

GLOWPOINT INC  
Form 10-Q/A  
January 31, 2007

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q/A**

Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2005.

or

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934

**Commission file number: 0-25940**

**GLOWPOINT, INC.**

(Exact Name of registrant as Specified in its Charter)

**Delaware**  
(State or other Jurisdiction of  
Incorporation or Organization)

**77-0312442**  
(I.R.S. Employer Number)

**225 Long Avenue, Hillside, New Jersey 07205**  
(Address of Principal Executive Offices)

**312-235-3888**  
(Issuer's Telephone Number, Including Area Code)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Check whether the registrant is an accelerated filer as defined in Rule 12b-2 of the Exchange Act of 1934.

Yes  No

The number of shares outstanding of the registrant's Common Stock as of November 14, 2005 was 46,046,340.

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**GLOWPOINT, INC**

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\* The Condensed Consolidated Balance Sheet at December 31, 2004 has been derived from the audited restated consolidated financial statements filed as an exhibit to our Report on Form 8-K on January 18, 2007.

**GLOWPOINT, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except par value)

|   | September 30, 2005<br>(Unaudited)<br>(Restated - Note 3) | December 31, 2004* |
|---|--|--------------------|
| <b>ASSETS</b>   |  |                    |
| Current assets:   |  |                    |
| Cash and cash equivalents   | \$ 6,221   | \$ 4,497           |
| Escrowed cash   | —  | 337                |
| Accounts receivable, net of allowance for doubtful accounts of \$152 and \$305; respectively  | 2,329  | 1,872              |
| Receivable from Gores Technology Group  | —  | 2,371              |
| Prepaid expenses and other current assets   | 923  | 554                |
| Total current assets  | 9,473  | 9,631              |
| Property and equipment, net   | 4,588  | 5,103              |
| Other assets  | 217  | 258                |
| Total assets  | \$ 14,278  | \$ 14,992          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |  |                    |
| Current liabilities:  |  |                    |
| Accounts payable  | \$ 3,732   | \$ 2,984           |
| Accrued expenses  | 4,353  | 3,822              |
| Current portion of derivative financial instrument  | 1,026  | 367                |
| Deferred revenue  | 449  | 265                |
| Capital lease obligations   | —  | 35                 |
| Total current liabilities   | 9,560  | 7,473              |
| Derivative financial instrument, less current portion   | 387  | 932                |
| Total liabilities   | 9,947  | 8,405              |
| Preferred stock, \$.0001 par value; 5,000 shares authorized and redeemable; 0.120 and 0.204 Series B shares issued and outstanding, (stated value of \$2,888 and \$4,888; liquidation value of \$3,279 and \$5,257), respectively | 2,888  | 4,888              |
| Stockholders' Equity:   |  |                    |
| Common stock, \$.0001 par value; 100,000 shares authorized; 46,086 and 37,935 shares issued and issuable; 45,966 and 37,815 shares outstanding, respectively  | 5  | 4                  |
| Deferred compensation   | (711)  | (1,176)            |
| Additional paid-in capital  | 160,328  | 148,510            |
| Accumulated deficit   | (157,939)  | (145,399)          |
|   | 1,683  | 1,939              |
| Less: Treasury stock, 40 shares at cost   | (240)  | (240)              |
| Total stockholders' equity  | 1,443  | 1,699              |
| Total liabilities and stockholders' equity  | \$ 14,278  | \$ 14,992          |

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·Derived from the audited restated consolidated financial statements filed as an exhibit to our Report on Form 8-K on January 18, 2007.

See accompanying notes to condensed consolidated financial statements.

**GLOWPOINT, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except per share data)

**(Restated- Note 3)**  
**(Unaudited)**

|  | Nine Months Ended<br>September 30, |             | Three Months Ended<br>September 30, |            |
|--|------------------------------------|-------------|-------------------------------------|------------|
|  | 2005                               | 2004        | 2005                                | 2004       |
| Revenue  | \$ 13,157                          | \$ 11,748   | \$ 4,558                            | \$ 4,383   |
| Cost of revenue  | 11,367                             | 11,851      | 3,675                               | 4,240      |
| Gross margin (loss)  | 1,790                              | (103)       | 883                                 | 143        |
| <b>Operating expenses:</b>                                     |                                    |             |                                     |            |
| Research and development                                       | 896                                | 794         | 320                                 | 313        |
| Sales and marketing  | 3,159                              | 2,190       | 1,011                               | 931        |
| General and administrative                                     | 10,616                             | 8,694       | 3,946                               | 3,118      |
| Total operating expense  | 14,671                             | 11,678      | 5,277                               | 4,362      |
| Loss from operations before other (income) expense             | (12,881)                           | (11,781)    | (4,394)                             | (4,219)    |
| <b>Other (income) expense:</b>                                 |                                    |             |                                     |            |
| Amortization of deferred financing costs                       | —                                  | 448         | —                                   | —          |
| Interest (income) expense, net                                 | (76)                               | (5)         | (43)                                | (26)       |
| Increase in fair value of derivative financial instrument      | 114                                | 88          | 33                                  | 45         |
| Amortization of discount on subordinated debentures            | —                                  | 2,650       | —                                   | —          |
| Other non-operating business                                   | —                                  | (132)       | —                                   | (132)      |
| Loss on exchange of debt                                       | —                                  | 743         | —                                   | —          |
| Gain on settlement with Gores                                  | (379)                              | —           | —                                   | —          |
| Total other (income) expense, net                              | (341)                              | 3,792       | (10)                                | (113)      |
| Net loss   | (12,540)                           | (15,573)    | (4,384)                             | (4,106)    |
| Preferred stock dividends                                      | (205)                              | ( 270)      | (58)                                | (99)       |
| Preferred stock deemed dividends                               | (1,282)                            | —           | —                                   | —          |
| Net loss attributable to common stockholders                   | \$ (14,027)                        | \$ (15,843) | \$ (4,442)                          | \$ (4,205) |
| <b>Net loss attributable to common stockholders per share:</b> |                                    |             |                                     |            |
| Basic and diluted  | \$ (0.32)                          | \$ (0.44)   | \$ (0.10)                           | \$ (0.11)  |
| <b>Weighted average number of common shares:</b>               |                                    |             |                                     |            |
| Basic and diluted  | 43,693                             | 35,865      | 45,966                              | 37,841     |

See accompanying notes to condensed consolidated financial statements.



**GLOWPOINT, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

**(Restated- Note 3)**  
**(Unaudited)**

|   | Nine Months Ended<br>September 30, |             |
|---|------------------------------------|-------------|
|   | 2005                               | 2004        |
| <b>Cash flows from Operating Activities:</b>  |                                    |             |
| Net loss  | \$ (12,540)                        | \$ (15,573) |
| Adjustments to reconcile net loss to net cash used in operating activities:                                   |                                    |             |
| Depreciation and amortization   | 1,727                              | 1,669       |
| Amortization of deferred financing costs  | —                                  | 448         |
| Amortization of discount on subordinated debentures   | —                                  | 2,650       |
| Loss on exchange of debt  | —                                  | 743         |
| Other expense recognized for the increase in the estimated fair value of the derivative financial instrument  | 114                                | 88          |
| Common stock issued for interest on convertible debentures  | —                                  | 45          |
| Gain on settlement with Gores   | (379)                              | —           |
| Equity-based compensation   | 775                                | 586         |
| Other   | —                                  | (78)        |
| Increase (decrease) in cash attributable to changes in assets and liabilities, net of effects of acquisition: |                                    |             |
| Escrowed cash   | 337                                | (2)         |
| Accounts receivable   | (457)                              | 188         |
| Receivable from Gores Technology Group  | —                                  | (400)       |
| Prepaid expenses and other current assets   | (369)                              | 350         |
| Other assets  | 41                                 | (220)       |
| Accounts payable  | 748                                | (449)       |
| Accrued expenses  | 577                                | 905         |
| Deferred revenue  | 184                                | 17          |
| Net cash used in operating activities   | (9,242)                            | (9,033)     |
| <b>Cash flows from Investing Activities:</b>  |                                    |             |
| Settlement from discontinued operations (Note 6)  | 2,750                              | —           |
| Purchases of property, equipment and leasehold improvements   | (1,212)                            | (852)       |
| Net cash provided by (used in) investing activities   | 1,538                              | (852)       |
| <b>Cash flows from Financing Activities:</b>  |                                    |             |
| Proceeds from issuance of common stock and warrants   | 9,389                              | 11,399      |
| Offering costs  | —                                  | (34)        |
| Proceeds attributed to derivative financial instrument  | —                                  | 1,164       |
| Proceeds from exercise of warrants and options, net   | 74                                 | 562         |
| Payments on capital lease obligations   | (35)                               | (97)        |
| Net cash provided by financing activities   | 9,428                              | 12,994      |
| Increase in cash and cash equivalents   | 1,724                              | 3,109       |
| Cash and cash equivalents at beginning of period  | 4,497                              | 4,105       |
| Cash and cash equivalents at end of period  | \$ 6,221                           | \$ 7,214    |

Supplement disclosures of cash flow information:

Cash paid during the period for:

|          |    |   |    |    |
|----------|----|---|----|----|
| Interest | \$ | 2 | \$ | 62 |
|----------|----|---|----|----|

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|   | Nine Months Ended<br>September 30, |        |
|---|------------------------------------|--------|
|   | 2005                               | 2004   |
| Non-cash investing and financing activities:  |                                    |        |
| Deferred compensation and additional paid-in capital recorded for the issuance of restricted common stock | \$ —                               | \$ 511 |
| Issuance of Series B convertible preferred stock in exchange for convertible debentures                   | —                                  | 4,888  |
| Conversion of Series B convertible preferred stock to common stock  | 2,000                              | —      |
| Preferred stock deemed dividends  | 1,282                              | —      |
| Preferred stock dividends   | 205                                | 270    |
| Equity issued as consideration for accrued preferred stock dividends                                      | 183                                | —      |

See accompanying notes to condensed consolidated financial statements.

**GLOWPOINT, INC.**  
**NOTES TO RESTATED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2005**

**Note 1 — The Business**

Glowpoint, Inc. (“Glowpoint” or “we” or “us”), a Delaware corporation, provides comprehensive video communications services. Prior to 2004, Glowpoint, then known as Wire One Technologies, Inc., sold substantially all of the assets of its video solutions (VS) business to an affiliate of Gores Technology Group (Gores) (See Note 6). Our services include IP-based and ISDN-based videoconferencing services, which are provided principally on a subscription basis, and managed bridging conferencing services for multi-point video and audio communications among three or more participants. We also provide hosting, IP-based broadcasting and event services.

On April 20, 2004, we entered into an agreement with Tandberg, Inc., a wholly owned subsidiary of Tandberg ASA (OSLO: TAA.OL), a global provider of visual communications solutions. As part of the agreement, we acquired for \$1.00 certain assets and the customer base of Tandberg owned Network Systems LLC. Network Systems customers, primarily ISDN-based video users, obtained immediate access to our video bridging and webcasting services. As part of the agreement, Tandberg’s corporate use of IP video communications and other telecommunications services, formerly purchased through Network Systems, is being provided exclusively by us under a multi-year agreement. In addition, we assumed current contractual commitments with AT&T, MCI and Sprint from Network Systems, which were subsequently consolidated into new agreements with these carriers. For accounting purposes, such commitments did not result in any additional asset or liability recognition. The transaction was accounted for following purchase accounting under Statement of Financial Accounting Standards (“SFAS”) No. 141, “*Business Combinations*”. The fair value of tangible assets acquired and liabilities assumed were nominal. Accordingly, we did not record any value of intangible assets acquired. Results of operations of the acquired business were included in the accompanying financial statements from April 20, 2004, the date of acquisition. The following restated (see Note 3) pro forma information for the nine months ended September 30, 2004 gives effect to the acquisition as if it had occurred on January 1, 2004 (in thousands, except per share amounts):

|  | Nine Months<br>Ended<br>September 30,<br>2004 |
|--|---|
| Revenue  | \$ 12,738                                     |
| Gross margin   | 410   |
| Net loss   | (15,268)                                      |
| Net loss attributable to common stockholders           | (15,538)                                      |
| Net loss attributable to common stockholders per share | \$ (0.43)                                     |

**Note 2 — Basis of Presentation**

Our accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and the restatement adjustments-see Note 3) considered necessary for a fair presentation have been included. Operating results for the nine months and three months ended September 30, 2005 and 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. For further information, refer to the restated consolidated financial statements and footnotes thereto for the fiscal year ended December 31, 2004 as filed with the

Securities and Exchange Commission as an exhibit to Form 8-K on January 18, 2007.

The restated condensed consolidated financial statements include the accounts of Glowpoint and our wholly owned subsidiaries, AllComm Products Corporation (“APC”) and VTC Resources, Inc. (“VTC”). All material inter-company balances and transactions have been eliminated in consolidation.

Our condensed consolidated financial statements have been prepared assuming we will continue as a going concern. We incurred a net loss of \$12.5 million and \$4.4 million for the nine months and three months ended September 30, 2005, respectively and of \$15.6 million and \$4.1 million for the nine months and three months ended September 30, 2004, respectively. We had net cash used in operations of \$9.2 million and \$9.0 million for the nine months ended September 30, 2005 and 2004, respectively. At September 30, 2005, we had cash and cash equivalents of \$6.2 million, a working capital deficit of \$0.1 million and an accumulated deficit of \$157.9 million. We continue to sustain losses and negative cash flows from operations. In March 2006, we commenced a restructuring of our business (see Note 11). In March and April 2006, we issued senior secured convertible notes and warrants and raised net proceeds of \$5.6 million. We believe that our available working capital at September 30, 2005, together with our operating activities and the March and April 2006 financing will enable us to continue as a going concern through September 30, 2006.

### **Note 3 — Restatement**

The accompanying unaudited condensed consolidated financial statements restate the unaudited condensed consolidated financial statements included in Form 10-Q, which was previously filed on May 11, 2006. These restatements relate to additional accruals for (i) estimated sales and use taxes, regulatory fees and related penalties and interest and (ii) a tax obligation of a predecessor of Glowpoint and (iii) recognition of compensation expense related to the issuance of 100,000 warrants to a financial advisor in May 2005 and for the extension in the expiration date of 130,500 warrants. The restated condensed consolidated balance sheet as of December 31, 2004 has been derived from the audited restated financial statements filed as an exhibit to our Report on Form 8-K on January 18, 2007. The restated condensed consolidated financial statements for the nine and three months ended September 30, 2004 are consistent with the restated unaudited condensed consolidated financial information included in the audited restated financial statements filed as an exhibit to Form 8-K on January 18, 2007. The restatements had the following effect as of September 30, 2005 and for the nine months ended September 30, 2005 (the 2005 period) and 2004 (the 2004 period) and for the three months ended September 30, 2005 (the 2005 quarter) and 2004 (the 2004 quarter):

**Accrued expenses** - Accrued expenses were increased by \$2,000,000 as of September 30, 2005 to reflect the revised liability for sales and use taxes, regulatory fees and related penalties and interest.

**Additional paid-in capital** - Additional paid-in capital as of September 30, 2005 has been increased by \$195,000, related to the issuance of 100,000 warrants to a financial advisor and recorded as compensation and for the extension of the expiration date of 130,500 warrants.

**Accumulated deficit** - Accumulated deficit as of September 30, 2005 has been increased by \$2,195,000, including an increase of \$1,401,000 as of January 1, 2005 and an increase in our net loss for the 2005 period of \$599,000 related to sales and use taxes, regulatory fees and related penalties and interest and \$195,000 for compensation expense related to warrants.

**General and administrative** - General and administrative expenses were increased by \$794,000 and \$582,000, respectively, in the 2005 and 2004 periods. The increase is comprised of sales and use taxes, regulatory fees and related penalties and interest of \$599,000 and \$582,000, respectively, for the 2005 and 2004 periods and \$195,000 in the 2005 period for compensation expense related to warrants. General and administrative expenses were increased for sales and use taxes, regulatory fees and related penalties and interest by \$226,000 and \$248,000, respectively, in the 2005 and 2004 quarters.

The following table summarizes the account balances that have been restated (In thousands, except per share amounts):

|                            | Previously<br>Reported<br>September 30, 2005<br>(unaudited) | As Restated |
|----------------------------|---|-------------|
| Balance sheets:            |   |             |
| Accrued expenses           | \$ 2,353  | \$ 4,353    |
| Total current liabilities  | 7,560   | 9,560       |
| Total liabilities          | 7,947   | 9,947       |
| Additional paid-in capital | 160,133   | 160,328     |
| Accumulated deficit        | (155,744)   | (157,939)   |
| Total stockholders' equity | \$ 3,443  | \$ 1,443    |

|  | Previously<br>Reported<br>Nine months ended<br>September 30, 2005<br>(unaudited) | As<br>Restated | Previously<br>Reported<br>Nine months ended<br>September 30, 2004<br>(unaudited) | As<br>Restated | Previously<br>Reported<br>Three months ended<br>September 30, 2005<br>(unaudited) | As<br>Restated | Previously<br>Reported<br>Three months ended<br>September 30, 2004<br>(unaudited) | As<br>Restated |
|--|--|----------------|--|----------------|---|----------------|---|----------------|
| Statements of Operations:                          |  |                |  |                |   |                |   |                |
| General and administrative                         | \$ 9,822   | \$ 10,616      | \$ 8,112   | \$ 8,694       | \$ 3,721  | \$ 3,946       | \$ 2,870  | \$ 3,118       |
| Total operating expenses                           | 13,877   | 14,671         | 11,096   | 11,678         | 5,052   | 5,277          | 4,114   | 4,362          |
| Loss from operations before other (income) expense | (12,087)   | (12,881)       | (11,199)   | (11,781)       | (4,169)   | (4,394)        | (3,971)   | (4,219)        |
| Net loss   | (11,746)   | (12,540)       | (14,991)   | (15,573)       | (4,159)   | (4,384)        | (3,858)   | (4,106)        |
| Net loss attributable to common stockholders       | (13,233)   | (14,027)       | (15,261)   | (15,843)       | (4,217)   | (4,442)        | (3,957)   | (4,205)        |
| Net loss per share - basic and diluted             | \$ (0.30)  | \$ (0.32)      | \$ (0.43)  | \$ (0.44)      | \$ (0.09)   | \$ (0.10)      | \$ (0.10)   | \$ (0.11)      |

#### Note 4 — Stock-Based Compensation

We periodically grant stock options to employees and directors in accordance with the provisions of our stock option plans, with the exercise price of the stock options being set at the closing market price of the common stock on the date of grant. We account for our employee stock-based compensation plans under Accounting Principles Board (“APB”) Opinion No. 25, “*Accounting for Stock Issued to Employees*”, and, accordingly, account for employee stock-based compensation utilizing the intrinsic value method. Statement of Financial Standards (“SFAS”) No. 123, “*Accounting for Stock-Based Compensation*”, establishes a fair value based method of accounting for stock-based compensation plans. We have adopted the disclosure only alternative under SFAS No. 123, and SFAS No. 148 “*Accounting for Stock Based Compensation - Transition and Disclosure*” which requires disclosure of the pro forma effects on our net loss attributable to common stockholders and the related per share amounts as if SFAS No. 123 had been adopted as well as certain other information.

The fair value of stock options or warrants issued in return for services rendered by non-employees is accounted for using the fair value based method. The following table illustrates the effect on net loss attributable to common

stockholders and net loss per share for the nine months and three months ended September 30, 2005 and 2004 if the fair value based method had been applied to all awards.

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|   | Nine Months Ended<br>September 30, |             | Three Months Ended<br>September 30, |            |
|---|------------------------------------|-------------|-------------------------------------|------------|
|   | 2005                               | 2004        | 2005                                | 2004       |
| Net loss attributable to common stockholders, as reported herein  | \$ (14,027)                        | \$ (15,843) | \$ (4,442)                          | \$ (4,205) |
| Add: stock-based compensation expense included in reported loss.  | 509                                | 550         | 198                                 | 172        |
| Deduct: total stock-based employee compensation expense determined under the fair value based method for all awards | (1,351)                            | (1,490)     | (504)                               | (710)      |
| Pro forma net loss attributable to common stockholders  | \$ (14,869)                        | \$ (16,783) | \$ (4,748)                          | \$ (4,743) |
| Net loss attributable to common stockholders per share:   |                                    |             |                                     |            |
| Basic and diluted - as reported herein  | \$ (0.32)                          | \$ (0.44)   | \$ (0.10)                           | \$ (0.11)  |
| Basic and diluted - pro forma   | \$ (0.34)                          | \$ (0.47)   | \$ (0.10)                           | \$ (0.13)  |

The weighted average grant date fair value of options granted during the nine months and three months ended September 30, 2005 were \$1.10 and \$0.99, respectively. The weighted average grant date fair value of options granted during the nine months and three months ended September 30, 2004 were \$1.06 and \$1.00, respectively. The weighted average grant date fair value of 190,000 shares of restricted common stock granted during the nine months ended September 30, 2004 was \$2.01. The fair value of our stock-based option awards to employees was estimated assuming no expected dividends and the following weighted average assumptions:

|                         | Nine Months Ended<br>September 30, |         | Three Months Ended<br>September 30, |         |
|-------------------------|------------------------------------|---------|-------------------------------------|---------|
|                         | 2005                               | 2004    | 2005                                | 2004    |
| Risk free interest rate | 4.07                               | 3.51    | 4.19                                | 3.57    |
| Expected lives          | 5 Years                            | 5 Years | 5 Years                             | 5 Years |
| Expected volatility     | 108.51%                            | 113.60% | 107.94%                             | 113.66% |

**Note 5 — Loss Per Share**

Basic loss per share is calculated by dividing net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted loss per share for the nine months and three months ended September 30, 2005 and 2004 is the same as basic loss per share. Potential shares of common stock associated with 14,787,000 and 12,345,000 outstanding and issuable options and warrants and 1,301,000 and 2,080,000 shares issuable upon the conversion of our Series B convertible preferred stock as of September 30, 2005 and 2004, respectively, have been excluded from the diluted calculations because the effects would be antidilutive.

**Note 6 — Sale of VS Business**

In September 2003, we completed the sale of all of the assets of our VS business to Gores pursuant to the terms of the asset purchase agreement dated as of June 10, 2003. The total consideration payable to us under the agreement was up to \$24 million, consisting of \$21 million in cash, of which \$19 million was payable as of closing (\$335,000 was placed in an escrow account) and \$2 million was held back by Gores to cover potential purchase price adjustments, an

unsecured \$1 million promissory note maturing on December 31, 2004 and bearing interest at 5% per annum and up to \$2 million in earn-out payments based on performance of the assets over the two years following the closing. As partial consideration for the purchase of assets, Gores also assumed certain liabilities related to the VS business, including (1) all liabilities to be paid or performed after the closing date that arose from or out of the performance or non-performance by Gores after the closing date of any contracts included in the assets or entered into after June 10, 2003 and (2) our accounts payable, customer deposits, deferred revenue and accrued liabilities related to the VS business.



Pursuant to the agreement, Gores agreed that, for a period of three years commencing on the closing date, it would not, directly or indirectly, acquire or own any equity interest in certain of our competitors identified in the agreement. The agreement further provided that Gores could acquire an identified competitor upon payment to us of a one-time fee of \$5 million. In November 2004, Gores acquired V-SPAN, Inc., which was one of the identified competitors.

Following the closing of the sale to Gores, we were unable to reach agreement with Gores on the amount, if any, of the adjustment to be made to the purchase price, which was based on the net assets, as defined, of the VS business sold to Gores as of June 30, 2003. Consequently, we entered into arbitration with Gores in July 2004, with PriceWaterhouseCoopers as the arbitrator. In January 2005, the arbitrator concluded that the net assets of the VS business sold to Gores should be reduced by \$4.3 million.

In March 2005, we entered into a settlement agreement with Gores, resolving the outstanding disputes between the companies relating to the sale of the VS business, various payables between the companies and Gores' acquisition of V-SPAN. Pursuant to the agreement, Gores paid us \$2.75 million and released the \$335,000, including interest thereon that was escrowed at the closing of the asset sale. We dismissed our lawsuit against Gores relating to the V-SPAN acquisition. We will not receive any payments under the earn-out provision in the agreement.

The ultimate settlement of amounts due to/from Gores that arose subsequent to the transaction closing date and unrelated to the sale transaction, including \$293,000 and \$77,000 of revenues that we recognized during the nine months and three months ended September 30, 2004, respectively have been excluded from the sale transaction, and a gain from the settlement of these items of \$379,000 has been recognized during the nine months ended September 30, 2005, when the settlement was reached with Gores.

The arbitrator's adjustment of \$4,340,000 related to the correction of specific financial reporting errors. Accordingly, the accompanying financial statements reflect these items prior to 2004 and the gain or loss on the transaction has been accounted for upon the closing in 2003. Pursuant to the settlement agreement with Gores in 2005, each party was released from amounts due to the other beyond the payment by Gores of \$2,750,000 and the release of the escrowed cash to us. Accordingly, we recognized the gain on settlement.

#### **Note 7 — Bank Loan Payable**

In February 2004, we terminated a working capital credit facility with JPMorgan Chase. As a result of the termination of this facility, we wrote off \$85,000 of unamortized deferred financing costs to expense in the nine months ended September 30, 2004.

#### **Note 8 — Stockholder's Equity**

In January 2004, in exchange for the cancellation and termination of convertible debentures with an aggregate face value of \$4,888,000 and forfeiture of any and all rights of collection, claim or demand under the debentures, we agreed to give the holders of the debentures: (i) an aggregate of 203.667 shares of series B convertible preferred stock; (ii) an aggregate of 250,000 shares of restricted common stock; and (iii) a reduction of the exercise price of the warrants issued pursuant to the original purchase agreement from \$3.25 to \$2.75. As a result of this exchange, the unamortized discount on subordinated debentures and deferred financing costs were written off to expense, resulting in amortization of discount of \$2,650,000 and amortization of deferred financing costs of \$363,000 for the nine months ended September 30, 2004. Additionally, we recognized a \$743,000 loss on the exchange. The investors have anti-dilution rights. As a result of the February 2004 and March 2005 financings, the conversion price of the Series B convertible preferred stock and the exercise price of the warrants have been adjusted to \$2.22 and \$2.47, respectively and we recognized deemed dividends of \$115,000 in the nine months ended September 30, 2005. The corresponding amount in the 2004 period was nominal.

In February 2004, we raised net proceeds of \$12.5 million in a private placement of 6,100,000 shares of our common stock at \$2.25 per share. We also issued warrants to the investors in the private placement to purchase 1,830,000 shares of our common stock at an exercise price of \$2.75 per share. The warrants expire five and a half years after the closing date. The warrants are subject to certain anti-dilution protection and as a result of the March 2005 financing, the exercise price was reduced to \$2.60 (the incremental fair value was nominal). We also issued to our placement agent five and a half year warrants to purchase 427,000 shares of common stock at an exercise price of \$2.71 per share with an estimated fair value of \$895,000. As a result of the March 2005 financing, the exercise price was reduced to \$2.60

The registration rights agreement for the February 2004 financing provides for liquidated damages of 3% of the aggregate purchase price for the first month and 1.5% for each subsequent month if we failed to register the common stock and the shares of common stock underlying the warrants or maintain the effectiveness of such registration. We account for the registration rights agreement as a separate freestanding instrument and account for the liquidated damages provision as a derivative liability subject to SFAS No. 133. The estimated fair value of the derivative liability is based on estimates of the probability and costs expected to be incurred and such estimates are revalued at each balance sheet date with changes in value recorded as other income or expense. Approximately \$1,164,000 of the proceeds of the financing was attributed to the estimated fair value of the derivative liability. We estimated the fair value of the derivative liability to be \$1,413,000 as of September 30, 2005 and \$1,298,000 as of December 31, 2004. We recognized other expense of \$88,000 and \$45,000 for the nine months and three months ended September 30, 2004, respectively and \$114,000 and \$33,000 for the nine months and three months ended September 30, 2005, respectively.

In March 2005, we raised net proceeds of \$9.4 million in a private placement of 6,766,667 shares of our common stock at \$1.50 per share. Investors in the private placement were also issued warrants to purchase 2,706,667 shares of common stock at an exercise price of \$2.40 per share. The warrants expire five years after the closing date. The warrants are subject to certain anti-dilution protection.

In March 2005, 83.333 shares of our outstanding Series B convertible preferred stock and accrued dividends of \$183,000 were exchanged for 1,333,328 shares of our common stock and warrants to purchase 533,331 shares of our common stock with an excess aggregate fair value of \$1,167,000. We recognized deemed dividends of \$1,167,000 during the 2005 period in connection with the warrants and a reduced conversion price, which were offered as an inducement to convert.

#### **Note 9 — Other Matters**

In April 2005, we amended our operating lease for our Hillside, New Jersey office to extend the term of the lease through April 2007. At such time, we also increased the square feet under lease. Payments under the amended lease aggregate \$145,000, \$218,000 and \$73,000 for the years ending December 31, 2005, 2006 and 2007, respectively, excluding operating costs.

#### **Note 10 — Subsequent Events**

In March 2006, we implemented a corporate restructuring plan designed to reduce certain operating, sales and marketing and general and administrative costs. As part of the strategic initiative, we implemented management changes, including the promotion of Michael Brandofino to Chief Operating Officer with principal responsibility for the implementation and management of the restructuring plan. Gerard Dorsey, Executive Vice President and Chief Financial Officer since December 2004, left Glowpoint in April 2006. In April 2006, Mr. Brandofino was appointed President and Chief Executive Officer and a member of the Board of Directors and Ed Heinen was appointed Chief Financial Officer.

In March and April 2006, we issued senior secured convertible notes and warrants in a private placement to private investors. In the transaction, we issued \$6.18 million aggregate principal amount of our 10% Senior Secured Convertible Notes, Series A warrants to purchase 6,180,000 shares of common stock at an exercise price of \$0.65 per share and Series B warrants to purchase 6,180,000 shares of common stock at an exercise price of \$0.01 per share. The warrants are subject to certain anti-dilutive protection. The Series B warrants only become exercisable if we fail to achieve positive operating income, determined in accordance with generally accepted accounting principles, excluding restructuring and non-cash charges, in the fourth quarter of 2006. In addition, the Series B warrants will be cancelled if we consummate a strategic transaction or repay the Notes prior to the date we make our financial statements for the fourth quarter of 2006 available to the public. We also agreed to change the exercise price of all

previously issued warrants held by the investors in this offering to \$0.65, and to extend the term of any such warrants that would expire earlier than three years after the offering date. Our costs related to the issuance of the notes were approximately \$0.58 million, a portion of which represents placement fees of \$0.5 million to Burnham Hill Partners, our placement agent. In addition, we issued to Burnham Hill Partners placement agent warrants to purchase 618,000 shares of our common stock at an exercise price of \$0.55 per share. The \$5.6 million net proceeds of the offering will be used to support our corporate restructuring program and for working capital.

The Notes bear interest at 10% per annum, mature on September 30, 2007 and are convertible into common stock at a conversion rate of \$0.50 per share. The Series A and Series B warrants are exercisable for a period of 5 years.

We are evaluating the accounting treatment of this transaction, including consideration of applicable accounting standards for derivative instruments. We are also evaluating the effect on the conversion price of our Series B convertible preferred stock and the exercise price of outstanding warrants that are subject to anti-dilution adjustments occasioned by this transaction. Reductions to the conversion price and exercise prices may result in deemed dividend treatment.

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

The following discussion should be read in conjunction with our condensed consolidated financial statements for the nine months and three months ended September 30, 2005 and 2004 and the notes thereto included elsewhere herein. The discussion of results, causes and trends should not be construed to imply any conclusion that such results or trends will necessarily continue in the future.

The statements contained herein, other than historical information, are or may be deemed to be 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 1934, as amended, and involve factors, risks and uncertainties that may cause our actual results in future periods to differ materially from such statements. These factors, risks and uncertainties, include market acceptance and availability of new video communications services; the non-exclusive and terminable at-will nature of sales agent agreements; rapid technological change affecting demand for our services; competition from other video communication service providers; and the availability of sufficient financial resources to enable us to expand our operations.

### **Overview**

Glowpoint, Inc. ("Glowpoint" or "we" or "us"), a Delaware corporation, provides comprehensive video communications services over its carrier-grade IP-based subscriber network enabling users to connect across the United States, as well as to business centers around the world. Prior to 2004, Glowpoint, then known as Wire One Technologies, Inc., sold substantially all of the assets of its video solutions (VS) business to an affiliate of Gores Technology Group (Gores). See Note 7 to the condensed consolidated financial statements for further information.

On April 20, 2004, we entered into an agreement with Tandberg, Inc., a wholly owned subsidiary of Tandberg ASA (OSLO:TAA.OL), a global provider of visual communications solutions. As part of the agreement, we acquired for \$1.00 certain assets and the customer base of Tandberg-owned Network Systems LLC (successor to the NuVision Companies). Network Systems customers, primarily ISDN-based video users, obtained immediate access to our video bridging and webcasting services. As part of the agreement, Tandberg's corporate use of IP video communications and other telecommunications services, formerly purchased through Network Systems, is being provided exclusively by us under a multi-year agreement. In addition, we assumed contractual commitments with AT&T, MCI and Sprint from Network Systems, which were subsequently consolidated into new agreements with these carriers. Tandberg named the Glowpoint Certified Program as a recognized external testing partner for its hardware and software products.

In March 2005, we entered into a strategic alliance with Sony Electronics, Inc. to create and launch a complete, Sony-customized, user-friendly video communication solution focused on broadening the use of IP-based video in and out of traditional office environments. Initially the relationship focused on creating a unique video experience for Sony customers by "private labeling" Glowpoint's features and services for Sony. The two companies launched a number of initiatives including broadcast solutions and an internet based video service called IVE (an acronym for Instant Video Everywhere). We developed and own IVE, but branded it for Sony as part of this initiative. In March

2006 Glowpoint and Sony modified and renewed their agreements to limit the focus to providing solutions for the broadcast market, which the parties believe has the most promise for near-term success.

In February 2006, we signed a separate agreement with Sony of Canada Ltd. to promote and resell our services, including the IVE video service. The IVE video service is now branded "Glowpoint's IVE."

On March 7, 2005, we announced a settlement agreement with Gores, resolving the outstanding disputes relating to the sale of the assets of our VS business to Gores in September 2003. The agreement also covered Gores' acquisition of V-SPAN Inc. in November 2004. Pursuant to the terms of the settlement agreement, Gores paid us \$2.75 million and released to us the \$335,000 that was escrowed at the closing of the asset sale. Also as part of the settlement, we dismissed our lawsuit against Gores relating to the V-SPAN acquisition.

On March 14, 2005, we entered into a common stock purchase agreement with several unrelated institutional investors in connection with the offering of (i) an aggregate of 6,766,667 shares of our common stock and (ii) warrants to purchase up to an aggregate of 2,706,667 shares of our common stock. We received proceeds from this offering of approximately \$10.15 million, less our expenses relating to the offering, which were approximately \$760,500, a portion of which represents investment advisory fees totaling \$710,500 to Burnham Hill Partners, our financial advisor. The warrants are exercisable for a five-year period term and have an exercise price of \$2.40 per share. The warrants may be exercised by cash payment of the exercise price or by "cashless exercise."

### **Restatement**

Glowpoint has reviewed its accruals relating to sales and use taxes, regulatory fees and related penalties and interest. This analysis caused Glowpoint to revise certain assumptions and determinations and, on September 20, 2006, Glowpoint's Board of Directors concluded that the restatement of previously issued financial statements was appropriate. We have also reflected an adjustment to recognize compensation expense related to the issuance of 100,000 warrants to a financial advisor in May 2005 and the modification of the expiration date for 130,500 warrants.

Additionally, on October 26, 2006, Glowpoint announced a potential tax owed by All Communications Corp. ("AllComm"), a predecessor of Glowpoint, to New York State Department of Taxation and Finance (the "AllComm Tax Liability"). Our representatives then met with New York State officials and presented the supporting documentation in an attempt to have this matter resolved on the merits of the case. On or about December 12, 2006, we and New York State agreed on the amount of \$269,000 owed to settle the AllComm Tax Liability.

Accordingly, we have restated our unaudited condensed consolidated balance sheet as of September 30, 2005 and the unaudited condensed consolidated statements of operations for the nine and three months ended September 30, 2005 and 2004 and cash flows for the nine months ended September 30, 2005 and 2004, which were previously filed on Form 10-Q on May 11, 2006. The restated condensed consolidated balance sheet as of December 31, 2004 has been derived from the audited restated financial statements filed as an exhibit to our Report on Form 8-K on January 18, 2007. The restated condensed consolidated financial statements for the nine and three months ended September 30, 2004 are consistent with the restated unaudited condensed consolidated financial information included in the audited restated financial statements filed as an exhibit to Form 8-K on January 18, 2007. We have described the specific impact of the restatement as of September 30, 2005 and for the nine months ended September 30, 2005 (the 2005 period) and 2004 (the 2004 period) and for the three months ended September 30, 2005 (the 2005 quarter) and 2004 (the 2004 quarter) in the discussion below.

**Results of Operations**

The following table sets forth for the nine months and three months ended September 30, 2005 and 2004, information derived from our restated condensed consolidated financial statements as expressed as a percentage of revenues:

|  | (Unaudited)                        |          |                                      |         |
|--|------------------------------------|----------|--------------------------------------|---------|
|  | Nine Months Ended<br>September 30, |          | Three Months Ended<br>September 30 , |         |
|  | 2005                               | 2004     | 2005                                 | 2004    |
| Revenue  | 100.0%                             | 100.0%   | 100.0%                               | 100.0%  |
| Cost of revenue  | 86.4                               | 100.9    | 80.6                                 | 96.7    |
| Gross margin (loss)                                      | 13.6                               | (0.9)    | 19.4                                 | 3.3     |
| <b>Operating expenses:</b>                               |                                    |          |                                      |         |
| Research and development                                 | 6.8                                | 6.8      | 7.0                                  | 7.1     |
| Sales and marketing                                      | 24.0                               | 18.6     | 22.2                                 | 21.2    |
| General and administrative                               | 80.7                               | 74.1     | 86.6                                 | 71.1    |
| Total operating expenses                                 | 111.5                              | 99.5     | 115.8                                | 99.4    |
| Loss from operations before other<br>(income)<br>expense | (97.9)                             | (100.4)  | (96.4)                               | (96.1)  |
| <b>Other (income) expense:</b>                           |                                    |          |                                      |         |
| Amortization of deferred financing<br>costs              | 0.0                                | 3.8      | 0.0                                  |         |
| Interest (income) expense, net                           | (0.6)                              | (0.1)    | (1.0)                                | (0.6)   |
| Increase in derivative financial<br>instrument           | 0.9                                | 0.7      | 0.7                                  | 1.0     |
| Amortization of discount on<br>subordinated debentures   | 0.0                                | 22.6     | 0.0                                  |         |
| Other non-operating business                             |                                    | (1.1)    |                                      | (3.0)   |
| Loss on exchange of debt                                 | 0.0                                | 6.3      | 0.0                                  |         |
| Gain on settlement with Gores                            | (2.9)                              |          |                                      |         |
| Total other (income) expenses, net                       | (2.6)                              | 32.2     | (0.3)                                | (2.6)   |
| Net loss   | (95.3)                             | (132.6)  | (96.1)                               | (93.5)  |
| Preferred stock dividends                                | (1.6)                              | (2.3)    | (1.3)                                | (2.3)   |
| Preferred stock deemed dividends                         | (9.7)                              |          |                                      |         |
| Net loss attributable to common<br>stockholders          | (106.6)%                           | (134.9)% | (97.4)%                              | (95.8)% |

**Nine Months Ended September 30, 2005 (the “2005 period”) Compared to Nine Months Ended September 30, 2004 (the “2004 period”) and the Three Months Ended September 30, 2005 (the “2005 quarter”) Compared to Three Months Ended September 30, 2004 ( the “ 2004 quarter”).**

**Revenue** - Revenue increased \$1.4 million, or 12%, in the 2005 period to \$13.2 million from \$11.8 million in the 2004 period. Subscription and related revenue (which includes contractual revenue related to the Network Services customer base, formerly known as NuVision) increased \$0.6 million, or 8%, in the 2005 period to \$8.2 million from \$7.6 million in the 2004 period. Contractual revenue related to the Network Services customer base was \$0.2 million in both the 2005 period and the 2004 period. We began receiving revenue from this customer base when we acquired it from Tandberg, Inc. in April 2004. Non-subscription revenue consisting of bridging, events and other one-time fees increased \$0.8 million, or 20%, in the 2005 period to \$4.9 million from \$4.1 million in the 2004 period. The growth in



non-subscription revenue was the result of an increase of \$0.7 million in revenue from the Network Services customer base in the 2005 period from the 2004 period. Revenues for the 2005 quarter increased \$0.2 million, or 4%, to \$4.6 million from \$4.4 million in the 2004 quarter. Subscription and related revenue increased \$.3 million, or 10%, in the 2005 quarter to \$2.9 million from \$2.6 million in the 2004 quarter. Non-subscription revenue consisting of bridging events and other one-time fees decreased \$0.1 million, or 3%, in the 2005 quarter to \$1.7 million from \$1.8 million in the 2004 quarter. This decrease was caused by a reduction in revenue from the Network Services customer base.

**Cost of revenue** - Cost of revenues for the 2005 period decreased \$0.5 million, or 4%, to \$11.4 million from \$11.9 million in the 2004 period. Cost of revenues decreased \$0.5 million, or 13%, in the 2005 quarter to \$3.7 million from \$4.2 million in the 2004 quarter. The decline in costs as a percentage of revenue in the 2005 period and the 2005 quarter is the result of the renegotiation of rates, the migration of service to lower cost providers where possible and a reduction of \$166,000 to reflect a vendor credit relating to a second quarter of 2005 billing dispute. For the 2005 period, additional revenue associated with the Network Services customer base, which began in the second quarter of 2004, resulted in increased gross margins. This additional revenue caused our gross margin to increase to 13.6% in the 2005 period (12.3% excluding the credit) from a negative 0.9% in the 2004 period. The additional revenue also caused our gross margin to increase to 19.4% (15.7% excluding the credit) in the 2005 quarter from 3.3% in the 2004 quarter. The rate of increase in our gross margin percentage is not indicative of results expected to be achieved in subsequent periods.

**Research and development** - Research and development costs, which include the costs of the personnel in this group, the equipment they use and their use of the network for development projects, increased by \$0.1 million in the 2005 period to \$0.9 million from \$0.8 million in the 2004 period. The increase was a result of increased usage of outside contractors to meet the demand for application development in conjunction with new product development for us and certain of our partners. Research and development expense was \$0.3 million for the 2005 quarter and 2004 quarter. Research and development expense as a percentage of revenue was 6.8% for the 2005 period, 6.8% for the 2004 period, 7.0% for the 2005 quarter and 7.1% for the 2004 quarter.

**Sales and marketing** - Sales and marketing expenses, which include sales salaries, commissions, overhead and marketing costs, increased \$1.0 million in the 2005 period to \$3.2 million from \$2.2 million in the 2004 period. The primary causes of the increase in costs for the 2005 period were a \$0.5 million increase in salaries, benefits and travel costs resulting from the addition of a direct sales force of 11 employees and an increase of \$0.3 million in marketing expense associated with a sales lead generation program and other initiatives. Sales and marketing expenses increased \$0.1 million to \$1.0 million for the 2005 quarter from \$0.9 million for the 2004 quarter. The primary causes of the increase in costs for the 2005 quarter were an increase in salaries, benefits and travel costs. Sales and marketing expense, as a percentage of revenue, was 24.0% for the 2005 period, 18.6% for the 2004 period, 22.2% for the 2005 quarter and 21.2% for the 2004 quarter.

**General and administrative** - General and administrative expenses, as restated, increased \$1.9 million in the 2005 period to \$10.6 million from \$8.7 million in the 2004 period. The primary components of the increase were \$1.1 million in salaries and benefits related to executive management and increased staffing levels, \$0.8 million for professional fees incurred in connection with the restatement of our financial statements and the related audit committee investigation, \$0.2 million of equity-based financial advisory fees and \$0.2 million for increased equipment rentals. These increases were partially offset by a reduction of \$0.4 million in consulting fees. General and administrative expenses increased \$0.8 million to \$3.9 million for the 2005 quarter from \$3.1 million for the 2004 quarter. Professional fees incurred in connection with the restatement of our financial statements and the related audit committee investigation resulted in an increase of \$0.8 million and salaries and benefits related to executive management and increased staffing levels increased \$0.3 million in the 2005 quarter. These increases were partially offset by reductions of \$0.2 million in consulting fees. General and administrative expenses include (i) estimated sales and use taxes, regulatory fees and related penalties and interest and (ii) a tax obligation of a predecessor of Glowpoint which totaled \$0.8 million for both the 2005 period and 2004 period and \$0.3 million for both the 2005 quarter and 2004 quarter. Sales taxes and regulatory fees are supposed to be, or are routinely, collected from customers and remitted to the applicable authorities in certain circumstances. We have not been collecting and remitting such taxes and regulatory fees and as a result our general and administrative expenses include costs for such matters that would otherwise not have been incurred. General and administrative expenses as a percentage of revenue were 80.7% in the 2005 period, 74.1% in the 2004 period, 86.6% in the 2005 quarter and 71.1% in the 2004 quarter.

**Restatement Impact - General and administrative** - General and administrative expenses were increased by \$794,000 and \$582,000, respectively, in the 2005 and 2004 periods. The increase is comprised of sales and use taxes, regulatory fees and related penalties and interest of \$599,000 and \$582,000, respectively, for the 2005 and 2004 periods and \$195,000 in the 2005 period for compensation expense related to warrants. General and administrative expenses were increased by \$226,000 and \$248,000, respectively, in the 2005 and 2004 quarters. The increase is comprised of sales and use taxes, regulatory fees and related penalties and interest.

**Other (income) expense** - Other income of \$0.3 million for the 2005 period principally reflects a gain on the settlement of an amount owed to Gores. Other expense of \$3.8 million for the 2004 period principally reflects amortization of discount on convertible debentures and related deferred financing costs and a loss on exchange of the debentures for Series B convertible preferred stock, common stock and a modification to warrants. Other income for the 2005 quarter reflects net interest income and for the 2004 quarter reflects a gain on marketable securities and an insurance claim payment.

**Preferred stock deemed dividends** - We recognized deemed dividends of \$1,167,000 for the 2005 period in connection with warrants and a reduced conversion price, which were offered as an inducement to convert our Series B convertible preferred stock. In addition, we recognized deemed dividends of \$115,000 in the 2005 period in connection with an anti-dilution adjustment to the conversion price of our Series B convertible preferred stock resulting from our March 2005 financing. There were no deemed dividends previously reported.

**Net loss** - Net loss attributable to common stockholders, as restated, increased to \$14.0 million, or \$0.32 per basic and diluted share, in the 2005 period from \$15.8 million, or \$0.44 per basic and diluted share, in the 2004 period. Net loss attributable to common stockholders, as restated, increased to \$4.4 million, or \$0.10 per basic and diluted share in the 2005 quarter, from \$4.2 million in the 2004 quarter, or \$0.11 per basic and diluted share, in the 2004 quarter.

**Earnings before interest, taxes, depreciation and amortization (EBITDA)** - EBITDA is not a standard financial measurement under accounting principles generally accepted in the United States of America (GAAP). EBITDA should not be considered as an alternative to net loss or cash flow from operating activities as a measure of liquidity or as an indicator of operating performance or any measure of performance derived in accordance with GAAP. EBITDA is provided below to more clearly present the financial results that management uses to internally evaluate its business. We believe that this non-GAAP financial measure allows investors and management to evaluate and compare our operating results from continuing operations from period to period in a meaningful and consistent manner. The following table provides a reconciliation of the net loss attributable to common stockholders to EBITDA from continuing operations.

|   | Nine Months Ended<br>September 30, |                    | Three Months Ended<br>September 30, |                    |
|---|------------------------------------|--------------------|-------------------------------------|--------------------|
|   | 2005<br>(Restated)                 | 2004<br>(Restated) | 2005<br>(Restated)                  | 2004<br>(Restated) |
| Net loss attributable to common stockholders        | \$ (14,027)                        | \$ (15,843)        | \$ (4,442)                          | \$ (4,205)         |
| Depreciation and amortization                       | 1,727                              | 1,669              | 580                                 | 567                |
| Amortization of deferred financing costs            | —                                  | 448                | —                                   | —                  |
| Amortization of discount on subordinated debentures | —                                  | 2,650              | —                                   | —                  |
| Loss on exchange of debt                            | —                                  | 743                | —                                   | —                  |
| Gain from discontinued operations                   | (379)                              | —                  | —                                   | —                  |
| Preferred stock dividends and deemed dividends      | 1,487                              | 270                | 58                                  | 99                 |
| Interest income, net                                | (76)                               | (5)                | (43)                                | (26)               |
| EBITDA from continuing operations                   | \$ (11,268)                        | \$ (10,068)        | \$ (3,847)                          | \$ (3,565)         |

### Liquidity and Capital Resources

At September 30, 2005, we had a working capital deficit of \$0.1 million compared to working capital of \$2.2 million at December 31, 2004, a decrease of approximately \$2.3 million or 105%. We had \$6.2 million in cash and cash equivalents at September 30, 2005 compared to \$4.5 million at December 31, 2004. The \$1.7 million increase in cash resulted from the net proceeds from the March 2005 private placement of common stock of \$9.4 million and the \$2.7 million from the Gores settlement offset by the \$9.2 million usage of cash in operations in the 2005 period and the purchase of \$1.2 million of property, equipment and leasehold improvements.

In January 2004, in exchange for the cancellation and termination of convertible debentures with an aggregate face value of \$4,888,000 and forfeiture of any and all rights of collection, claim or demand under the debentures, we

agreed to give the holders of the debentures: (i) an aggregate of 203.667 shares of series B convertible preferred stock; (ii) an aggregate of 250,000 shares of restricted common stock; and (iii) a reduction of the exercise price of the warrants issued pursuant to the original purchase agreement from \$3.25 to \$2.75.

In February 2004, we raised net proceeds of \$12.5 million in a private placement of 6,100,000 shares of our common stock at \$2.25 per share. We also issued warrants to purchase 1,830,000 shares of our common stock at an exercise price of \$2.75 per share. The warrants expire on August 17, 2009. The warrants are subject to certain anti-dilution protection and as a result of the March 2005 financing, the exercise price was reduced to \$2.60 (the incremental fair value was nominal). In addition, we issued to our placement agent five and a half year warrants to purchase 427,000 shares of common stock at an exercise price of \$2.71 per share.

In February 2004, we terminated a \$7.5 million revolving credit facility with JPMorgan Chase.

In March 2005, we entered into a common stock purchase agreement with several unrelated institutional investors in connection with the offering of (i) an aggregate of 6,766,667 shares of our common stock and (ii) warrants to purchase up to an aggregate of 2,706,667 shares of our common stock. We received proceeds from this offering of approximately \$10.15 million, less our expenses relating to the offering, which were approximately \$760,500, a portion of which represents investment advisory fees totaling \$710,500 to Burnham Hill Partners, our financial advisor. The warrants are exercisable for a five-year period term and have an exercise price of \$2.40 per share. The warrants are subject to certain anti-dilution protection. The warrants may be exercised by cash payment of the exercise price or by "cashless exercise."

In March and April 2006, we issued senior secured convertible notes and warrants in a private placement to private investors. In the transaction, we issued \$6.18 million aggregate principal amount of our 10% Senior Secured Convertible Notes, Series A warrants to purchase 6,180,000 shares of common stock at an exercise price of \$0.65 per share and Series B warrants to purchase 6,180,000 shares of common stock at an exercise price of \$0.01 per share. The warrants are subject to certain anti-dilution protection. The Series B warrants only become exercisable if we fail to achieve positive operating income, determined in accordance with GAAP, excluding restructuring and non-cash charges, in the fourth quarter of 2006. In addition, the Series B warrants will be cancelled if we consummate a strategic transaction or repay the Notes prior to the date we make our financial statements for the fourth quarter of 2006 available to the public. We also agreed to change the exercise price of all previously issued warrants held by the investors in this offering to \$0.65, and to extend the term of any such warrants that would expire earlier to three years after the offering date. Our costs related to the issuance of the notes were approximately \$0.58 million, a portion of which represents placement fees of \$0.5 million to Burnham Hill Partners, our placement agent. In addition, we issued to Burnham Hill Partners placement agent warrants to purchase 618,000 shares of our common stock at an exercise price of \$0.55 per share. The \$5.6 million net proceeds of the offering will be used to support our corporate restructuring program and for working capital.

The Notes bear interest at 10% per annum, mature on September 30, 2007 and are convertible into common stock at a conversion rate of \$0.50 per share. The Series A and Series B warrants are exercisable for a period of 5 years.

We are currently evaluating the accounting treatment of this transaction, including consideration of applicable accounting standards for derivative instruments. We are also evaluating the effect on the conversion price of our Series B convertible preferred stock and the exercise price of outstanding warrants that are subject to anti-dilution adjustments occasioned by this transaction. Reductions to the conversion price and exercise prices may result in deemed dividend treatment.

Net cash used in operating activities was \$9.2 million for the 2005 period and \$9.0 million for the 2004 period. For the 2005 period, the primary components of the net cash usage were the net loss of \$12.5 million which was increased by a \$0.5 million increase in accounts receivable, a \$0.4 million increase in prepaid expenses and other current assets and a non-cash gain on the settlement with Gores of \$0.4 million and reduced by depreciation and amortization expense of \$1.7 million, a \$0.7 million increase in accounts payable and accrued expenses, \$0.8 million of equity-based compensation and consulting fees, the receipt of \$0.3 million in previously escrowed cash in conjunction with the Gores settlement agreement and an increase in deferred revenue of \$0.2 million. For the 2004 period, the primary

components of the net cash usage were the net loss of \$15.6 million and an increase in the amount due from Gores of \$0.4 million, reduced by amortization of discount on subordinated debentures of \$2.7 million, depreciation and amortization of \$1.7 million, loss on exchange of debt of \$0.7 million, an increase in accounts payable and accrued expenses of \$0.5 million, equity-based compensation of \$0.6 million and amortization of deferred financing costs of \$0.4 million.

During the quarter ended September 30, 2005, there were no material changes in our contractual obligations.

Cash provided by investing activities for the 2005 period amounted to \$1.5 million which consisted of \$2.7 collected in the settlement with Gores partially offset by \$1.2 million for the purchase of property, equipment and leasehold improvements. For the 2004 period, cash used in investing activities was \$0.9 million for the purchase of property, equipment and leasehold improvements. The Glowpoint network is currently built out to handle the anticipated level of subscriptions through 2006. We do not anticipate current expansion for the network and therefore currently have no significant commitments to make capital expenditures in 2006.

Cash provided by financing activities for the 2005 and 2004 periods was \$9.4 million and \$13.0 million, respectively. Financing activities for the 2005 and 2004 periods included receipt of the \$9.4 million and \$11.4 million of net proceeds from the private placements of common stock and warrants. The 2004 period includes \$1.2 million of proceeds attributable to a derivative financial instrument and \$0.6 million for the exercise of warrants and options.

We believe that our available capital as of September 30, 2005, together with our operating activities, will enable us to continue as a going concern through September 30, 2006.

### **Other Matters**

On June 2, 2005, we dismissed our independent accounting firm, BDO Seidman LLP, for geographic reasons, and retained the independent accounting firm of Eisner LLP. In the course of its initial assessment of our December 31, 2004 balance sheet, Eisner raised certain issues relating to property and equipment. Our internal accounting team looked into the matter and subsequently concluded, on a preliminary basis, that the costs associated with certain purchases of videoconferencing equipment for resale and certain other operating costs that represented cost of revenue had erroneously been capitalized as property and equipment.

These preliminary conclusions were discussed at a meeting of our board of directors on July 21, 2005. At that meeting, our Audit Committee determined to undertake an independent investigation of the matter. Following that meeting, our internal accounting team conducted a further review of the audited financial statements for 2002 through 2004 and held several discussions with our former CFO. Based on these discussions, on August 2, 2005, we concluded that our financial statements for fiscal years 2002 through 2004 (and the related quarters) and the quarter ended March 31, 2005 needed to be restated and should no longer be relied upon.

We requested that BDO Seidman audit our restated consolidated financial statements for fiscal years 2002 through 2004 and review our condensed consolidated financial statements for the applicable inclusive interim periods and the quarter ended March 31, 2005, which BDO Seidman declined. We have twice restated our consolidated financial statements as of December 31, 2004 and for the year then ended, including disclosure of the effect of the restatements on our unaudited condensed consolidated financial information for the interim periods within 2004, which have been filed as exhibits to our Reports on Form 8-K filed with the Securities and Exchange Commission on January 18, 2007, and previously on March 17, 2006. We have restated our unaudited condensed consolidated financial statements as of March 31, 2005 and for the three months ended March 31, 2005 and 2004, which have been filed on Form 10-Q/A with the Commission on January 31, 2007 and previously on March 22, 2006. We restated our unaudited condensed consolidated financial statements for the six and three months ended June 30, 2004, which were filed on our June 30, 2005 Form 10-Q on April 20, 2006 and our unaudited condensed consolidated financial statements for the nine and three months ended September 30, 2004, which were filed on our September 30, 2005 Form 10-Q on May 11, 2006. We restated our unaudited condensed consolidated financial statements as of June 30, 2005 and for the six and three months ended June 30, 2005 and 2004, which were filed on our June 30, 2005 Form 10-Q/A on January 31, 2007. We are restating our unaudited condensed consolidated financial statements as of September 30, 2005 and for the nine and three months ended September 30, 2005 and 2004, which were filed on Form 10Q/A on January 31, 2007 and our unaudited condensed consolidated financial statements as of September 30, 2005 and for the nine and three months ended September 30, 2005 and 2004, which are included elsewhere in this Report on Form 10-Q/A.



Our internal accounting team is working diligently to complete our fiscal 2005 results. Restating financial statements for fiscal years 2002 and 2003 will require significant additional time and resources, primarily because of the following reasons:

- During 2003, we completed the sale of our VS business to Gores. As part of the sale, we transferred four data communication servers which contained various documents and audit support workpapers associated with the books and records of the VS business for all periods prior to the sale. We did not retain backups of the information on those servers and we just recently received data downloads from such servers. Gores was only able to locate three of the four servers transferred.

We may not be able to quantify inventory in periods prior to 2004. Effective with the sale to Gores, we no longer owned any inventory and BDO Seidman was the only auditor who observed the physical inventory counts that affect those periods. To date, we have not been able to verify such inventory amounts, which will be necessary in order to complete a restatement of our consolidated financial statements for the years ended December 31, 2002 and 2003. We will take all available actions to gain access to the BDO Seidman workpapers.

At this time, we cannot determine whether the resolution of the above items will enable us to restate fiscal years 2002 and 2003 in a reasonable amount of time or at all.

**Audit Committee Investigation.** The Audit Committee commenced its independent investigation following the July 21, 2005 board meeting. The Audit Committee hired independent counsel, the law firm of Kronish Lieb Weiner & Hellman LLP, to conduct the investigation. Kronish Lieb retained a forensic audit firm, Alix Partners LLP, to assist in the investigation. The investigation was concluded in late September 2005 and found that expenses associated with services provided to and equipment purchased by customers during 2001 through 2003 were improperly capitalized as additions to our fixed assets, and that such practices affected our 2001 through 2004 financial statements. The Audit Committee investigation also found that, during the same period, some of the amounts associated with practices described in the preceding sentence were written off in subsequent accounting journal entries that were themselves improper, and that similarly improper additions to our fixed assets continued even after such write-offs had occurred. Our prior CFO, who participated in these practices and under whose supervision they occurred, left Glowpoint in April 2005 after the planned relocation of the finance department from New Hampshire to our headquarters in New Jersey. In addition to issues affecting fixed assets, the investigation found that during the relevant period, we lacked adequate internal accounting controls. Finally, the investigation identified certain areas that warrant further review, including past revenue recognition practices when we were a reseller of videoconferencing equipment, costs allocated to the accounting associated with the Gores transaction and internal reallocation of communication costs.

As noted above, the Audit Committee investigation found that during the relevant periods being restated, we lacked adequate internal controls. A material weakness in internal controls is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will be not be prevented or detected. We believe that a material weakness in our internal controls arose as the result of aggregating several significant deficiencies, including: inadequate review and approval of journal entries in the financial statement preparation process and a lack of supporting documentation and assumptions used therein, an insufficient number of technical accounting and public company reporting personnel in the finance department, the absence of a formal monthly closing process and subsequent formal reporting of monthly financial statements and account variance analysis. Additionally, our finance office was located in New Hampshire and our headquarters was located in New Jersey.

The Audit Committee investigation further found that our current management has instituted improved internal accounting controls, including the hiring of our current CFO based in New Jersey and the subsequent relocation and restaffing of the finance organization to our headquarters in April 2005. Our restaffing included a corporate Controller who has over twenty years experience in public company reporting, has earned his CPA and will become our acting CFO in April 2006. We also instituted a formal monthly closing process, including account analysis, oversight of all closing processes, formal monthly review of the financial statements and the implementation of monthly written reports to the Board of Directors. We are continuing to evaluate and improve our internal control procedures, where applicable.

**SEC Inquiry.** On August 2, 2005, we contacted the Securities and Exchange Commission to notify it of our determination to restate our financial statements. On August 3, 2005, the SEC notified us that it was conducting an informal inquiry into our reported accounting issues. The SEC has met with our outside counsel as well as counsel to the Audit Committee. The SEC also sent us a document production request on October 27, 2005, and we responded to the request on November 14, 2005. The SEC has also recently contacted our former CFO and BDO Seidman LLP, our

former independent accounting firm.

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**Delisting.** On August 16, 2005, we received a letter from the Nasdaq National Market indicating that our common stock would be delisted from Nasdaq because of our failure to timely file our Form 10-Q for the quarter ended June 30, 2005. We requested and were granted a hearing to seek a conditional listing exception. The hearing occurred on September 15, 2005. On October 3, 2005, the Nasdaq Listing Qualifications Panel notified us that our common stock would be delisted from the Nasdaq National Market effective with the open of business on October 5, 2005. Our common stock now trades over the counter in the pink sheets under the symbol "GLOW.PK".

### **Critical Accounting Policies**

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America. Preparing financial statements in accordance with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclose contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The following paragraphs include a discussion of some critical areas where estimates are required. The significant areas of estimation includes determining the allowance for doubtful accounts, accrued sales tax, the estimated lives of property and equipment and the fair value of the derivative financial instrument.

### **Revenue Recognition**

We recognize service revenue, including amounts related to surcharges charged by our carriers, related to the Glowpoint network subscriber service and the multi-point video and audio bridging services as service is provided. As the non-refundable, upfront activation fees charged to the subscribers do not meet the criteria as a separate unit of accounting, they are deferred and recognized over the life of the customer contracts. Revenues derived from other sources are recognized when services are provided or events occur.

### **Allowance for Doubtful Accounts**

We record an allowance for doubtful accounts based on specifically identified amounts that we believe to be uncollectible. We also record additional allowances based on certain percentages of our aged receivables, which are determined based on historical experience and our assessment of the general financial conditions affecting our customer base. If our actual collections experience changes, revisions to our allowance may be required. After all attempts to collect a receivable have failed, we write off the receivable against the allowance.

### **Long-Lived Assets**

We evaluate impairment losses on long-lived assets used in operations, primarily fixed assets, when events and circumstances indicate that the carrying value of the assets might not be recoverable in accordance with Statement of Financial Accounting Standards ("SFAS") No. 144 "*Accounting for the Impairment or Disposal of Long-Lived Assets*". For purposes of evaluating the recoverability of long-lived assets, the undiscounted cash flows estimated to be generated by those assets are compared to the carrying amounts of those assets. If and when the carrying values of the assets exceed their fair values, the related assets will be written down to fair value. In the 2005 period, no impairment losses were recorded.

### **Inflation**

Management does not believe inflation had a material adverse effect on the financial statements for the periods presented.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

We have exposure to interest rate risk related to our cash equivalents portfolio. The primary objective of our investment policy is to preserve principal while maximizing yields. Our cash equivalents portfolio is short-term in nature; therefore changes in interest rates will not materially impact our consolidated financial condition. However, such interest rate changes can cause fluctuations in our results of operations and cash flows.

There are no other material qualitative or quantitative market risks particular to us.

#### **Item 4. Controls and Procedures**

During the periods covered by this report, we lacked adequate internal controls. A material weakness in internal controls is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will be not be prevented or detected. We believe that a material weakness in our internal controls arose as the result of aggregating several significant deficiencies, including: inadequate review and approval of journal entries in the financial statement preparation process and a lack of supporting documentation and assumptions used therein, an insufficient number of technical accounting and public company reporting personnel in the finance department, an externally maintained warrant registry, the absence of a formal monthly closing process and subsequent formal reporting of monthly financial statements and account variance analysis. Additionally, our finance office was located in New Hampshire and our headquarters was located in New Jersey.

Our current management team has instituted improved internal accounting controls, including the institution of a formal monthly closing process, including account analysis, oversight of all closing processes, formal monthly review of the financial statements and the implementation of monthly written reports to the Board of Directors and an internally maintained warrant registry. We are continuing to evaluate and improve our internal control procedures, where applicable.

## **PART II - OTHER INFORMATION**

#### **Item 1. Legal Proceedings**

We are defending several suits in the ordinary course of business that are not material to our business, financial condition or results of operations.

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

None.

#### **Item 3. Defaults upon Senior Securities**

None.

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

None.

#### **Item 5. Other Information**

None.

#### **Item 6. Exhibits**

None.

**(i) Signatures**

In accordance with 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.

GLOWPOINT, INC.  
Registrant

Date: January 31, 2007

By:

/s/ Michael Brandofino

Michael Brandofino, Chief Executive Officer  
(principal executive officer)

Date: January 31, 2007

By:

/s/ Edwin F. Heinen

Edwin F. Heinen, Chief Financial Officer  
(principal financial and accounting officer)