology for custom configuration systems and computer assisted design applications due to the long sales cycles, high level of custom engineering, and relative difficulty of applying customer-specific solutions to other companies.

Thus, our primary initiatives include:

Licensing technology for web site marketing and e-commerce visualization solutions;

Licensing technology for internet advertising purposes;

Providing a full range of fee-based digital asset content creation and software engineering services for implementing visualization solutions for marketing

Forging technological alliances with leading interactive agencies, Web content providers, major portals and ISPs, tools companies, and computer OEMs; and

Maximizing market penetration of the Viewpoint Media Player.

Long-term success in our business requires us to spend significant resources in several areas that do not directly result in short-term revenues, including: continued development of the Viewpoint Media Player and associated content creation software; development of infrastructure software that allows third parties, such as advertisers, to take full advantage of the functions of the Viewpoint Media Player; support of, and integration with, third party manufacturers of content creation tools; training of content creation professionals; pursuit of appropriate alliances with software tools companies, publishers, advertisers and advertising agencies, and computer OEMs; and general marketing activities. A primary challenge facing management is the proper balance of these expenditures against the desire for near-term profitability: whereas it may be possible to reduce expenditures further to reduce losses and/or achieve profitability in the short term, management has, to date, opted to limit reductions in these areas, believing that it should strive to maximize prospects for long-term profitability. Management will continue to monitor economic and business conditions and constantly re-evaluate these issues.

In light of the relatively recent change in the Company's strategic focus from selling prepackaged software, we have a limited operating history upon which an evaluation of our business and our prospects can be based. Our prospects must be considered in light of the risks and difficulties frequently encountered by early stage technology companies. We have had significant quarterly and annual operating losses since our inception, and as of December 31, 2002, had an accumulated deficit of \$224,077,000. There can be no assurance that we will achieve or sustain profitability.

We may, from time to time, provide guidance of certain financial and non-financial expectations and we have done so within this Form 10-K/A. We use these expectations to assist us in making decisions about our allocations of resources, not as predictions of future results. The expectations are subject to risks of our business as well as those contained in Factors That May Affect Future Results of Operations.

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

	Years Ended December 31,		
	2002	2001	2000
Statements of Operations Data			
Revenues:			
Licenses	28%	58%	40%
Related party licenses	42	11	
Services	18	25	46
Related party services	12	6	14
	<u>100</u>	<u>100</u>	<u>100</u>
Total revenues			
Cost of revenues:			
Licenses	2	2	2
Services	20	24	41
	<u>22</u>	<u>26</u>	<u>43</u>
Total cost of revenues			
Gross profit	<u>78</u>	<u>74</u>	<u>57</u>
Operating expenses:			
Sales and marketing (including non-cash stock-based compensation charges)	92	125	520
Research and development (including non-cash stock-based compensation charges)	30	70	295
General and administrative (including non-cash stock-based compensation charges)	50	74	274
Depreciation	11	13	23
Amortization of intangible assets	4	24	34
Amortization of goodwill		101	49
Impairment of goodwill and other intangible assets	35	57	
Compensation charge related to forgiveness of an officer loan			65
Non-cash sales and marketing charges			559
Acquired in-process research and development costs			27
	<u>222</u>	<u>464</u>	<u>1,846</u>
Total operating expenses			
Loss from operations	(144)	(389)	(1,789)
Other income	1	7	60
	<u>(143)</u>	<u>(382)</u>	<u>(1,729)</u>
Loss before provision for income taxes			
Provision for income taxes	(1)		
	<u>(144)</u>	<u>(382)</u>	<u>(1,729)</u>
Loss before minority interest in loss of subsidiary			
Minority interest in loss of subsidiary			124
	<u>(144)</u>	<u>(382)</u>	<u>(1,605)</u>
Net loss from continuing operations			
Adjustment to net loss on disposal of discontinued operations	1	8	42
	<u>(143)</u>	<u>(374)</u>	<u>(1,563)</u>

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Net loss	(143)	(374)	(1,563)
Accretion of mandatorily redeemable preferred stock of subsidiary	—	—	(12)
Net loss applicable to common shareholders	(143)%	(374)%	(1,575)%

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	<u>2002</u>	<u>% Change</u>	<u>2001</u>	<u>% Change</u>	<u>2000</u>
	(Dollars in thousands)				
Licenses	\$ 5,039	(38)%	\$ 8,148	473%	\$ 1,421
Related party licenses	7,554	393%	1,533	N/A	
Services	3,302	(6)%	3,500	111%	1,659
Related party services	2,244	171%	827	65%	500
Total revenues	\$ 18,139	29%	\$ 14,008	291%	\$ 3,580

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

Viewpoint generates revenues through two sources: (a) software licenses and (b) services. License revenues are generated from licensing the rights to use our products directly to end-users and indirectly through value added resellers (VARs). Service revenues are generated from fee-based professional services, sales of customer support services (maintenance contracts), and training services performed for customers that license our products.

License revenues from direct customers include sales of perpetual and term-based licenses for broadcasting digital content in the Viewpoint format, and licenses for our digital content library. License revenues are recognized over the term of the license in a term-based broadcast license model when the term is less than 15 months, and up-front in a perpetual broadcast license model and term-based broadcast license model when the term is 15 months or longer, providing no further significant obligations exist and the resulting receivable is deemed collectible by management. License revenues for our digital content library are recognized when the license right begins, which is upon contract signing, provided all other revenue recognition criteria are met and no further significant obligations exist. Arrangements with VARs require either (i) an upfront, non-refundable payment or (ii) a percentage royalty based on sell through, or both, as consideration for the right to resell our technology. Up-front, non-refundable payments are recognized as license revenues when the VARs right to resell our technology begins and the technology has been delivered to the VAR, which is upon contract signing, provided all other revenue recognition criteria are met and no further significant obligations exist. For arrangements that do not call for an up-front, non-refundable payment, revenues are recognized as the royalties are earned, which is upon notification of sell through, provided all other revenue recognition criteria are met and no further significant obligations exist.

Fee-based professional services for customized software development are performed on a time-and-material or fixed-fee basis, under separate service arrangements. Revenues for fixed-fee arrangements are recognized on a percentage-of-completion basis in accordance with the provisions of SOP 81-1 Accounting for Performance of Construction-Type and Certain Production-Type Contracts and SAB No. 101. Percentage-of-completion for service contracts is measured principally by the percentage of costs incurred and accrued to date for each contract, which principally consist of direct labor costs and overhead, to the estimated total cost for each contract at completion. Revenues from customer support services are recognized ratably over the term of the contract. Revenues from training services are recognized as services are performed.

Fees from licenses sold together with fee-based professional services are generally recognized upon delivery of the software, provided that the payment of the license fees are not dependent upon the performance of the services, and the services are not essential to the functionality of the licensed software. If the services are essential to the functionality of the software, or payment of the license fees are dependent upon the performance of the services, both the software license and service fees are recognized on a percentage of completion method of contract accounting.

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For arrangements involving multiple elements, we defer revenue for the undelivered elements based on their fair value and recognize the difference between the total arrangement fee and the amount deferred for the undelivered elements as revenue. The determination of fair value of each undelivered element in multiple element arrangements is based on the price charged when the same element is sold separately. For maintenance and technical support elements, we use renewal rates to determine the price when sold separately.

License revenues decreased approximately \$3,109,000, or 38%, for 2002 compared to 2001. The decrease is due to revenues generated by our digital content library decreasing by \$3,203,000. The decrease is the direct result of a license agreement entered into during the fourth quarter of 2001, under which the Company perpetually licensed its digital content library to a long-time, leading distributor of 3D animation software for \$750,000, which represented a non-refundable minimum license fee of \$500,000 in cash due upon signing and \$250,000 due within 90 days. As a result of this transaction, the Company significantly reduced its sales efforts relating to its digital content library in return for an expected revenue share. For the period commencing the day following the date on which net revenues, less an \$85,000 monthly expense retainer, exceed \$500,000, the Company will receive a 50% share in future net revenues derived from sublicenses of its digital content library. During the year ended December 31, 2002, net revenues (\$1,005,000) less an \$85,000 monthly expense retainer (\$1,020,000), did not exceed \$500,000, therefore the Company did not receive a revenue share. Because we will not begin to share in this revenue until the \$500,000 target is met, it is likely that we will not derive significant revenue, if any, from this arrangement in 2003. Although the amount of revenue share will be based on a number of factors, including overall economic and market conditions, we expect to begin receiving a revenue share in 2004.

Related party license revenues increased by approximately \$6,021,000, or 393%, for 2002 compared to 2001. The increase in related party license revenues is the result of \$5,993,000 in increased AOL license revenues and \$125,000 in increased Adobe license revenues, which were partially offset by a decrease of \$97,000 in Computer Associates license revenues. The increase in AOL license revenues is due to our expanding relationship with AOL which was evidenced by two new licensing arrangements in 2002 in addition to a full year of license revenues in 2002 related to a contract entered into in July of 2001. In addition, in March 2002, the Company amended the July 2001 contract, which resulted in the Company recording revenues when payments are due, as compared to the partial deferral of those payments, which would otherwise have occurred. This amendment resulted in the Company recognizing \$5,825,000 in license revenues for this contract as opposed to \$2,700,000 if the contract had not been amended.

Service revenues decreased \$198,000, or 6%, for 2002 compared to 2001. The decrease was caused by the persistence of unfavorable economic conditions.

Related party service revenues increased by approximately \$1,417,000, or 171%, for 2002 compared to 2001. The increase is primarily related to our expanding relationship with AOL, which accounted for a \$1,837,000 increase in service revenues primarily related to the creation of customized digital content and specific engineering services. This increase was partially offset by a \$420,000 decrease in service revenues with Computer Associates primarily due to the expiration, during the year, of an engineering services agreement from 1999.

Total related party revenues for the year ended December 31, 2002, were \$9,337,000, \$336,000, and \$125,000 related to agreements, including reseller agreements, with AOL, Computer Associates, and Adobe, respectively, all of whom have representatives on the Company's Board of Directors.

License revenues increased by approximately \$6,727,000, or 473%, and service revenues increased by approximately \$1,841,000 or 111%, in 2001 compared to 2000. The increase was primarily attributable to an expansion of our direct sales force and indirect channel partnerships, and incremental sales from the acquisition of Viewpoint Digital.

Related party license revenues increased by \$1,533,000, and related party service revenues increased \$327,000, or 65%, in 2001 compared to 2000. The increase was due to the new contract with AOL entered into in July 2001, which accounted for \$1,350,000 and \$317,000 of the increase in related party license revenues and related party service revenues, respectively.

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Total related party revenues for the year ended December 31, 2001 were \$1,507,000 and \$853,000, related to agreements, including reseller arrangements, with AOL and Computer Associates, respectively.

During the year ended December 31, 2001, the Company established a strategic relationship with one of its customers whereby the customer purchased licenses from the Company and the Company agreed to purchase publicly traded equities of the customer's parent. The Company also entered into a license agreement with another customer in exchange for the customer's mass distribution of Viewpoint Media Player to an important target audience. These transactions effectively include nonmonetary sales of our software for equity securities and services of our customers, and accordingly the Company used the fair value of the equities and services received in determining the amount of revenues and expenses to record. Total revenues and expenses were \$429,000 and \$264,000, respectively, related to these transactions.

The increase in license and service revenues in 2002 compared to 2001, and 2001 compared to 2000, were the direct result of increases in the amount of licenses sold and services performed as the Company's pricing and product offerings did not materially change from 2000 to 2002.

Revenues in 2000 were related to sales of licenses and fee-based professional services with two customers accounting for 40% of total revenues. Revenues of \$2,459,000 were the result of the acquisition of Viewpoint Digital in September 2000. Related party service revenues for 2000 were \$500,000 related to an engineering services agreement with Computer Associates.

Cost of Revenues

	<u>2002</u>	<u>% Change</u>	<u>2001</u>	<u>% Change</u>	<u>2000</u>
(Dollars in thousands)					
Licenses	\$ 353	14%	\$ 309	307%	\$ 76
Services	3,587	9%	3,283	124%	1,467
Total cost of revenues	\$3,940	10%	\$3,592	133%	\$1,543
Percentage of total revenues	22%		26%		43%

Cost of revenues for licenses consist of commissions to VARs for the resale of our technology and license fees to third parties for certain software and digital media that are sublicensed to direct customers. Cost of revenues for services consist primarily of salaries and consulting fees for those who provide fee-based professional services.

Cost of revenues for licenses increased by \$44,000, or 14%, in 2002 compared to 2001 due to an increase in license fees to third parties for certain software and digital media of \$203,000 and an increase in commissions to VARs of \$107,000. These increases were partially offset by a decrease in royalties to publishers of our digital content library of \$266,000, as a result of a license agreement entered into during the fourth quarter of 2001, under which the Company perpetually licensed its digital content library to a long-time leading distributor of 3D animation software. Cost of revenues for services increased by \$304,000, or 9%, in 2002 compared to 2001 due to an increase in service revenues, which was partially offset by higher margins related to an increase in engineering professional services.

Cost of revenues for licenses increased by \$233,000, or 307%, in 2001 compared to 2000 which was primarily due to an increase in royalties to publishers of our digital content library of \$190,000 due to a full year of digital content library revenues in 2001 compared to four months in 2000. Cost of revenues for services increased by \$1,816,000, or 124%, in 2001 compared to 2000 due to an increase in service revenues.

Sales and Marketing (Including Non-Cash Stock-Based Compensation Charges Totalling \$3,187 in 2002, \$2,335 in 2001, and \$5,122 in 2000)

	<u>2002</u>	<u>% Change</u>	<u>2001</u>	<u>% Change</u>	<u>2000</u>
(Dollars in thousands)					