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HEMISPHERX BIOPHARMA INC

Form S-1

March 22, 2004

As filed with the Securities and Exchange Commission on March 22, 2004

Registration No. 333-_____

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-1
REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

HEMISPHERX BIOPHARMA, INC.
(Exact name of registrant as specified in its charter)

Delaware	2836	52-0845822
(State or other jurisdiction	(Primary Standard	(I.R.S. Employer
of incorporation	Industrial Classification	Identification Number)
or organization)	Code Number)	

1617 JFK Boulevard
Philadelphia, Pennsylvania 19103
(215) 988-0080
(Address, including zip code, and telephone number, including
area code, of registrant's principal executive offices)

William A. Carter, M.D., Chief Executive Officer
Hemispherx Biopharma, Inc.
1617 JFK Boulevard
Philadelphia, Pennsylvania 19103
(215) 988-0080
(Name, address, including zip code, and telephone number,
including area code, of agent for service)

Copies of all communications to:
Richard Feiner, Esq.
Silverman Sclar Shin & Byrne PLLC
381 Park Avenue South, Suite 1601
New York, New York, 10016
(212) 779-8600
Fax (212) 779-8858

Approximate date of proposed sale to the public: From time to time or at
any time after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered

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on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 ("Securities Act"), other than securities offered only in connection with dividend or reinvestment plans, check the following box. [X]

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. []

If this form is a post-effective amendment filed pursuant to 462(c) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering. []

If this form is a post-effective amendment filed pursuant to 462(d) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering. []

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. []

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CALCULATION OF REGISTRATION FEE

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Title of Each Class of Securities to be Registered	Amount to be Registered (1)	Proposed Maximum Offering Price Per Share (3)	Proposed Maximum Aggregate Offering Price	Amount Registered
Common Stock	3,496,893 (2)	\$3.35	\$11,714,591	\$1,
Common Stock	1,098,860 (4)	\$3.35	\$3,681,181	\$46
Common Stock	662,204 (5)	\$3.35	\$2,218,383	\$28
Common Stock	310,160 (6)	\$3.35	\$1,039,036	\$13
Total Registration Fee				\$2,

(1) Pursuant to Rule 416 of the Securities Act of 1933, there are also being registered an indeterminate number of additional shares of common stock as may become offered, issuable or sold to prevent dilution resulting from stock splits, stock dividends or similar transactions.

(2) Pursuant to an agreement with the beneficial holders of these shares, represents 135% of the shares of common stock that are issuable upon the

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- (a) conversion, prepayment or otherwise relating to the registrant's 6% Senior Convertible Debentures due January 2006 issued in a private placement on January 27, 2004 and as payment of interest thereon and (b) exercise of warrants issued by the registrant in the private placement.
- (3) Estimated solely for the purpose of computing the registration fee in accordance with Rules 457(c) of the Securities Act on the basis of \$3.35 per share, which was the average of the high and low sales prices of the shares of common stock of the Registrant reported on the American Stock Exchange on March 18, 2004.
- (4) Pursuant to an agreement with the beneficial holders of these shares, represents 135% of the shares of common stock that are issuable upon the conversion, prepayment or otherwise relating to the registrant's 6% Senior Convertible Debentures due January 2006 and as payment of interest thereon. These Debentures are issuable upon exercise of Additional Investment Rights issued in a private placement on January 27, 2004.
- (5) Represent shares owned by certain selling stockholders.
- (6) Represents shares of our common stock issuable upon exercise of warrants held by selling stockholders.

Pursuant to Rule 429 under the Securities Act of 1933, as amended, the prospectus included in this Registration Statement also relates to the remaining unsold shares which were previously registered by the Registrant under Registration Statement Nos. 333-108645 and 333-111135.

The Registrant hereby amends this registration statement on the date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended, or until the registration statement shall become effective on a date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be amended. Neither we nor the selling stockholders may sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where an offer or sale is not permitted.

Subject to Completion
Preliminary Prospectus Dated March 22, 2004

HEMISPHERX BIOPHARMA, INC.

10,237,091 Shares of Common Stock

This prospectus relates to the resale of 10,237,091 shares of our common stock that may be offered and sold from time to time by selling shareholders, consisting of: (1) 135% of 1,682,664 shares of common stock issuable upon the conversion, redemption or other payments relating to our 6% Senior Convertible Debentures Due January 2006 ("January 2004 Debentures") and as payment of interest thereon and 135% of 790,514 shares of common stock issuable upon the exercise of the related warrants ("2009 Warrants"); (2) 135% of 813,970 shares

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of common stock issuable upon the conversion, redemption or other payments relating to our January 2004 Debentures and as payment of interest thereon, which January 2004 Debentures are issuable upon exercise of Additional Investment Rights held by the holders of the January 2004 Debentures; (3) 135% of 1,585,978 shares of common stock issuable upon the conversion, redemption or other payments relating to our 6% Senior Convertible Debentures Due October 2005 ("October Debentures") and as payment of interest thereon and 135% of 410,134 shares of common stock issuable upon the exercise of the related warrants ("October 2008 Warrants"); (4) 135% of 1,137,650 shares of common stock issuable upon the conversion, redemption or other payments relating to our 6% Senior Convertible Debentures Due July 2005 ("July Debentures") and as payment of interest thereon and 135% of 507,102 shares of common stock issuable upon the exercise of the related warrants ("July 2008 Warrants") and 135% of 1,000,000 shares of common stock issuable upon the exercise of warrants issued to the Debenture holders in June 2003 ("June 2008 Warrants"); (5) 1,286,410 shares of common stock issuable upon exercise of other warrants; and (6) 1,022,689 shares of common stock to be sold by certain of the selling stockholders listed on page 64 of this prospectus. We are registering these shares of common stock pursuant to commitments to register the securities with the selling stockholders.

We will not receive any proceeds from the sale of the shares of common stock by the selling stockholders other than payment of the exercise price of the warrants.

Our common stock is listed on the American Stock Exchange under the symbol HEB. The reported last sale price on the American Stock Exchange on March 15, 2004 was \$3.20.

Please see the risk factors beginning on page 6 to read about certain factors you should consider before buying shares of common stock.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined that this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is March __, 2004

PROSPECTUS SUMMARY

In the following summary, we have highlighted information that we believe is the most important about us. However, because this is a summary, it may not contain all information that may be important to you. You should read this entire prospectus, including the information incorporated by reference and the financial data and related notes, before making an investment decision. When used in this prospectus, the terms "we," "our" and "us" refer to Hemispherx and not to the selling stockholders.

About Hemispherx

In the course of almost three decades, we have established a strong foundation of laboratory, pre-clinical and clinical data with respect to the development of nucleic acids to enhance the natural antiviral defense system of the human body and the development of therapeutic products for the treatment of chronic diseases. Our strategy is to obtain the required regulatory approvals which will allow the progressive introduction of Ampligen(R) (our proprietary drug) for treating Myalgic Encephalomyelitis/ Chronic Fatigue Syndrome

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("ME/CFS"), HIV, Hepatitis C ("HCV") and Hepatitis B ("HBV") in the U.S., Canada, Europe and Japan. Ampligen(R) is currently in the open label portion of phase III clinical trials in the U.S. for use in treatment of ME/CFS and is in Phase IIb Clinical Trials in the U.S. for the treatment of newly emerging multi-drug resistant HIV, and for the induction of cell mediated immunity in HIV patients that are under control using potentially toxic drug cocktails.

Our proprietary drug technology utilizes specifically configured ribonucleic acid ("RNA") and is protected by more than 350 patents worldwide, with over 60 additional patent applications pending to provide further proprietary protection in various international markets. Certain patents apply to the use of Ampligen(R) alone and certain patents apply to the use of Ampligen(R) in combination with certain other drugs. Some compositions of matter patents pertain to other new RNA compounds, which have a similar mechanism of action.

In March 2003 we obtained from Interferon Sciences, Inc. ("ISI") all of its raw materials, work-in-progress and finished product ALFERON N Injection(R), together with a limited license to sell ALFERON N Injection(R), a natural alpha interferon that has been approved for commercial sale for the intralesional treatment of refractory or recurring external condylomata acuminata ("genital warts") in patients 18 years of age or older in the United States. In March 2004, we acquired from ISI the balance of ISI's rights to its product as well as ISI's production facility. We are marketing the ALFERON N Injection(R) in the United States through sales facilitated via third party marketing agreements. Additionally, we intend to implement studies testing the efficacy of ALFERON N Injection(R) in multiple sclerosis and other chronic viral diseases. In this regard, the FDA recently authorized a Phase II clinical study designed to investigate the activity and safety of Alferon LDO(R) in early stage HIV positive patients.

We were incorporated in Maryland in 1966 under the name HEM Research, Inc., and originally served as a supplier of research support products. Our business was redirected in the early 1980's to the development of nucleic acid pharmaceutical technology and the commercialization of RNA drugs. We were reincorporated in Delaware and changed our name to HEM Pharmaceutical Corp., in 1991 and to Hemispherx Biopharma, Inc., in June 1995. We have three domestic subsidiaries `BioPro Corp., BioAegean Corp., and Core BioTech Corp., all of which are incorporated in Delaware. Our foreign subsidiaries include Hemispherx Biopharma Europe N.V./S.A. established in Belgium in 1998 and Hemispherx Biopharma Europe S.A. ("Hemispherx, S.A.") incorporated in Luxembourg in 2002.

Our principal executive offices are located at One Penn Center, 1617 JFK Boulevard, Philadelphia, Pennsylvania 19103, and its telephone number is 215-988-0080.

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THE OFFERING

Common stock to be offered by the selling stockholders	10,237,091 Shares
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Common stock outstanding prior to this offering	41,617,249 Shares
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Use of Proceeds	We will not receive any of the proceeds from the sale of the shares of common stock because they are being offered by the selling stockholders and we are not
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offering any shares for sale under this prospectus, but we may receive proceeds from the exercise of warrants held by certain of the selling stockholders. We will apply such proceeds, if any, toward funding our research and development efforts, working capital and, possibly, acquisitions. See "Use of Proceeds."

American Stock Exchange symbol HEB

The 10,237,091 shares of our common stock offered consist of:

- o 135% of 1,682,664 shares of common stock issuable upon the conversion, redemption or other payments relating to our 6% Senior Convertible Debentures Due January 2006 ("January 2004 Debentures") and as payment of interest thereon;
- o 135% of 790,514 shares of common stock issuable upon the exercise of the related warrants ("2009 Warrants");
- o 135% of 813,970 shares of common stock issuable upon the conversion, redemption or other payments relating to our January 2004 Debentures and as payment of interest thereon, which January 2004 Debentures are issuable upon exercise of Additional Investment Rights held by the holders of the January 2004 Debentures;
- o 135% of 1,585,978 shares of common stock issuable upon the conversion, redemption or other payments relating to our 6% Senior Convertible Debentures Due October 2005 ("October Debentures") and as payment of interest thereon;
- o 135% of 410,134 shares of common stock issuable upon the exercise of the related warrants ("October 2008 Warrants"); o 135% of 1,137,650 shares of common stock issuable upon the conversion, redemption or other payments relating to our 6% Senior Convertible Debentures Due July 2005 ("July Debentures") and as payment of interest thereon;
- o 135% of 507,102 shares of common stock issuable upon the exercise of the related warrants ("July 2008 Warrants");
- o 135% of 1,000,000 shares of common stock issuable upon the exercise of warrants issued to the Debenture holders in June 2003 ("June 2008 Warrants");
- o 1,286,410 shares of common stock issuable upon exercise of other warrants; and
- o 1,022,689 shares of common stock owned by certain of the selling stockholders.

We are registering these shares of common stock pursuant to commitments to register the securities with the selling stockholders.

Summary Consolidated Financial Data

In the table below, we provide you with our summary historical financial data. We have prepared this information using our audited financial statements

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for each of the five years in the period ended December 31, 2003.

It is important that you read this summary historical financial data in conjunction with our historical financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this prospectus.

(in thousands except share and per share data)
Year ended December 31,

Consolidated Statements of Operations Data:

	1999 ----	2000 ----	2001 ----	2002 ----	2003 ----
Revenues:					
Sale of Products	\$ --	\$ --	\$ --	\$ --	\$ --
Clinical Treatment Programs	678	788	390	341	
License Fees Income	--	--	--	563	
	-----	-----	-----	-----	-----
Total Revenues	678	788	390	904	
Cost & Expenses:					
Production Costs/ Costs of Goods Sold					
Research & Development	4,737	6,136	5,780	4,946	3,412
General & Administrative(1)	8,721	3,695	3,412	2,015	4,015
Total Cost and Expenses	13,458	9,831	9,192	6,961	7,427
Interest and Other Income	482	572	284	103	
Interest Expense	--	--	--	--	
Financing Costs(3)	--	--	--	--	(7)
Other Expense	--	(81)	(565)	(1,470)	
Net Loss	\$ (12,298)	\$ (8,552)	\$ (9,083)	\$ (7,424)	\$ (14,019)
Basic and Diluted Loss Per Share	\$ (.47)	\$ (.29)	\$ (.29)	\$ (.23)	\$ (.23)
Basic and Diluted	26,380,351		31,443,208		35,234,000
Weighted Average Shares Outstanding		29,251,846		32,095,776	

Other Cash Flow Data

Cash Used in

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Operating Activities	\$ (6,990)	\$ (8,074)	\$ (7,281)	\$ (6,409)	\$ (7,022)
Capital Expenditures	(251)	(171)	--	--	19

Balance Sheet Data:		December 31,					Pro Forma Adjusted For Asset Acquisition
	1999	2000	2001	2002	2003		2003 (4) (5)
	----	----	----	----	----		----- (unaudited)
Working Capital	\$ 9,507	\$ 7,550	\$ 7,534	\$2,925	\$ 7,000		\$ 7,000
Total Assets	14,168	13,067	12,035	6,040	13,404		15,070
Shareholders' Equity	12,657	11,572	10,763	3,630	9,248		9,462

- (1) General and Administrative expenses include stock compensation expense totaling \$4,618, \$397, \$673, \$132 and \$237 for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively.
- (2) For information concerning recent acquisitions of certain assets of Interferon Sciences, Inc. ("ISI") and related financing see notes 1, 4 and 7 to our consolidated financial statements for the year ended December 31, 2003, contained elsewhere in this prospectus.
- (3) In accounting for the March 12, 2003, July 10, 2003, and October 29, 2003 issuances of 6% Senior Convertible Debentures in the principal amounts of \$5,426,000, \$5,426,000, and \$4,142,357, respectively, and related embedded conversion features and warrant issuances, we recorded debt discounts of approximately \$11.3 million which, in effect, reduced the carrying value of the debt to \$1.6 million. Excluding the application of related accounting standards, our debt outstanding as of December 31, 2003 totaled approximately \$6.6 million. Through December 31, 2003, we have recorded charges of approximately \$7.3 million for amortization of original issue discount and other related debt costs. Such amounts have been reflected as financing costs in the statement of operations. For additional information refer to note 7 to our consolidated financial statements for the year ended December 31, 2003.
- (4) The unaudited Pro Forma consolidated statements of operations data for the year ended December 31, 2003 have been prepared giving effect to the acquisition of certain assets of ISI and the related funding of the transaction, by our March 12, 2003 6% senior convertible debentures, as if they occurred on January 1, 2003.
- The unaudited Pro Forma consolidated balance sheet data has been prepared as if the second portion of the acquisition of certain assets of ISI had occurred on December 31, 2003.
- (5) Does not reflect the issuance of the January 26, 2004 \$4,000,000 6% Senior Convertible Debenture resulting in net cash proceeds to us of \$3,695,000.

RISK FACTORS

Special Note Regarding Forward-Looking Statements

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Certain statements in this prospectus constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1995 (collectively, the "Reform Act"). Certain, but not necessarily all, of such forward-looking statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "will," "should," or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. All statements other than statements of historical fact, included in this prospectus regarding our financial position, business strategy and plans or objectives for future operations are forward-looking statements. Without limiting the broader description of forward-looking statements above, we specifically note that statements regarding potential drugs, their potential therapeutic effect, the possibility of obtaining regulatory approval, our ability to manufacture and sell any products, market acceptance or our ability to earn a profit from sales or licenses of any drugs or our ability to discover new drugs in the future are all forward-looking in nature.

Such forward-looking statements involve known and unknown risks, uncertainties and other factors, including but not limited to, the risk factors discussed below, which may cause the actual results, performance or achievements of Hemispherx and its subsidiaries to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements and other factors referenced in this prospectus. We do not undertake and specifically decline any obligation to publicly release the results of any revisions which may be made to any forward-looking statement to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

The following cautionary statements identify important factors that could cause our actual result to differ materially from those projected in the forward-looking statements made in this prospectus. Among the key factors that have a direct bearing on our results of operations are:

No assurance of successful product development

Ampligen(R) and related products. The development of Ampligen(R) and our other related products is subject to a number of significant risks. Ampligen(R) may be found to be ineffective or to have adverse side effects, fail to receive necessary regulatory clearances, be difficult to manufacture on a commercial scale, be uneconomical to market or be precluded from commercialization by proprietary right of third parties. Our products are in various stages of clinical and pre-clinical development and, require further clinical studies and appropriate regulatory approval processes before any such products can be marketed. We do not know when, if ever, Ampligen(R) or our other products will be generally available for commercial sale for any indication. Generally, only a small percentage of potential therapeutic products are eventually approved by the U.S. Food and Drug Administration ("FDA") for commercial sale.

ALFERON N Injection(R). Although ALFERON N Injection(R) is approved for marketing in the United States for the intralesional treatment of refractory or recurring external genital warts in patients 18 years of age or older, to date it has not been approved for other indications. We face many of the risks discussed above, with regard to developing this product for use to treat other ailments such as multiple sclerosis and cancer.

Our drug and related technologies are investigational and subject to regulatory approval. If we are unable to obtain regulatory approval, our operations will be

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significantly affected.

All of our drugs and associated technologies other than ALFERON N Injection(R) are investigational and must receive prior regulatory approval by appropriate regulatory authorities for general use and are currently legally available only through clinical trials with specified disorders. At present, ALFERON N Injection(R) is only approved for the intralesional treatment of refractory or recurring external genital warts in patients 18 years of age or older. Use of ALFERON N Injection(R) for other indications will require regulatory approval. In this regard, Interferon Sciences, Inc. ("ISI"), the company from which we obtained our rights to ALFERON N Injection(R), conducted clinical trials related to use of ALFERON N Injection(R) for treatment of HIV and Hepatitis C. In both instances, the FDA determined that additional studies were necessary in order to fully evaluate the efficacy of ALFERON N Injection(R) in the treatment of HIV and Hepatitis C diseases. We have no obligation or immediate plans to conduct these additional studies at this time.

Our products, including Ampligen(R), are subject to extensive regulation by numerous governmental authorities in the U.S. and other countries, including, but not limited to, the FDA in the U.S., the Health Protection Branch ("HPB") of Canada, and the European Medical Evaluation Agency ("EMEA") in Europe. Obtaining regulatory approvals is a rigorous and lengthy process and requires the expenditure of substantial resources. In order to obtain final regulatory approval of a new drug, we must demonstrate to the satisfaction of the regulatory agency that the product is safe and effective for its intended uses and that we are capable of manufacturing the product to the applicable regulatory standards. We require regulatory approval in order to market Ampligen(R) or any other proposed product and receive product revenues or royalties. We cannot assure you that Ampligen(R) will ultimately be demonstrated to be safe or efficacious. In addition, while Ampligen(R) is authorized for use in clinical trials in the United States and other countries, we cannot assure you that additional clinical trial approvals will be authorized in the United States or in other countries, in a timely fashion or at all, or that we will complete these clinical trials. If Ampligen(R) or one of our other products does not receive regulatory approval in the U.S. or elsewhere, our operations most likely will be materially adversely affected.

We may continue to incur substantial losses and our future profitability is uncertain.

We began operations in 1966 and last reported net profit from 1985 through 1987. Since 1987, we have incurred substantial operating losses, as we pursued our clinical trial effort and expanded our efforts in Europe. As of December 31, 2003 our accumulated deficit was approximately \$113,843,000. We have not yet generated significant revenues from our products and may incur substantial and increased losses in the future. We cannot assure that we will ever achieve significant revenues from product sales or become profitable. We require, and will continue to require, the commitment of substantial resources to develop our products. We cannot assure that our product development efforts will be successfully completed or that required regulatory approvals will be obtained or that any products will be manufactured and marketed successfully, or be profitable.

We may require additional financing which may not be available.

The development of our products will require the commitment of substantial resources to conduct the time-consuming research, preclinical development, and clinical trials that are necessary to bring pharmaceutical products to market. As of December 31, 2003, we had approximately \$5.3 million in cash and short term investments. We believe that these funds plus 1) the \$3,695,000 in net proceeds from the January Debenture placement, 2) the anticipated infusion of approximately \$1.55 million in remaining net proceeds from the October

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Debentures, 3) the projected net cash flow from the sale of ALFERON N Injection(R), 4) the proceeds from licensing agreements and/or the expected infusion of \$2,000,000 in

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proceeds from our investors exercising their additional investment rights should be sufficient to meet our operating cash requirements including debt service during the 2004 fiscal year. We may need to raise additional funds through additional equity or debt financing or from other sources in order to complete the necessary clinical trials and the regulatory approval processes and begin commercializing Ampligen(R) products. There can be no assurances that we will raise adequate funds from these or other sources, which may have a material adverse effect on our ability to develop our products.

We have guaranteed the value of a number of shares issued as a result of our acquisition of assets from Interferon Sciences. If our share price is not above \$1.59 per share 12 or 24 months after the dates of issuance of the guaranteed shares, our financial condition could be adversely affected.

In March 2004, when we consummated the second ISI asset acquisition, we issued 487,028 shares to ISI. In May 2003 we issued an aggregate of 581,761 shares to two of ISIs' creditors. We have guaranteed the value of all but 62,500 of these shares to be \$1.59 per share on the relevant termination dates. As of March 18, 2004, 738,993 of the guaranteed shares have not been sold. The termination dates are 24 months after the dates of issuance and delivery of the guaranteed shares to ISI and 12 months after the date of issuance of the guaranteed shares to the American National Red Cross. The guarantee relates only to those shares still held by ISI and the American National Red Cross on the applicable termination date. If, within 30 days after the relevant termination date, holders of the guaranteed shares request that we honor the guarantees, we will reacquire the holders' remaining guaranteed shares and pay the holders \$1.59 per share. By way of example, assuming that all remaining 738,993 shares are still held on the relevant termination dates, we would be obligated to pay to ISI \$675,000 and the American National Red Cross \$500,000. The reported last sale price for our common stock on the American Stock Exchange on March 15, 2004 was \$3.20 per share. If, during the 31 days commencing on the relevant termination dates, the market price of our stock is not above \$1.59 per share, we most likely would be requested and obligated to pay the guaranteed amount on the guaranteed shares outstanding on the relevant termination dates. We believe that the number of guaranteed shares still outstanding on the relevant termination dates will be a factor of the market price and sales volume of our common stock during the 24 and 12 month periods prior to the relevant termination date.

If the holders of the guaranteed shares do not sell a significant amount of their guaranteed shares prior to the relevant termination dates and the price of our common stock during the 31 day period commencing on the relevant termination dates is not above \$1.59 per share, we most likely will be required to repurchase a significant number of guaranteed shares and our financial condition could be materially and adversely affected.

We may not be profitable unless we can protect our patents and/or receive approval for additional pending patents.

We need to preserve and acquire enforceable patents covering the use of Ampligen(R) for a particular disease in order to obtain exclusive rights for the commercial sale of Ampligen(R) for such disease. If and when we obtain all rights to ALFERON N Injection(R), we will need to preserve and acquire enforceable patents covering its use for a particular disease too. Our success

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depends, in large part, on our ability to preserve and obtain patent protection for our products and to obtain and preserve our trade secrets and expertise. Certain of our know-how and technology is not patentable, particularly the procedures for the manufacture of our drug product which are carried out according to standard operating procedure manuals. We have been issued certain patents including those on the use of Ampligen(R) and Ampligen(R) in combination with certain other drugs for the treatment of HIV. We also have been issued patents on the use of Ampligen(R) in combination with certain other drugs for the treatment of chronic Hepatitis B virus, chronic Hepatitis C virus, and a patent which affords protection on the use of Ampligen(R) in patients with Chronic Fatigue Syndrome. We have not yet been issued any

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patents in the United States for the use of Ampligen(R) as a sole treatment for any of the cancers, which we have sought to target. With regard to ALFERON N Injection(R), we have acquired from ISI its patents for natural alpha interferon produced from human peripheral blood leukocytes and its production process. We cannot assure that our competitors will not seek and obtain patents regarding the use of similar products in combination with various other agents, for a particular target indication prior to our doing such. If we cannot protect our patents covering the use of our products for a particular disease, or obtain additional patents, we may not be able to successfully market our products.

The patent position of biotechnology and pharmaceutical firms is highly uncertain and involves complex legal and factual questions.

To date, no consistent policy has emerged regarding the breadth of protection afforded by pharmaceutical and biotechnology patents. There can be no assurance that new patent applications relating to our products or technology will result in patents being issued or that, if issued, such patents will afford meaningful protection against competitors with similar technology. It is generally anticipated that there may be significant litigation in the industry regarding patent and intellectual property rights. Such litigation could require substantial resources from us and we may not have the financial resources necessary to enforce the patent rights that we hold. No assurance can be made that our patents will provide competitive advantages for our products or will not be successfully challenged by competitors. No assurance can be given that patents do not exist or could not be filed which would have a materially adverse effect on our ability to develop or market our products or to obtain or maintain any competitive position that we may achieve with respect to our products. Our patents also may not prevent others from developing competitive products using related technology.

There can be no assurance that we will be able to obtain necessary licenses if we cannot enforce patent rights we may hold. In addition, the failure of third parties from whom we currently license certain proprietary information or from whom we may be required to obtain such licenses in the future, to adequately enforce their rights to such proprietary information, could adversely affect the value of such licenses to us.

If we cannot enforce the patent rights we currently hold we may be required to obtain licenses from others to develop, manufacture or market our products. There can be no assurance that we would be able to obtain any such licenses on commercially reasonable terms, if at all. We currently license certain proprietary information from third parties, some of which may have been developed with government grants under circumstances where the government maintained certain rights with respect to the proprietary information developed. No assurances can be given that such third parties will adequately enforce any rights they may have or that the rights, if any, retained by the government will

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not adversely affect the value of our license.

There is no guarantee that our trade secrets will not be disclosed or known by our competitors.

To protect our rights, we require certain employees and consultants to enter into confidentiality agreements with us. There can be no assurance that these agreements will not be breached, that we would have adequate and enforceable remedies for any breach, or that any trade secrets of ours will not otherwise become known or be independently developed by competitors.

If our distributors do not market our products successfully, we may not generate significant revenues or become profitable.

We have limited marketing and sales capability. We are dependent upon existing and, possibly future, marketing agreements and third party distribution agreements for our products in order to generate

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significant revenues and become profitable. As a result, any revenues received by us will be dependent on the efforts of third parties, and there is no assurance that these efforts will be successful. Our agreement with Accredo offers the potential to provide some marketing and distribution capacity in the United States while agreements with Bioclones (Proprietary), Ltd , Biovail Corporation and Laboratorios Del Dr. Esteve S.A. should provide a sales force in South America, Africa, United Kingdom, Australia and New Zealand, Canada, Spain and Portugal.

We cannot assure that our domestic or foreign marketing partners will be able to successfully distribute our products, or that we will be able to establish future marketing or third party distribution agreements on terms acceptable to us, or that the cost of establishing these arrangements will not exceed any product revenues. The failure to continue these arrangements or to achieve other such arrangements on satisfactory terms could have a materially adverse effect on us.

There are no long-term agreements with suppliers of required materials. If we are unable to obtain the required raw materials, we may be required to scale back our operations or stop manufacturing ALFERON N Injection.

A number of essential materials are used in the production of ALFERON N Injection(R), including human white blood cells. We do not have long-term agreements for the supply of any of such materials. There can be no assurance we can enter into long-term supply agreements covering essential materials on commercially reasonable terms, if at all. If we are unable to obtain the required raw materials, we may be required to scale back our operations or stop manufacturing ALFERON N Injection(R). The costs and availability of products and materials we need for the commercial production of ALFERON N Injection(R) and other products which we may commercially produce are subject to fluctuation depending on a variety of factors beyond our control, including competitive factors, changes in technology, and FDA and other governmental regulations and there can be no assurance that we will be able to obtain such products and materials on terms acceptable to us or at all.

There is no assurance that successful manufacture of a drug on a limited scale basis for investigational use will lead to a successful transition to commercial, large-scale production.

Small changes in methods of manufacturing may affect the chemical

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structure of Ampligen(R) and other RNA drugs, as well as their safety and efficacy. Changes in methods of manufacture, including commercial scale-up may affect the chemical structure of Ampligen(R) and can, among other things, require new clinical studies and affect orphan drug status, particularly, market exclusivity rights, if any, under the Orphan Drug Act. The transition from limited production of pre-clinical and clinical research quantities to production of commercial quantities of our products will involve distinct management and technical challenges and will require additional management and technical personnel and capital to the extent such manufacturing is not handled by third parties. There can be no assurance that our manufacturing will be successful or that any given product will be determined to be safe and effective, capable of being manufactured economically in commercial quantities or successfully marketed.

We have limited manufacturing experience and capacity.

Ampligen(R) is currently produced only in limited quantities for use in our clinical trials and we are dependent upon certain third party suppliers for key components of our products and for substantially all of the production process. The failure to continue these arrangements or to achieve other such arrangements on satisfactory terms could have a material adverse affect on us. Also, to be successful, our products must be manufactured in commercial quantities in compliance with regulatory requirements and at acceptable costs. To the extent we are involved in the production process, our current facilities are not adequate for the production of our proposed products for large-scale commercialization, and we currently

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do not have adequate personnel to conduct commercial-scale manufacturing. We intend to utilize third-party facilities if and when the need arises or, if we are unable to do so, to build or acquire commercial-scale manufacturing facilities. We will need to comply with regulatory requirements for such facilities, including those of the FDA and HPB pertaining to current Good Manufacturing Practices ("cGMP") regulations. There can be no assurance that such facilities can be used, built, or acquired on commercially acceptable terms, or that such facilities, if used, built, or acquired, will be adequate for our long-term needs.

The purified drug concentrate utilized in the formulation of ALFERON N Injection(R) is manufactured in ISI's facility and ALFERON N Injection(R) is formulated and packaged at a production facility operated by Abbott Laboratories located in Kansas. In March 2004 we acquired ISI's New Brunswick, NJ facility. We still will be dependent upon Abbott Laboratories and/or another third party for product formulation and packaging.

We may not be profitable unless we can produce Ampligen(R) or other products in commercial quantities at costs acceptable to us.

We have never produced Ampligen(R) or any other products in large commercial quantities. Ampligen(R) is currently produced for use in clinical trials. We must manufacture our products in compliance with regulatory requirements in large commercial quantities and at acceptable costs in order for us to be profitable. We intend to utilize third-party manufacturers and/or facilities if and when the need arises or, if we are unable to do so, to build or acquire commercial-scale manufacturing facilities. If we cannot manufacture commercial quantities of Ampligen(R) or enter into third party agreements for its manufacture at costs acceptable to us, our operations will be significantly affected. Also, each production lots of Alferon N Injection(R) is subject to FDA review and approval prior to releasing the lots to be sold. This review and

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approval process could take considerable time, which would delay our having product in inventory to sell. Alferon N Injection(R) has a shelf life of 18 months after having been bottled.

Rapid technological change may render our products obsolete or non-competitive.

The pharmaceutical and biotechnology industries are subject to rapid and substantial technological change. Technological competition from pharmaceutical and biotechnology companies, universities, governmental entities and others diversifying into the field is intense and is expected to increase. Most of these entities have significantly greater research and development capabilities than us, as well as substantial marketing, financial and managerial resources, and represent significant competition for us. There can be no assurance that developments by others will not render our products or technologies obsolete or noncompetitive or that we will be able to keep pace with technological developments.

Our products may be subject to substantial competition.

Ampligen(R). Competitors may be developing technologies that are, or in the future may be, the basis for competitive products. Some of these potential products may have an entirely different approach or means of accomplishing similar therapeutic effects to products being developed by us. These competing products may be more effective and less costly than our products. In addition, conventional drug therapy, surgery and other more familiar treatments may offer competition to our products. Furthermore, many of our competitors have significantly greater experience than us in pre-clinical testing and human clinical trials of pharmaceutical products and in obtaining FDA, HPB and other regulatory approvals of products. Accordingly, our competitors may succeed in obtaining FDA, HPB or other regulatory product approvals more rapidly than us. There are no drugs approved for commercial sale with respect to treating ME/CFS in the United States. The dominant competitors with drugs to treat HIV diseases include Gilead Pharmaceutical, Pfizer, Bristol-Myers, Abbott Labs, Glaxo Smithkline, Merck and Schering-Plough Corp. These potential competitors are among the largest pharmaceutical companies

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in the world, are well known to the public and the medical community, and have substantially greater financial resources, product development, and manufacturing and marketing capabilities than we have. Although we believe our principal advantage is the unique mechanism of action of Ampligen(R) on the immune system, we cannot assure that we will be able to compete.

ALFERON N Injection(R). Many potential competitors are among the largest pharmaceutical companies in the world, are well known to the public and the medical community, and have substantially greater financial resources, product development, and manufacturing and marketing capabilities than we have. ALFERON N Injection(R) currently competes with Schering's injectable recombinant alpha interferon product (INTRON(R) A) for the treatment of genital warts. 3M Pharmaceuticals also received FDA approval for its immune-response modifier, Aldara(R), a self-administered topical cream, for the treatment of external genital and perianal warts. ALFERON N Injection(R) also competes with surgical, chemical, and other methods of treating genital warts. We cannot assess the impact products developed by our competitors, or advances in other methods of the treatment of genital warts, will have on the commercial viability of ALFERON N Injection(R). If and when we obtain additional approvals of uses of this product, we expect to compete primarily on the basis of product performance. Our potential competitors have developed or may develop products (containing either alpha or beta interferon or other therapeutic compounds) or other treatment

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modalities for those uses. In the United States, three recombinant forms of beta interferon have been approved for the treatment of relapsing-remitting multiple sclerosis. There can be no assurance that, if we are able to obtain regulatory approval of ALFERON N Injection(R) for the treatment of new indications, we will be able to achieve any significant penetration into those markets. In addition, because certain competitive products are not dependent on a source of human blood cells, such products may be able to be produced in greater volume and at a lower cost than ALFERON N Injection(R). Currently, our wholesale price on a per unit basis of ALFERON N Injection(R) is higher than that of the competitive recombinant alpha and beta interferon products.

General. Other companies may succeed in developing products earlier than we do, obtaining approvals for such products from the FDA more rapidly than we do, or developing products that are more effective than those we may develop. While we will attempt to expand our technological capabilities in order to remain competitive, there can be no assurance that research and development by others or other medical advances will not render our technology or products obsolete or non-competitive or result in treatments or cures superior to any therapy we develop.

Possible side effects from the use of Ampligen(R) or ALFERON N Injection(R) could adversely affect potential revenues and physician/patient acceptability of our product.

Ampligen(R). We believe that Ampligen(R) has been generally well tolerated with a low incidence of clinical toxicity, particularly given the severely debilitating or life threatening diseases that have been treated. A mild flushing reaction has been observed in approximately 15% of patients treated in our various studies. This reaction is occasionally accompanied by a rapid heart beat, a tightness of the chest, urticaria (swelling of the skin), anxiety, shortness of breath, subjective reports of "feeling hot," sweating and nausea. The reaction is usually infusion-rate related and can generally be controlled by slowing the infusion rate. Other adverse side effects include liver enzyme level elevations, diarrhea, itching, asthma, low blood pressure, photophobia, rash, transient visual disturbances, slow or irregular heart rate, decreases in platelets and white blood cell counts, anemia, dizziness, confusion, elevation of kidney function tests, occasional temporary hair loss and various flu-like symptoms, including fever, chills, fatigue, muscular aches, joint pains, headaches, nausea and vomiting. These flu-like side effects typically subside within several months. One or more of the potential side effects might deter usage of Ampligen(R) in certain clinical situations and therefore, could adversely affect potential revenues and physician/patient acceptability of our product.

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ALFERON N Injection(R). At present, ALFERON N Injection(R) is only approved for the intralesional (within the lesion) treatment of refractory or recurring external genital warts in adults. In clinical trials conducted for the treatment of genital warts with ALFERON N Injection(R), patients did not experience serious side effects; however, there can be no assurance that unexpected or unacceptable side effects will not be found in the future for this use or other potential uses of ALFERON N Injection(R) which could threaten or limit such product's usefulness.

We may be subject to product liability claims from the use of Ampligen(R) or other of our products which could negatively affect our future operations.

We face an inherent business risk of exposure to product liability claims in the event that the use of Ampligen(R) or other of our products results in

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adverse effects. This liability might result from claims made directly by patients, hospitals, clinics or other consumers, or by pharmaceutical companies or others manufacturing these products on our behalf. Our future operations may be negatively affected from the litigation costs, settlement expenses and lost product sales inherent to these claims. While we will continue to attempt to take appropriate precautions, we cannot assure that we will avoid significant product liability exposure. Although we currently maintain product liability insurance coverage, there can be no assurance that this insurance will provide adequate coverage against product liability claims. A successful product liability claim against us in excess of our \$1,000,000 in insurance coverage or for which coverage is not provided could have a negative effect on our business and financial condition.

The loss of Dr. William A. Carter's services could hurt our chances for success.

Our success is dependent on the continued efforts of Dr. William A. Carter because of his position as a pioneer in the field of nucleic acid drugs, his being the co-inventor of Ampligen(R), and his knowledge of our overall activities, including patents and clinical trials. The loss of Dr. Carter's services could have a material adverse effect on our operations and chances for success. We have secured key man life insurance in the amount of \$2 million on the life of Dr. Carter and we have an employment agreement with Dr. Carter that, as amended, runs until May 8, 2008. However, Dr. Carter has the right to terminate his employment upon not less than 30 days prior written notice. The loss of Dr. Carter or other personnel, or the failure to recruit additional personnel as needed could have a materially adverse effect on our ability to achieve our objectives.

Uncertainty of health care reimbursement for our products.

Our ability to successfully commercialize our products will depend, in part, on the extent to which reimbursement for the cost of such products and related treatment will be available from government health administration authorities, private health coverage insurers and other organizations. Significant uncertainty exists as to the reimbursement status of newly approved health care products, and from time to time legislation is proposed, which, if adopted, could further restrict the prices charged by and/or amounts reimbursable to manufacturers of pharmaceutical products. We cannot predict what, if any, legislation will ultimately be adopted or the impact of such legislation on us. There can be no assurance that third party insurance companies will allow us to charge and receive payments for products sufficient to realize an appropriate return on our investment in product development.

There are risks of liabilities associated with handling and disposing of hazardous materials.

Our business involves the controlled use of hazardous materials, carcinogenic chemicals and various radioactive compounds. Although we believe that our safety procedures for handling and disposing of such materials comply in all material respects with the standards prescribed by applicable regulations, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event

of such an accident or the failure to comply with applicable regulations, we could be held liable for any damages that result, and any such liability could be significant. We do not maintain insurance coverage against such liabilities.

The market price of our stock may be adversely affected by market volatility.

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The market price of our common stock has been and is likely to be volatile. In addition to general economic, political and market conditions, the price and trading volume of our stock could fluctuate widely in response to many factors, including:

- o announcements of the results of clinical trials by us or our competitors;
- o adverse reactions to products;
- o governmental approvals, delays in expected governmental approvals or withdrawals of any prior governmental approvals or public or regulatory agency concerns regarding the safety or effectiveness of our products;
- o changes in U.S. or foreign regulatory policy during the period of product development;
- o developments in patent or other proprietary rights, including any third party challenges of our intellectual property rights;
- o announcements of technological innovations by us or our competitors;
- o announcements of new products or new contracts by us or our competitors;
- o actual or anticipated variations in our operating results due to the level of development expenses and other factors;
- o changes in financial estimates by securities analysts and whether our earnings meet or exceed the estimates;
- o conditions and trends in the pharmaceutical and other industries;
- o new accounting standards; and
- o the occurrence of any of the risks described in these "Risk Factors."

Our common stock is listed for quotation on the American Stock Exchange. For the 12-month period ended December 31, 2003, the price of our common stock has ranged from \$1.33 to \$2.96. We expect the price of our common stock to remain volatile. The average daily trading volume of our common stock varies significantly. Our relatively low average volume and low average number of transactions per day may affect the ability of our stockholders to sell their shares in the public market at prevailing prices and a more active market may never develop.

In the past, following periods of volatility in the market price of the securities of companies in our industry, securities class action litigation has often been instituted against companies in our industry. If we face securities litigation in the future, even if without merit or unsuccessful, it would result in substantial costs and a diversion of management attention and resources, which would negatively impact our business.

Our stock price may be adversely affected if a significant amount of shares, primarily those registered herein and in a prior registration statement, are sold in the public market.

As of March 18, 2004, approximately 745,519 shares of our common stock, constituted "restricted securities" as defined in Rule 144 under the Securities

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Act of 1933. Substantially all of these shares are registered herein or in a prior registration statement pursuant to agreements between us and the holders of these shares. In addition, we have registered 9,506,572 shares issuable (i) upon conversion of approximately 135% of the Debentures issued in January 2004 (the "January 2004 Debentures"), the October Debentures, the July Debentures and the January 2004 Debentures issuable upon exercise of Additional Investment Rights (issued in conjunction with the January 2004 Debentures); (ii) as payment

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of 135% of the interest on all of the Debentures; (iii) upon exercise of 135% of the 2009 Warrants issued in conjunction with the January 2004 Debentures, the October 2008 Warrants, the July 2008 Warrants and the June 2008 Warrants; (iv) upon exercise of certain other warrants and stock options and (v) shares issued to certain suppliers and service providers. Registration of the shares permits the sale of the shares in the open market or in privately negotiated transactions without compliance with the requirements of Rule 144. To the extent the exercise price of the warrants is less than the market price of the common stock, the holders of the warrants are likely to exercise them and sell the underlying shares of common stock and to the extent that the conversion price and exercise price of these securities are adjusted pursuant to anti-dilution protection, the securities could be exercisable or convertible for even more shares of common stock. We also may issue shares to be used to meet our capital requirements or use shares to compensate employees, consultants and/or directors. We are unable to estimate the amount, timing or nature of future sales of outstanding common stock. Sales of substantial amounts of our common stock in the public market could cause the market price for our common stock to decrease. Furthermore, a decline in the price of our common stock would likely impede our ability to raise capital through the issuance of additional shares of common stock or other equity securities.

Provisions of our Certificate of Incorporation and Delaware law could defer a change of our management which could discourage or delay offers to acquire us.

Provisions of our Certificate of Incorporation and Delaware law may make it more difficult for someone to acquire control of us or for our stockholders to remove existing management, and might discourage a third party from offering to acquire us, even if a change in control or in management would be beneficial to our stockholders. For example, our Certificate of Incorporation allows us to issue shares of preferred stock without any vote or further action by our stockholders. Our Board of Directors has the authority to fix and determine the relative rights and preferences of preferred stock. Our Board of Directors also has the authority to issue preferred stock without further stockholder approval. As a result, our Board of Directors could authorize the issuance of a series of preferred stock that would grant to holders the preferred right to our assets upon liquidation, the right to receive dividend payments before dividends are distributed to the holders of common stock and the right to the redemption of the shares, together with a premium, prior to the redemption of our common stock. In this regard, in November, 2002 we adopted a shareholder rights plan and, under the Plan, our Board of Directors declared a dividend distribution of one Right for each outstanding share of Common Stock to stockholders of record at the close of business on November 29, 2002. Each Right initially entitles holders to buy one unit of preferred stock for \$30.00. The Rights generally are not transferable apart from the common stock and will not be exercisable unless and until a person or group acquires or commences a tender or exchange offer to acquire, beneficial ownership of 15% or more of our common stock. However, for Dr. Carter, our chief executive officer, who already beneficially owns 12.3% of our common stock, the Plan's threshold will be 20%, instead of 15%. The Rights will expire on November 19, 2012, and may be redeemed prior thereto at \$.01 per Right under certain circumstances.

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Because the risk factors referred to above could cause actual results or outcomes to differ materially from those expressed in any forward-looking statements made by us, you should not place undue reliance on any such forward-looking statements. Further, any forward-looking statement speaks only as of the date on which it is made and we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict which will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Our research in clinical efforts may continue for the next several years and we may continue to incur losses due to clinical costs incurred in the development of Ampligen(R) for commercial application. Possible losses may fluctuate from quarter to quarter as a result of differences in the timing of significant expenses incurred and receipt of licensing fees and/or cost recovery treatment revenues in Europe, Canada and in the United States.

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USE OF PROCEEDS

Proceeds, if any, from stockholders exercising some or all of the Warrants will be used to fund our research and development efforts, working capital and possible acquisitions.

DIVIDEND POLICY

We have not paid any cash dividends since our inception and do not anticipate paying cash dividends in the foreseeable future.

PRICE RANGE OF COMMON STOCK

Since October 1997, our common stock has been listed and traded on the American Stock Exchange ("AMEX") under the symbol HEB. The following table sets forth the high and low sales prices for our Common Stock for the last two fiscal years as reported by the AMEX.

COMMON STOCK	High ----	Low ---
Year Ended December 31, 2002		
First Quarter	\$4.76	\$3.45
Second Quarter	3.97	2.50
Third Quarter	2.63	.80
Fourth Quarter	2.86	1.40
Year Ending December 31, 2003		
First Quarter	2.12	1.41
Second Quarter	2.96	1.33
Third Quarter	2.29	1.85
Fourth Quarter	2.85	1.88

On March 15, 2004, the closing sale price of our common stock as reported on the AMEX was \$3.20 per share. As of March 17, 2004, there were approximately 263 holders of record of our common stock not including holders in street name. We estimate that there are some 3,300 holders if you include shares held in street name.

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SELECTED CONSOLIDATED FINANCIAL DATA

Our selected historical consolidated financial information presented as of December 31, 1999, 2000, 2001, 2002 and 2003 and for each of the five years ended December 31, 2003 was derived from our audited consolidated financial statements.

This information should be read in conjunction with the historical financial statements and related notes included herein, and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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(in thousands except share and per share data)					
Consolidated Statements of Operations Data:	Year ended December 31,				
	1999 ----	2000 ----	2001 ----	2002 ----	2003 ----
Revenues:					
Sale of Products	\$ --	\$ --	\$ --	\$ --	\$ --
Clinical Treatment Programs	678	788	390	341	
License Fee Income	--	--	--	563	
	-----	-----	-----	-----	-----
Total Revenues	678	788	390	904	
Cost & Expenses:					
Production Costs/ Cost of Goods Sold	--	--	--	--	
Research & Development	4,737	6,136	5,780	4,946	
General & Administrative(1)	8,721	3,695	3,412	2,015	
Total Cost and Expenses	13,458	9,831	9,192	6,961	
Interest and Other Income	482	572	284	103	
Interest Expense	--	--	--	--	
Financing Costs(3)	--	--	--	--	
Other Expense	--	(81)	(565)	(1,470)	
Net Loss	\$ (12,298)	\$ (8,552)	\$ (9,083)	\$ (7,424)	\$ (1,470)
Basic and Diluted Loss Per Share	\$ (.47)	\$ (.29)	\$ (.29)	\$ (.23)	\$ (.23)
Basic and Diluted Weighted Average Shares Outstanding	26,380,351	29,251,846	31,443,208	32,095,776	35,230,000

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Other Cash						
Flow Data						
Cash Used in						
Operating						
Activities	\$ (5,853)	\$ (6,990)	\$ (8,074)	\$ (7,281)	\$ (6,409)	\$ (7,022)
Capital						
Expenditures	(151)	(251)	(171)	--	--	(19)

Balance Sheet Data:

December 31,

	1999	2000	2001	2002	2003
	----	----	----	----	----
Working Capital	\$ 9,507	\$ 7,550	\$ 7,534	\$2,925	\$ 7,000
Total Assets	14,168	13,067	12,035	6,040	13,404
Shareholders'					
Equity	12,657	11,572	10,763	3,630	9,248
Book value per					
share(4)	\$.48	\$.40	\$.34	\$.11	\$.24

- (1) General and Administrative expenses include stock compensation expense totaling \$397, \$673, \$132, \$132 and \$237 for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively.
- (2) For information concerning recent acquisitions of certain assets of ISI and related financing see notes 4 and 7 to our consolidated financial statements for the year ended December 31, 2003, contained elsewhere in this prospectus.
- (3) In accounting for the March 12, 2003, July 10, 2003, and October 29, 2003 issuances of 6% Senior Convertible Debentures in the principal amounts of \$5,426,000, \$5,426,000, and \$4,142,357, respectively, and related embedded conversion features and warrant issuances, we recorded debt discounts of approximately \$11.3 million which, in effect, reduced the carrying value of the debt to \$1.6 million. Excluding the application of related accounting standards, our debt outstanding as of December 31, 2003 totaled approximately \$6.6 million. Through December 31, 2003, we have recorded charges of approximately \$7.3 million for amortization of original issue discount and other related debt costs. Such amounts have been reflected as financing costs in the statement of operations. For additional information refer to note 7 to our consolidated financial statements for the year ended December 31, 2003.
- (4) Book value per share is computed by dividing shares outstanding into shareholders' equity as of the above date.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our financial statements and related notes included elsewhere in this prospectus. This discussion and analysis contains forward-looking statements that involve risks, uncertainties

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and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of a number of factors including, but not limited to, those set forth under "Risk Factors" and elsewhere in this prospectus.

Background

We have reported net income only from 1985 through 1987. Since 1987, we have incurred, as expected, substantial operating losses due to our conducting clinical testing.

We have established a strong foundation of laboratory and pre-clinical data with respect to the development of nucleic acid to enhance the natural antiviral defense system of the human body and the development of the therapeutic products for the treatment of chronic disease. Our strategy is to obtain the required regulatory approval which will allow the progressive introduction of Ampligen(R) (our proprietary drug) for treating Myalgic Encephalomyelitis Chronic Syndrome (ME/CFS), HIV, hepatitis C ("HCV") and hepatitis B ("HBV") in the U.S., Canada, Europe and Japan. In February, 2004, we completed the double-blind segment of the AMP 516 Phase III clinical trial for use of Ampligen(R) in treating ME/CFS. The 14 remaining patients are enrolled in the open label portion of the trial and should complete this segment by June, 2004. With the conclusion of the double-blind segment we can finalize data collection and start data analysis in anticipation of preparing the NDA for submission to the FDA. Ampligen(R) is also in Phase IIb Clinical trials in the U.S. for the treatment of newly emerged multi-drug resistant HIV, and for the induction of Cell mediated immunity in HIV patients that are under control using potentially toxic drug cocktail.

Our proprietary drug technology utilizes specifically configured ribonucleic acid ("RNA") and is protected by more than 350 patents worldwide as well as over 80 additional patent applications pending to provide further proprietary protection in various international markets. Certain patents apply to the use of Ampligen(R) alone and certain patent apply to the use of Ampligen(R) in combination with certain other drugs. Some composition of matter patents pertain to other new medication, which have a similar mechanism of action.

In March, 2003, we acquired from ISI, all of ISI's raw materials, work-in-progress and finished product of Alferon N Injection(R), together with a limited license for the production, manufacture, use, marketing and sale of the product. Alferon N Injection(R) of. In March 2004, we acquired from ISI the balance of ISI's rights to its product as well as ISI's production facility. We intend to market this product in the United States through sales facilitated via third party marketing agreements. Additionally, we intend to implement studies, beyond those conducted by ISI, for testing the potential treatment of HIV, Hepatitis C and other indications, including multiple sclerosis.

Result of Operations

Years Ended December 31, 2003 vs. 2002

During the year ended December 31, 2003, we 1) acquired certain assets and patent rights to ALFERON N Injection(R), 2) privately placed the March 2005, the July 2005, and October 2005, 6%

convertible debentures with an aggregate maturity value of \$14,994,357 (gross proceeds of \$12,850,000), 3) continued our efforts to develop Ampligen(R) for

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the treatment of patients afflicted with ME/CFS and HIV, 4) activated the ISI New Brunswick production facility to process doses of Alferon N and 5) produced some 21,000 doses of Alferon N for sale in 2003.

Net loss

Our net loss was approximately \$14,770,000 for the year ended December 31, 2003 versus a net loss of \$7,424,000 in 2002. Per share loss in 2003 was \$0.42 cents versus a per share loss of \$0.23 in 2002. This year-to-year increase in losses of \$7,346,000 is primarily due to non-cash financing costs of \$7,345,000 relating to our March 2005, July 2005, and October 2005 6% convertible debentures. These non-cash charges account for 48% of our net losses for the year ended December 31, 2003. In addition, our losses during this period include \$957,000 in operating expenses relating to our new Alferon division. Solely for comparison purposes, excluding our 2003 losses for these two factors, our losses were \$6,775,000 in 2003 compared to \$7,424,000 in 2002 or a reduction totaling \$649,000. This was primarily due to a decrease in research and development direct costs of \$1,800,000 in 2003 due to reduced costs associated with the development of Ampligen(R) to treat ME/CFS patients. During 2002, our AMP 516 ME/CFS Phase III clinical trial was in full force and effect therefore increasing our manufacturing and clinical support expenses during that period (See "Research and Development Costs" below). This was offset by the recovery of certain legal expenses in 2002 of approximately \$1,050,000 related to the Asensio lawsuit and trial from our insurance carrier. This recovery produced a one-time reduction in G&A Expenses for 2002 (See "General and Administrative Expenses" below).

Revenues

Our revenues were \$657,000 in 2003 compared to revenues of \$904,000 in 2002. Our 2002 revenues included a licensing fee payment of approximately \$563,000 which was not repeated in 2003.

Revenues from our ME/CFS cost recovery treatment programs principally underway in the U.S., Canada and Europe were \$148,000 in 2003 versus \$341,000 in 2002. These clinical programs allow us to provide Ampligen(R) therapy at our cost to severely debilitated ME/CFS patients. Under this program the patients pay for the cost of Ampligen(R) doses infused. These costs total approximately \$7,200 for a 24 weeks treatment program. In addition, since the March 11, 2003, acquisition of inventory from ISI, revenues from sales of ALFERON N totaled \$509,000. Sales of Alferon N are anticipated to increase as we are producing more product and our marketing/sales programs are underway.

Revenues from the cost recovery treatment programs in 2002 were \$341,000 or 57% higher than 2003 revenues. We expected revenues in the U.S. to decline due to our efforts to complete the AMP 516 ME/CFS Phase III trials and the focus of our clinical resources on the start up of the AMP 720 HIV clinical trials. The clinical data collected from treating patients under the cost recovery treatment programs will augment and supplement the clinical data collected in the U.S. AMP 516 Phase III ME/CFS trial.

In 2002, We received a licensing fee of 625,000 Euros (\$563,000) from Laboratorios Del Dr. Esteve S.A. ("Esteve") pursuant to a sales and distribution agreement in which Esteve was granted the exclusive right to market Ampligen(R) in Spain, Portugal and Andorra for the treatment of ME/CFS in turn we provided to Esteve technical scientific and commercial information. The agreement terms require no additional performance by us.

Since acquiring the right to manufacture and market Alferon N in March 2003, we have focused on converting the work-in-progress inventory into finished goods. This work-in-progress inventory included

three production lots totaling the equivalent of approximately 55,000 vials (doses) at various stages of the manufacturing process. In August 2003, we released the first lot of product to Abbott Laboratories for bottling and realized some 21,000 vials of ALFERON N. Preliminary work has started on completing the second lot of approximately 16,000 vials. Our production and quality control personnel in the New Brunswick facility are involved in the extensive process of manufacturing and validation required by the FDA. Plans are underway for completing the third lot of some 18,000 vials now in very early stages of production.

Our marketing and sales plan for ALFERON N consists of engaging sales force contract organizations and supplementing their sales efforts with marketing support. This marketing support would consist of building awareness of ALFERON N with physicians as a successful and effective treatment of refractory on recurring external genital warts in patients of age 18 or older and to assist primary prescribers in expanding their practice.

On August 18, 2003, we entered into a sales and marketing agreement with Engitech, LLC. to distribute ALFERON N on a nationwide basis. The agreement stipulated that Engitech will deploy a sales force of 100 sales representatives within one year in the U.S. domestic market and further expand the sales team up to 250 sales representative in the second year and after that as many as it takes to continually drive market share. Engitech, Inc. is to develop and implement marketing plans including extensive scientific and educational programs for use in marketing ALFERON N.

Production costs

Production costs were \$502,000 for the year ended December 31, 2003. These costs reflect approximately \$240,000 for the cost of sales of ALFERON N Injection(R) during the period of April 1, 2003 through December 31, 2003. In addition, we recorded \$262,000 of production costs at the New Brunswick facility. We ramped up the facility in April 2003 and started production on three lots of Alferon N Injection(R) work in process inventory of which one lot was completed and is ready to be sold.

Research and Development costs

Our overall research and development direct costs in 2003 were \$3,150,000 compared to research and development direct costs in 2002 of \$4,946,000. These costs primarily reflect the direct costs associated with our effort to develop our lead product, Ampligen(R), as a therapy in treating chronic diseases and cancers. At this time, this effort consists of on-going clinical trials involving patients with HIV. Our research and development direct costs are \$1,796,000 lower in 2003 due to reduced costs associated with the development of Ampligen(R) to treat ME/CFS patients. During 2002, our AMP 516 ME/CFS Phase III clinical trial was in full force and effect, therefore, increasing our manufacturing and clinical support expenses during that period.

Our strategy is to develop our lead compound, the experimental immunotherapeutic Ampligen(R), to treat chronic diseases for which there is currently no adequate treatment available. We seek the required regulatory approval, which will allow the commercial introduction of Ampligen for ME/CFS and HIV/AIDS in the U.S., Canada, Europe and Japan.

We recently completed the double-blind segment of our AMP 516 ME/CFS Phase III clinical trial for use of Ampligen(R) in the treatment of ME/CFS. Ampligen is also currently in two Phase IIb studies for the treatment of HIV to overcome

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multi-drug resistance, virus mutation and toxicity associated with current HAART therapies. One study, the AMP-719, is a Salvage Therapy, conducted in the U.S. and evaluating the potential synergistic efficacy of Ampligen in multi-drug resistant HIV patients for immune enhancement. The second study, the AMP-720, is a clinical trial designed to evaluate the effect

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of Ampligen under Strategic Treatment Intervention and is also conducted in the U.S. The AMP 719 study is presently on hold as we devote our efforts on the AMP 720 study.

AMP 516

Over 230 patients have participated in our ME/CFS Phase III clinical trial. Approximately 14 patients are in the open label phase of the clinical process. We have completed the randomized placebo controlled phase of this study and expect to complete data collection and start the data analysis process with the expectation of filing an NDA (New Drug Application) with the FDA by the end of 2004. As with any experimental drug being tested for use in treating human diseases, the FDA must approve the testing and clinical protocols employed and must render their decision based on the safety and efficacy of the drug being tested. Historically this is a long and costly process. Our ME/CFS AMP 516 clinical study is a Phase III study, which based on favorable results, will serve as the basis for us to file a new drug application with the FDA. The FDA review process could take 18-24 months and result in one of the following events; 1) approval to market Ampligen(R) for use in treating ME/CFS patients, 2) required more research, development, and clinical work, 3) approval to market as well as conduct more testing, or 4) reject our application. Given these variables, we are unable to project when material net cash inflows are expected to commence from the sale of Ampligen(R).

AMP 719 and AMP 720

We are currently focused on recruiting additional clinical investigators and HIV patients to participate in the AMP 720 HIV clinical trial. Our efforts to do this have been somewhat hampered in late 2003 as most of our clinical resources have been directed to completing the AMP 516 ME/CFS clinical trial. Now that the AMP 516 patients have completed the randomized segment of the clinical trial, we expect to devote more resources toward the AMP 720 HIV clinical trial. Our AMP 719 HIV clinical trial has been put on hold at this time.

In July 2003, Dr. Blick, a principal investigator in our HIV studies, presented updated results on our Amp 720 HIV study at the 2nd IAS CONFERENCE ON HIV PATHOGENESIS AND TREATMENT in Paris France. In this study using Strategic Treatment Interruption (STI), patients' antiviral HAART regimens are interrupted and Ampligen(R) is substituted as mono-immunotherapy. Ampligen(R) is an experimental immunotherapeutic designed to display both antiviral and immune enhancing characteristics. Prolonged use of Highly Active Antiretroviral Therapy (HAART) has been associated with long-term, potentially fatal, toxicities. The clinical study AMP 720 is designed to address these issues by evaluating the administration of our lead experimental agent, Ampligen(R), a double stranded RNA drug acting potentially both as an immunomodulator and antiviral. Patients, who have completed at least nine months of Ampligen(R) therapy, were able to stay off HAART for a total STI duration with a mean time of 29.0 weeks whereas the control group, which was also taken off HAART, but not given Ampligen(R), had earlier HIV rebound with a mean duration of 18.7 weeks. Thus, on average, Ampligen(R) therapy spared the patients excessive exposure to HAART, with its inherent toxicities, for more than 11 weeks. As more patients are enrolled, the

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related clinical costs will continue to increase with some offset to our overall expenses due to the diminishing cost of the ME/CFS clinical trial. It is difficult to estimate the duration or projected costs of these two clinical trials due to the many variables involved, i.e.: patient drop out rate, recruitment of clinical investigators, etc. The length of the study and costs related to our clinical trials cannot be determined at this time as such will be materially influenced by (a) the number of clinical investigators needed to recruit and treat the required number of patients, (b) the rate of accrual of patients and (c) the retention of patients in the studies and their adherence to the study protocol requirements. Under optimal conditions, the cost of completing the studies could be approximately \$2.0 to \$3.0 million. The rate of enrollment depends on patient availability and on other products being in clinical trials for the treatment of HIV, as there is competition for the same patient population. At present, more than 18 FDA approved drugs for HIV

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treatment may compete for available patients. The length, and subsequently the expense of these studies, will also be determined by an analysis of the interim data, which will determine when completion of the ongoing Phase IIb is appropriate and whether a Phase III trial be conducted or not. In case a Phase III study is required; the FDA might require a patient population exceeding the current one which will influence the cost and time of the trial. Accordingly, the number of "unknowns" is sufficiently great to be unable to predict when, or whether, we may obtain revenues from our HIV treatment indications.

General and Administrative Expenses

General and Administrative expenses ("G&A") were \$4,257,000 during the year ended December 31, 2003, which includes \$957,000 of expenses relating to our new Alferon Division and \$237,000 for a non cash stock compensation charge. Excluding the Alferon expenses, our G&A costs were \$3,300,000 compared to \$2,015,000 of expenses in 2002. This increase of \$1,285,000 is primarily due to the recovery of certain legal expenses in 2002 of approximately \$1,050,000 related to the Asensio lawsuit and trial from our insurance carrier. This recovery produced a one time reduction in G&A Expenses for 2002. Also, we recorded non-cash stock compensation expenses of \$237,000 in 2003 as compared to \$133,000 in 2002.

Equity Loss-Unconsolidated Affiliates

In the year ended December 31, 2002, we recorded a non-cash charge of \$1,470,000 to operations with respect to our investments in unconsolidated affiliates. \$1,074,000 of these charges were related to our investment in R.E.D. These charges were the result of our determination that R.E.D.'s business and financial position had deteriorated to the point that our investment had been permanently impaired.

We also recorded a non-cash charge of \$292,000 with respect to our investment in Chronix Biomedical. This impairment reduced our carrying value in this investment to reflect a permanent decline in Chronix's market value based on its then proposed equity offerings.

These charges are reflected in the Consolidated Statements of Operations under the caption "Equity loss in unconsolidated affiliate." Please see "Research And Development/Collaborative Agreements" in "Our Business" for more details on these transactions.

Other Income/Expense

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Interest and other income totaled \$80,000 in 2003 compared to \$103,000 recorded in 2002. Lower cash available for investment basically accounted for the difference as interest rates remained relatively low in 2003. All funds in excess of our immediate need are invested in short-term high quality securities.

Interest Expense and Financing Costs

Interest expense and financing costs were \$7,598,000 in 2003. Non-cash financing costs consist of \$581,000 for the amortization of debenture closing costs, \$1,066,000 for the amortization of Original Issue Discounts and \$5,698,000 for the amortization of costs associated with beneficial conversion features of the debentures and the fair value of the warrants relating to the January 2005, July 2005 and October 2005 6% convertible debentures. These charges are reflected in the Consolidated Statements of Operations under the caption "Financing Costs." Please see Note 16 in the consolidated financial statements contained herein for more details on these transactions.

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Years Ended December 31, 2002 vs. 2001

Net loss

Our net loss was approximately \$7,424,000 for the year ended December 31, 2002 versus a net loss of \$9,083,000 in 2001. Per share loss in 2002 was \$0.23 versus a per share loss of \$0.29 in 2001. This year to year decrease in losses of \$1,659,000 was primarily due to higher revenues and lower costs in 2002. Revenues were up \$514,000 in 2002 and total expenses were down by \$2,231,000 offset by a write down in the carrying value of our investments in the amount of \$1,366,000 for a net cost decrease of \$865,000.

Revenues

Our revenues came from our ME/CFS cost recovery treatment programs principally underway in the U.S., Canada and Europe. These clinical programs allow us to provide Ampligen(R) therapy at our cost to severely debilitated ME/CFS patients. Under this program the patients pay for the cost of Ampligen(R) doses infused. These costs total approximately \$7,200 for a 24 weeks treatment program. Revenues from cost recovery treatment programs totaled some \$341,000 in 2002. In 2001, these revenues were \$390,000 or 14% higher than 2002 revenues. We expected revenues in the U.S. to decline due to the focus of our clinical resources on conducting and completing the AMP 516 ME/CFS Phase III clinical trial as well as the start up of the AMP 719 and AMP 720 HIV clinical trials. The clinical data collected from treating patients under the cost recovery treatment programs will augment and supplement the data collected in the U.S. Phase III ME/CFS trial.

We received a licensing fee of 625,000 Euros (some \$563,000) from Esteve pursuant to a sales and distribution agreement in which Esteve was granted the exclusive right to market Ampligen(R) in Spain, Portugal and Andorra for the treatment of ME/CFS in turn we provided to Esteve technical scientific and commercial information. The agreement terms require no additional performance by us. Our total revenues, including this licensing fee, in 2002 was \$904,000 compared to revenues of \$390,000 in 2001.

Research and Development costs

Our strategy is to develop our lead compound, the experimental immunotherapeutic Ampligen(R), to treat chronic diseases for which there is currently no adequate treatment available. We seek the required regulatory

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approval, which will allow the commercial introduction of Ampligen for ME/CFS and HIV/AIDS in the U.S., Canada, Europe and Japan.

At December 31, 2002, Ampligen was being tested in a Phase III clinical trial, in the U.S., for use in treatment of ME/CFS, the so-called AMP-516 study. It also was in two Phase IIb studies for the treatment of HIV to overcome multi-drug resistance, virus mutation and toxicity associated with current HAART therapies. One study, the AMP-719, is a Salvage Therapy, conducted in the U.S. and evaluating the potential synergistic efficacy of Ampligen in multi-drug resistant HIV patients for immune enhancement. The second study, the AMP-720, is a clinical trial designed to evaluate the effect of Ampligen under Strategic Treatment Intervention and is also conducted in the U.S.

AMP 516

As of December, 2002, the AMP 516 clinical trial was fully enrolled with more than the targeted 230 patients in order to potentially compensate for "drop outs". The last patients completed the randomized segment of this clinical trial in February, 2004. The next stage of the program is final data

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collection, quality assurance of the data to insure its accuracy and analysis of the data according to regulatory guidelines to facilitate the New Drug Application (NDA), expected to be filed by the end of 2004. The date of potential commercial approval depends on whether we receive Fast Track Status from the FDA. In case of Fast Track the FDA approval time is maximum six months. If we are not granted Fast Track Designation, the approval time can take substantially longer, depending on the progress made by the FDA in review of the application. The FDA may deny full commercial approval to the drug at any time, including after Fast Track Status has been awarded.

As with any experimental drug being tested for use in treating human diseases, the FDA must approve the testing and clinical protocols employed and must render their decision based on the safety and efficacy of the drug being tested. Historically this is a long and costly process. Our ME/CFS AMP 516 clinical study is a Phase III study, which based on favorable results, will serve as the basis for us to file a new drug application with the FDA. The FDA review process could take 18-24 months and result in one of the following events; 1) approval to market Ampligen(R) for use in treating ME/CFS patients, 2) require more research, development, and clinical work, 3) approval to market as well as conduct more testing, or 4) reject our application. Given these variables, we are unable to project when material net cash inflows are expected to commence from the sale of Ampligen(R).

AMP 719 and AMP 720

As of December 2002, approximately 55 patients had been enrolled in both studies combined and they were being treated in approximately 10 different active sites around the U.S.

The length of the study and the costs related to these trials cannot be determined at this time as it will be materially influenced by (a) the number of clinical investigators needed to fulfill the required number of patients, (b) the rate of accrual of patients and (c) the retention of patients on the protocol and their adherence to the protocol requirements. See "AMP 719 and AMP 720" in "Result of Operations; Years Ended December 31, 2003 vs. 2002; Research and Development costs" above.

Our overall research and development direct costs in 2002 were \$4,946,000

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compared to direct research and development costs in 2001 of \$5,780,000 and \$6,136,000 in 2000. We estimate that 80% of these expenditures to be related to our ME/CFS research and development and 20% related to our HIV studies.

General and Administrative Expenses

Excluding stock compensation expense, general and administrative expenses were approximately \$1,882,000 in 2002 versus \$2,741,000 in 2001. This decrease in expenses of \$859,000 in 2002, is due to several factors including the recovery of certain legal expenses of approximately \$1,050,000 relating to the Asensio lawsuit from our insurance carrier and lower overall legal expenses due to less litigation, partially offset by higher Insurance premiums.

Stock compensation expenses was \$133,000 or \$538,000 lower than recorded in the year 2001. The compensation reflects the imputed non-cash expense recorded to reflect the cost of warrants granted to outside parties for services rendered to us.

Equity Loss-Unconsolidated Affiliates

During the three months ended June 2002 and December 2002, we recorded a non-cash charge of \$678,000 and \$396,000 respectively, to operations with respect to our \$1,074,000 investment in R.E.D. These charges were the result of our determination that R.E.D.'s business and financial position had

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deteriorated to the point that our investment had been permanently impaired. Please see "Research And Development/Collaborative Agreements" in "Our Business" for more details on these transactions.

In May 2000, we acquired an equity interest in Chronix Biomedical Corp. ("Chronix") for \$700,000. During the quarter ended December 31, 2002, we recorded a noncash charge of \$292,000 with respect to our investment in Chronix. This impairment reduces our carrying value to reflect a permanent decline in Chronix's market value based on its then proposed equity offerings. Please see "Research And Development/Collaborative Agreements" in "Our Business" for more details on these transactions.

In April, 1999 we acquired a 30% equity position in the California Institute of Molecular Medicine ("CIMM") for \$750,000. During the fourth quarter of 2001 we recorded a non-cash charge of \$485,000 with respect to our investment in CIMM. This was a result of our determination that CIMM's operations have not yet evolved to the point where the full carrying value of our investment could be supported based on that company's financial position and operating results. This amount represented the unamortized balance of goodwill included as part of our investment. During 2002, CIMM continued to suffer significant losses resulting in a deterioration of its financial condition. The \$485,000 written off during 2001 represented the un-amortized balance of goodwill included as part of our investment. Additionally, during 2001 we reduced our investment in CIMM based on our percentage interest in CIMM's continued operating losses. Our remaining investment at December 12, 2002 in CIMM, representing a 30% interest in CIMM's equity at such date, was completely written off during 2002. Such amount was not material.

These charges are reflected in the Consolidated Statements of Operations under the caption "Equity loss in unconsolidated affiliate." Please see "Research And Development/Collaborative Agreements" in "Our Business" for more details on these transactions.

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Interest and Other Income

Interest and other income totaled \$103,000 in 2002 compared to \$284,000 recorded in 2001. Significantly lower interest rates on money market accounts and lower cash available for investment basically account for the difference. All funds in excess of our immediate need are invested in short term high quality securities, which earned much lower interest income in 2002.

Liquidity And Capital Resources

Cash used in operating activities for the twelve months ended December 31, 2003 was \$7,022,000. Cash provided by financial activities for twelve months ended December 31, 2003 amounted to \$10,317,000, substantially from proceeds from debentures (see below). As of December 31, 2003, we had approximately \$5,260,000 in cash, cash equivalents and short term investments. We believe that these funds plus the net proceeds of approximately \$3.7 million from the recently placed January 2004 Debentures, 2) the potential receipt of the \$1.55 million of proceeds held back pending the acquisition of the ISI facility and pledging of such facility as additional security under the Debentures), 3) potential licensing fee income, 4) the \$2,000,000 in proceeds we expect when the investors exercise their additional investment rights, and 5) and the projected revenue from the acquisition of the ALFERON N Injection(R) business will be sufficient to meet our operating requirements including debt service during the 2004 fiscal year. Sales of ALFERON N Injection(R) could be greater than expected which would improve our cash position during the next twelve months. Also, we have the ability to curtail discretionary spending, including some research and development activities, if required to conserve cash. If we do not timely complete the second ISI asset acquisition, our financial condition could be adversely affected (see the risk factor "If we do not complete the second Interferon Sciences asset acquisition, our ability to generate revenues from the sales of ALFERON N Injection(R) and our financial condition will be adversely affected").

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On March 12, 2003, we issued an aggregate of \$5,426,000 in principal amount of 6% Senior Convertible Debentures due January 2005 (the "March Debentures") and an aggregate of 743,288 warrants to two investors in a private placement for aggregate gross proceeds of \$4,650,000. Pursuant to the terms of the March Debentures, \$1,550,000 of the proceeds from the sale of the March Debentures were to have been held back and released to us if, and only if, we acquired ISI's facility within a set timeframe. These funds were released to us in June 2003 although we had not acquired ISI's facility at that time. The March Debentures were to mature on January 31, 2005 and bore interest at 6% per annum, payable quarterly in cash or, subject to satisfaction of certain conditions, common stock. Any shares of common stock issued to the investors as payment of interest were valued at 95% of the average closing price of the common stock during the five consecutive business days ending on the third business day immediately preceding the applicable interest payment date. Pursuant to the terms and conditions of the March Debentures, we pledged all of our assets, other than our intellectual property, as collateral and were subject to comply with certain financial and negative covenants, which include but were not limited to the repayment of principal balances upon achieving certain revenue milestones.

The March Debentures were convertible at the option of the investors at any time through January 31, 2005 into shares of our common stock. The conversion price under the March Debentures was fixed at \$1.46 per share, subject to adjustment for anti-dilution protection for issuance of common stock or securities convertible or exchangeable into common stock at a price less than

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the conversion price then in effect.

The investors also received Warrants to acquire at any time through March 12, 2008 an aggregate of 743,288 shares of common stock at a price of \$1.68 per share. On March 12, 2004, the exercise price of the Warrants was to reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between March 13, 2003 and March 11, 2004 (but in no event less than \$1.176 per share). The exercise price (and the reset price) under the Warrants also is subject to similar adjustments for anti-dilution protection. All of these warrants have been exercised.

We entered into a Registration Rights Agreement with the investors in connection with the issuance of the March Debentures and the Warrants. The Registration Rights Agreement requires that we register the shares of common stock issuable upon conversion of the Debentures, as interest shares under the Debentures and upon exercise of the Warrants. In accordance with this agreement, we have registered these shares for public sale.

As of December 31, 2003 the investors had converted the total \$5,426,000 principal of the March Debentures into 3,716,438 shares of our common stock. The total interest on the debenture was \$111,711 of which \$17,290 was paid in cash and \$94,421 was paid by the issuance of shares of our common stock. The investor exercised 742,288 warrants in July 2003 which produced proceeds in the amount of \$1,248,724.

On July 10, 2003, we issued an aggregate of \$5,426,000 in principal amount of 6% Senior Convertible Debentures due July 31, 2005 (the "July Debentures") and an aggregate of 507,103 Warrants (the "July 2008 Warrants") to the same investors who purchased the March 12, 2003 Debentures, in a private placement for aggregate anticipated proceeds of \$4,650,000. Pursuant to the terms of the July Debentures, \$1,550,000 of the proceeds from the sale of the July Debentures were to have been held back and released to us if, and only if, we acquired ISI's facility within a set timeframe. These funds were released to us in October 2003 although we had not acquired ISI's facility at that time. The July Debentures mature on July 31, 2005 and bear interest at 6% per annum, payable quarterly in cash or, subject to satisfaction of certain conditions, common stock. Any shares of common stock issued to the investors as payment of interest shall be valued at 95% of the average closing price of the common stock during the five consecutive business days ending on the third business day immediately preceding the applicable interest payment date.

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The July Debentures are convertible at the option of the investors at any time through July 31, 2005 into shares of our common stock. The conversion price under the July Debentures was fixed at \$2.14 per share; however, as part of the new debenture placement closed on October 29, 2003 (see below), the conversion price under the July Debentures was lowered to \$1.89 per share. The conversion price is subject to adjustment for anti-dilution protection for issuance of common stock or securities convertible or exchangeable into common stock at a price less than the conversion price then in effect.

The July 2008 Warrants received by the investors, as amended, are to acquire at any time commencing on July 26, 2004 through January 31, 2009 an aggregate of 507,102 shares of common stock at a price of \$2.46 per share. On July 10, 2004, the exercise price of these July 2008 Warrants will reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between July 11, 2003 and July 9, 2004 (but in no event less than \$2.14 per share). The exercise price (and the reset price) under the July 2008 Warrants also is subject to similar adjustments for

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anti-dilution protection.

We entered into a Registration Rights Agreement with the investors in connection with the issuance of the July Debentures and the July 2008 Warrants. The Registration Rights Agreement requires that we register on behalf of the holders the shares of common stock issuable upon conversion of the Debentures, as interest shares under the Debentures and upon exercise of the July 2008 Warrants. These shares have been registered for public sale.

On June 25, 2003, we issued to each of the March 12, 2003 Debenture holders a warrant to acquire at any time through June 25, 2008 an aggregate of 500,000 shares of common stock at a price of \$2.40 per share. On June 25, 2004, the exercise price of these June 2008 Warrants will reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between June 26, 2003 and June 24, 2004 (but in no event less than \$1.68 per share). The exercise price (and the reset price) under the June 2008 Warrants also is subject to adjustments for anti-dilution protection similar to those in the July 2008 Warrants. Pursuant to our agreement with the Debenture holders, we have registered the shares issuable upon exercise of these June 2008 Warrants for public sale.

On October 29, 2003, we issued an aggregate of \$4,142,357 in principal amount of 6% Senior Convertible Debentures due October 31, 2005 (the "October Debentures") and an aggregate of 410,134 Warrants (the "October 2008 Warrants") in a private placement for aggregate anticipated gross proceeds of \$3,550,000. Pursuant to the terms of the October Debentures, \$1,550,000 of the proceeds from the sale of the October Debentures have been held back and will be released to us if, and only if, we acquired ISI's facility within 90 days of January 26, 2004 and provide a mortgage on the facility as further security for the October Debentures. In March 2004, we acquired the facility and we are in the process of mortgaging the facility to the Debenture holders. The October Debentures mature on October 31, 2005 and bear interest at 6% per annum, payable quarterly in cash or, subject to satisfaction of certain conditions, common stock. Any shares of common stock issued to the investors as payment of interest shall be valued at 95% of the average closing price of the common stock during the five consecutive business days ending on the third business day immediately preceding the applicable interest payment date.

Upon completing the sale of the October Debentures, we received \$3,275,000 in net proceeds consisting of \$1,725,000 from the October Debentures and \$1,550,000 that had been withheld from the July Debentures. As noted above, \$1,550,000 of the proceeds from the October Debentures have been held back pending our mortgaging of the ISI facility to the Debenture holders. We are in the process of providing this mortgage.

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The October Debentures are convertible at the option of the investors at any time through October 31, 2005 into shares of our common stock. The conversion price under the October Debentures is fixed at \$2.02 per share, subject to adjustment for anti-dilution protection for issuance of common stock or securities convertible or exchangeable into common stock at a price less than the conversion price then in effect.

The October 2008 Warrants, as amended, received by the investors are to acquire at any time commencing on July 26, 2004 through April 30, 2009 an aggregate of 410,134 shares of common stock at a price of \$2.32 per share. On October 29, 2004, the exercise price of these October 2008 Warrants will reset to the lesser of the exercise price then in effect or a price equal to the average of the daily price of the common stock between October 29, 2003 and

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October 27, 2004 (but in no event less than \$2.19 per share). The exercise price (and the reset price) under the October 2008 Warrants also is subject to similar adjustments for anti-dilution protection.

As of March 18, 2004, the investors had converted \$12,133,690 of debt from the March, July and October Debentures into 7,221,838 shares of our common stock. The remaining principal balance on the debentures is convertible into shares of our stock at the option of the investors at any time, through the maturity date. In addition, we have paid \$1,300,000 into the debenture cash collateral account as required by the terms of the October Debentures. The amounts paid through December 31, 2003 have been accounted for as advances receivable and are reflected as such on the accompanying balance sheet as of December 31, 2003. The cash collateral account provides partial security for repayment of the March, July and October 2003 and January 2004 Debentures in the event of default.

We entered into a Registration Rights Agreement with the investors in connection with the issuance of the October Debentures and the October 2008 Warrants. The Registration Rights Agreement requires that we register on behalf of the holders the shares of common stock issuable upon conversion of the October Debentures, as interest shares under the October Debentures and upon exercise of the 2008 Warrants. These shares have been registered for public sale. If, subject to certain exceptions, sales of all shares required to be registered cannot be made pursuant to the registration statement, then we will be required to pay to the investors their pro rata share of \$3,635 for each day such conditions exists.

On January 26, 2004, we issued an aggregate of \$4,000,000 in principal amount of 6% Senior Convertible Debentures due January 31, 2006 (the "January 2004 Debentures"), an aggregate of 790,514 warrants (the "2009 Warrants") and 158,103 shares of common stock, and Additional Investment Rights (to purchase up to an additional \$2,000,000 principal amount of January 2004 Debentures commencing in six months) in a private placement for aggregate net proceeds of \$3,695,000. The January 2004 Debentures mature on January 31, 2006 and bear interest at 6% per annum, payable quarterly in cash or, subject to satisfaction of certain conditions, common stock. Any shares of common stock issued to the investors as payment of interest shall be valued at 95% of the average closing price of the common stock during the five consecutive business days ending on the third business day immediately preceding the applicable interest payment date. Commencing six months after issuance, we are required to start repaying the then outstanding principal amount under the January 2004 Debentures in monthly installments amortized over 18 months in cash or, at our option, in shares of common stock. Any shares of common stock issued to the investors as installment payments shall be valued at 95% of the average closing price of the common stock during the 10-day trading period commencing on and including the eleventh trading day immediately preceding the date that the installment is due.

The January 2004 Debentures are convertible at the option of the investors at any time through January 31, 2006 into shares of our common stock. The conversion price under the January 2004 Debentures is fixed at \$2.53 per share, subject to adjustment for anti-dilution protection for issuance

of common stock or securities convertible or exchangeable into common stock at a price less than the conversion price then in effect.

There are two classes of July 2009 warrants received by the Investors: Class A and Class B. The Class A warrants are to acquire any time from July 26, 2004 through July 26, 2009 an aggregate of up to 395,257 shares of common stock

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at a price of \$3.29 per share. The Class B warrants are to acquire any time from July 26, 2004 through July 26, 2009 an aggregate of up to 395,257 shares of common stock at a price of \$5.06 per share. On January 27, 2005, the exercise price of these July 2009 Class A and Class B Warrants will reset to the lesser of their respective exercise price then in effect or a price equal to the average of the daily price of the common stock between January 27, 2004 and January 26, 2005 (but in no event less than \$2.58 per share with regard to the Class A warrants and \$3.54 per share with regard to the Class B warrants). The exercise price (and the reset price) under the July 2009 Warrants also is subject to similar adjustments for anti-dilution protection.

We also issued to the investors Additional Investment Rights pursuant to which the investors have the right to acquire up to an additional \$2,000,000 principal amount of January 2004 Debentures from us. These Debentures are identical to the January 2004 Debentures except that the conversion price is \$2.58. The Additional Investment Rights are exercisable commencing on July 26, 2004 (the "Trigger" date) for a period of 90 days from the Trigger Date or 90 days from the date which the registration statement registering the shares issuable upon the conversion of the January 2004 Debentures to be issued pursuant to the Additional Investment Rights is declared effective, whichever is longer.

We entered into a Registration Rights Agreement with the investors in connection with the issuance of the January 2004 Debentures (including any Debentures issued pursuant to the Additional Investment Rights), the shares, and the January 2009 Warrants. The Registration Rights Agreement requires that we register on behalf of the investors the shares issued to the investors and 135% of the shares issuable upon conversion of the Debentures (including payment of interest thereon) and upon exercise of the January 2009 Warrants. If the Registration Statement containing these shares is not filed within the time period required by the agreement, not declared effective within the time period required by the agreement or, after it is declared effective and subject to certain exceptions, sales of all shares required to be registered thereon cannot be made pursuant thereto, then we will be required to pay to the investors their pro rata share of \$3,635 for each day any of the above conditions exist with respect to this Registration Statement.

By agreement between us and the investors, the date upon which all warrants previously issued to the investors may become exercisable is now July 26, 2004 and the exercise periods of these warrants have been extended accordingly.

By agreement with Cardinal Securities, LLC, for general financial advisory services and in conjunction with the private debenture placements in March, July and October 2003 and in January 2004, we paid Cardinal Securities, LLC an investment banking fee equal to 7% of the investments made by the two Debenture holders and issued to Cardinal certain warrants. A portion of the investment banking fee was paid with the issuance of 30,000 shares of our common stock. Cardinal also received 612,000 warrants to purchase common stock, of which 112,500 are exercisable at \$1.74 per share, 112,500 are exercisable at \$2.57 per share, 200,000 are exercisable at \$2.50 per share, 87,500 are exercisable at \$2.42 per share and 100,000 are exercisable at \$3.04 per share. The \$1.74 warrants expire on July 10, 2008, the \$2.57 and \$2.50 warrants expire on March 12, 2008, the \$2.42 warrants expire on October 30, 2008 and the \$3.04 warrants expire on January 5, 2009. By agreement with Cardinal, we have registered 542,500 shares for public sale and have agreed to register the balance.

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of credit of \$1 million as additional collateral.

On March 11, 2003, we acquired from ISI, ISI's inventory of ALFERON N Injection(R), a pharmaceutical product used for intralesional treatment of refractory or recurring external genital warts in patients 18 years of age or older, and a limited license for the production, manufacture, use, marketing and sale of this product. As partial consideration, we issued 487,028 shares of our common stock to ISI Pursuant to our agreements with ISI, we registered these shares for public sale and ISI has reported that it has sold all of these shares. We also agreed to pay ISI 6% of the net sales of ALFERON N Injection(R).

On March 11, 2003, we also entered into an agreement to purchase from ISI all of its rights to the product and other assets related to the product including, but not limited to, real estate and machinery. For these assets, we agreed to issue to ISI an additional 487,028 shares and to issue 314,465 shares and 267,296 shares, respectively to The American National Red Cross and GP Strategies Corporation, two creditors of ISI. We have guaranteed the market value of all but 62,500 of these shares to be \$1.59 per share on the termination date. GP Strategies reports that it has sold all of its shares. The termination date for the remaining guarantees is 24 months after the date of issuance and delivery of the additional 487,028 guaranteed shares to ISI and 12 months after the date of issuance of the guaranteed shares to the American National Red Cross. These stockholders are permitted to periodically sell certain amounts of their shares. If, within 30 days after the respective termination date, one or more of these stockholders requests that we honor the guarantee, we will be obligated to reacquire their remaining guaranteed shares and pay them \$1.59 per share. Please see "We have guaranteed the value of a number of shares issued and to be issued as a result of our acquisition of assets from Interferon Sciences. If our share price is not above \$1.59 per share 12 or 24 months after the dates of issuance of the guaranteed shares, our financial condition could be adversely affected" in "Risk Factors," above.

We also agreed to satisfy other liabilities of ISI which are past due and secured by a lien on ISI's real estate and to pay ISI 6% of the net sales of products containing natural alpha interferon.

In March 2004, we issued 487,028 shares to ISI to complete the acquisition of the balance of ISI's rights to market its product as well its production facility in New Brunswick, New Jersey.

On May 30, 2003, we issued the shares to GP Strategies and the American National Red Cross. Pursuant to our agreements with ISI and these two creditors, we have registered the foregoing shares for public sale. As noted above, GP Strategies had sold all of its shares.

In addition, as of December 31, 2003, we have \$200,000 in restricted cash under other letter of credit agreements required by our insurance carrier. Prior to our annual meeting of stockholders in September 2003, we had a limited number of shares of Common Stock authorized but not issued or reserved for issuance upon conversion or exercise or outstanding convertible and exercisable securities such as debentures, options and warrants. Prior to the meeting, to permit consummation of the sale of the July 2005 Debentures and the related warrants, Dr. Carter agreed that he would not exercise his warrants or options unless and until our stockholders approve an increase in our authorized shares of common stock. For Dr. Carter's waiver of his right to exercise certain options and warrants prior to approval of the increase in our authorized shares, we agreed to compensate Dr. Carter. See "Executive Compensation; Employment Agreements" for details related to how Dr. Carter has been compensated with respect to this matter.

On November 6, 2003 we acquired some of the outstanding ISI property tax lien certificates in the aggregate amount of \$456,839 from certain investors.

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These tax liens were issued for property taxes and utilities due for 2000, 2001 and 2002.

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Because of our long-term capital requirements, we may seek to access the public equity market whenever conditions are favorable, even if we do not have an immediate need for additional capital at that time. Any additional funding may result in significant dilution and could involve the issuance of securities with rights, which are senior to those of existing stockholders. We may also need additional funding earlier than anticipated, and our cash requirements, in general, may vary materially from those now planned, for reasons including, but not

1.90

1.22

1st Quarter

1.38

1.00

2005

4th Quarter

\$

1.45

\$

1.01

3rd Quarter

1.96

1.00

2nd Quarter

3.08

1.35

1st Quarter

3.36

2.10

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 our Proxy Statement relating to our 2007 annual meeting of stockholders and is incorporated herein by reference.

On November 27, 2006 the Company received notice from The NASDAQ Listing Qualifications Department that for the prior 30 consecutive business days, the bid price of the Company's common stock closed below the minimum \$1.00 per share requirement for continued listing under Marketplace Rule 4450(a)(5). The Company may regain compliance with Marketplace Rule 4450(a)(5) if at any time before May 29, 2007, the bid price of the Company's common stock closes at \$1.00 per share for a minimum of ten consecutive business days.

If the Company does not regain compliance by May 29, 2007, the Company will be notified that its securities will be delisted. At that time the Company may appeal NASDAQ's determination to delist its securities to a Listing Qualifications Panel. Alternatively, the Company may also apply for listing on The NASDAQ Capital Market. If its application is approved, the Company will be afforded the remainder of The NASDAQ Capital Market's second 180 calendar day compliance period in order to regain compliance while on The NASDAQ Capital Market.

The Company had cash, cash equivalents and marketable securities of \$4.3 million at December 31, 2006. During the year ended December 31, 2006, net cash used in operations amounted to \$5.8 million. As of December 31, 2006, the Company had an accumulated deficit of \$285.6 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. If the Company's expected revenue targets are not achieved, or the Company fails to raise sufficient equity or debt capital, 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. All these factors raise substantial doubt about the Company's ability to continue as a going concern and may materially and adversely affect our stock price.

Based on the above factors our independent registered public accountants have included an explanatory paragraph in their report for our fiscal year ended December 31, 2006 with respect to our ability to continue as a going concern.

Performance Graph

This performance graph shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act) or otherwise subject to the liabilities under that Section and shall not be deemed incorporated by reference into any filing of Viewpoint under the Securities Act of 1933, as amended or the Exchange Act.

The following graph compares, for the five year period ended December 31, 2006, the cumulative total stockholder return for the Company's common stock, the Nasdaq Stock Market (U.S. companies) Index (the Nasdaq Market Index), the Goldman Sachs Internet Trading Index (the GIN) and the Standard & Poor's 500 Stock Index (the S&P 500 Index). Measurement points are the last trading day of each of the Company's fiscal years ended December 31, 2001, December 31, 2002, December 31, 2003, December 31, 2004, December 31, 2005 and December 31, 2006. The graph assumes that \$100 was invested on December 31, 2001 in the common stock of the Company, the Nasdaq Market Index, the GIN and the S&P 500 Stock Index and assumes reinvestment of any dividends. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

	12/31/2001	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006
Viewpoint Corporation	\$ 100	\$ 27.46	\$ 11.01	\$ 45.52	\$ 16.15	\$ 9.84
NASDAQ Market Index	\$ 100	\$ 68.47	\$ 102.7	\$ 111.5	\$ 113.1	\$ 123.8
GIN	\$ 100	\$ 71.17	\$ 137.9	\$ 169.9	\$ 195.5	\$ 190.3
S&P 500 Index	\$ 100	\$ 76.63	\$ 96.9	\$ 105.6	\$ 108.7	\$ 123.5

Item 6. Selected Financial Data

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

	Years Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share data)				
Statements of Operations Data					
Revenues:					
Advertising systems (1)	\$ 7,252	\$ 5,448	\$ 305	\$	\$
Search (2)	6,307	9,424	2,698		
Services	3,470	5,269	4,822	4,291	3,302
Related party services (3)		1,057	2,468	5,226	2,244
Licenses	148	608	704	2,283	5,039
Related party licenses (3)		3,490	3,535	1,729	7,554
Total revenues	17,177	25,296	14,532	13,529	18,139
Cost of Revenues:					
Advertising systems	4,176	3,721	132		
Search	154	173	45		
Services	2,337	3,658	3,270	6,182	4,137
Licenses	8	12	6	97	353
Total cost of revenues	6,675	7,564	3,453	6,279	4,490
Gross profit	10,502	17,732	11,079	7,250	13,649
Operating expenses:					
Sales and marketing	5,892	5,115	3,732	8,723	16,682
	3,919	4,479	3,432	4,209	4,348

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Research and development					
General and administrative	8,466	10,054	7,220	11,549	10,334
Depreciation	466	645	657	1,137	1,412
Amortization of intangible assets	570	491	17	10	664
Restructuring charges	92		(106)	2,023	
Impairment of goodwill (4)	10,655	7,778			6,275
Total operating expenses	30,060	28,562	14,952	27,651	39,715
Loss from operations	(19,558)	(10,830)	(3,873)	(20,401)	(26,066)
Other income (expense):					
Interest and other income	332	131	60	254	153
Interest expense (5)	(926)	(1,178)	(936)	(958)	
Changes in fair values of warrants to purchase common stock and conversion options of convertible notes (5)	515	1,204	(4,180)	1,209	
Loss on conversion of debt			(810)		
Loss on early extinguishment (5)				(1,682)	
Other income (expense):	(79)	157	(5,866)	(1,177)	153
Loss before provision for taxes	(19,637)	(10,673)	(9,739)	(21,578)	(25,913)
	78	64	90	81	107

Provision for taxes						
Net loss from continuing operations	(19,715)	(10,737)	(9,829)	(21,659)	(26,020)	
Adjustment to net loss on disposal of discontinued operations		145	129	157	127	
Net loss	\$ (19,715)	\$ (10,592)	\$ (9,700)	\$ (21,502)	\$ (25,893)	
Basic and diluted net loss per common share:						
Net loss per common share from continuing operations	\$ (0.30)	\$ (0.18)	\$ (0.18)	\$ (0.47)	\$ (0.64)	
Net income (loss) per common share from discontinued operations	\$	\$	\$	\$	\$	
Net loss per common share	\$ (0.30)	\$ (0.18)	\$ (0.18)	\$ (0.47)	\$ (0.64)	
Weighted average number of shares outstanding basic and diluted	66,610	58,631	52,955	45,280	40,759	

	2006	2005	December 31, 2004	2003	2002
			(In thousands)		
Balance Sheet Data					
Cash, cash equivalents and marketable securities (5)	\$ 4,267	\$ 9,111	\$ 8,662	\$ 9,488	\$ 11,568
Working capital (5)	4,551	8,697	4,416	3,324	9,051
Total assets (4) (5)	27,687	45,136	45,273	45,743	53,352

Convertible notes, subordinated notes and warrants (5)	4,853	5,468	3,674	4,748	7,000
Stockholders' equity (5)	19,695	34,882	33,958	27,467	38,352
		21			

- (1) In 2004, Viewpoint began to offer an online advertising delivery service. On December 1, 2004, Viewpoint Corporation entered into an agreement to acquire all of the outstanding capital stock of Unicast Communications Corp. (Unicast), an online ad delivery company. Viewpoint 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. See Note 2 to the financial statements.
- (2) In March 2004, Viewpoint entered the internet search business, by launching the Viewpoint Toolbar. 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.

- (3) America Online, Inc. (AOL) had a representative on the Company's Board of Directors until

December 2003.

All contracts entered into with AOL prior to that date were recorded as related party revenue. In addition, in 2003, the Company entered into an amended license agreement with AOL which provides for payments by AOL of \$10.0 million which were all received during the fourth quarter of 2003. The agreement contained 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 \$9.0 million of revenue from this agreement ratably as license and services revenue, through December 31, 2005, which represents the duration of the Company's obligation for

post-contract
customer support
of the source
code element
including
quarterly
upgrades and
maintenance
requirements.

The Company
recognized \$4.6
million in related
party license
revenue and \$1.1
million in related
party service
revenue for the
year ended
December 31,
2005, relating to
this agreement.

The Company
recognized \$3.5
million and \$1.0
million in related
party license and
service revenue,
respectively, for
the year ended
December 31,
2004, and \$0.7
million and \$0.1
million in related
party license and
service revenue,
respectively, for
the year ended
December 31,
2003, relating to
this agreement.

- (4) In December
2005, the
Company
determined that,
based upon a
decline in
operating
performance
during the fourth
quarter of 2005,

that the Services segment had experienced an impairment of its allocated goodwill. The Company recorded an impairment expense of \$7.8 million. In the third quarter of 2006, based on a further decline in the operating performance, the Company determined that the Services segment experienced another impairment of its allocated goodwill. The Company recorded an additional impairment expense of \$10.7 million. Also refer to financial statement footnote 6.

- (5) The Company issued convertible notes with a principal balance of \$7.0 million on December 31, 2002, then subsequently redeemed \$3.3 million of the notes at par, exchanged \$1.0 million of the notes for common stock

and exchanged
\$2.7 million of
the notes for new
notes on March
25, 2003.

Additionally, the
Company issued
\$3.5 million of
subordinated
notes on March
26, 2003. The
\$6.2 million
aggregate
principal
balances of the
convertible and
subordinated
notes were at an
interest rate of
4.95% per
annum. The \$2.7
million of
convertible notes
were converted in
2004 into 2.6
million shares of
the Company's
common stock.
The Company
paid down \$0.4
million of the
subordinated
notes in March
2006 and
extended the
maturity period
of the remaining
\$3.1 million from
March 2006 to
March 2008.

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

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

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Factors That May Affect Future Results of Operations." You should carefully review the risks described in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q to be filed in 2007. 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 the forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

Overview

Our financial statements have been prepared on the going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Since our inception, we have experienced substantial operating losses and negative cash flow from operations. As of December 31, 2006, we have an accumulated deficit of \$285.6 million, and cash, cash equivalents and marketable securities of \$4.3 million. These factors raise substantial doubt about our ability to continue as a going concern. Also, as a result of these conditions, the opinion of our Independent Registered Public Accountants on our audited financial statements for fiscal year 2006 has included an explanatory paragraph relating to going concern. Our ability to continue as a going concern ultimately depends on our ability to increase revenues and reduce expenses to a level that will allow us to operate profitably and sustain positive operating cash flows and/or raise additional capital.

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 in a simple way, and allows for user interaction. Since 2003, we have extended the historical imaging capabilities of our proprietary graphics technology to develop an advertising delivery system that specializes in deploying video and rich media advertising, and a search business that provides internet consumers a flexible graphical searching experience. The Company supplements its revenues in these product segments by using its in-house services team to build sophisticated content that is used by customers in each product segment. Finally, the Company previously licensed its platform to internet publishers enabling them to deploy graphical sophisticated content at their websites. However, in June 2005, the Company began to enable free use of its platform (except for special purpose licenses) to facilitate growth in its search and advertising systems segments.

Viewpoint offers an online advertising campaign management and deployment product known as the Unicast Advertising Platform or UAP . UAP permits publishers, advertisers, and their agencies to manage the process of deploying online advertising campaigns. This process includes creating the advertising assets, selecting the sites on which the advertisements will be deployed, setting the metrics (ad rotation, the frequency with which an ad may be deployed, and others) associated with the campaign, ad deployment, and tracking of campaign results. UAP enables users to manage advertising campaigns across many sites.

On January 3, 2005, Viewpoint purchased all the outstanding stock of Unicast Communications Corp. (Unicast), a leader in the delivery of interstitial and superstitial video internet advertisements. Unicast delivered video advertisements for its customers using a format that complemented Viewpoint's in-page and in-stream video advertising provided by AirTime. Additionally, Unicast generated monthly revenues from dozens of advertisers who

purchased advertising on some of the internet's most active

websites including America Online, Microsoft's MSN, and Yahoo!. The addition of Unicast significantly accelerated the Company's growth in its advertising systems segment.

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

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.

In July 2005, we 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, we released version 3.5 of the Viewpoint Toolbar and re-named it the Fotomat Toolbar. In July, 2005, we licensed the trademark and internet url Fotomat.com for our 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. In 2006, we purchased the Fotomat trademark and internet url Fotomat.com outright from Konica-Minolta Imaging, U.S.A. Our new Fotomat Toolbar provides enhanced photograph editing capabilities and an efficient method of creating albums of photographs, which we believe will enhance the utility of the toolbars for users, while simultaneously allowing users to use the Toolbar to search the internet.

Prior to launching our Search product we principally leveraged our 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 our customers' web sites, web sites can transmit relatively small files that can yield rich media on the end user's computer. In this way, website owners can deploy digital content representing three-dimensional views of their products, include pre-set animations, and provide high-resolution two-dimensional views, video, audio, text, and other media types. For example, we have 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. Our licensees helped facilitate the growth of our distributed base of VMP's that we used to launch our Search Toolbar business.

We provide 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 our marketing team. Our professional services group uses the Viewpoint platform, as well as a spectrum of tools and other technologies to create enhanced rich media solutions for a client's particular purpose, whether over the web, intranet systems or offline media and applications. We provide the support our clients need to implement the rich media

content, to fully utilize the

enhanced software, or to maximize the branding potential of the advertising opportunity. Clients supported during 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 December 31, 2006, had an accumulated deficit of \$285.6 million. Viewpoint's prospects must be considered in light of the risks and difficulties frequently encountered by early stage technology companies. There can be no assurance that Viewpoint will achieve or sustain profitability.

RESULTS OF OPERATIONS

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

	Years Ended December 31,		
	2006	2005	2004
Statements of Operations Data			
Revenues:			
Advertising systems	42 %	22 %	2 %
Search	37	37	19
Services	20	21	33
Related party services		4	17
Licenses	1	2	5
Related party licenses		14	24
Total revenues	100	100	100
Cost of revenues:			
Advertising systems	24	14	1
Search	1	1	
Services	14	14	23
Licenses			
Total cost of revenues	39	29	24
Gross profit	61	71	76
Operating expenses:			
Sales and marketing	34	20	26
Research and development	23	18	25
General and administrative	49	40	48
Depreciation	3	3	4
Amortization of intangible assets	3	2	
Restructuring charges	1		(1)
Impairment of goodwill	62	31	
Total operating expenses	175	114	102
Loss from operations	(114)	(43)	(26)
Other income (expense):			

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Interest and other income, net	2	1	
Interest expense	(5)	(5)	(6)
Changes in fair values of warrants to purchase common stock and conversion options of convertible notes	3	5	(29)
Loss on conversion of debt			(6)
Other income (expense)		1	(41)
Loss before provision for taxes	(114)	(42)	(67)
Provision for taxes			1
Net loss from continuing operations	(114)	(42)	(68)
Adjustment to net loss on disposal of discontinued operations			1
Net loss	(114)	(42)	(67)
Net loss applicable to common shareholders	(114)%	(42)%	(67)%

Critical Accounting Policies and Estimates

Viewpoint's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of

assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances though actual results may differ from these estimates under different assumptions or conditions. For a complete description of the Company's accounting policies, see Note 2 to the consolidated financial statements included elsewhere herein.

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

Revenue Recognition

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

Viewpoint generates revenues through four sources: (a) advertising systems, (b) search advertising, (c) services, and (d) software licenses. Advertising systems revenue is generated by charging customers to host and/or deliver advertising campaigns based on a cost per thousand (CPM) impressions. The Search toolbar is an extension of the Company's licensing revenue, and is derived from a share of the fees charged by Yahoo! to advertisers who pay for sponsored links when a customer clicks on the paid link on the results provided by the Viewpoint Toolbar. Service revenues are generated from fee-based professional services, customer support services (maintenance arrangements), and training services performed for customers that license the Company's products. License revenues are generated from licensing the rights to use products directly to customers. In June 2005, the Company discontinued charging customers a license fee (except for special purpose licenses requiring customization), as the Company believes that distribution of Viewpoint content and the VMP will increase Search revenue.

Viewpoint offers an online advertising campaign management and deployment product. 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 expects revenues from advertising systems to grow in future quarters. The Company also provides another advertising services product whereby the Company purchases media space from web-site publishers and re-sells 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.

Additionally, in March 2004 Viewpoint entered the Internet search business, by launching the Viewpoint Toolbar. Search revenue is generated when a customer uses the Viewpoint Toolbar to search the internet, and clicks on a sponsored advertisement included in the search results. The Viewpoint Toolbar's search results are provided by Yahoo!, who collects a fee from the advertiser and remits a percentage of the fee to Viewpoint. Revenue generated is a function of the number of Viewpoint Toolbars performing searches, the number of searches that are sponsored by advertisers, the number of advertisements that are clicked on by Viewpoint Toolbar searchers, the rate advertisers pay for those advertisements, and the percentage retained by Yahoo! for providing the results.

Viewpoint 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 pattern of performance basis if all other revenue recognition criteria are satisfied.

Prior to 2006, the Company also generated revenues by selling licenses to the Viewpoint graphical platform principally to internet content publishers. In June 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 businesses.

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

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

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

Pattern of Performance

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

Stock-Based Compensation

The Company has adopted the provisions of FAS No. 123(R), 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 123(R) 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 a number of complex and subjective assumptions. These assumptions 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. FAS 123(R) 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. A change in any single assumption 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 123(R) apply to new or modified 2006 grants and to grants that were unvested as of the effective date.

The Company recognized \$2.0 million in non-cash stock-based compensation expense for the year ended December 31, 2006.

Reserve for Bad Debt

We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by a review of their current credit information. The Company regularly monitors collections and payments from our customers and maintains a provision for estimated credit losses based upon historical experience and any specific customer collection issues that have been identified. If actual results differ from estimates made, expense recognized would be adjusted in the period that the differences became known and the difference could be material.

Valuation of Goodwill and Intangible Assets

We assess goodwill for impairment annually unless events occur that require more frequent reviews. Long-lived assets, including amortizable intangibles, are tested for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Estimated fair market values of each reporting unit, based on public company comparables or discounted cash flows, are used to determine if goodwill has been impaired while undiscounted cash flow analyses are used to assess long-lived asset impairment. If an assessment indicates impairment, the impaired asset is written down to its fair market value based on the best information available. Considerable management judgment is necessary in order to establish the value of these assets. Changes in assumptions could have a material impact on the financial statements. Assumptions used for these valuations are consistent with internal forecasts.

Management also reviews the period of amortization or depreciation of long-lived assets, including intangible assets. During this review, we re-evaluate the significant assumptions used in determining the useful lives of long-lived assets.

At December 31, 2005 the Company determined that, based upon a decline in operating performance during the fourth quarter of 2005, the Services reporting unit had experienced an impairment of its allocated Goodwill. The Company then performed the second step of the impairment test in accordance with SFAS No. 142 using a discount rate of 18% and a revenue growth rate of 18%. Following the completion of that step the Company recorded an impairment expense of \$7.8 million.

Due to a continued decline in operating performance during the third quarter of 2006, the Company determined that the Services reporting unit experienced another impairment of its allocated Goodwill and 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%, the Company recognized an impairment of \$10.7 million as of September 30, 2006. Also refer to financial statement

footnote 6.

Investments

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

Derivatives

In December 2005, the Company issued 1.3 million warrants to purchase common stock to several investors and as issuance costs, in connection with a private placement. The Company is required to carry these warrants on its balance sheet at fair value and the unrealized changes in the value of these warrants are reflected in net loss as changes in fair values of warrants to purchase common stock. Such changes in fair value are recorded as a gain or loss within operations.

Contingencies and Litigation

We evaluate contingent liabilities including threatened or pending litigation in accordance with SFAS No. 5, *Accounting for Contingencies* and record accruals when the outcome of these matters is deemed probable and the liability is reasonably estimable. We make these assessments based on the facts and circumstances and in some instances based in part on the advice of outside legal counsel. If actual results differ from estimates made, expense recognized would be adjusted in the period that the differences became known and the difference could be material.

Financial Performance Summary

Viewpoint reported total revenue of \$17.2 million for 2006, compared to \$25.3 million for 2005, and \$14.5 million for 2004. Gross profit for the year ended December 31, 2006 was \$10.5 million, compared to \$17.7 million, and \$11.1 million for the twelve months ended December 31, 2005, and December 31, 2004, respectively. The decrease in gross profit in 2006 compared to 2005 was due to the expiration of a 2003 license agreement with AOL in 2005. In addition the Company experienced a \$3.1 million decrease in search revenue, a 98% margin business. This was partially offset by strong growth from the ad systems product portfolio. The improvement in gross profit in 2005 compared to 2004 was due to increased revenues from the higher margin search and ad systems products, of \$6.7 million and \$5.1 million, respectively.

Operating loss for the year ended December 31, 2006 was \$19.6 million compared to \$10.8 million and \$3.9 million for the years ended December 31, 2005 and 2004, respectively. The increased operating loss in 2006 was attributable primarily to the \$7.2 million decrease in gross margin and a goodwill impairment increase of \$2.9 million associated with the services unit resulting from further decreased performance of that unit in the third quarter of 2006. The increased operating loss in 2005 compared to 2004 was attributable primarily to the \$7.8 million goodwill impairment in 2005. The Company also recognized an additional \$1.5 million in non-cash stock based compensation charges in 2005 compared to 2004.

The Company recognized a net loss of \$19.7 million, or \$(0.30) per share in 2006, compared to a net loss of \$10.6 million, or \$(0.18) per share in 2005, and \$9.7 million, or \$(0.18) per share in 2004.

The Company had cash, cash equivalents and marketable securities of \$4.3 million at December 31, 2006. During the year ended December 31, 2006, net cash used in operations amounted to \$5.8 million. As of December 31, 2006, the Company had an accumulated deficit of \$285.6 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. If the Company's expected revenue targets

are not achieved, or the Company fails to raise sufficient equity or debt capital, 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. All these factors raise substantial doubt about the Company's ability to continue as a going concern and may materially and adversely affect our stock price.

Based on the above factors our independent registered public accountants have included an explanatory paragraph in their report for our fiscal year ended December 31, 2006 with respect to our ability to continue as a going concern.

Revenues

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Advertising systems	\$ 7,252	33 %	\$ 5,448	1,686 %	\$ 305
Search	6,307	(33)	9,424	249	2,698
Services	3,470	(34)	5,269	9	4,822
Related party services		(100)	1,057	(57)	2,468
Licenses	148	(76)	608	(14)	704
Related party licenses		(100)	3,490	(1)	3,535
Total revenues	\$ 17,177	(32)%	\$ 25,296	74 %	\$ 14,532

Viewpoint offers an online advertising campaign management and deployment product. 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 expects revenues from advertising systems to grow in future quarters. The Company also provides another advertising services product whereby the Company purchases media space from web-site publishers and re-sells 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.

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

Viewpoint 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 pattern of performance basis if all other revenue recognition criteria are satisfied.

Prior to 2006, the Company also generated revenues by selling licenses to the Viewpoint graphical platform principally to internet content publishers. In June 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 businesses.

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 of 2005 as related party license revenue and \$0.2 million as related party services revenue.

Advertising systems revenues were \$7.3 million in 2006 compared to \$5.4 million in 2005. The increase in revenues was due to the increased investment in the sales and marketing and research and development of the advertising system products, as well as the industry trend of transferring more advertising spend from traditional media to the internet. The Company expects this increased investment and online advertising industry growth to continue in 2007.

Search revenues were \$6.3 million for the year ended December 31, 2006 compared to \$9.4 million for 2005. Search revenues are generated when users of the Viewpoint Toolbar are provided search results from advertisers that they click to view. These advertisers then pay a fee to Yahoo!, who remits a percentage of the fee to Viewpoint. The Company had installed 21.4 million Viewpoint Toolbars through December 31, 2005, 22.6 million through March 31, 2006, 23.9 through June 30, 2006, 25.3 million through September 30, 2006 and 26.6 million through December 31, 2006. Internet users can uninstall the Viewpoint Toolbar, and through December 31, 2006, 13.4 million users who had accepted the installation of the Toolbar had later uninstalled it. The Company experienced a decrease in installations as well as a decrease in the cost per click of the installed toolbars in 2006. If the Company is unable to increase installation or the cost per click, search revenue will continue to decline in 2007.

Service revenues of \$3.5 million decreased \$1.8 million or 34% compared to \$5.3 million in 2005. The Company experienced a decline in revenue from the automotive sector and slower growth in revenue from the development of creative products and activities. The decrease in service revenues in 2006 triggered goodwill impairment in this segment. The Company expects revenues in this segment to increase in 2007, though not to the levels of 2005.

The Company did not recognize related party service revenues in 2006 compared to \$1.1 million for 2005. The decrease is the result of the change in related party status of AOL who had a representative on the Company's Board of Directors until December 31, 2003. Agreements for services executed prior to that date have been accounted for as related party revenue.

License revenues were minimal in 2006 resulting from the Company discontinuing the practice of charging customers a license fee for using the Viewpoint Media Player. License revenues of \$0.6 million in 2005 decreased slightly compared to the year ended December 31, 2004. Revenues in this product line principally represented the amortization of 12 month licenses sold in prior periods. The Company discontinued the practice of charging customers a license fee in June 2005. Currently, the Company only charges for special purpose licenses that require customization.

The Company did not recognize related party license revenue in 2006 as the related party license revenues from 2005 and 2004 were attributable to a 27 month agreement with AOL that was executed in October 2003 and expired in December 2005.

Cost of revenues

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Advertising systems	\$ 4,176	12 %	\$ 3,721	2,542 %	\$ 132
Search	154	(11)	173	284	45
Services	2,337	(36)	3,658	6	3,270
Licenses	8	(33)	12	100	6
Total cost of revenues	\$ 6,675	(12)%	\$ 7,564	107 %	\$ 3,453
Percentage of total revenues	39 %		29 %		24 %

Cost of revenues from advertising systems was \$4.2 million for the year ended December 31, 2006 compared to \$3.7 million and \$0.1 million in 2005 and 2004, respectively. These costs consist of the web-hosting and employee fees associated with serving advertising content, costs for media space at websites when we package the media space with delivery, and costs of developing certain advertisements in contracts that include a combined price for developing creative material and delivering that material. The Company is continually evaluating pricing for hosting services in order to reduce the delivery expenses to the greatest extent practicable. As advertising system revenue increases, expenses for bandwidth will also increase, however, the Company believes that costs as a percentage of revenue will decrease since it expects to receive improved pricing efficiencies for hosting and delivery services.

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 have been minimal, and the Company believes these costs will stay consistent.

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 was \$2.3 million for the year ended December 31, 2006 compared to \$3.7 million in 2005. The decrease in cost of revenue for services was due to a decrease in third party services work associated with the \$2.9 million decrease in total services revenue. The Company believes that the costs for services as a percentage of revenue will remain fairly constant in 2007.

Cost of revenues for services was \$3.7 million for the year ended December 31, 2005 compared to \$3.3 million in 2004. The increase in expense was primarily due to an increase in salaries of \$0.3 million. Services expenses as a percentage of services revenues increased from 45% of revenues in 2004 to 58% in 2005. The increase was principally due to a reduction in higher margin maintenance revenues in 2005 as compared to 2004.

Sales and marketing

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Sales and Marketing	\$ 5,892	15 %	\$ 5,115	37 %	\$ 3,732
Percentage of total revenues	34 %		20 %		26 %

Sales and marketing expenses include salaries and benefits, sales commissions, non-cash stock-based compensation charges, consulting fees and travel and entertainment expenses for our sales and marketing personnel. Sales and

marketing expenses also include the cost of programs aimed at increasing revenue, such as advertising, trade shows and public relations.

Sales and marketing expenses of \$5.9 million for the year ended December 31, 2006 increased by \$0.8 million or 15% compared to the same period last year. The increase was principally due to an increase in personnel costs in sales and marketing reflecting an increased focus by the Company in this area. The Company believes that sales and marketing expenses will remain constant in 2007

Sales and marketing expenses increased by \$1.4 million, or 37%, for the year ended December 31, 2005 compared to the same period in 2004. The increase was principally due to an increase in personnel costs in sales and marketing associated with the Unicast acquisition. Personnel costs including commissions increased by \$1.2 million, in addition to ad systems marketing costs which increased by \$0.2 million. This was offset by a decrease in search marketing costs of \$0.3 million related to the launch of the search business in the first quarter of 2004.

Research and development

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Research and development	\$ 3,919	(13)%	\$ 4,479	31 %	\$ 3,432
Percentage of total revenues	23 %		18 %		25 %

Research and development expenses consist primarily of salaries and benefits for software developers, and contracted development 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 during the application development stage. The Company expenses costs incurred during preliminary project assessment.

The Company's research and development efforts are primarily directed at creating new technology in an effort to improve the overall quality of Viewpoint's products: the Viewpoint Media Player and Enliven, its proprietary software tools for creating digital content; advertising systems products; and the Viewpoint Toolbar.

Research and development expenses decreased by \$0.6 million, or 13%, for the year ended December 31, 2006 compared to the same period in 2005. The change resulted directly from a decrease in salaries, severance, and overtime. The decrease in 2006 came after the development of a number of key features in 2005. The Company is staying focused on monetizing these features in 2007 and beyond.

Research and development expenses increased by \$1.0 million, or 31%, for the year ended December 31, 2005 compared to the same period in 2004. The most significant change resulted from salaries which increased by \$0.9 million associated with employees added as a result of the Unicast acquisition. In addition, the Company's research and development team created a new advertising platform used to host the ad serving business.

General and administrative

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
General and Administrative	\$ 8,466	(16)%	\$ 10,054	39 %	\$ 7,220
Percentage of total revenues	49 %		40 %		48 %

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

General and administrative expenses decreased by \$1.6 million, or 16%, for the year ended December 31, 2006 compared to the same period last year. The decrease in general and administrative expenses was due to a decrease in salaries, severance and overtime of \$0.7 million

General and administrative expenses increased by \$2.8 million, or 39%, for the year ended December 31, 2005 compared to the same period in 2004. Non-cash stock based compensation increased by \$1.5 million related to charges taken on extending the options for former officers who left the Company during 2005. Salary, bonus and fringe benefit costs increased by \$0.7 million due primarily to new employees associated with the Unicast acquisition and reclassifications of certain employees to this department. Bad debt expense increased \$0.1 million principally due to receipt of a payment in 2004 from customers who had an account that was written off by the Company in 2003, in addition to increased receivable balances related to the ad systems business increasing the Company's overall reserve balance.

Depreciation

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Depreciation	\$ 466	(28)%	\$ 645	(2)%	\$ 657
Percentage of total revenues	3 %		3 %		5 %

Depreciation expense decreased by \$0.2 million or 28% in 2006 compared to 2005 due to a reduction in depreciable equipment used in our Company stemming from our 2006 restructuring and the retirement of equipment at the conclusion of its useful life. Depreciation expense remained relatively constant in 2005 compared to 2004.

Amortization of intangible assets

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Amortization of intangible assets	\$ 570	16 %	\$ 491	2,788 %	\$ 17
Percentage of total revenues	3 %		2 %		0 %

Amortization of intangible assets relates to the amortization of patents, trademarks and other intangible assets acquired in the Unicast acquisition, which amounted to \$0.6 million. Intangible assets, excluding Goodwill, included trademarks, acquired technology and website partner relationships. Viewpoint will be amortizing these values over the useful lives which range from 3 to 10 years.

Restructuring charges

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Restructuring charges	\$ 92	N/A %	\$ (100)	(100)%	\$ (106)
Percentage of total revenues	1 %		%		(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 statement of operations. This restructuring plan was completed by March 31, 2006 and the severance was paid in the second quarter of 2006.

Impairment of goodwill and other intangible assets

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Impairment of goodwill and other intangible assets	\$ 10,655	37 %	\$ 7,778	N/A	\$
Percentage of total revenues	62 %		31 %		%

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.

During the Company's annual goodwill impairment review in 2005, the Company determined that, based upon a decline in operating performance during the fourth quarter of 2005, the Services segment had experienced an impairment of its allocated Goodwill at December 31, 2005. The Company then performed the second step of the impairment test in accordance with SFAS No. 142. Following the completion of that step the Company recorded an impairment expense of \$7.8 million. See Note 6 of the consolidated financial statements.

Interest and other income

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Interest and other income, net	\$ 332	153 %	\$ 131	118 %	\$ 60
Percentage of total revenues	2 %		1 %		%

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

Interest and other income increased by \$0.2 million or 153%, in 2006 compared to 2005, and increased by \$0.1 million or 118%, in 2005 compared to 2004 based on the change in average cash, cash equivalents and marketable securities balances as well as the change in interest rates.

Interest expense

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Interest expense	\$ (926)	(21)%	\$ (1,178)	26 %	\$ (936)
Percentage of total revenues	(5)%		(5)%		(6)

Interest expense consists of interest paid and accrued, and amortization of debt discount and debt issue costs on the Company's outstanding Unicast and subordinated notes.

In 2005, as a result of the Unicast acquisition, the Company assumed \$2.8 million of debt, which caused the increase in interest expense for the year. The debt includes \$1.0 million of unsecured debt bearing an interest rate of 5% per annum that matures in 2011, and a \$1.8 million five year term loan maturing in 2011 with an interest rate of 5% per annum.

The Company issued convertible notes with a principal balance of \$7.0 million on December 31, 2002, then subsequently redeemed \$3.3 million of the notes at par, exchanged \$1.0 million of the notes for common stock and exchanged \$2.7 million of the notes for new notes on March 25, 2003. Additionally, the Company issued \$3.5 million of subordinated notes on March 26, 2003. The \$6.2 million aggregate principal balances of the convertible and subordinated notes were at an interest rate of 4.95% per annum.

The \$2.7 million of convertible notes were converted in 2004 into 2.6 million shares of the Company's common stock. The Company paid down \$0.4 million of the subordinated notes in March 2006 and extended the maturity period of the remaining \$3.1 million from March 2006 to March 2008.

In March 2007, the Company and the holder of the subordinated debt amended the 4.95% subordinated note in the principal amount of \$3.1 million to extend the maturity date from March 31, 2008 to September 30, 2009 and waive the requirement that the Company's common stock remain listed on a national stock exchange, as defined, until December 31, 2008, in exchange for the payment by Viewpoint of \$0.2 million to the Holder of the subordinated note, and adding \$0.3 million to the principle of the note.

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

convertible notes

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Changes in fair value of warrants to purchase common stock and conversion options of convertible notes gain/(loss)	\$ 515	(57)%	\$ 1,204	(129)%	\$ (4,180)
Percentage of total revenues	3 %		5 %		(29)%

Based on the provisions of SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, and EITF Issue No. 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, the Company recorded a gain of \$0.5 million in 2006 and \$1.2 million in 2005 based on the changes in fair values of the outstanding warrants to purchase common stock due to the decrease in the value of the Company's common stock. In 2004, the

Company recognized a loss of \$4.2 million based on the changes in fair value of the conversion options of the convertible notes of \$3.0 million and warrants to purchase common stock of \$1.2 million. Gains and losses are calculated based upon changes in the Company's common stock value and the number of common stock equivalents that the associated financial instruments may be settled in.

The expenses in this area in 2007 will be driven by changes in the Company's common stock price that is beyond the control of the Company. This account will experience an increase in expense if the Company's stock price increases.

Loss on conversion of debt

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Loss on conversion of debt	\$	N/A	\$	N/A	\$ (810)
Percentage of total revenues	%		%		(6)%

During 2004, \$2.7 million of convertible debt converted into 2.6 million shares of common stock (see Notes 2 and 8 to the financial statements.) In connection with the conversion, the Company incurred a loss of \$0.8 million which represented the write-off of unamortized deferred financing cost and debt discount at the time of the conversion.

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

	2006	% Change	2005	% Change	2004
	(Dollars in thousands)				
Adjustment to net loss on disposal of discontinued operations, net of tax	\$	(100)%	\$ 145	12 %	\$ 129
Percentage of total revenues	%		1 %		1 %

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

The Company did not record an adjustment to net loss on disposal of discontinued operations, net of tax, in 2006. During the years ended December 31, 2005, and 2004, the Company recorded an adjustment to net loss on disposal of discontinued operations, net of tax, of \$0.1 million and \$0.1 million respectively, as a result of changes in estimates related to accounts receivable and liabilities of the discontinued business. Changes in estimates, which are not expected to be significant, will be accounted for prospectively and included in adjustment to net loss on disposal of discontinued operations.

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 are currently evaluating and do not believe the adoption of FIN 48 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 February 2007, FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an Amendment of FASB Statement No. 115 (FAS 159). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. FAS 159 is effective for fiscal years after November 15, 2007. We do not believe that the adoption of the provisions of FAS 159 will materially impact our consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

The Company had cash, cash equivalents and marketable securities of \$4.3 million at December 31, 2006. During the year ended December 31, 2006, net cash used in operations amounted to \$5.8 million. As of December 31, 2006, the Company had an accumulated deficit of \$285.6 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. If the Company's expected revenue targets are not achieved, or the Company fails to raise sufficient equity or debt capital, 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. All these factors raise substantial doubt about the Company's ability to continue as a going concern and may materially and adversely affect our stock price.

Based on the above factors our independent registered public accountants have included an explanatory paragraph in their report for our fiscal year ended December 31, 2006 with respect to our ability to continue as a going concern.

Cash, cash equivalents, and marketable securities totaled \$4.3 million at December 31, 2006, as compared to \$9.1 million at December 31, 2005 and \$8.7 million at December 31, 2004. There were no off-balance sheet arrangements for the periods presented.

	2006	2005	2004
Cash used in operating activities	\$ (5,802)	\$ (5,958)	\$ (9,656)
Cash provided by (used in) investing activities	1,886	(657)	(1,813)
Cash provided by financing activities	1,633	7,245	9,242

Operating activities

In 2006, cash used in operating activities was \$5.8 million, remaining relatively constant compared to 2005. The difference in the use of cash was caused by the increase in net loss of \$9.1 million offset by \$4.6 million in related

party deferred revenue which was recognized as revenue in 2005 and an additional \$2.9 million in impairment expense. The \$4.6 million related party deferred revenue represented cash received in 2003 relating to the 2003 AOL agreement.

In 2005, cash used in operating activities was \$6.0 million, a decrease of \$3.7 million from 2004. The decrease in use of cash was caused by a net increase in search revenue. The Company had a net loss of

\$10.6 million including a non-cash impairment charge of \$7.8 million, as compared to a net loss of \$9.7 million in 2004 with no impairment charge.

In 2004 cash used in operating activities was \$9.7 million, an increase of \$5.6 million compared to 2003. The use of cash was caused by \$9.7 million in net loss increased by the recognition of \$5.1 million in revenue principally associated with the \$9 million AOL amended license agreement that was executed and paid in the fourth quarter of 2003. Revenue for this agreement is recognized ratably over the nine quarters ending in December 2005. Additionally, outstanding billings for our new search and advertising systems segments increased by over \$2.0 million in comparable fourth quarters which contributed to an increase of \$1.9 million in accounts receivable. This was offset by several non-cash expenses that impacted the net loss including the \$4.2 million non-cash loss related to the change in fair value of warrants to purchase common stock and conversion feature of the convertible debt caused by the increase in the Company's share price. Additionally non-cash stock based compensation, depreciation and amortization, and write-off of debt discount and issuance cost, and the loss related to the conversion of debt and issuance of stock below fair market value related to the private placement in March 2004 totaled \$2.6 million decreasing the use of cash by operating activities.

Investing activities

In 2006, cash provided by investing activities was \$1.9 million, attributable to net proceeds from the sale and maturity of marketable securities of \$2.6 million, offset by capital expenditures for fixed assets and patents and trademarks of \$0.7 million.

In 2005, cash used by investing activities was \$0.7 million, attributable to capital expenditures of \$0.4 million, and \$0.5 million related to the acquisition of Unicast, offset by net proceeds from short-term marketable securities of \$0.2 million.

In 2004, cash used by investing activities was \$1.8 million, primarily due to net purchases of short-term marketable securities of \$1.4 million. Capital expenditures were \$0.4 million.

Financing activities

In 2006, net cash provided by financing activities was \$1.6 million, caused primarily by \$2.4 million in proceeds from the exercise of stock options, offset by repayment of notes outstanding of \$0.8 million.

In 2005, net cash provided by financing activities was \$7.2 million, caused primarily by the private placements in the second and fourth quarters amounting to \$6.8 million net of issuance costs.

In 2004, net cash provided by financing activities was \$9.2 million. This resulted from the issuance of 1.5 million shares of common stock to an institutional investor, who had previously purchased Convertible Notes (Convertible Notes) on March 17, 2004 for \$3.7 million and the issuance of 1.9 million shares of common stock to a private investor in December 2004 for \$5.0 million. Proceeds from the exercise of stock options totaled \$0.6 million.

Long-Term Debt

The Company issued convertible notes with a principal balance of \$7.0 million on December 31, 2002, then subsequently redeemed \$3.3 million of the notes at par, exchanged \$1.0 million of the notes for common stock and exchanged \$2.7 million of the notes for new notes on March 25, 2003. Additionally, the Company issued \$3.5 million of subordinated notes on March 26, 2003. The \$6.2 million aggregate principal balances of the convertible and subordinated notes were at an interest rate of 4.95% per annum.

The \$2.7 million of convertible notes were converted in 2004 into 2.6 million shares of the Company's common stock. The Company paid down \$0.4 million of the subordinated notes in March 2006 and extended the maturity period of the remaining \$3.1 million from March 2006 to March 2008.

In March 2007, 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, 2008 to September 30, 2009 in exchange for the payment by Viewpoint of \$0.2 million to the Holder of the subordinated note, and adding \$0.3 million to the

principle of the note. In addition, the amended note also extended the aforementioned de-listing covenant until December 31, 2008.

Other Transactions

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

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

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

In October 2003, the Company entered into an amended license agreement with AOL which provided for payments by AOL of \$10.0 million. 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 through December 31, 2005, which represented the duration of the Company s obligation for post-contract customer support including quarterly upgrades and maintenance requirements.

In December 2005, the Company sold 5.1 million shares of common stock and warrants in a private placement to several investors for \$5.1 million. The warrants were to purchase an additional 1.0 million shares of common stock at an exercise price of \$1.20 per share with a term of three years. In addition, pursuant to this private placement we 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 as issuance costs in the transaction. In July 2005, the Company sold 1.3 million shares of stock in a private placement for \$2.0 million or \$1.55 per share. From March through June, 2004 Viewpoint converted \$2.7 million of convertible debt to equity. Additionally, in March 2004 the Company sold 1.5 million shares of stock in a private placement for \$3.7 million or \$2.45 per share. Finally, in December 2004, the Company sold 1.9 million shares of common stock in a private placement for \$5.0 million or \$2.65 per share.

As of December 31, 2006, the Company had cash commitments totaling approximately \$9.1 million through 2011, related to long-term convertible notes, employee agreements, future minimum lease payments for office space, and equipment.

Payments Due By Period

	Total	1 Year or Less	2-3 Years	4-5 Years	More than 5 Years
(Dollars in thousands)					
Long-Term Debt Obligations (A)	\$ 3,050	\$	\$ 3,050	\$	\$
Operating Lease Obligations	2,762	1,016	1,656	90	
Interest Payments on Long-Term Debt Obligations	428	223	124	81	
Unicast Debt Obligations (B)	2,426	318	700	1,408	
Purchase Obligations	457	457			
 Total	 \$ 9,123	 \$ 2,014	 \$ 5,530	 \$ 1,579	 \$

(A) Amounts disclosed within the Company's balance sheet represent the discounted value as of December 31, 2006. The Company is accreting the note to its face value using the interest method. As of December 31, 2006, the discount on the debt totaled \$0.6 million.

(B) Amounts disclosed

within the
Company's
balance
sheet
represent
the
discounted
value as of
December
31, 2006.
The
Company
is accreting
the note to
its face
value using
the interest
method. As
of
December
31, 2006,
the
discount on
the debt
totaled
\$0.5
million.

Item 7A. *Quantitative and Qualitative Disclosure About Market Risk*

The Company is subject to concentration of credit risk and interest rate risk related to cash, cash equivalents and marketable securities. The Company has no derivative financial instruments other than warrants to purchase its own common stock as of December 31, 2006. 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 composed 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 8. Financial Statements and Supplementary Data**1. Index to Financial Statements**

The following financial statements are filed as part of this Report:

	Page
Report of Independent Registered Public Accounting Firm	43
Audited Financial Statements	
Consolidated Balance Sheets as of December 31, 2006 and 2005	45
Consolidated Statement of Operations for each of the three years in the period ended December 31, 2006	46
Consolidated Statement of Stockholders' Equity and Comprehensive Loss for each of the three years in the period ended December 31, 2006	47
Consolidated Statement of Cash Flows for each of the three years in the period ended December 31, 2006	48
Notes to Consolidated Financial Statements	50

	Page
2. Index to Financial Statement Schedule	
Schedule	
Schedule II Valuation and Qualifying Accounts	75

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Viewpoint Corporation

We have completed integrated audits of Viewpoint Corporation's 2006, 2005, and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Viewpoint Corporation and its subsidiaries (the Company) at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the financial statements, the Company adopted the provisions of FAS No. 123(R), Share-Based Payment on January 1, 2006.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has incurred negative cash flow from operations and net losses since inception and has limited capital to fund future operations that raise substantial doubt about their ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 2. The consolidated financial statements do not include any adjustment that might result from this uncertainty.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Annual Report on Internal Control Over Financial Reporting appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United

States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting,

evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

New York, New York
March 16, 2007

VIEWPOINT CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands)

	December 31,	
	2006	2005
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 4,154	\$ 6,437
Marketable securities	113	2,674
Accounts receivable, net of reserve of \$230 and \$419, respectively	3,037	4,336
Related party accounts receivable		6
Prepaid expenses and other current assets	543	510
Total current assets.	7,847	13,963
Restricted cash	190	182
Property and equipment, net	1,023	1,218
Goodwill	14,882	25,537
Intangible assets, net	3,689	4,131
Other assets	56	105
Total assets	\$ 27,687	\$ 45,136
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,660	\$ 2,834
Accrued expenses	401	635
Deferred revenues	70	178
Related party deferred revenues		29
Current portion of notes payable	389	814
Accrued incentive compensation	545	545
Current liabilities related to discontinued operations	231	231
Total current liabilities	3,296	5,266
Deferred rent	232	334
Warrants to purchase common stock	467	982
Subordinated notes-related party	2,456	2,090
Unicast notes	1,541	1,582
Total liabilities	7,992	10,254

Commitments and contingencies (note 11)

Stockholders' equity:

Preferred stock, \$.001 par value; 5,000 shares authorized no shares issued and outstanding at December 31, 2006 and 2005

Common stock, \$.001 par value; 150,000 shares authorized 67,830 shares issued and 67,670 shares outstanding at December 31, 2006, and 64,849 shares issued and 64,689 shares outstanding at December 31, 2005

	68	65
Paid-in capital	306,214	301,769
Deferred compensation		(3)
Treasury stock at cost; 160 at December 31, 2006 and 2005	(1,015)	(1,015)
Accumulated other comprehensive income (loss)	14	(63)
Accumulated deficit	(285,586)	(265,871)

Total stockholders' equity	19,695	34,882
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Total liabilities and stockholders' equity	\$ 27,687	\$ 45,136
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The accompanying notes are an integral part of these consolidated financial statements.

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

	Years Ended December 31,		
	2006	2005	2004
Revenues:			
Advertising systems	\$ 7,252	\$ 5,448	\$ 305
Search	6,307	9,424	2,698
Services	3,470	5,269	4,822
Related party services		1,057	2,468
Licenses	148	608	704
Related party licenses		3,490	3,535
 Total revenues	 17,177	 25,296	 14,532
Cost of Revenues:			
Advertising systems	4,176	3,721	132
Search	154	173	45
Services	2,337	3,658	3,270
Licenses	8	12	6
 Total cost of revenues	 6,675	 7,564	 3,453
 Gross profit	 10,502	 17,732	 11,079
 Operating expenses:			
Sales and marketing	5,892	5,115	3,732
Research and development	3,919	4,479	3,432
General and administrative	8,466	10,054	7,220
Depreciation	466	645	657
Amortization of intangible assets	570	491	17
Restructuring charges	92		(106)
Impairment of goodwill	10,655	7,778	
 Total operating expenses	 30,060	 28,562	 14,952
 Loss from operations	 (19,558)	 (10,830)	 (3,873)
 Other income (expense)			
Interest and other income	332	131	60

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Interest expense	(926)	(1,178)	(936)
Changes in fair values of warrants to purchase common stock and conversion options of convertible notes	515	1,204	(4,180)
Loss on conversion of debt			(810)
Total other income (expense)	(79)	157	(5,866)
Loss before provision for taxes	(19,637)	(10,673)	(9,739)
Provision for taxes	78	64	90
Net loss from continuing operations	(19,715)	(10,737)	(9,829)
Adjustment to net loss on disposal of discontinued operations		145	129
Net loss	\$ (19,715)	\$ (10,592)	\$ (9,700)
Basic and diluted net loss per common share:			
Net loss per common share from continuing operations	\$ (0.30)	\$ (0.18)	\$ (0.18)
Net income (loss) per common share from discontinued operations			
Net loss per common share	\$ (0.30)	\$ (0.18)	\$ (0.18)
Weighted average number of shares outstanding basic and diluted	66,610	58,631	52,955

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

VIEWPOINT CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE LOSS
For the Years Ended December 31, 2006, 2005, and 2004
(In thousands)

	Common Stock				Treasury Stock		Accumulated Other Comprehensive Income (Loss)
	Shares	Amount	Paid-in Capital	Deferred Compensation	Shares	Amount	
Balances at December 31, 2003	49,965	\$ 50	\$ 274,351	\$ (275)	(160)	\$ (1,015)	\$ (6)
Issuance of common stock upon the exercise of stock options	716	1	581				
Issuance of common stock, net of issuance cost of \$15	3,387	3	8,657				
Issuance of common stock upon conversion of debt	2,636	3	6,611				
Cancellation of common stock option awards			(18)	18			
Issuance of common stock option awards			59				
Amortization of deferred compensation				252			
Issuance of common stock for interest expense			19				
Translation adjustment							
Net loss							
Balances at December 31,	56,704	57	290,260	(5)	(160)	(1,015)	(6)

2004

Issuance of common stock upon the exercise of stock options	670	1	517
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Issuance of common stock related to acquisition of Unicast	1,085	1	2,966
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Issuance of common stock to related party net of issuance cost of \$68	1,290	1	1,931
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Capital contribution resulting from restructuring of notes payable.	458
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Issuance of common stock, net of issuance cost of 336	5,100	5	3,858
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Amortization of deferred compensation	2
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Stock compensation related to modification of stock options	1,779
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Unrealized gain on investments	(
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Translation
adjustment

Net (loss)

Balances at December 31, 2005	64,849	65	301,769	(3)	(160)	(1,015)	(6
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Issuance of common stock upon the	2,981	3	2,404
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exercise of stock options											
Reclassification in connection with adoption of FAS 123(R)											
Share Based Payment			(3)		3						
Stock-based compensation			2,044								
Unrealized gain on investments										2	
Translation adjustment										5	
Net (loss)											
Balances at December 31, 2006	67,830	\$	68	\$	306,214	\$	(160)	\$	(1,015)	\$	1

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

VIEWPOINT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Years Ended December 31,		
	2006	2005	2004
Cash flows from operating activities:			
Net loss	\$ (19,715)	\$ (10,592)	\$ (9,700)
Adjustments to reconcile net loss to net cash used in operating activities:			
Stock-based compensation charges	2,044	1,781	312
Restructuring charges			(106)
Impairment of goodwill and other intangible assets	10,655	7,778	
Depreciation and amortization	1,242	1,548	870
Provision for bad debt	24	78	(33)
Interest expense paid using common stock			18
Loss on sale and disposal of equipment			31
Changes in fair values of warrants to purchase common stock and conversion feature of convertible debt	(515)	(1,204)	4,180
Amortization of debt discount and issuance costs	690	996	656
Loss on conversion of debt			810
Changes in operating assets and liabilities, net of acquisitions:			
Accounts receivable	1,296	223	(1,900)
Related party accounts receivable	6	20	888
Prepaid expenses		(17)	235
Accounts payable	(1,092)	(707)	(95)
Accrued expenses	(336)	(1,031)	(779)
Deferred revenues	(108)	(253)	8
Related party deferred revenues	(29)	(4,578)	(5,051)
Other	36		
Net cash used in operating activities	(5,802)	(5,958)	(9,656)
Cash flows from investing activities:			
Proceeds from sales and maturities of marketable securities	12,153	10,290	5,350
Purchases of marketable securities	(9,572)	(10,112)	(6,752)
Net (increase)/decrease in restricted cash	(8)	138	68
Purchases of property and equipment	(450)	(389)	(418)
Purchases of patents and trademarks	(237)	(72)	(61)
Acquisition of Unicast		(512)	

Net cash provided (used) by investing activities	1,886	(657)	(1,813)
Cash flows from financing activities:			
Proceeds from issuance of common stock net of issuance costs		6,789	8,660
Repayment of subordinate notes	(450)		
Repayment of Unicast debt	(324)		
Payment of issuance costs on convertible notes		(61)	
Proceeds from exercise of stock options	2,407	517	582
Net cash provided by financing activities	1,633	7,245	9,242
Effect of exchange rates changes on cash	0	3	(1)
Net increase (decrease) in cash and cash equivalents	(2,283)	633	(2,228)
Cash and cash equivalents at beginning of year	6,437	5,804	8,032
Cash and cash equivalents at end of year	\$ 4,154	\$ 6,437	\$ 5,804

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

VIEWPOINT CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Years Ended December 31,		
	2006	2005	2004
Supplemental disclosure of cash flow activities:			
Cash paid during the year for income taxes	\$ 78	\$ 64	\$ 89
Cash paid during the year for interest	237	226	169
Net assets acquired in Unicast acquisition			
Accounts receivable, net		2,056	
Prepays		7	
Other assets		22	
Fixed assets		128	
Goodwill and intangible assets		6,547	
Accounts payable and accrued expenses		(3,578)	
Unicast Debt		(1,702)	
Supplemental disclosure of non-cash investing and financing activities:			
Non-cash cost of Unicast acquisition			
Common stock		(1)	
APIC		(2,967)	
Unrealized gain (loss) on marketable securities	21	(6)	(1)
Stock issuance costs accrued and not yet paid		25	
Capital contribution resulting from restructuring of note payable		458	
Issuance of warrants in conjunction with stock issuance		901	
Issuance of common stock for convertible notes			2,700
Acquisitions costs accrued and not yet paid			50
Purchase of property and equipment accrued and not yet paid	3	85	86

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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Business and Organization

Overview. The accompanying consolidated financial statements of Viewpoint Corporation (Viewpoint or the Company) have been prepared on the going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As discussed in more detail in Note 2, since inception, Viewpoint has experienced substantial operating losses and negative cash flow from operations. As of December 31, 2006, Viewpoint had an accumulated deficit of \$285.6 million, and cash, cash equivalents and marketable securities of \$4.3 million. All the above factors raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is ultimately dependent on its ability to increase sales and reduce expenses to a level that will allow it to operate profitably and sustain positive operating cash flows and/or raise additional capital. However, there can be no assurance that these sources will provide sufficient cash inflows to enable the Company to continue as a going concern.

Viewpoint 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 in a simple way, and allows for user interaction.

Viewpoint offers an online advertising campaign management and deployment product known as the Unicast Advertising Platform or UAP . UAP permits publishers, advertisers, and their agencies to manage the process of deploying online advertising campaigns. This process includes creating the advertising assets, selecting the sites on which the advertisements will be deployed, setting the metrics (ad rotation, the frequency with which an ad may be deployed, and others) associated with the campaign, ad deployment, and tracking of campaign results. UAP enables users to manage advertising campaigns across many sites.

On January 3, 2005 Viewpoint purchased all the outstanding stock of Unicast Corporation (Unicast), a leader in the delivery of interstitial and superstitial video internet advertisements. Unicast delivered video advertisements for its customers using a format that complemented Viewpoint's in-page and in-stream video advertising provided by AirTime. Additionally, Unicast generated monthly revenues from dozens of advertisers who purchased advertising on some of the internet's most active websites including Microsoft's MSN, Yahoo! and America Online. The addition of Unicast significantly accelerated the Company's growth in its advertising systems segment.

In 2004, Viewpoint entered the internet search business by launching a toolbar search product which the Company calls the Viewpoint Toolbar and executed a search advertising agreement with Yahoo!, which was amended in 2006. 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 rights to display search results to the Viewpoint Toolbar. This variable fee is based on users' clicks on sponsored advertisements included in the search results provided by Yahoo!, through the Viewpoint Toolbar. The Viewpoint Toolbar's search results are provided by Yahoo!, who collects a fee from the advertiser and remits a percentage of the fee to Viewpoint. Revenue generated is a function of the number of Viewpoint Toolbars performing searches, the number of searches that are sponsored by advertisers, the number of advertisements that are clicked on by Viewpoint Toolbar searchers, the rate advertisers pay for those advertisements, and the percentage retained by Yahoo! for providing the results.

In July 2005, we 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, we released version 3.5 of the Viewpoint Toolbar and re-named it the Fotomat Toolbar. Prior to November 2006, the Company licensed the trademark and internet url

Fotomat.com for our 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. In November 2006, we

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

purchased the trademark and internet url and capitalized approximately \$0.1 million which will be amortized over 3 years. Our new Fotomat Toolbar provides enhanced photograph editing capabilities and an efficient method of creating albums of photographs, which we believe will enhance the utility of the toolbars for users, while simultaneously allowing users to use the Toolbar to search the internet.

Viewpoint also provides fee-based professional services for creating content and implementing visualization solutions. Clients include both content-related licensees and advertisers who use UAP as well as internal services provided to our marketing team. The 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. Viewpoint 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 2006 include America Online, Toyota Motor Services, General Electric and Sony.

Viewpoint began business in 1987 as a software maker focused primarily on products that enabled content authors to create images in three dimensions and to paint artistic images digitally. Viewpoint initiated internet activities with the release of a beta version of the Viewpoint Media Player (VMP) in 1999. Simultaneously, Viewpoint released a suite of free content authoring tools specifically designed to enable customers who published digital content on their websites to create material that can be read or played back by the VMP. With the VMP residing on the web consumer's computer and interpreting instructions delivered by our customers' web sites, web sites can transmit relatively small files that can yield rich media on the end user's computer. In this way, website owners can deploy digital content representing three-dimensional views of their products, include pre-set animations, and provide high-resolution two-dimensional views, video, audio, text, and other media types. For example, several of our licensing and creative services customers are auto manufacturers that deploy from their websites 3D representations of their vehicles which viewers can interact with by opening doors, zooming in on features, configuring accessories, or swapping colors.

2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Viewpoint and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Certain reclassifications have been made to the 2005 consolidated financial statements to conform to the 2006 presentation (See Note 6).

Liquidity

The accompanying consolidated financial statements of the Company have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company had cash, cash equivalents and marketable securities of \$4.3 million at December 31, 2006. During the year ended December 31, 2006, net cash used in operations amounted to \$5.8 million. As of December 31, 2006, the Company had an accumulated deficit of \$285.6 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. If the Company's expected revenue targets are not achieved or the Company fails to raise sufficient equity or debt capital, 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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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. Without improving operating results through increasing revenues, reducing expenses and/or raising additional capital, future operations will need to be discontinued. All these factors raise substantial doubt about the Company's ability to continue as a going concern.

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 impact the following transactions or account balances: stock compensation, revenue, receivables, liabilities, warrants, goodwill, and intangible and fixed assets.

Net Loss Per Common Share

Basic net loss per common share is computed using the weighted average number of outstanding shares common stock. Diluted per share data is computed using the weighted average number of outstanding shares of common stock increased by the weighted average of dilutive common stock equivalent shares using the treasury stock method. Dilutive per share data has been omitted since such amounts are anti-dilutive. Common equivalent shares related to stock options and warrants totaling 5.2 million, 9.3 million and 7.7 million for each of the three years in the period ended December 31, 2006, respectively.

Common Stock Issuance

In 2004, the Company sold 3.4 million shares of common stock for \$8.7 million and converted \$2.7 million of convertible debt into 2.6 million shares of common stock (also see Note 8). In connection with conversion of debt, the Company incurred a loss on conversion of \$0.8 million and the \$3.1 million liability which represented the fair value of the conversion option was reclassified to paid-in capital (also see Note 2 Derivatives).

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 (2005 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. As discussed in more detail below, 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 in accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedge Activities, and EITF Issue No. 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settles in, a Company's Own Stock. 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.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Rights Plan

In July 1998, the Board of Directors adopted a stockholder rights plan, which was amended in June, 1999 and further amended in November, 2000. The stockholder rights plan, as amended, provides for the issuance to the holders of the Company's common stock one preferred stock purchase right (the Rights) for each share of common stock they hold. The Rights have certain anti-takeover effects and are designed to protect and maximize the value of the outstanding equity interests in the Company in the event of an unsolicited attempt by an acquiror to take over the Company in a manner or on terms not approved by the Board of Directors.

The Rights will expire on August 13, 2008, unless such expiration date is extended or unless the rights are earlier redeemed or exchanged by the Company. Each Right entitles the holder to buy one one-thousandth of a share of Series A Preferred Stock at an exercise price of \$38.00. The Rights are not separately traded and become exercisable only in the event that (i) a person or group of persons acquires 15% or more (17.5% or more for Computer Associates International, Inc., pursuant to the November, 2000 amendment) (an Acquiror) of the Company's outstanding common stock or (ii) a person or group of persons commences or announces a tender offer or exchange offer that will result in such person or group of persons owning such percentage of the Company's outstanding common stock, in each case, on terms not approved by the Board of Directors.

Upon any person or group acquiring 15% or more of the Company's outstanding common stock (17.5% with respect to Computer Associates International, Inc.), each Right will entitle its holder (other than the Rights beneficially owned by the Acquiror which will be void) to buy shares of the Company's common stock (or of the stock of the acquiring company if it is the surviving entity in a business combination) having a market value equal to twice the exercise price of each Right. The Board of Directors may redeem the Rights at any time prior to their becoming exercisable.

Cash Equivalents and Marketable Securities

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

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

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

Restricted Cash

Included in restricted cash at December 31, 2006 and 2005 was \$0.2 million and \$0.2 million, respectively, which was pledged as collateral to secure a letter of credit used for a security deposit on the Company's New York facility.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Goodwill and Intangible Assets

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

All other intangible assets continue to be 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*.

Property and Equipment

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

Software Development Costs

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

Software Developed for Internal Use

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

Stock-Based Compensation

The Company has adopted the provisions of FAS No. 123(R), *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 123(R) 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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

as a number of complex and subjective assumptions. These assumptions 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. FAS 123(R) also amends FASB Statement No. 95, Statement of Cash Flows, to require that excess tax benefits, as defined, realized from the exercise of stock options be reported as a financing cash inflow rather than as a reduction of taxes paid in cash flow from operations. As the result of the uncertainty regarding the Company's ability to utilize its deferred tax assets, the impact of windfall tax benefits on the accompanying financial statements was immaterial. A change in any single assumption could significantly increase or decrease operating expenses. For various reasons, including the expectations that additional stock options will be granted, historical stock-based compensation may not be a good indicator of future results.

The Company elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123(R) apply to new or modified 2006 grants and to grants that were unvested as of the effective date.

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. 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.

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 the employment term.

The adoption of FAS 123(R) had a material impact on our 2006 consolidated results of operations. The table below summarizes the assumptions used to determine the fair value of stock-based awards using the Black-Scholes option pricing model:

	Year Ended December 31,		
	2006	2005	2004
Risk-free interest rate	4.67 %	4.40 %	3.41 %
Dividend yield			
Volatility factor	1.32	1.00	1.00
Weighted average expected life in years	4.52	2.4	4.3

The following summarizes the weighted average fair value of options granted during the years ended December 31, 2006, 2005, and 2004:

2006	2005	2004
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Weighted average fair value	\$	1.41	\$	1.91	\$	1.84
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The Company's pro forma net loss and net loss per common share had the Company adopted FAS No. 123 Accounting for Stock-Based Compensation are below (in thousands, except per share amounts). The estimated fair value of the Company's options is amortized to expense over the options' vesting period. Pro-forma data for 2006 has been intentionally omitted as the Company adopted FAS No. 123(R) in 2006:

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31,	
	2005	2004
Net Loss	\$ (10,592)	\$ (9,700)
Add: Stock-based employee expense included in reported net loss	1,781	311
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(4,159)	(3,143)
Pro form net loss	\$ (12,970)	\$ (12,532)
Basic and diluted net loss per share-as reported	\$ (0.18)	\$ (0.18)
Basic and diluted net loss per share-pro forma	\$ (0.22)	\$ (0.24)
Weighted average number of shares outstanding basic and diluted	58,631	52,955

The Company currently has outstanding performance awards with a fair value of \$0.1 million which will vest if certain operating performance is achieved by December 31, 2007. 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. 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 December 31, 2006, total unrecognized share-based compensation cost related to unvested stock options was \$4.1 million (excluding performance based awards noted above), which is expected to be recognized over a weighted average period of approximately 2.4 years.

Share-based compensation expense recognized during the year ended December 31, 2006 included (1) compensation expense for awards granted prior to, but not yet fully vested as of January 1, 2006 as the Company elected the modified prospective method pursuant to the provisions of SFAS 123R, 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. 123(R).

On August 25, 2005, the Company entered into a separation agreement with its chief executive officer whereby the officer's employment with the Company would end on September 15, 2005. The separation agreement also modified the terms of option issuances to extend the life of 2.1 million options vested at the date of separation from three months to two years. As the officer's options were fully vested on September 15, 2005, the date of the officer's separation, the Company recorded an expense of \$1.1 million on that date, which represented the incremental intrinsic value (difference between market value and the exercise price of the option) on the date of modification.

On June 30, 2005, upon termination of an executive officer, a prior modification to the executive's options was determined to be beneficial to the executive. In accordance with FIN 44, on that date, the Company recorded a non-cash compensation charge of \$0.6 million. In addition, on June 30, 2005, another employee became a consultant of the Company. As the option plan allowed for this transfer in duties, no modification expense was recognized, but the Company began to account for the options outstanding at fair market value in accordance with EITF 96-18

Accounting for Equity Instruments That Are Issued To Other Than Employees for Acquiring or in Conjunction With Selling Goods or Services, and recognized a compensation expense of \$0.1million.

Foreign Currency Translation

The functional currency of each of the Company's foreign subsidiaries is its local currency. Financial statements of these foreign subsidiaries are translated to U.S. dollars for consolidation purposes using current rates of exchange for assets and liabilities and average rates of exchange for revenues and expenses. The effects of currency translation adjustments are included as a component of accumulated other comprehensive income (loss) in the statements of stockholders' equity. Transaction gains and losses arising from transactions denominated in a currency other than the functional currency

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of the entity involved, are included in other income in the statements of operations. Overseas operations were immaterial for all periods presented.

Revenue Recognition

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

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

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

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

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

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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Income Taxes

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

Concentration of Risk

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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Derivatives

The Company issued convertible notes and warrants which would require Viewpoint to issue shares of common stock upon conversion of the notes or exercise of the warrants. The Company accounts for the fair values of the outstanding warrants to purchase common stock and the conversion options of its convertible notes in accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities, and ETIF Issue No. 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock, which requires the Company to bifurcate and separately account for the conversion option and warrants as derivatives contained in the Company's convertible notes. The Company is required to carry these derivatives on its balance sheet as a liability at fair value and the changes in the value from period-to-period are reflected in operating results as changes in fair values of warrants to purchase common stock and conversion options of convertible notes. Such changes in fair value are recorded as an adjustment to reconcile net loss to net cash used in operating activities in the consolidated statement of cash flows. In 2004, the convertible notes were converted into common stock. As of December 31, 2006, the only outstanding derivative is the 2005 Warrants which have a current value of approximately \$.5 million. For the years ended December 31, 2006, 2005 and 2004, the Company recognized within operating results the change in fair value of the conversion option and the warrants which was a benefit of \$.5 million and \$1.2 million in 2006 and 2005 respectively and a detriment of \$4.2 million in 2004.

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

Comprehensive Loss

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Net income (loss) and other comprehensive income (loss), which includes foreign exchange translation adjustments and unrealized gains and losses on marketable securities, are reported net of their related tax effect, to arrive at comprehensive income (loss).

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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recorded as an adjustment to opening retained earnings. We are currently evaluating and do not believe the adoption of FIN 48 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 February 2007, FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (FAS 159). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. FAS 159 is effective for fiscal years after November 15, 2007. We do not believe that the adoption of the provisions of FAS 159 will materially impact our consolidated financial statements.

3. Unicast Acquisition

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

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

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

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

Tangible equipment value was determined based on fair market value at the date of acquisition. The remaining useful life of this equipment was predominantly determined to be one year. Intangible values acquired included trademarks, acquired technology, website partner relationships and goodwill.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Acquired technology was determined to have a life of three years while the other intangible values were determined to have a life of 5-10 years. Unicast had no in-process research and development.

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

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

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

4. Cash, Cash Equivalents and Marketable Securities

The cost and fair value of the Company's cash, cash equivalents and marketable securities as of December 31, 2006, by type of security, contractual maturity, and its classification in the balance sheet, are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gain	Gross Unrealised (Loss)	Fair Value	Maturity
Type of security:					
Cash	\$ 490	\$	\$	\$ 490	
Money Market Funds	3,164			3,164	
Corporate Bonds and Notes	250			250	2007
Equity Securities	99	14		113	
U.S. Government Agencies	250			250	2007
	\$ 4,253	\$ 14	\$	\$ 4,267	

Classification in Balance Sheet:

Cash and Cash Equivalents	\$	4,154	\$		\$		\$	4,154
Marketable Securities		99		14				113
	\$	4,253	\$	14	\$		\$	4,267

The cost and fair value of the Company's cash, cash equivalents and marketable securities as of December 31, 2005, by type of security, contractual maturity, and its classification in the balance sheet, are as follows (in thousands):

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Amortized Cost	Gross Unrealized Gain	Gross Unrealised (Loss)	Fair Value	Maturity
Type of security:					
Cash	\$ 2,034	\$	\$	\$ 2,034	
Money Market Funds	4,005			4,005	
Corporate Bonds and Notes	398			398	2006
Equity Securities	98		(4)	94	
U.S. Government Agencies	2,582		(2)	2,580	2006
	\$ 9,117	\$	\$ (6)	\$ 9,111	

**Classification in Balance
Sheet:**

Cash and Cash Equivalents	\$ 6,437	\$	\$	\$ 6,437
Marketable Securities	2,680		(6)	2,674
	\$ 9,117	\$	\$ (6)	\$ 9,111

5. Property and Equipment

Property and equipment (including Unicast acquisition) consist of the following (in thousands):

	December 31,	
	2006	2005
Computer equipment and software	\$ 5,542	\$ 5,365
Office furniture and equipment	1,173	1,180
Leasehold improvements	1,527	1,527
Website	108	
	8,350	8,072
Less accumulated depreciation and amortization	(7,327)	(6,854)
	\$ 1,023	\$ 1,218

Depreciation and leasehold amortization expense for the years ended December 31, 2006, 2005, and 2004 was approximately \$0.6 million, \$0.9 million and \$0.9 million, respectively.

6. 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.

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. The Company then performed the second step of the impairment test in accordance with SFAS No. 142 using a discount rate of 18% and a revenue growth rate of 18%. Following the completion of that step the Company recorded an impairment expense of \$7.8 million.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As stated in Note 2, the Company has reclassified amortization expense amounts in the 2005 and 2004 financial statements to conform to the 2006 presentation. The reclassifications consisted of the allocation of amortization from operating expenses into cost of sales. For the years ended December 31, 2006, 2005, and 2004, amortization amounted to \$0.7 million, \$0.7 million, and less than \$0.1 million respectively, of which \$0.1 million was recorded in cost of sales in 2006 and \$0.2 million was recorded in cost of sales in 2005. No amortization was allocated to cost of sales in 2004.

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

	Goodwill				Intangible Assets
	Technology	Advertising Systems	Services	Total	
Balance as of December 31, 2005	\$ 10,206	\$ 2,039	\$ 13,292	\$ 25,537	\$ 4,131
Additions during period					240
Impairment			(10,655)	(10,655)	
Amortization					(682)
Balance as of December 31, 2006	\$ 10,206	\$ 2,039	\$ 2,637	\$ 14,882	\$ 3,689

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

	Goodwill				Intangible Assets
	Technology	Advertising Systems	Services	Total	
Balance as of December 31, 2004	\$ 10,206	\$	\$ 21,070	\$ 31,276	\$ 230
Additions during period		2,133		2,133	4,579
Impairment			(7,778)	(7,778)	
Adjustments		(94)		(94)	
Amortization					(678)
Balance as of December 31, 2005	\$ 10,206	\$ 2,039	\$ 13,292	\$ 25,537	\$ 4,131

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

		December 31, 2006			December 31, 2005		
		Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Website Partner							
Relationships	Unicast	\$ 3,772	\$ (778)	\$ 2,994	\$ 3,772	\$ (404)	\$ 3,368
Acquired							
Technology	Unicast	410	(299)	111	410	(187)	223
Patents and							
Trademarks	Unicast	326	(141)	185	326	(80)	246
Fotomat		134	(8)	126			
Patents and							
Trademarks		438	(165)	273	332	(38)	294
Total Intangible							
Assets		\$ 5,080	\$ (1,391)	\$ 3,689	\$ 4,840	\$ (709)	\$ 4,131

Amortization of intangible assets is estimated to be \$0.7 million a year for the next five years.

7. Related Party Transactions

During 2005 and 2004 the Company recorded revenues totaling \$4.5 million, and \$6.0 million, respectively, primarily related to agreements with AOL that were entered into prior to December 31, 2003. AOL had a representative on the Company's Board of Directors until December 2003.

In 2003, the Company entered into an amended license agreement with AOL which provides for payments by AOL of \$10.0 million which were all received during the fourth quarter of 2003. The agreement contains multiple elements consisting of a perpetual broadcast license, a perpetual source

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

code license, quarterly updates to the source code through December 2005, and maintenance and consulting services. The Company recognized the fee ratably as license and services revenue, through December 31, 2005, which represents the duration of the Company's obligation for post-contract customer support of the source code element including quarterly upgrades and maintenance requirements.

The Company has outstanding a \$3.1 million note payable (face value \$2.5 million) to a related party (see Note 8 and 15).

8. Long Term Debt (Also see Note 15)

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 expired on December 31, 2006.

As discussed in Note 2, pursuant to SFAS No. 133, the Company was required to bifurcate the fair value of the conversion options from the new convertible notes. In addition, pursuant to EITF Issue No. 00-19, the Company was required to record the fair value of the conversion options as long-term liabilities.

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

In 2004, all of the new convertible notes were converted into 2.6 million shares of the Company's common stock. In addition, in March of 2004, the Company sold 1.5 million shares of common stock in a private placement to one of the former holders of the notes for \$3.7 million. The Company recorded a loss on conversion of debt in the amount of \$0.8 million.

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 amendments discussed below, the subordinated notes were scheduled to mature on March 31, 2006. Interest on these notes is payable quarterly in arrears in cash. The subordinated notes were subordinated to the convertible notes until June 18, 2004 when the remaining outstanding convertible notes converted into shares of common stock. The Company has the right at any time to redeem up to all of the outstanding notes at par plus accrued and unpaid interest. In the event of a change in control as defined, the holders of the subordinated notes have the right to require that the Company repurchase all or a portion of the subordinated notes.

The \$3.5 million of proceeds was allocated to subordinated notes in the amount of \$1.7 million, common stock for the par value of \$0.001 for the shares issued, and additional paid in capital of \$1.8 million based on the market value of the Company's common stock on March 26, 2003. Debt issuance costs, which amounted to \$0.2 million, were recorded as other assets in the Company's consolidated balance sheet. The amortization of the discount on the subordinated notes and debt issue costs totaled \$0.4 million, \$0.7 million, and \$0.7 million for the years ended

December 31, 2006, 2005 and 2004, respectively, using the effective interest method.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

At the time of the amendment, 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 as of December 31, 2006, 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.

As discussed in Note 15, in March 2007, the Company and the Holder of the subordinated debt amended the 4.95% subordinated note in the principal amount of \$3.1 million to extend the maturity date from March 31, 2008 to September 30, 2009 and waive the requirement that the Company's common stock remain listed on a national stock exchange, as defined, until December 31, 2008, in exchange for the payment by Viewpoint of \$0.2 million to the Holder of the subordinated note, and adding \$0.3 million to the principle of the note.

Unicast Notes

On January 3, 2005, as disclosed in Note 3, Viewpoint purchased Unicast and assumed debt which included an uncollateralized 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 \$0.3 million and \$0.3 million for the years ended December 31, 2006 and 2005 respectively. In March 2006, the

Company began making monthly payments on the collateralized note as required by the agreement.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company's total carrying value by note at December 31, 2006 and 2005 is as follows:

	December 31,	
	2006	2005
Subordinated notes	\$ 2,456	\$ 2,505
Unicast notes	1,930	1,981
	4,386	4,486
Less current portion	389	814
	\$ 3,997	\$ 3,672

The reconciliation of the carrying value to the face value of each note as of December 31, 2006, is as follows:

	Subordinated Notes	Unicast Notes	Total
Book Value of long-term debt	\$ 2,456	\$ 1,930	\$ 4,386
Discount on long-term debt	594	496	1,090
Face value of the long-term debt	\$ 3,050	\$ 2,426	\$ 5,476

The maturity schedule for the Company's debt subsequent to December 31, 2006 is as follows:

2007	\$ 318
2008	3,400
2009	350
2010	350
2011	1,058
	\$ 5,476

9. Employee Benefit Plans

401(k) Plan

In September 1995, the Company adopted a Defined Contribution Plan (the "401(k) Plan"). Participation in the 401(k) Plan is available to substantially all employees. Employees can contribute up to 20% of their salary, up to the Federal maximum allowable limit, on a before tax basis to the 401(k) Plan. Company contributions to the 401(k) Plan are

discretionary. The Company made contributions totaling \$0.1 million, to the 401(k) Plan during each of the years ended December 31, 2006, 2005, and 2004, respectively.

Stock Based Compensation

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 December 31, 2006, options to purchase an aggregate of 3.3 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 ten years. The ability to issue options out of this plan expired in 2005.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1995 Director Option Plan

The Company's 1995 Director Option Plan (the "Director Plan") provides for an automatic grant of options to purchase shares of common stock to each non-employee director of the Company. Options granted under the 1995 Director Plan vest over one and a half to four and a half years and are exercisable for a period of ten years. As of December 31, 2006, 0.1 million options were outstanding under the 1995 Director Plan. The ability to issue options out of this plan expired in 2005.

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 December 31, 2006, options to purchase an aggregate of 0.9 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 ten years. The ability to issue options out of this plan expired in 2006.

2006 Nonstatutory Stock Option Plan

The Company's 2006 Nonstatutory Stock Option Plan (the "2006 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 December 31, 2006, options to purchase an aggregate of 1.2 million shares of common stock were outstanding under the 2006 Nonstatutory Plan, with vesting provisions ranging up to four years. Options granted under the 2006 Nonstatutory Plan are exercisable for a period of ten years. At December 31, 2006, an aggregate of 3.3 million shares of common stock were reserved for future issuance under the 2006 Nonstatutory Plan.

The 1995 Plan, the Director Plan, 1996 Nonstatutory Plan, and the 2006 Nonstatutory Stock Option Plan are collectively referred to as "Option Plans".

Options Issued Outside the Option Plan

During 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 at the opening price 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, with the exception of their vesting, which varies. There are 3.9 million shares outstanding outside the Option Plans.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Summary of All Outstanding Options

The following summarizes activity in all stock option plans for the year ended December 31, 2006 (in thousands, except per share data):

	Options Available for Grant	Options Outstanding Number of Shares	Weighted Average Exercise Price
Options outstanding at December 31, 2005	363	12,556	\$ 1.79
Granted	(1,779)	1,779	1.40
Granted non-plan options		250	1.53
Plan approved at June 30, 2006	4,500		
Exercised		(2,981)	0.81
Cancelled	205	(205)	2.71
Cancelled expired plan		(1,789)	3.21
Cancelled non-plan options		(288)	3.15
Options outstanding at December 31, 2006	3,289	9,322	\$ 1.68

The exercise price of all stock option grants during 2006 were equal to the fair market value of the Company's common stock on the date of grant.

The following summarizes information about the Company's stock options outstanding at December 31, 2006 (in thousands, except per share data and lives):

Outstanding				Exercisable		
	Shares	Average Life	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	
\$0.46 \$ 0.78	1,950	6.66	\$ 0.74	1,728	\$ 0.74	
\$0.80 \$ 1.14	1,868	5.48	0.93	1,597	0.91	
\$1.15 \$ 1.36	2,212	7.64	1.33	1,063	1.33	
\$1.40 \$ 2.61	1,894	6.56	1.81	572	2.18	
\$2.62 \$12.88	1,398	5.23	4.36	1,372	4.39	
Total	9,322	6.42	1.68	6,332	1.80	

	Intrinsic Value Options Outstanding	Intrinsic Value Options Exercisable
Aggregate intrinsic value (in thousands)	\$ 1	\$ 1

	Outstanding Average Life	Exercisable Average Life
Weighted average remaining contractual life	6.42	6.10

The aggregate intrinsic value in the table above is based on the Company's closing stock price of \$0.67 per share as of December 31, 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 year ended December 31, 2006 was \$2.0 million.

During the year ended December 31, 2006, 2005, and 2004, the total intrinsic value of options exercised to purchase common stock was \$1.9 million, \$0.8 million, and \$1.5 million, respectively, and the weighted average fair value of options to purchase common stock that were granted was \$1.41, \$1.91, and \$1.84, respectively.

During the year ended December 31, 2006, financing cash generated from share-based compensation arrangements amounted to \$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.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company accrued incentive compensation expense for the difference between the grant price and the deemed fair value of the common stock underlying options, which were issued in connection with the RTG acquisition in December 1996. At December 31, 2006 and 2005 accrued incentive compensation related to the options, which are fully vested totaled \$0.5 million.

10. 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.

During October 2004, the Company signed an agreement releasing it from any additional obligation under the remaining lease commitment related to a 2003 restructuring. As a result of this release the Company reversed the remaining accrued amount of \$0.1 million as the Company completed its obligations under the release agreement.

11. 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.

Rent expense for office space, equipment, and a leased vehicle for a former executive totaled approximately \$1.0 million, \$1.1 million, and \$1.0 million, for the years ended December 31, 2006, 2005, and 2004, respectively.

Future minimum lease payments under non-cancelable operating leases for each year subsequent to December 31, 2006 are as follows (in thousands):

2007	1,016
2008	857
2009	799
2010	90
2011 and thereafter	

\$ 2,762

Legal Proceedings

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

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Taxes

The components of the current provision for taxes for the years ended December 31, 2006, 2005, and 2004 are as follows (in thousands):

	Years Ended December 31,		
	2006	2005	2004
Current:			
Federal	\$	\$	\$
State	78	64	89
Foreign			
Total current	\$ 78	\$ 64	\$ 89

There was no deferred tax provision for each of the years ended December 31, 2006, 2005 and 2004.

The differences between the statutory rate and the Company's effective income tax rate are as follows:

	Years Ended December 31,		
	2006	2005	2004
Federal tax benefit at the statutory rate	(34.00) %	(34.00) %	(34.00) %
State and local income taxes, net of federal income tax benefit	(2.85)	(1.02)	(5.41)
Other	(0.73)	(0.48)	2.13
Amortization and impairment of goodwill and other intangibles	18.39	25.20	
Change in state and local income tax rate	15.36		
Nondeductible expenses	8.35		
Change in valuation allowance	(4.52)	10.91	38.21
Effective income tax rate	0.00 %	0.61 %	0.93 %

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, together with net operating loss and tax credit carry-forwards. Significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	December 31,
	2006 2005

Deferred tax assets:		
Balance sheet reserves	\$ 47	\$ 170
Accrued expenses	1,174	423
Tax credit carryforwards	1,838	1,838
Other	(856)	(1,049)
Net operating loss carryforwards	85,018	86,731
	87,221	88,113
Valuation allowance	(87,221)	(88,113)
Net deferred taxes	\$	\$

The tax effect of net operating loss carryforwards above excludes \$0.7 million attributable to stock based compensation. This benefit will not be recognized until utilized by reducing taxes payable.

At December 31, 2006, the Company has net operating loss and tax credit carryforwards of approximately \$218.2 million and \$1.8 million, respectively, for federal income tax purposes, which begin to expire in 2011. The Company's federal net operating loss carryforward relates to the Company's acquisitions of Unicast, RTG and Specular and the net losses incurred by the Company. The Company also has net operating loss and tax credit carryforwards for state income tax purposes, which

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

begin to expire in 2011. The Company's state net operating loss carryforward primarily relates to the net losses incurred by the Company. The net operating loss carryforwards may be used to offset any future taxable income, subject to potential limitations on the Company's ability to utilize such loss carryforwards pursuant to the ownership rule changes of the Internal Revenue Code, Section 382. Inability to generate taxable income within the carryforward period would affect the ultimate realizability of such assets. Consequently, management determined that sufficient uncertainty exists regarding the realizability of these assets to warrant the establishment of the full valuation allowance. Management's assessment with respect to the amount of deferred tax assets considered realizable may be revised over the near term-based on actual operating results and revised financial statement projections.

13. Segment Information and Enterprise-Wide Disclosures

As discussed in more detail in Notes 1 and 2 to these financial statements, 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 costs below costs of revenue. 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 a cost per thousand (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 segment are the same as the consolidated accounting policies disclosed in Note 2.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Years Ended December 31,		
	2006	2005	2004
Revenues:			
Advertising systems	7,252	5,448	305
Technology:			
Licenses	148	608	704
Related party licenses		3,490	3,535
Search	6,307	9,424	2,698
Total technology revenue:	6,455	13,522	6,937
Services:			
Services	3,470	5,269	4,822
Related party services		1,057	2,468
Total services revenue:	3,470	6,326	7,290
Total revenues	17,177	25,296	14,532
Cost of Revenues:			
Advertising systems	4,176	3,721	132
Technology:			
License	8	12	6
Search	154	173	45
Total technology cost of revenues	162	185	51
Services	2,337	3,658	3,270
Total cost of revenues	6,675	7,564	3,453
Gross profit			
Advertising systems	3,076	1,727	173
Technology:			
Licenses	140	4,086	4,233
Search	6,153	9,251	2,653
Total technology gross profit	6,293	13,337	6,886
Services	1,133	2,668	4,020

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Total gross profit	\$ 10,502	\$ 17,732	\$ 11,079
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Gross profit margin

Advertising systems	42 %	32 %	57 %
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Technology:

Licenses	95	100	100
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Search	98	98	98
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Total technology gross profit margin	97	99	99
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Services	33	42	55
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Total gross profit	61 %	70 %	76 %
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At December 31,

2006

2005

2004

Total assets:

Technology	\$ 12,512	\$ 13,171	\$ 13,038
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Advertising systems	3,925	8,627	200
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Services	6,793	14,045	23,053
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Corporate(*)	4,457	9,293	8,982
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Total assets	\$ 27,687	\$ 45,136	\$ 45,273
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* Corporate assets consists solely of cash, cash equivalents, marketable securities and restricted cash as the Company does not allocate such amounts to the individual reporting units.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Major Customers

Customers whose revenues represent greater than 10 percent of the Company's consolidated revenues from continuing operations for the years ended December 31, 2006, 2005, and 2004 are as follows:

	Years Ended December 31,		
	2006	2005	2004
Customer A	31%	37%	19%
Customer B	13%	7%	0%
Customer C	18%	25%	48%

Customers whose accounts receivable represent greater than 10 percent of the Company's consolidated net accounts receivable from continuing operations at December 31, 2006, and, 2005, are as follows:

	Years Ended December 31,	
	2006	2005
Customer A	32%	35%
Customer B	0%	16%

15. Subsequent Events

In March 2007, the Company and the Holder of the subordinated debt amended the 4.95% subordinated note in the principal amount of \$3.1 million to extend the maturity date from March 31, 2008 to September 30, 2009 and waive the requirement that the Company's common stock remain listed on a national stock exchange, as defined, until December 31, 2008, in exchange for the payment by Viewpoint of \$0.2 million to the Holder of the subordinated note, and adding \$0.3 million to the principle of the note.

On March 12, 2007, Viewpoint entered into a Purchase Agreement to acquire all of the outstanding partnership interests of Makos Advertising, L.P. The transaction is expected to close in the second quarter of 2007. Under the terms of the agreement, Viewpoint will be obligated, at the closing, to pay \$0.6 million in cash and issue an aggregate number of shares of common stock equal to \$0.4 million. The number of shares issuable will be based on a volume-weighted average price over a five day period preceding the closing; provided that such price shall not be lower than \$0.60, nor greater than \$1.50. In addition, the purchase price is subject to a net book value adjustment.

VIEWPOINT CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. Quarterly Results of Operations (Unaudited)

Summarized quarterly financial information for the years 2006 and 2005, are as follows (in thousands, except per share amounts):

	Quarter Ended			
	March 31	June 30	September 30	December 31
Fiscal year 2006:				
Total revenues	\$ 3,983	\$ 5,709	\$ 3,211	\$ 4,274
Gross profit	2,238	2,822	2,318	3,124
Net loss from continuing operations	(3,949)	(2,821)	(12,337)	(608)
Adjustment to net loss on disposal of discontinued operations				
Net loss	(3,949)	(2,821)	(12,337)	(608)
Basic and diluted net loss per share (1)	(0.06)	(0.04)	(0.18)	(0.01)
Fiscal year 2005:				
Total revenues	\$ 5,578	\$ 6,573	\$ 5,959	\$ 7,186
Gross profit	4,072	4,559	4,551	4,549
Net loss from continuing operations	(890)	(446)	(1,451)	(7,950)
Adjustment to net loss on disposal of discontinued operations	145			
Net loss	(745)	(446)	(1,451)	(7,950)
Basic and diluted net loss per share (1)	(0.01)	0.01	(0.02)	(0.13)

(1) The sum of the quarterly net (loss) per share amounts may not total to the annual amounts as the result of rounding.

VIEWPOINT CORPORATION
SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended December 31, 2006, 2005, and 2004

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other	Deductions	Balance at End of Period
Allowance for Accounts Receivable:					
Year Ended December 31, 2006	\$ 419	\$ 110	109	\$ 408	\$ 230
Year Ended December 31, 2005	430	90		101	419
Year Ended December 31, 2004	1,611	43	3	1,227	430
Valuation for Deferred Tax Assets:					
Year Ended December 31, 2006	\$ 88,113				\$ 88,113
Year Ended December 31, 2005	82,753	5,360			88,113
Year Ended December 31, 2004	81,322	1,431			82,753

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. Controls and Procedures

1. Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Interim Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2006. Based on this evaluation, our Chief Executive Officer and Interim Chief Financial Officer concluded that, as of December 31, 2006, our disclosure controls and procedures were (1) designed to ensure that material information relating to us, including its consolidated subsidiaries, is made known to our Chief Executive Officer and Interim Chief Financial Officer by others within those entities, particularly during the period in which this report was being prepared and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

2. Internal Control over Financing Reporting

Management's Annual Report on Internal Control Over Financing Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

(1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company.

(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company, and

(3) Provide reasonable assurances regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2006. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework.

Based on our assessment, we concluded that as of December 31, 2006, our internal control over financial reporting is effective based on those criteria.

Our Independent Registered Public Accounting Firm PricewaterhouseCoopers LLP, has audited our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006, as stated in their report which appears herein.

3. Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the year ended December 31, 2006 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. *Directors and Executive Officers of the Registrant*

Information regarding our Executive Officers required by Item 10 of Part III is set forth in Item 1 of Part I

Business Executive Officers of the Registrant. Information required by Item 10 of Part III regarding our Directors is included in our Proxy Statement relating to our 2007 annual meeting of stockholders, and is incorporated herein by reference. Information relating to compliance with Section 16(a) of the Securities Exchange Act of 1934 is set forth in the Proxy Statement relating to our 2007 annual meeting of stockholders and is incorporated herein by reference.

Audit Committee Financial Expert

The Company has determined that Dennis R. Raney, chairman of the Audit Committee of the Board of Directors, qualifies as an audit committee financial expert as defined in Item 401 (h) of Regulation S-K, and that Mr. Raney is independent as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Securities Exchange Act.

Code of Business Conduct

The Company has adopted a Code of Business Conduct and Ethics applicable to directors, officers, and all employees of the Company. Viewpoint's Code of Business Conduct and Ethics is available on the Company's web site at www.viewpoint.com under the Company tab. The Company intends to post on its web site any amendments to, or waivers from its Code of Business Conduct and Ethics applicable to any employees.

Item 11. *Executive Compensation*

Information required by Item 11 of Part III is included in our Proxy Statement relating to our 2007 annual meeting of stockholders and is incorporated herein by reference.

Item 12. *Security Ownership of Certain Beneficial Owners and Management*

Information required by Item 12 of Part III is included in our Proxy Statement relating to our 2007 annual meeting of stockholders and is incorporated herein by reference.

Item 13. *Certain Relationships and Related Transactions*

Information required by Item 13 of Part III is included in our Proxy Statement relating to our 2007 annual meeting of stockholders and is incorporated herein by reference.

Item 14. *Principal Accountant Fees and Services*

Information required by Item 14 of Part III is included in our Proxy Statement relating to our 2007 annual meeting of stockholders and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedule

(a) The following documents are filed as part of this report:

1. *Financial Statements*. See Index to Financial Statements at Item 8 on page 42 of this Report.
2. *Financial Statement Schedule*. See Index to Financial Statements at Item 8 on page 42 of this Report.
3. *Exhibits*.

Exhibit No. 2: Plan of Acquisition, Reorganization, Arrangement, Liquidation or Succession

- 2.1 Stock Purchase Agreement, dated as of August 23, 2000, by and between the Registrant and Computer Associates International, Inc. (incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K, filed on September 8, 2000 (File No. 000-27168))
- 2.2 Stock Purchase Agreement between the Registrant and the selling stockholders of Unicast Communications Corp., dated December 1, 2004 (incorporated by reference from Exhibit 2.2 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004 filed on March 16, 2005 (File No. 000-27168))
- 2.3 Purchase Agreement among the Registrant, Delaney, L.L.C. and Mark Turner (incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K, filed on March 16, 2007)

Exhibit No. 3: Articles of Incorporation and Bylaws

- 3.1 Restated Certificate of Incorporation of Registrant (incorporated by reference from Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2004, filed on March 16, 2005 (File No. 000-27168))
- 3.2 Amended Bylaws of Registrant

Exhibit No. 4: Instruments Defining the Rights of Security Holders

- 4.1 Specimen of Common Stock Certificate of Registrant (incorporated by reference from Exhibit 2.4 to the Registrant's Form 8-K, filed on June 13, 1997 (File No. 000-27168))
- 4.2 Amended and Restated Rights Agreement, dated as of June 24, 1999 between the Registrant and BankBoston, N.A., including form of Certificate of Designations, Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B, and C respectively (incorporated by reference from Exhibit 4 to the Registrant's Form 8-A/A, filed on October 29, 1999 (File No. 000-27168))
- 4.3 Amendment No. 1 to Amended and Restated Rights Agreement, dated as of June 24, 1999 between the Registrant and BankBoston, N.A. (incorporated by reference from Exhibit 5 to the Registrant's Form 8-A/A, filed on December 5, 2000 (File No. 000-27168))

Exhibit No. 10: Material Contracts

- 10.1 1995 Stock Plan, as amended on November 28, 2000 (incorporated by reference from Exhibit 10.2 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000 filed on March 30, 2001 (File No. 000-27168))
- 10.2 1995 Director Option Plan (incorporated by reference from Exhibit 10.7 to the Registrant's Registration Statement on Form SB-2, filed on December 11, 1995, as amended (File No. 33-98628LA))
- 10.3 1996 Nonstatutory Stock Option Plan, as amended on June 29, 1999 (incorporated by reference from Exhibit 4.2 to the Registrant's Registration Statement on Form S-8, filed on September 9, 1999 (File

No. 333-86817))

- 10.4 Employment Agreement between the Registrant and Robert E. Rice dated December 29, 2004
(incorporated by reference from Exhibit 10.1 to the Registrant's Report on Form 8-K filed by the
Registrant on December 30, 2004)
- 10.5 Employment Agreement between the Registrant and Jay S. Amato, dated August 7, 2003
(incorporated by reference from Exhibit 10.1 to Form 10-Q filed by the Registrant on November 14,
2003)

- 10.6 Employment Agreement between the Registrant and William H. Mitchell dated July 18, 2003 (incorporated by reference from Exhibit 10.2 to Form 10-Q filed by Registrant on November 14, 2003)
- 10.7 Form of Indemnification Agreement for Executive Officers and Directors (incorporated by reference from Exhibit 10.1 to the Registrant's Registration Statement on Form SB-2, filed on December 11, 1995, as amended (File No. 33-98628LA))
- 10.8 Securities Purchase Agreement, dated as of December 31, 2002, by and among the Registrant and the Buyers named therein, as amended by the Redemption, Amendment and Exchange Agreement, dated as of March 25, 2003, by and among the Registrant and the Buyers named therein (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on January 2, 2003)
- 10.9 Form of Replacement 4.95% Convertible Note of the Registrant, (incorporated by reference from Exhibit 10.2 to Form 8-K filed by the Registrant on January 2, 2003)
- 10.10 Form of Subsequent/Additional 4.95% Convertible Note of the Registrant, (incorporated by reference from Exhibit 10.3 to Form 8-K filed by the Registrant on January 2, 2003)
- 10.11 Form of Initial Warrant for Common Stock of the Registrant, (incorporated by reference from Exhibit 10.4 to Form 8-K filed by the Registrant on January 2, 2003)
- 10.12 Form of Subsequent/Additional Warrant for Common Stock of the Registrant, (incorporated by reference from Exhibit 10.5 to Form 8-K filed by the Registrant on January 2, 2003)
- 10.13 Registration Rights Agreement, dated as of December 31, 2002, by and among the Registrant and the Buyers named therein, as amended by the Redemption, Amendment and Exchange Agreement, dated as of March 25, 2003, by and among the Registrant and the Buyers named therein, (incorporated by reference from Exhibit 10.6 to Form 8-K filed by the Registrant on January 2, 2003)
- 10.14 Pledge Agreement, dated as of December 31, 2002, by Viewpoint Corporation as Pledgor, in favor of Smithfield Fiduciary LLC as collateral agent, for the benefit of the holders named therein, (incorporated by reference from Exhibit 10.7 to Form 8-K filed by the Registrant on January 2, 2003)
- 10.15 Redemption, Amendment and Exchange Agreement, dated as of March 25, 2003, by and among the Registrant and Smithfield Fiduciary LLC (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on March 25, 2003)
- 10.16 Redemption, Amendment and Exchange Agreement, dated as of March 25, 2003, by and among the Registrant and Riverview Group, LLC (incorporated by reference from Exhibit 10.2 to Form 8-K filed by the Registrant on March 25, 2003)
- 10.17 Redemption, Amendment and Exchange Agreement, dated as of March 25, 2003, by and among the Registrant and Portside Growth & Opportunity Fund (incorporated by reference from Exhibit 10.3 to Form 8-K filed by the Registrant on March 25, 2003)
- 10.18 Form of Redemption Warrant for Common Stock of the Registrant (incorporated by reference from Exhibit 10.9 to Form 8-K filed by the Registrant on March 25, 2003)
- 10.19 Stock Purchase Agreement, dated as of November 12, 2003, by and between the Registrant and Federal Partners, L.P. (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on November 13, 2003)
- 10.20 Registration Rights Agreement dated as of November 12, 2003, by and between the Registrant and Federal Partners, L.P. (incorporated by reference from Exhibit 10.2 to Form 8-K filed by Registrant on November 13, 2003)
- 10.21*

Overture Master Agreement, dated January 14, 2004 by and between the Registrant and Overture Services, Inc. (incorporated by reference from Exhibit 10.21 to Form 10-K filed by Registrant for the year ended December 31, 2004 filed on March 16, 2005 (File No. 000-27168))

10.22

Registration Rights Agreement, by and between the Registrant and the selling stockholders of Unicast Communications, Corp. (incorporated by reference from Exhibit 10.22 to Form 10-K filed by Registrant on March 16, 2006)

- 10.23 Securities Purchase Agreement, by and between the Registrant and the investors listed on the Schedule of Buyers attached thereto (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on March 18, 2004)
- 10.24 Registration Rights Agreement, by and between the Registrant and the investors listed on the Schedule of Buyers attached thereto (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on March 18, 2004)
- 10.25 Securities Purchase Agreement, dated as of December 20, 2004, by and between the Registrant and EagleRock Master Fund, LP (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on December 22, 2004)
- 10.26 Registration Rights Agreement dated as of December 20, 2004, by and between the Registrant and EagleRock Master Fund, LP (incorporated by reference from Exhibit 10.2 to Form 8-K filed by Registrant on December 22, 2004)
- 10.27 Employment Agreement between the Registrant and Patrick Vogt dated August 25, 2005 (incorporated by reference from Exhibit 10.2 to Form 10-Q filed by the Registrant on November 9, 2005)
- 10.28 Employment Agreement between the Registrant and Andrew J. Graf, dated May 24, 2005
- 10.29* Amendment No. 1 to Overture Master Agreement, dated May 11, 2004 by and between the Registrant and Overture Services, Inc. (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on November 23, 2005)
- 10.30* Amendment No. 2 to Overture Master Agreement, dated December 1, 2004 by and between the Registrant and Overture Services, Inc. (incorporated by reference from Exhibit 10.2 to Form 8-K filed by the Registrant on November 23, 2005)
- 10.31* Amendment No. 3 to Overture Master Agreement, dated October 18, 2005 by and between the Registrant and Overture Services, Inc. (incorporated by reference from Exhibit 10.3 to Form 8-K filed by the Registrant on November 23, 2005)
- 10.32 Securities Purchase Agreement, dated December 29, 2005 by and between the Registrant and the investors listed on Schedule of Purchasers (incorporated by reference from Exhibit 4.1 to Form S-3 filed by the Registrant on February 14, 2006)
- 10.33 Registration Rights Agreement, dated December 29, 2005 by and between the Registrant and the investors listed on Schedule of Purchasers (incorporated by reference from Exhibit 4.2 to Form S-3 filed by the Registrant on February 14, 2006)
- 10.34 2006 Equity Incentive Plan (incorporated by reference from Exhibit 4.1 to the Registrant's Registration Statement on Form S-8, filed on August 3, 2006 (File No. 333-136271))
- 10.35 Amendment to Amended and Restated 4.95% Subordinated Note Due March 31, 2008 (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on March 15, 2007)
- 10.36 Second Amended and Restated 4.95% Subordinated Note Due September 30, 2009 (incorporated by reference from Exhibit 10.2 to Form 8-K filed by the Registrant on March 15, 2007)
- 10.37 Stock Purchase Agreement, dated as of July 27, 2005 by and between Registrant and Federal Partners, L.P. (incorporated by reference from Exhibit 10.1 to Form 8-K filed by the Registrant on July 28, 2005)
- 10.38 Registration Rights Agreement, dated as of July 27, 2005, by and between Registrant and Federal Partners, L.P. (incorporated by reference from Exhibit 10.2 to Form 8-K filed by Registrant of July 28, 2005).

Exhibit No. 21: Subsidiaries of the Registrant

- 21.1 Listing of Registrant's Subsidiaries (incorporated by reference from Exhibit 21.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 30, 2001 (File No. 000-27168))
- 23.1 Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm

Exhibit No. 24: Power of Attorney

24.1 Power of Attorney

Exhibit Nos. 31 and 32: Additional Exhibits

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Confidential
treatment
has been
requested for
portions of
this exhibit.

Incorporated
by reference
to the
registrant's
Annual Report
on Form 10-K
for the year
ended
December 31,
2006, which
was filed on
March 16,
2007.

Incorporated
by reference
to signature
page to the
registrant's
Annual Report
on Form 10-K
for the year
ended
December 31,
2006, which
was filed on
March 16,
2007.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of New York, State of New York, on the 26th day of April, 2007.

VIEWPOINT CORPORATION

Dated: April 26, 2007 By: /s/ SOLID 0.50PT K;">PATRICK VOGT
Patrick Vogt
Director, President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities indicated.

Dated: April 26, 2007 By: /s/ SOLID 0.50PT K;">PATRICK VOGT
Patrick Vogt
Director, President and
Chief Executive Officer
(Principal Executive Officer)

Dated: April 26, 2007 By: /s/ SOLID 0.50PT K;">CHRISTOPHER C. DUIGNAN
Christopher C. Duignan
Interim Chief Financial Officer
(Interim Principal Financial Officer)

Dated: April 26, 2007 By: *
Samuel H. Jones, Jr.
Director

Dated: April 26, 2007 By: *
Dennis R. Raney
Director

Dated: April 26, 2007 By: *
James J. Spanfeller
Director

Dated: April 26, 2007 By: *
Harvey D. Weatherson
Director

* Patrick Vogt, by signing his name hereto, does sign this document on behalf of the above noted individuals, pursuant to powers of attorney duly executed by such individuals, which have been filed as Exhibit 24.1 to this Report.

By: /s/ SOLID 0.50PT K;">PATRICK VOGT
Patrick Vogt
Attorney-in-fact

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: April 26, 2007 By: /s/ SOLID 0.50PT K;">PATRICK VOGT
Patrick Vogt
President and Chief Executive Officer

Dated: April 26, 2007 By: /s/ SOLID 0.50PT K;">CHRISTOPHER C. DUIGNAN
Christopher C. Duignan
Interim Chief Financial Officer