

GLOWPOINT INC
Form 10-Q
November 12, 2008

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

FORM 10-Q

ii

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

For the quarterly period ended: **September 30, 2008.**

or

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

For the transition period from: _____ to _____

Commission File Number: **0-25940**

GLOWPOINT, INC.

(Exact name of registrant as specified in its charter)

Delaware **77-0312442**
(State or other jurisdiction *(I.R.S. Employer*
of incorporation or organization) *Identification No.)*
225 Long Avenue, Hillside, New Jersey 07205
(Address of Principal Executive Office) (Zip Code)
312-235-3888
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

| | | | |
|-------------------------|---|---------------------------|--------------------------|
| Large accelerated filer | | Accelerated filer | |
| Non-accelerated filer | (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/> |

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

The number of shares outstanding of the registrant's common stock as of November 12, 2008 was 46,549,673.

GLOWPOINT, INC

Index

Page

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

1

Condensed Consolidated Balance Sheets At September 30, 2008 (Unaudited)
And December 31, 2007*

1

Condensed Consolidated Statements Of Operations For The Nine And
Three Months Ended September 30, 2008 And 2007

2

Condensed Consolidated Statements Of
Stockholders Deficit For Nine And Three Months Ended September 30, 2008

3

Condensed Consolidated Statements Of Cash Flows For The Nine Months
Ended September 30, 2008 And 2007

4

Notes To Condensed Consolidated Financial Statements

6

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

18

Item 3. Quantitative and Qualitative Disclosures about Market Risk

26

Item 4. Controls and Procedures

29

PART II OTHER INFORMATION

Item 1. Legal Proceedings

30

Item 1A. Risk Factors

30

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

30

Item 3. Defaults upon Senior Securities

30

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

30

Item 5. Other Information

30

Item 6. Exhibits

30

Signatures

31

Certifications

32

*

The Condensed Consolidated Balance Sheet at December 31, 2007 has been derived from the audited consolidated financial statements filed as an exhibit to our Report on Form 10-K on March 27, 2008.

PART I FINANCIAL INFORMATION**Item 1.****Financial Statements**

**GLOWPOINT, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except par value and shares)

| | September 30, | December 31, |
|---|---------------|--------------|
| | 2008 | 2007 |
| | (Unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 1,715 | \$ 2,312 |
| Accounts receivable, net of allowance for doubtful accounts of \$181 and \$208, respectively | 2,903 | 2,546 |
| Prepaid expenses and other current assets | 366 | 348 |
| Total current assets | 4,984 | 5,206 |
| Property and equipment, net | 2,563 | 2,692 |
| Other assets | 293 | 664 |
| Total assets | \$ 7,840 | \$ 8,562 |
| LIABILITIES AND STOCKHOLDERS DEFICIT | | |
| Current liabilities: | | |
| Accounts payable | \$ 2,868 | \$ 1,575 |
| Accrued expenses | 873 | 1,427 |
| Accrued sales taxes and regulatory fees | 4,208 | 4,011 |
| Senior Secured Notes, net of discount of \$1,865 and \$0, respectively | 9,679 | |
| Senior Secured Notes held by Insider Purchasers - related parties, net of discount of \$110 and \$0, respectively | 372 | |
| Derivative financial instruments | 5,964 | 6,117 |
| Customer deposits | 599 | 713 |
| Deferred revenue | 340 | 330 |
| Current portion of capital lease | 151 | 125 |
| Total current liabilities | 25,054 | 14,298 |
| Long term liabilities: | | |
| Senior Secured Notes, net of discount of \$0 and \$3,912, respectively | | 6,647 |
| Senior Secured Notes held by Insider Purchasers - related parties, net of discount of \$0 and \$221, respectively | | 226 |

Edgar Filing: GLOWPOINT INC - Form 10-Q

| | | |
|--|-----------|-----------|
| Capital lease, less current portion | 116 | 233 |
| Total long term liabilities | 116 | 7,106 |
| Total liabilities | 25,170 | 21,404 |
| Preferred stock, \$10,000 par value; 1,500 shares authorized and redeemable; 475 Series C shares issued and outstanding recorded at fair value (stated value and liquidation value of \$4,748) | 4,330 | 4,330 |
| Commitments and contingencies | | |
| Stockholders' deficit: | | |
| Common stock, \$.0001 par value; 150,000,000 shares authorized; 48,114,564 and 47,629,564 shares issued; 46,549,673 and 46,064,673 shares outstanding, respectively | 5 | 5 |
| Additional paid-in capital | 162,915 | 162,300 |
| Accumulated deficit | (183,197) | (178,094) |
| | (20,277) | (15,789) |
| Less: Treasury stock, 1,564,891 shares at cost | (1,383) | (1,383) |
| Total stockholders' deficit | (21,660) | (17,172) |
| Total liabilities and stockholders' deficit | \$ 7,840 | \$ 8,562 |

See accompanying notes to condensed consolidated financial statements.

GLOWPOINT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

| | Nine Months Ended | | Three Months Ended | |
|---|-------------------|--------------|--------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Revenue | \$ 18,557 | \$ 17,311 | \$ 6,066 | \$ 5,803 |
| Cost of revenue | 10,757 | 11,751 | 3,630 | 3,932 |
| Gross margin | 7,800 | 5,560 | 2,436 | 1,871 |
| Operating expenses: | | | | |
| Research and development | 775 | 570 | 271 | 216 |
| Sales and marketing | 2,717 | 2,230 | 811 | 731 |
| General and administrative | 5,789 | 6,082 | 1,998 | 1,807 |
| Total operating expense | 9,281 | 8,882 | 3,080 | 2,754 |
| Loss from operations | (1,481) | (3,322) | (644) | (883) |
| Interest and other expense (income): | | | | |
| Interest expense, including \$111, \$224, \$44 and \$224, respectively, for Insider Purchasers | 3,425 | 5,139 | 1,293 | 3,135 |
| Interest income | (18) | (35) | (3) | (7) |
| Increase (decrease) in fair value of derivative financial instruments, including \$0 for Insider Purchasers | (153) | 3,513 | (211) | 2,507 |
| Amortization of deferred financing costs, including \$37, \$1, \$13 and \$1, respectively, for Insider Purchasers | 368 | 404 | 130 | 143 |
| Total interest and other expense, net | 3,622 | 9,021 | 1,209 | 5,778 |
| Net loss | (5,103) | (12,343) | (1,853) | (6,661) |
| Gain on redemption of preferred stock | | 799 | | 799 |
| Preferred stock dividends | | (252) | | (80) |
| Net loss attributable to common stockholders | \$ (5,103) | \$ (11,796) | \$ (1,853) | \$ (5,942) |
| Net loss attributable to common stockholders per share: | | | | |
| Basic and diluted | \$ (0.11) | \$ (0.25) | \$ (0.04) | \$ (0.13) |

Weighted average number of common shares:

| | | | | |
|-------------------|--------|--------|--------|--------|
| Basic and diluted | 46,387 | 46,968 | 46,550 | 47,369 |
|-------------------|--------|--------|--------|--------|

See accompanying notes to condensed consolidated financial statements.

GLOWPOINT, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIT
Nine Months Ended September 30, 2008

(In thousands)

(Unaudited)

| | Common Stock | | Paid In Capital | Accumulated Deficit | Treasury Stock | | Total |
|---|--------------|--------|--------------------|------------------------|----------------|-------------|--------------|
| | Shares | Amount | | | Shares | Amount | |
| Balance at January 1, 2008 | 47,630 | \$ 5 | \$ 162,300 | \$ (178,094) | 1,565 | \$ (1,383) | \$ (17,172) |
| Net loss | | | | (5,103) | | | (5,103) |
| Stock-based compensation restricted stock to directors and officers | 10 | | 128 | | | | 128 |
| Stock-based compensation options to employees | | | 157 | | | | 157 |
| Stock-based compensation options to directors and officers | | | 120 | | | | 120 |
| Stock-based compensation restricted stock to employees | 150 | | 10 | | | | 10 |
| Stock-based compensation restricted stock for consulting services | | | 21 | | | | 21 |
| Settlement of accrued 2007 management bonus with restricted stock | 325 | | 179 | | | | 179 |
| Balance at September 30, 2008 | 48,115 | \$ 5 | \$ 162,915 | \$ (183,197) | 1,565 | \$ (1,383) | \$ (21,660) |

See accompanying notes to condensed consolidated financial statements.

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

(Unaudited)

| | Nine Months Ended | |
|--|-------------------|--------------|
| | September 30, | |
| | 2008 | 2007 |
| Cash flows from Operating Activities: | | |
| Net loss | \$ (5,103) | \$ (12,343) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 959 | 1,121 |
| Other (income) expense recognized for the increase in the estimated fair value of the derivative financial instruments | (153) | 3,513 |
| Amortization of deferred financing costs | 368 | 404 |
| Accretion of discount on Senior Secured Notes | 2,158 | 2,332 |
| Beneficial conversion feature for Senior Secured Notes | | 1,976 |
| Loss on disposal of equipment | 17 | 10 |
| Stock-based compensation | 436 | 714 |
| Increase (decrease) in cash attributable to changes in assets and liabilities: | | |
| Accounts receivable | (357) | (176) |
| Prepaid expenses and other current assets | (18) | (63) |
| Other assets | 3 | |
| Accounts payable | 1,293 | (137) |
| Customer deposits | (114) | 619 |
| Accrued expenses, sales taxes and regulatory fees | 842 | 602 |
| Deferred revenue | 10 | 63 |
| Net cash provided by (used in) operating activities | 341 | (1,365) |
| Cash flows from Investing Activities: | | |
| Purchases of property and equipment | (847) | (906) |
| Net cash used in investing activities | (847) | (906) |
| Cash flows from Financing Activities: | | |
| Capital lease payments | (91) | |
| | | 3,230 |

Edgar Filing: GLOWPOINT INC - Form 10-Q

| | | | |
|--|----------|----|-------|
| Proceeds from issuance of Senior Secured Notes, including \$400 from Insider Purchasers, net of financing costs of \$308 | | | |
| Costs incurred in extension of maturity date of Senior Secured Notes and Series C Convertible Preferred Stock exchange | | | (83) |
| Net cash (used in) provided by financing activities | (91) | | 3,147 |
| (Decrease) increase in cash and cash equivalents | (597) | | 876 |
| Cash and cash equivalents at beginning of period | 2,312 | | 2,153 |
| Cash and cash equivalents at end of period | \$ 1,715 | \$ | 3,029 |
| Supplement disclosures of cash flow information: | | | |
| Cash paid during the period for | | | |
| Interest | \$ 91 | \$ | 3 |

See accompanying notes to condensed consolidated financial statements.

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

(Unaudited)

| | Nine Months Ended | |
|---|-------------------|-----------------------|
| | 2008 | September 30, 2007 |
| Non-cash investing and financing activities: | | |
| Preferred stock dividends | \$ | \$ 252 |
| Gain on redemption of preferred stock | | 799 |
| Additional Senior Secured Notes issued as payment for interest | 1,020 | 575 |
| Deferred financing costs for Senior Secured Notes incurred by issuance of placement agent warrants | | 332 |
| Deferred financing costs for extension of maturity date of Senior Secured Notes incurred by issuance of financial advisory warrants | | 86 |
| Settlement of accrued 2007 management bonus with restricted stock | 179 | |
| Treasury stock received in connection with Series C Convertible Preferred Stock exchange | | 1,143 |

See accompanying notes to condensed consolidated financial statements.

GLOWPOINT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

(Unaudited)

Note 1 - Basis of Presentation

The Business

Glowpoint, Inc. ("Glowpoint" or "we" or "us" or the Company), a Delaware corporation, is a premiere broadcast-quality, IP (Internet Protocol)-based managed video services provider. Our mission is to improve the ease-of-use, cost-effectiveness, functionality, and quality of existing video communications in order to make it an integral and ubiquitous part of everyday business and personal communications. We believe video communications should be as easy and spontaneous to use as your telephone, but with the power of face-to-face communication. The Company operates in one segment and therefore segment information is not presented.

We view our services as analogous to cellular service providers in the cellular telephone industry. Regardless of the cellular phone purchased, users must select a cellular service provider to make it work. Users make that service decision based on the features, reliability and price offered by the service provider. In our industry, regardless of the video conferencing equipment purchased, Glowpoint provides the managed video services to make it work. In doing so, we offer a vast array of managed video services, including video application services, managed network services, IP and ISDN videoconferencing services, multi-point conferencing (bridging), technology hosting and management, and professional services. In order to address specific needs within an industry, such as broadcast/media content acquisition or retail call center environments, we have bundled some of our managed services to offer unique video communication solutions. We also wholesale some of our services to and provide branding for manufacturers, carriers, and integrators for resale. We provide our managed video services to a wide variety of companies, from global enterprises and large governmental entities to small and medium-sized businesses to other providers of video or telecommunications services. Since its launch in 2000, Glowpoint has been exclusively focused on innovating high quality two-way video communications and has supported millions of video calls. Currently, we support thousands of customer locations in over 1,200 cities in 37 countries around the world.

With the advent of telepresence, we have combined various components of our features and services into a comprehensive video network operations center support service (VNOG Support Service) offering that can support the telepresence systems manufactured by Cisco, Polycom, Tandberg and virtually all other telepresence solutions on the market today. Telepresence is a term to describe high quality, true to life meetings via video communications where participants feel as though they are all sitting in the same physical room even though they may be continents apart. This is accomplished with the use of multiple monitors, special furniture, and strategic camera placement and sound panels to create an immersive experience. We believe that the expensive equipment cost and customer expectations for telepresence demand that a managed service provider, such as Glowpoint, be involved to ensure that all telepresence rooms operate consistently and meetings occur reliably. Given the projected potential market size for these services in the next couple of years, we have focused more resources and time on, and accelerated certain expenses to support, our VNOG Support Service and related sales opportunities, which sales opportunities tend to be of a larger magnitude than our historical sales opportunities of managed video services.

Liquidity and Going Concern

Our condensed consolidated financial statements have been prepared assuming we will continue as a going concern. We have incurred recurring operating losses and negative operating cash flows since our inception including a net loss attributable to common stockholders of \$5,103,000 for the nine months ended September 30, 2008. At September

30, 2008, we had a working capital deficit of \$20,070,000. We have \$1,715,000 in cash and cash equivalents at September 30, 2008 and cash and cash equivalents provided by operating activities of \$341,000 for the nine months ended September 30, 2008. Additionally, the Senior Secured Notes (see Note 6) which mature in March 2009 along with the recurring operating losses, negative operating cash flows and sales and use tax and regulatory fee liability raise substantial doubt as to our ability to continue as a going concern. Assuming we are able to renegotiate or refinance the Senior Secured Notes and negotiate favorable terms with the authorities regarding our sales and use taxes and regulatory fees and we are able to continually achieve positive operating cash flows, we believe that our available capital as of September 30, 2008, will enable us to continue as a going concern through September 30, 2009. We have initiated discussions with the holders of the Senior Secured Notes to identify terms for the extension of the maturity date beyond March 2009 and/or the conversion of the Senior Secured Notes into a

new equity security. Additionally, we have initiated efforts to raise additional capital with the sale of additional shares of the new equity security. There can be no assurances, however, that we will be able to raise additional capital as needed or upon acceptable terms nor any assurances that we will be able to renegotiate the terms and maturity date of the Senior Secured Notes. If we are unable to renegotiate the maturity of the Senior Secured Notes or issue new securities on favorable terms to repay them, it would have a material adverse effect on the Company. The accompanying condensed consolidated financial statements do not include any adjustments that might result from this uncertainty.

Summary of Significant Accounting Policies

Quarterly Financial Information and Results of Operations

The condensed consolidated financial statements as of September 30, 2008 and for the nine and three months ended September 30, 2008 and 2007 are unaudited and, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the financial position as of September 30, 2008, and the results of operations for the nine and three months ended September 30, 2008 and 2007 and cash flows for the nine months ended September 30, 2008 and 2007. The results for the nine and three months ended September 30, 2008 are not necessarily indicative of the results to be expected for the entire year. While management of the Company believes that the disclosures presented are adequate to make the information not misleading, these condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the footnotes thereto for the fiscal year ended December 31, 2007 as filed with the Securities and Exchange Commission as an exhibit to our Form 10-K on March 27, 2008 (the Audited 2007 Financials).

See Note 2 - Basis of Presentation, Liquidity and Summary of Significant Accounting Policies in the Audited 2007 Financials for a discussion of the estimates and judgments inherent in the Company's accounting for allowance for doubtful accounts, concentration of credit risk, lives of property and equipment, income taxes, stock-based compensation, amortization of deferred financing costs, fair value of financial instruments, derivative financial instruments and accrued sales taxes and regulatory fees. There have been no changes to our critical accounting policies in the nine and three months ended September 30, 2008. Critical accounting policies and the significant estimates made in accordance with them are regularly discussed with our Audit Committee.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of Glowpoint and our wholly owned subsidiary, GP Communications, LLC. All material inter-company balances and transactions have been eliminated in consolidation.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current period presentation.

Use of Estimates

Preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from the estimates made. We continually evaluate estimates used in the preparation of the condensed consolidated financial statements for reasonableness. Appropriate adjustments, if any, to the estimates used are made prospectively based upon such periodic evaluation. The significant areas of estimation include determining the allowance for doubtful accounts, deferred tax valuation allowance, accrued sales taxes, regulatory fees and related

penalties and interest, the estimated life of customer relationships, the estimated lives and recoverability of property and equipment, the fair value of derivative financial instruments and the valuation of our Series C convertible preferred stock, among others.

Revenue Recognition

We recognize subscription revenue when the related services have been performed. Revenue billed in advance is deferred until the revenue has been earned. Other service revenue, including amounts related to surcharges charged by our carriers, related to the Glowpoint managed network service and the multi-point video and audio bridging services are recognized 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 twenty-four month period estimated life of the customer relationship. Revenue related to integration services is recognized at the time the services are performed, and presented in accordance with EITF 99-19 Reporting Revenue Gross as a Principal Versus Net as an Agent. Revenues derived from other sources are recognized when services are provided or events occur.

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 nine and three months ended September 30, 2008 and 2007, no impairment losses were indicated or recorded.

Related Party Transactions

The Company receives consulting and tax services from an accounting firm in which one of our directors is a partner and software development from a firm in which one of our other directors is the president. Management believes that such transactions are at arm's-length and for terms that would have been obtained from unaffiliated third parties. For the nine and three months ended September 30, 2008, we incurred aggregate fees for these services of \$153,000 and \$72,000, respectively. For the nine and three months ended September 30, 2007, we incurred aggregate fees for these services of \$141,000 and \$58,000, respectively.

Software Development Costs

The Company incurs costs for the development of its Customer Connect software that is to be sold, leased or licensed to third parties in the future. All software development costs have been appropriately accounted for in accordance with SFAS 86 *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*. Software development costs are required to be capitalized when a product's technological feasibility has been established by completion of a detailed program design or working model of the product, and ending when a product is available for release to customers. The Company did not capitalize any software development costs for the nine and three months ended September 30, 2008 and capitalized \$139,000 and \$14,000 of software development costs for the nine and three months ended September 30, 2007, respectively. Software development costs of \$188,000 are being amortized over 24 months beginning in September 2007, when the product became available for general release to customers and the capitalization of software costs ceased. For the nine and three months ended September 30, 2008, we amortized \$72,000 and \$24,000 respectively, to cost of revenues. For the nine and three months ended September 30, 2007, we amortized \$8,000 of software development costs, to the cost of revenues. As of September 30, 2008, there was \$86,000 of unamortized capitalized software costs. The Company did not capitalize any costs related to the purchase of software and related technologies and content.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to choose to measure many financial assets

and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) (SFAS No. 141 (R)), *Business Combinations (SFAS No. 141(R))* . SFAS No. 141(R) revises SFAS No. 141 on establishing the requirements in recognizing and measuring identifiable assets acquired and liabilities assumed within a business combination, any

noncontrolling interest, goodwill acquired in a business combination or a gain from a bargain purchase, and any applicable disclosures needed to evaluate the nature and financial effect of a business combination. SFAS No. 141 (R) is effective the first annual reporting period beginning on or after December 15, 2008, and therefore would be effective for the Company beginning January 1, 2009.

Effective January 1, 2008, the Company adopted SFAS No. 157, "*Fair Value Measurements*". In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, "*Effective Date of FASB Statement No. 157*", which provides a one year deferral of the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Therefore, the Company has adopted the provisions of SFAS 157 with respect to its financial assets and liabilities only. SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under SFAS 157 as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under SFAS 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The adoption of this Statement did not have a material impact on the Company's consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, (*Noncontrolling Interests in Consolidated Financial Statements*), an amendment of ARB No. 51 (*SFAS No. 160*). SFAS 160 amends ARB No. 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary, in which the noncontrolling interest will be reclassified as equity; and the income, expense and comprehensive income from a noncontrolling interest will be fully consolidated. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, and therefore would be effective for the Company beginning January 1, 2009. The Company is evaluating the impact SFAS 160 will have on its consolidated financial statements.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (*Statement No. 162*). The statement is intended to improve financial reporting by identifying a consistent hierarchy for selecting accounting principles to be used in preparing financial statements that are presented in conformity with

GAAP. Prior to the issuance of Statement No. 162, GAAP hierarchy was defined in the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. Unlike SAS No. 69, Statement No. 162 is directed to the entity rather than the auditor. Statement No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. Statement No. 162 is not expected to have any material impact on the Company's results of operations, financial condition or liquidity.

Note 2 Stock Options

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. Effective January 1, 2006, the Company adopted SFAS No. 123R, *Share-Based Payment* (SFAS No. 123R) which requires that compensation cost relating to share-based payment transactions be recognized as an expense in the financial statements and that measurement of that cost be based on the estimated fair

value of the equity or liability instrument issued. SFAS No. 123R also requires that forfeitures be estimated and recorded over the vesting period of the instrument.

The intrinsic value of options outstanding and exercisable at September 30, 2008 and 2007 was \$61,000 and \$78,000, respectively. There were no options exercised during the nine and three months ended September 30, 2008.

The remaining unrecognized stock-based compensation expense at September 30, 2008 was \$270,000 and will be amortized over a weighted average period of 1.17 years.

The weighted average fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions during the nine and three months ended September 30, 2008 and 2007:

| | Nine Months Ended | | Three Months Ended | |
|---|-------------------|---------|--------------------|--------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Risk free interest rate | 3.2% | 4.7% | 3.0% | 4.4% |
| Expected option lives | 5 Years | 5 Years | 5 Years | 5 Year |
| Expected volatility | 95.4% | 99.5% | 96.2% | 95.4% |
| Estimated forfeiture rate | 10% | 10% | 10% | 10% |
| Expected dividend yields | None | None | None | None |
| Weighted average grant date fair value of options | \$0.39 | \$0.43 | \$0.40 | \$0.44 |

The Company calculates expected volatility for a stock-based grant based on historic daily stock price observations of our common stock during the period immediately preceding the grant that is equal in length to the expected term of the grant. The expected term of the options is estimated based on the Company's historical exercise rate and forfeiture rates are estimated based on employment termination experience. The risk free interest rate is based on U.S. Treasury yields for securities in effect at the time of grants with terms approximating the term of the grants. The assumptions used in the Black-Scholes option valuation model are highly subjective, and can materially affect the resulting valuations.

A summary of options granted, exercised, expired and forfeited under our plans and options outstanding as of and for the nine months ended September 30, 2008 with respect to all outstanding options is as follows (options in thousands):

| | Outstanding | | Exercisable | |
|--------------------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Options outstanding, January 1, 2008 | | 4,213 | | \$ 1.47 |
| Granted | 485 | 0.52 | | |
| Exercised | | | | |

Edgar Filing: GLOWPOINT INC - Form 10-Q

| | | | | | |
|---|--------|----|------|-------|---------|
| Expired | | | | | |
| Forfeited | (107) | | 0.60 | | |
| Options outstanding, September 30, 2008 | 4,591 | \$ | 1.39 | 3,232 | \$ 1.75 |

Edgar Filing: GLOWPOINT INC - Form 10-Q

Stock option compensation expense is allocated as follows for the nine and three months ended September 30, 2008 and 2007 (in thousands):

| | Nine Months Ended | | Three Months Ended | |
|----------------------------|-------------------|--------|--------------------|--------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Cost of revenue | \$ 15 | \$ 16 | \$ 5 | \$ 3 |
| Research and development | 17 | 36 | 5 | 8 |
| Sales and marketing | 51 | 36 | 16 | 14 |
| General and administrative | 194 | 288 | 45 | 77 |
| | \$ 277 | \$ 376 | \$ 71 | \$ 102 |

There was no income tax benefit recognized for stock-based compensation for the nine and three months ended September 30, 2008 and 2007. No compensation costs were capitalized as part of the cost of an asset.

Note 3 - Restricted Stock

A summary of restricted stock granted, vested, forfeited and unvested restricted stock outstanding as of September 30, 2008, is presented below (restricted shares in thousands):

| | Restricted Shares | Weighted Average Exercise Price | |
|--|----------------------|--|------|
| | | | |
| | | | |
| Unvested restricted shares outstanding, January 1, 2008 | 1,027 | \$ | 0.54 |
| Granted | 485 | | 0.55 |
| Vested | (552) | | 0.55 |
| Forfeited | | | |
| Unvested restricted shares outstanding, September 30, 2008 | 960 | \$ | 0.54 |

Restricted stock compensation expense is allocated as follows for the nine and three months ended September 30, 2008 and 2007 (in thousands):

| | Nine Months Ended | | Three Months Ended | |
|----------------------------|-------------------|--------|--------------------|-------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| General and administrative | \$ 156 | \$ 338 | \$ 48 | \$ 62 |
| Sales and marketing | 3 | | 2 | |
| | \$ 159 | \$ 338 | \$ 50 | \$ 62 |

There was no income tax benefit recognized for stock-based compensation for the nine and three months ended September 30, 2008 and 2007, respectively. No compensation costs were capitalized as part of the cost of an asset.

Note 4 - 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 and three months ended September 30, 2008 and 2007 is the same as basic loss per share. Potential shares of common stock associated with 27,466,000 and 27,389,000 outstanding options and warrants, 4,748,000 and 4,748,000 shares issuable upon conversion of our Series C convertible preferred stock, 24,052,000 and 21,438,000 shares issuable upon conversion of the Senior Secured Notes as of September 30, 2008 and 2007, respectively, have been excluded from the calculation of diluted loss per share because the effects would be anti-dilutive.

Note 5 - Stockholders Deficit

In February 2004, we raised net proceeds of \$12,480,000 in a private placement of 6,100,000 shares of our common stock at \$2.25 per share. 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 accounted for the registration rights agreement as a separate freestanding instrument and accounted 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 \$1,116,000 and \$1,200,000 as of September 30, 2008 and December 31, 2007, respectively. We recognized other income of \$84,000 and \$58,000 for the nine and three months ended September 30, 2008. We recognized other income of \$30,000 and \$17,000 for the nine and three months ended September 30, 2007, respectively.

Note 6 - Senior Secured Notes**Senior Secured Notes and Senior Secured Notes Discount**

In March and April 2006 and September 2007, we issued our 10% Senior Secured Convertible Notes (the Senior Secured Notes) in private placements to private investors. The September 2007 private placement also included Insider Purchasers. Activity for the Senior Secured Notes and Senior Secured Notes discount during the nine months ended September 30, 2008 and as of December 31, 2007 was as follows (in thousands):

| | December 31, 2007 | 2008 Activity | September 30, 2008 |
|---|----------------------|------------------|-----------------------|
| Principal of Senior Secured Notes: | | | |
| March 2006 private placement | \$ 5,665 | \$ | \$ 5,665 |
| April 2006 private placement | 515 | | 515 |
| September 2007 private placement | 3,100 | | 3,100 |
| September 2007 private placement, Insider Purchasers | 438 | | 438 |
| Senior Secured Notes issued as payment for interest | 1,279 | 985 | 2,264 |
| Senior Secured Notes issued as payment for interest, Insider Purchasers | 9 | 35 | 44 |
| | 11,006 | 1,020 | 12,026 |
| Discount: | | | |
| Derivative financial instrument Series A Warrants | (2,873) | | (2,873) |
| Derivative financial instrument Series A-2 Warrants | (4,484) | | (4,484) |
| Derivative financial instrument Series A-2 Warrants, Insider Purchasers | (250) | | (250) |
| Reduction of exercise price and extension of expiration dates of warrants | (766) | | (766) |
| | (8,373) | | (8,373) |

Edgar Filing: GLOWPOINT INC - Form 10-Q

| | | | |
|---|----------|----------|----------|
| Accretion of discount | 4,211 | 2,047 | 6,258 |
| Accretion of discount, Insider Purchasers | 29 | 111 | 140 |
| | (4,133) | 2,158 | (1,975) |
| Senior Secured Notes, including those held by Insider Purchasers, net of discount | 6,873 | 3,178 | 10,051 |
| Less: Senior Secured Notes, Insider Purchasers, net of discount | 226 | 146 | 372 |
| Senior Secured Notes, net of discount | \$ 6,647 | \$ 3,032 | \$ 9,679 |

The Senior Secured Notes bear interest at 10% per annum, increasing to 12% on the first anniversary following their issuance, and mature on March 31, 2009. Beginning in January 2008, the per annum interest rate on the unpaid principal balance of the Senior Secured Notes then in effect shall increase if the Company fails to achieve a minimum adjusted quarterly earnings before interest, taxes, depreciation and amortization (the Adjusted EBITDA) as defined in the Senior Secured Notes. The per annum interest rate shall increase by 200 basis points if the stated quarterly Adjusted EBITDA is not achieved, and such increase will be cumulative for each subsequent quarterly failure to achieve the stated Adjusted EBITDA; provided, however, that the per annum interest rate shall

revert to the lower interest rate in the event the Company achieves or exceeds the stated or cumulative minimum Adjusted EBITDA in any subsequent quarterly period. The Senior Secured Notes and other transaction documents provide that the Insider Purchasers will not be entitled to all of the rights and benefits available to the other purchasers upon the failure by the Company to achieve Adjusted EBITDA (see Senior Secured Notes Adjusted EBITDA Requirements below).

The Senior Secured Notes are convertible into common stock at a conversion rate of \$0.50 per share (x) at any time at the holder's election or (y) automatically if the closing bid price (as defined in the Senior Secured Notes) of the Company's common stock exceeds \$1.25 (as adjusted for stock splits, stock dividends, combinations and similar transactions) for twenty (20) consecutive trading days. We have the option to pay the accrued interest for the Senior Secured Notes in cash or additional Senior Secured Notes. To date, all required interest payments have been made by issuing additional Senior Secured Notes.

During the nine and three months ended September 30, 2008 the accretion of discount was \$2,158,000 and \$822,000, respectively. During the nine and three months ended September 30, 2007 the accretion of discount was \$2,332,000 and \$952,000, respectively.

Financing Costs

The financing costs, net of accumulated amortization, which were included in the other assets in the accompanying balance sheets, were \$268,000 and \$635,000 as of September 30, 2008 and December 31, 2007, respectively. The financing costs for the March and April 2006 private placement were amortized over the 18 month period through September 30, 2007, the maturity date of the originally issued Senior Secured Notes. The financing costs for the September 2007 private placement and extension of the maturity date of the March and April 2006 private placement are being amortized over the 18 month period through March 31, 2009, the stated maturity date of the Senior Secured Notes. During the nine and three months ended September 30, 2008 the amortization of financing costs, using the effective interest method over the term of the financing, was \$368,000 and \$130,000, respectively. During the nine and three months ended September 30, 2007 the amortization of financing costs, using the effective interest method over the term of the financing, was \$404,000 and \$143,000, respectively.

Accounting for Conversion Feature and Series A and A-2 Warrants Derivative Liabilities

Activity for derivative liabilities as of December 31, 2007 and during the nine months ended and as of September 30, 2008 was as follows (in thousands):

| | | December 31, | Increase | September |
|---------------------------------------|---|---------------------|----------------------|------------------|
| | | 2007 | (decrease) in | 30, |
| | | | Fair Value | 2008 |
| (i) Derivative financial instrument | February 2004 capital raise | \$ 1,200 | \$ (84) | \$ 1,116 |
| (ii) Derivative financial instrument | Placement agent and financial advisory warrants | 457 | (4) | 453 |
| (iii) Derivative financial instrument | Series A Warrants | 1,758 | (50) | 1,708 |
| (iv) Derivative financial instrument | Series A-2 Warrants, September 2007 private placement | 1,008 | (6) | 1,002 |
| (iv) Derivative financial instrument | Series A-2 Warrants, September 2007 private placement, Insider Purchasers | 142 | | 142 |

Edgar Filing: GLOWPOINT INC - Form 10-Q

| | | | |
|--|----------|----------|----------|
| (v) Derivative financial instrument Series A-2 Warrants, issued in connection with Senior Secured Notes Extension | 1,552 | (9) | 1,543 |
| Long term derivative financial instruments | \$ 6,117 | \$ (153) | \$ 5,964 |

Edgar Filing: GLOWPOINT INC - Form 10-Q

The components of the increase (decrease) in the fair value of derivative financial instruments with changes in value recorded as other (income) expense for the nine and three months ended September 30, 2008 and 2007 was as follows (in thousands):

| | Nine Months Ended | | Three months ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2008 | September 30, 2007 | September 30, 2008 | September 30, 2007 |
| (i) Derivative financial instrument February 2004 capital raise | \$ (84) | \$ (30) | \$ (58) | \$ (17) |
| (ii) Derivative financial instrument Placement agent and financial advisory warrants | (4) | | (13) | |
| (iii) Derivative financial instrument Series A Warrants | (50) | 1,780 | (84) | 761 |
| (iv) Derivative financial instrument Series A-2 Warrants, September 2007 private placement | (6) | 3 | (21) | 3 |
| (iv) Derivative financial instrument Series A-2 Warrants, September 2007 private placement, Insider Purchasers | | | (3) | |
| (v) Derivative financial instrument Series A-2 Warrants, issued in connection with Senior Secured Notes Extension | (9) | 3 | (32) | 3 |
| (vi) Derivative financial instrument Beneficial conversion feature Senior Secured Notes | | 1,757 | | 1,757 |
| (vi) Derivative financial instrument Beneficial conversion feature Senior Secured Notes, Insider Purchasers | | | | |
| | \$ (153) | \$ 3,513 | \$ (211) | \$ 2,507 |

(i) We accounted for the registration rights agreement related to the February 2004 capital raise as a separate freestanding instrument and accounted 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.

(ii) We accounted for the issuance of the placement agent and financial advisory warrants issued in connection with the March and April 2006 and September 2007 private placements of the Senior Secured Notes as a derivative liability subject to SFAS No. 133. Management determined that the events or actions necessary to deliver registered shares are not controlled by the Company and that the holders have the right to demand that the Company pay the holders in cash, calculated as defined in the Series A and Series A-2 warrant, under certain circumstances. Accordingly the Company accounted for the placement agent and financial advisory warrants as a derivative liability. The estimated fair value of the derivative liability is calculated using the Black-Scholes method and such estimates are revalued at each balance sheet date with changes in value recorded as other income or expense.

(iii) We accounted for the issuance of the Series A warrants to purchase 6,180,000 shares of common stock at an exercise price of \$0.65 per share as a derivative liability subject to SFAS No. 133. Management determined that certain events or actions necessary to deliver registered shares are not controlled by the Company and that the holders

have the right to demand that the Company pay the holders in cash, calculated as defined in the Series A warrant, under certain circumstances. Accordingly the Company accounted for the Series A warrants as a derivative liability. The estimated fair value of the derivative liability is calculated using the Black-Scholes method and such estimates are revalued at each balance sheet date, with changes in value recorded as other income or expense.

(iv) In connection with the September 2007 private placement we accounted for the issuance of the Series A-2 warrants to purchase 3,538,000 shares of common stock at an exercise price of \$0.65 per share as a derivative liability subject to SFAS No. 133. Management determined that certain events or actions necessary to deliver registered shares are not controlled by the Company and that the holders have the right to demand that the Company pay the holders in cash, calculated as defined in the Series A-2 warrant, under certain circumstances. Accordingly the Company accounted for the Series A-2 warrants as a derivative liability. The estimated fair value of the derivative liability is calculated using the Black-Scholes method and such estimates are revalued at each balance sheet date, with changes in value recorded as other income or expense.

(v) In connection with the Senior Secured Notes extension in September 2007 we accounted for the issuance of the Series A-2 warrants to purchase 4,773,000 shares of common stock at an exercise price of \$0.65 per share as a derivative liability subject to SFAS No. 133. Management determined that certain events or actions necessary to deliver registered shares are not controlled by the Company and that the holders have the right to

demand that the Company pay the holders in cash, calculated as defined in the Series A-2 warrant, under certain circumstances. Accordingly the Company accounted for the Series A warrants as a derivative liability. The estimated fair value of the derivative liability is calculated using the Black-Scholes method and such estimates are revalued at each balance sheet date, with changes in value recorded as other income or expense.

(vi) We initially accounted for the convertibility of the Senior Secured Notes into common stock at a conversion rate of \$0.50 per share as a derivative liability subject to SFAS No. 133. Management determined that certain events or actions necessary to deliver registered shares are not controlled by the Company and that the holders have the right to demand that the Company pay the holders in cash, calculated as defined in the Senior Secured Notes, under certain circumstances. Accordingly, the Company accounted for the beneficial conversion feature as a derivative liability. The estimated fair value of the derivative liability is based on the prepayment amount that would be owed to a Senior Secured Notes holder if payment is required. The prepayment amount is the greater of (i) 125% of the value of the Senior Secured Notes and accrued interest and (ii) the value if the Senior Secured Notes and accrued interest converted into common stock at \$0.50 per share and then multiplied by the then current stock price. Since the Senior Secured Notes are convertible at the issuance date, an expense related to the derivative liability is recognized on that date.

In December 2007, in light of changes to Rule 144 of the Securities Act, we amended the Registration Rights Agreement to eliminate the requirement to register the shares issuable upon conversion of the Senior Secured Notes, thereby eliminating any requirement to deliver registered shares, which effectively eliminated the right of the holders of the Senior Secured Notes to demand that the Company pay such holders cash, calculated as defined in the Senior Secured Notes.

Insider Purchasers investment in September 2007 Private Placement

In the September 2007 private placement, the Insider Purchasers invested an aggregate of \$438,000 and were issued Senior Secured Notes and Series A-2 warrants to acquire 438,000 shares of common stock. The Senior Secured Notes and other transaction documents provide that the Insider Purchasers will not be entitled to all of the rights and benefits available to the other purchasers upon the occurrence of certain events, including, but not limited to, an event of default, the failure by Glowpoint to achieve specified Adjusted EBITDA (as defined below), and the failure to timely file the required registration statement.

Senior Secured Notes Adjusted EBITDA Requirements

If the Company does not achieve the following minimum Adjusted EBITDA the per annum interest rate on the unpaid principal balance of the Senior Secured Notes then in effect shall increase by 200 basis points, and such increase will be cumulative for each subsequent period; provided, however, that the per annum interest rate shall revert to the lower interest rate in the event the Company achieves or exceeds the cumulative minimum Adjusted EBITDA for any subsequent determination date. Failure to maintain the minimum Adjusted EBITDA, however, shall not constitute an Event of Default as defined in the Senior Secured Notes agreements. The Adjusted EBITDA (as defined below) targets for the determination dates are as follows:

| Determination Date | Adjusted EBITDA |
|---------------------------|--|
| As of March 31, 2008 | \$0 for the quarter ending March 31, 2008 |
| As of June 30, 2008 | \$1,000,000 for the period commencing on January 1, 2008 and ending on June 30, 2008. |
| As of September 30, 2008 | \$1,500,000 for the quarter ending September 30, 2008, or \$2,500,000 for the period commencing on January 1, 2008 and ending on September 30, 2008. |
| As of December 31, 2008 | |

Edgar Filing: GLOWPOINT INC - Form 10-Q

\$2,000,000 for the quarter ending December 31, 2008 or \$4,500,000 for the year ended December 31, 2008.

Adjusted EBITDA is defined as the sum of the amounts for such period of (i) net income or loss before dividends, plus (ii) charges for foreign, federal, state and local taxes as computed on our income tax returns, plus (iii) interest expense, plus (iv) depreciation, plus (v) amortization expense, including, without limitation, amortization of goodwill and other intangible assets and amortization of stock based compensation expense, plus (vi) extraordinary losses, plus (vii) charges related to any financing consummated on or prior to the September 2007 private placement, plus (viii) the cost of any beneficial conversion feature of any outstanding security, plus (ix) the cost of any accretion of discounts minus (x) interest income, minus (xi) extraordinary gains, and (xii) such other adjustments to eliminate the impact of any derivative financial instruments.

Edgar Filing: GLOWPOINT INC - Form 10-Q

The Company achieved the minimum Adjusted EBITDA for the quarter ended March 31, 2008 but did not achieve the minimum Adjusted EBITDA for the nine months ended September 30, 2008 and the six months ended June 30, 2008.

Therefore, the interest rate on the unpaid principal balance of the Senior Secured Notes increased by 200 basis points beginning July 1, 2008 and an additional 200 basis points on October 1, 2008. The following table sets forth the Adjusted EBITDA, for the nine months ended September 30, 2008, the six months ended June 30, 2008 and the three months ended March 31, 2008 (in thousands):

| | Nine Months | Six Months | Three Months |
|---|----------------------|-------------------|---------------------|
| | Ended | Ended | Ended |
| | September 30, | June 30, | March 31, |
| Net loss before dividends | \$ (5,103) | \$ (3,250) | \$ (2,938) |
| Adjustments: | | | |
| Income taxes | | | |
| Interest expense | 1,267 | 796 | 394 |
| Depreciation and amortization | 959 | 647 | 331 |
| Stock-based compensation | 436 | 314 | 158 |
| Extraordinary losses | | | |
| Amortization of deferred financing costs | 368 | 238 | 113 |
| Costs of beneficial conversion features | | | |
| Accretion of discount on Senior Secured Notes | 2,158 | 1,336 | 623 |
| Interest income | (18) | (16) | (11) |
| Extraordinary gains | | | |
| Increase (decrease) in fair value of derivative financial instruments | (153) | 58 | 1,456 |
| Adjusted EBITDA | \$ (86) | \$ 123 | \$ 126 |

Past performance is not indicative of future results. Therefore, achieving the above-stated Adjusted EBITDA is not any indication of any result expected to be achieved in subsequent quarters. We note that the failure to achieve the stated Adjusted EBITDA does not result in an event of default of the Senior Secured Notes; such a failure only triggers the interest rate increase (noted above) of the Senior Secured Notes.

Note 7 - Interest Expense

The components of interest expense for the nine and three months ended September 30, 2008 and 2007 are presented below (in thousands):

| | Nine Months Ended | | Three Months ended | |
|---|--------------------------|-------------|---------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Accretion of discount on Senior Secured Notes | \$ 2,047 | \$ 2,329 | \$ 778 | \$ 949 |
| | 111 | 3 | 44 | 3 |

Edgar Filing: GLOWPOINT INC - Form 10-Q

| | | | | |
|---|----------|----------|----------|----------|
| Accretion of discount on Senior Secured Notes, Insider Purchasers | | | | |
| Interest on Senior Secured Notes | 1,013 | 599 | 389 | 225 |
| Interest on Senior Secured Notes, Insider Purchasers | 35 | 1 | 12 | 1 |
| Beneficial conversion feature Senior Secured Notes | | 1,755 | | 1,661 |
| Beneficial conversion feature Senior Secured Notes, Insider Purchasers | | 220 | | 220 |
| Interest expense for sales and use taxes and regulatory fees | 128 | 229 | 38 | 75 |
| Other interest expense | 91 | 3 | 32 | 1 |
| | \$ 3,425 | \$ 5,139 | \$ 1,293 | \$ 3,135 |

Note 8 - Commitments and Contingencies

We have entered into a number of agreements with telecommunications companies to purchase communications services. Some of the agreements require a minimum amount of services purchased over the life of the agreement, or during a specified period of time.

Glowpoint believes that it will meet its commercial commitments. In certain instances where Glowpoint did not meet the minimum commitments, no such penalties for minimum commitments have been assessed and the Company has entered into new agreements. It has been our experience that the prices and terms of successor agreements are similar to those offered by other carriers.

Glowpoint does not believe that any loss contingency related to a potential shortfall should be recorded in the condensed consolidated financial statements because it is not probable, from the information available and from prior experience, that Glowpoint has incurred a liability.

Item 2.

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

Certain statements in this Quarterly Report on Form 10-Q, (the Report), are forward-looking statements. These forward-looking statements include, but are not limited to, statements about the plans, objectives, expectations and intentions of Glowpoint, Inc. (Glowpoint or we or us), a Delaware corporation and other statements contained in this Report that are not historical facts. Forward-looking statements in this Report or hereafter included in other publicly available documents filed with the Securities and Exchange Commission, or the Commission, reports to our stockholders and other publicly available statements issued or released by us involve known and unknown risks, uncertainties and other factors which could cause our actual results, performance (financial or operating) or achievements to differ from the future results, performance (financial or operating) or achievements expressed or implied by such forward-looking statements. Such future results are based upon management's best estimates based upon current conditions and the most recent results of operations. When used in this Report, the words expect, anticipate, intend, plan, believe, seek, estimate and similar expressions are generally intended to identify forward-looking statements, because these forward-looking statements involve risks and uncertainties. There are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including our plans, objectives, expectations and intentions and other factors that are discussed under the section entitled Risk Factors, in item 7 of our consolidated financial statements and the footnotes thereto for the fiscal year ended December 31, 2007 as filed with the Commission as an exhibit to Form 10-K on March 27, 2008.

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this Report.

Overview

Glowpoint is a premiere broadcast-quality, IP (Internet Protocol)-based managed video services provider. Our mission is to improve the ease-of-use, cost-effectiveness, functionality, and quality of existing video communications in order to make it an integral and ubiquitous part of everyday business and personal communications. We are primarily focused on innovating high quality two-way video communications and believe video communications should be as easy and spontaneous to use as your telephone, but with the power of face-to-face communication.

We view our services as analogous to cellular service providers in the cellular telephone industry. Regardless of the cellular phone purchased, users must select a cellular service provider to make it work. Users make that service decision based on the features, reliability and price offered by the service provider. In our industry, regardless of the video conferencing equipment purchased, Glowpoint provides the managed video services to make it work. In doing so, we offer a vast array of managed video services, including video application services, managed network services, IP and ISDN videoconferencing services, multi-point conferencing (bridging), technology hosting and management, and professional services. In order to address specific needs within an industry, such as broadcast/media content acquisition or retail call center environments, we have bundled some of our managed services to offer unique video communication solutions. We also wholesale some of our services to provide branding for manufacturers, telecommunications carriers, and integrators for resale.

We provide our managed video services to a wide variety of companies, from global enterprises and large governmental entities to small and medium-sized businesses to other providers of video or telecommunications services. Currently, Glowpoint supports thousands of customer locations in over 1,200 cities in 37 countries around the world.

With the advent of telepresence, we have combined various components of our features and services into a comprehensive video network operations center support service (VNOC Support Service) offering that can support the

telepresence systems manufactured by Cisco, Polycom, Tandberg and virtually all other telepresence solutions on the market today. Telepresence is a term to describe high quality, true to life meetings via video communications where participants feel as though they are all sitting in the same physical room even though they may be continents apart. This is accomplished with the use of multiple monitors, special furniture, and strategic camera placement and sound panels to create an immersive experience. We believe that the expensive equipment cost and customer expectations for telepresence demand that a managed service provider, such as Glowpoint, be involved to ensure that all telepresence rooms operate consistently and meetings occur reliably.

Our VNOC Support Services include, but are not limited to, room certification, proactive room and component monitoring, comprehensive room scheduling support and conflict management, conference production and monitoring, specialized call launching, help support, training and adoption, interoperability testing and support, comprehensive reporting (including statistical room usage and performance data), stewardship reporting, and advanced video network traffic monitoring. Representative purchasers of our VNOC Support Services include enterprise end user customers, who have typically paid hundreds of thousands of dollars for the required telepresence equipment and installation and require assurance that it reliably and properly functions so as to be used to its fullest extent to maximize that investment. Other representative purchasers of our VNOC Support Services include equipment manufacturers and integrators, who purchase our VNOC Support Services on a wholesale basis and resell them in order to ensure that their sold product is reliable and satisfactory to their customer, which will result in greater adoption and increased future sales of products. The value of VNOC Support Service sales tend to be of a larger magnitude than our historical sales opportunities of managed video services. In opportunities that we have participated to date, however, we have found that some end user customers interested in VNOC Support Services are also interested in having their non-telepresence video endpoints also managed, which can equal or rival the value of the VNOC Support Service opportunity.

According to some estimates, including market research by IDC and a published Cisco white paper, the projected potential market size for telepresence support services and network may exceed \$1 billion by 2010 and perhaps reach as much as \$3 billion by 2011. To seek a prominent place in this burgeoning industry and to garner market share, we have focused more resources and time on, and accelerated certain expenses to support, our VNOC Support Service and related sales opportunities.

Glowpoint's traditional managed video services are hardware agnostic, supporting all recognized video standards. As a result, we have become the global video interconnection point, linking together islands of video across third party private networks (e.g., provided by AT&T, SBC, Qwest and others), protocols (e.g., H320, H323, IP, SIP, and VoIP), and devices (e.g., desktop, laptop, and mobile phone). Glowpoint's services provide users with a consistent experience - regardless of how they are connecting or where they are connecting from.

Glowpoint's managed video services involve two major components, the Glowpoint video applications services (including, without limitation, VNOC Support Services) and the Glowpoint network services. The video application services are network agnostic and may be leveraged by customers on any QoS (Quality of Service) network that supports two-way video transport. The Glowpoint network services leverage the Glowpoint network, a multiple protocol layer switching (MPLS) QoS network that is dedicated to high-quality two-way video transport built and managed by Glowpoint. The Glowpoint network is exclusively dedicated to IP-based video communications, which allows us to optimize performance and routing of video and audio packets so as to offer broadcast quality images with telephony-like reliability, features and ease-of-use. Glowpoint's reach spans the globe; with 11 points of presence (POPs) in hardened facilities and unlimited peering capability to cost effectively deliver Glowpoint services to customers in virtually any region in the world. A unique feature of the Glowpoint network is its sophisticated gatekeeper infrastructure and configuration along with its patent-pending call control capabilities, which enable customers to seamlessly connect to nearly any standards-based video communications user, whether they are still using ISDN or the Internet, across the United States as well as to virtually any major city around the world. Since videoconferencing users typically can only communicate to others on the same service, Glowpoint is bridging these isolated islands of video and making video communications more ubiquitous.

Critical Accounting Policies

There have been no changes to our critical accounting policies in the nine and three months ended September 30, 2008. Critical accounting policies and the significant estimates made in accordance with them are regularly discussed with our Audit Committee. Those policies are discussed under Critical Accounting Policies in our Management's Discussion and Analysis of Financial Condition and Results of Operations included in Item 7 of our consolidated financial statements and the footnotes thereto for the fiscal year ended December 31, 2007 as filed with the

Commission as an exhibit to Form 10-K on March 27, 2008.

Results of Operations

The following table sets forth for the nine and three months ended September 30, 2008 and 2007; information derived from our condensed consolidated financial statements as expressed as a percentage of revenue:

| | (Unaudited) | | (Unaudited) | |
|---|-------------------|----------|--------------------|-----------|
| | Nine Months Ended | | Three Months Ended | |
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Revenue | 100.0 % | 100.0 % | 100.0 % | 100.0 % |
| Cost of revenue | 58.0 | 67.9 | 59.8 | 67.8 |
| Gross margin | 42.0 | 32.1 | 40.2 | 32.2 |
| Operating expenses: | | | | |
| Research and development | 4.2 | 3.3 | 4.5 | 3.7 |
| Sales and marketing | 14.6 | 12.9 | 13.4 | 12.6 |
| General and administrative | 31.2 | 35.1 | 32.9 | 31.2 |
| Total operating expenses | 50.0 | 51.3 | 50.8 | 47.5 |
| Loss from operations | (8.0) | (19.2) | (10.6) | (15.3) |
| Interest and other expense (income): | | | | |
| Interest expense, including 0.6%, 1.3%, 0.7% and 3.8%, respectively, for Insider Purchasers | 18.4 | 29.7 | 21.3 | 54.0 |
| Interest income | (0.1) | (0.2) | | (0.1) |
| Increase (decrease) in fair value of derivative financial instruments, including 0.0% for Insider Purchasers | (0.8) | 20.3 | (3.5) | 43.2 |
| Amortization of deferred financing costs, including 0.2%, 0.0%, 0.2% and 0.0%, respectively, for Insider Purchasers | 2.0 | 2.3 | 2.1 | 2.5 |
| Total interest and other expense, net | 19.5 | 52.1 | 19.9 | 99.6 |
| Net loss | (27.5) | (71.3) | (30.5) | (114.9) |
| Gain on redemption of preferred stock | | 4.6 | | 13.8 |
| Preferred stock dividends | | (1.5) | | (1.4) |
| Net loss attributable to common stockholders | (27.5)% | (68.2)% | (30.5)% | (102.5)% |

Nine Months Ended September 30, 2008 (the 2008 period) Compared to Nine Months Ended September 30, 2007 (the 2007 period).

Revenue - Revenue increased \$1,246,000, or 7.2%, in the 2008 period to \$18,557,000 from \$17,311,000 in the 2007 period. We have separated our revenue into Core Revenue and Non-core Revenue. Core Revenue is revenue derived from the products and services that meet our overall strategic goals from a growth, margin and core competency

perspective. We believe these products and services offer the greatest prospects for high margin sales and growth and, therefore, our sales and marketing efforts are primarily focused on promoting them. Non-core Revenue is revenue derived from products and services that we believe do not fit into our overall strategic plan, but nonetheless generate revenue. These non-core products and services are typically low margin and, therefore, we do not spend sales or marketing efforts on them and expect them to decline over time.

Our Core Revenue includes:

.

Subscription and related services, which includes VNOC Support Services (described above), a new revenue stream for 2008, represent about 68% of our total current revenue and is generally tied to contracts of 12 months or more;

.

Multi-point Bridging, which represents about 16% of our total current revenue and is a usage based service where we enable customers to have video meetings with multiple locations on the screen at one time;

Events and Professional Services, which represent about 5% of our total current revenue and is revenue derived from non-recurring services (e.g., the professional football draft event) or from providing professional services to develop custom solutions; and

Our Non-core Revenue includes:

ISDN resale business, which represents about 10% of our total current revenue. We do not actively pursue more ISDN resale business and have actively sought to reduce the amount of low margin revenue from this line of business; and

Integration services, which include integrating various hardware components, or procuring hardware components for our customers, to support our managed video services. In most cases, we provide integration services as a pass-through or at low margin in order to facilitate the completion of the project on behalf of our customer. We do not actively pursue this type of revenue and only accommodate requests of high profile customers.

| | Nine Months Ended September 30, | | | |
|--|--|-------------|--------------------------------|-----------------|
| | 2008 | 2007 | Increase (Decrease) | % Change |
| Revenue | | | | |
| Core revenue: | | | | |
| Subscription and related revenue ⁽¹⁾ | \$ 12,923 | \$ 11,353 | \$ 1,570 | 13.8 % |
| Non-subscription revenue | | | | |
| Bridging ⁽²⁾ | 2,948 | 2,496 | 452 | 18.1 % |
| Special events and professional services ⁽³⁾ | 528 | 395 | 133 | 33.7 % |
| | 16,399 | 14,244 | 2,155 | 15.1 % |
| Non-core revenue: | | | | |
| Integration services for a broadcast customer ⁽⁴⁾ | 350 | 973 | (623) | (64.0 %) |
| ISDN resale revenue ⁽⁵⁾ | 1,808 | 2,094 | (286) | (13.7 %) |
| | 2,158 | 3,067 | (909) | (29.6 %) |
| Total revenue | \$ 18,557 | \$ 17,311 | \$ 1,246 | 7.2 % |

⁽¹⁾ The increased subscription and related revenue is caused by increases in installed subscription circuits, revenue per circuit and VNOC support services which started in the 2nd quarter of 2008.

- (2) The increased bridging services revenue was a result of a concerted effort by the Company to grow revenue from bridging services and was facilitated by the hiring of a Product Manager who focused on the bridging business.
- (3) The increased special events and professional services revenue was a result of new events and a development project for a potential VNOC customer.
- (4) In the 2008 period the Company provided integration services on equipment required by a VNOC customer and a broadcast customer and in the 2007 period a broadcast customer as part of the implementation of their subscription agreements. Glowpoint was asked to facilitate the procurement and integration of equipment on behalf of a these customers and agreed to do so as a pass through service. Therefore all equipment integrated into the solution was billed to the customers at cost and the related costs are included in cost of revenue.
- (5) We are actively considering alternatives with respect to our ISDN resale business whether to sell, transfer or discontinue this line of business. Currently, we resell ISDN and other services to Tandberg, Inc. (Tandberg), from whom we acquired our ISDN resale business in April 2004. While we resell ISDN services to many customers, in the year ended December 31, 2007, approximately 44% of our resold ISDN revenues, or approximately \$1,174,000, were from Tandberg, which was approximately 5.2% of our total gross revenues. Pursuant to the terms of the April 2004 purchase, as amended, Tandberg was contractually obligated to exclusively purchase certain enumerated services from us through January 31, 2007. While Tandberg has continued to purchase services from us after January 31, 2007, Tandberg has begun the process of transitioning its business from Glowpoint and intends to cease buying these services from Glowpoint, which we expect to occur in the coming months. Because this revenue is our lowest margin revenue, however, we expect our overall gross margin percentage to increase once we lose this gross revenue.

Cost of revenue - Cost of revenue for the 2008 period decreased \$994,000, or 8.5%, to \$10,757,000 from \$11,751,000 in the 2007 period. The primary components of this decrease were \$614,000 from a reduction in integration services (discussed in the Revenue section above) and \$151,000 of depreciation and amortization. These savings were partially offset by \$262,000 of increased salaries, benefits and other costs related to the expansion of our services to encompass 24/7 staffing.

Gross margin - Gross margin for the 2008 period increased by \$2,240,000, or 40.3%, to \$7,800,000 from \$5,560,000 in the 2007 period. The savings discussed in Cost of Revenue section along with \$503,000 of additional gross margin generated by elimination of network costs and our on-going activity involving the renegotiation of rates and the migration of service to lower cost providers where possible caused our gross margin to increase to 42.0% in the 2008 period from 32.1% in the 2007 period. Excluding the customer integration transactions our gross margin percentage is 42.6% in the 2008 period and 33.7% in the 2007 period. 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 \$205,000, or 36.0%, in the 2008 period to \$775,000 from \$570,000 in the 2007 period. This increase was primarily related to accelerating our VNOC Support Services and included contract employee cost increases of \$83,000. In the 2008 and 2007 periods we capitalized \$0 and \$117,000, respectively, of software development costs related to our Customer Connect software which had the effect of reducing our costs. The capitalization of these software development costs ceased in the third quarter of 2007. Research and development expense, as a percentage of revenue, was 4.2% for the 2008 period and 3.3% for the 2007 period.

Sales and marketing - Sales and marketing expenses, which include sales salaries, commissions, overhead and marketing costs, increased by \$487,000, or 21.8%, in the 2008 period to \$2,717,000 from \$2,230,000 in the 2007 period. The primary components of the increase were \$217,000 of salaries and benefits, \$130,000 for agent commissions and \$128,000 of travel and advertising and marketing expenses. Sales and marketing expense, as a percentage of revenue, was 14.6% for the 2008 period and 12.9% for the 2007 period.

General and administrative - General and administrative expenses decreased by \$293,000, or 4.8%, in the 2008 period to \$5,789,000 from \$6,082,000 in the 2007 period. The primary components of this decrease were reductions of \$273,000 in professional fees related to the restatements of the financial statements for the years ended December 31, 2004 and 2005, \$190,000 in the amortization of stock-based deferred compensation, \$171,000 in the accrual for sales taxes and regulatory fees and penalties, \$86,000 for salaries and benefits and \$31,000 for SEC filing fees. These decreases were partially reduced by increases of \$254,000 of training and contract employee costs, incurred to prepare the Company for our VNOC Support Services, \$78,000 for maintenance and repairs, \$64,000 for bad debts, \$40,000 for travel and entertainment and \$38,000 for board of director fees. In the 2008 and 2007 periods we capitalized \$0 and \$24,000, respectively, of software development costs related to our Customer Connect software which had the effect of reducing our costs. General and administrative expense, as a percentage of revenue, was 31.2% in the 2008 period and 35.1% in the 2007 period.

Loss from operations - Loss from operations decreased by \$1,841,000, or 55.4%, to \$1,481,000 in the 2008 period from \$3,322,000 in the 2007 period.

Other expense (income) - Other expense in the 2008 period of \$3,622,000 principally reflects interest expense of \$3,425,000 which is comprised of \$2,158,000 for the accretion of the discount related to the Senior Secured Notes, \$1,048,000 of accrued interest expense related to the Senior Secured Notes, \$128,000 of interest related to sales and use taxes and regulatory fees and \$91,000 of other interest. Amortization of deferred financing costs incurred in connection with the Senior Secured Notes was \$368,000. Those expenses are partially offset by the \$153,000 net decrease in fair value of derivative financial instruments which was comprised of a decrease in the fair value of derivative financial instruments related to warrants issued in connection with the March and April 2006 and

September 2007 private placements and \$18,000 of interest income. Other expense in the 2007 period of \$9,021,000 principally reflects interest expense of \$5,139,000 which is comprised of \$2,332,000 for the accretion of the discount related to the Senior Secured Notes, \$600,000 of accrued interest expense related to the Senior Secured Notes, \$1,975,000 for the expensing of the beneficial conversion feature related to additional Senior Secured Notes, \$229,000 of interest related to sales and use taxes and regulatory fees and \$3,000 of other interest. The \$3,513,000 net increase in fair value of derivative financial instruments was comprised of an increase in the fair value of derivative financial instruments related to the Series A warrants and a decrease related to the February 2004 capital

raise. Amortization of deferred financing costs incurred in connection with the Senior Secured Notes was \$404,000. Those expenses are partially offset by \$35,000 of interest income.

Income taxes - As a result of our losses we recorded no provision for incomes taxes in the three months ended September 30, 2008 and 2007. Any deferred tax asset that would be related to our losses has been fully reserved under a valuation allowance, reflecting the uncertainties as to realization evidenced by the Company's historical results and restrictions on the usage of the net operating loss carryforwards.

Net loss - Net loss decreased by \$7,240,000, or 58.7%, to \$5,103,000 in the 2008 period from \$12,343,000 in the 2007 period.

Gain on redemption of preferred stock As a result of the Preferred Stock Exchange in September 2007 we recognized a gain for the \$799,000 excess of Series B Carrying Amount over the Series C Fair Value in the 2007 period.

Preferred stock dividends - We recognized preferred stock dividends of \$0 for the 2008 period and \$252,000 for the 2007 period. The elimination of preferred stock dividends in 2008 resulted from the September 2007 issuance of 474.8126 shares of a new Series C Preferred Stock, which does not pay dividends, in exchange for all of our then issued and outstanding Series B Preferred Stock, which bore 12% dividends.

Net loss attributable to common stockholders - Net loss attributable to common stockholders decreased by \$6,693,000, or 56.7% in the 2008 period to \$5,103,000, or \$0.11 per basic and diluted share from \$11,796,000, or \$0.25 per basic and diluted share, in the 2007 period.

Three Months Ended September 30, 2008 (the 2008 quarter) Compared to Three Months Ended September 30, 2007 (the 2007 quarter).

Revenue - Revenue increased \$263,000, or 4.5%, in the 2008 quarter to \$6,066,000 from \$5,803,000 in the 2007 quarter. We have separated our revenue into Core Revenue and Non-core Revenue.

| | Three Months Ended September 30, | | | |
|--|---|-------------|--------------------------------|-----------------|
| | 2008 | 2007 | Increase (Decrease) | % Change |
| Revenue | | | | |
| Core revenue: | | | | |
| Subscription and related revenue ⁽¹⁾ | \$ 4,332 | \$ 3,875 | \$ 457 | 11.8 % |
| Non-subscription revenue | | | | |
| Bridging ⁽²⁾ | 891 | 774 | 117 | 15.1 % |
| Special events and professional services | 186 | 249 | (63) | (25.3)% |
| | 5,409 | 4,898 | 511 | 10.4 % |
| Non-core revenue: | | | | |
| Integration services for a broadcast customer ⁽³⁾ | 101 | 301 | (200) | (66.4)% |

Edgar Filing: GLOWPOINT INC - Form 10-Q

| | | | | |
|------------------------------------|----------|----------|--------|----------|
| ISDN resale revenue ⁽⁴⁾ | 556 | 604 | (48) | (7.9 %) |
| | 657 | 905 | (248) | (27.4 %) |
| Total revenue | \$ 6,066 | \$ 5,803 | \$ 263 | 4.5 % |

(1) The increased subscription and related revenue is caused by increases in installed subscription circuits, revenue per circuit and VNOC support services.

(2) The increased bridging services revenue was a result of a concerted effort by the company to grow revenue from bridging services and was facilitated by the hiring of a Product Manager who focused on the bridging business.

(3) In the 2008 period the Company provided integration services on equipment required by a VNOC customer and in the 2007 period a broadcast customer as part of the implementation of their subscription agreements. Glowpoint was asked to facilitate the procurement and integration of equipment on behalf of a these

customers and agreed to do so as a pass through service. Therefore all equipment integrated into the solution was billed to the customers at cost and the related costs are included in cost of revenue.

(4) We are actively considering alternatives with respect to our ISDN resale business whether to sell, transfer or discontinue this line of business. Currently, we resell ISDN and other services to Tandberg, from whom we acquired our ISDN resale business in April 2004. While we resell ISDN services to many customers, in the year ended December 31, 2007, approximately 44% of our resold ISDN revenues, or approximately \$1,174,000, was from Tandberg, which was approximately 5.2% of our total gross revenues. Pursuant to the terms of the April 2004 purchase, as amended, Tandberg was contractually obligated to exclusively purchase certain enumerated services from us through January 31, 2007. While Tandberg has continued to purchase services from us after January 31, 2007, Tandberg has begun the process of transitioning its business from Glowpoint and intends to cease buying these services from Glowpoint, which we expect to occur in the coming months. Because this revenue is our lowest margin revenue, however, we expect our overall gross margin percentage to increase once we lose this gross revenue.

Cost of revenue - Cost of revenue for the 2008 quarter decreased \$302,000, or 7.7%, to \$3,630,000 from \$3,932,000 in the 2007 quarter. The decrease was primarily related to \$207,000 of decreased costs related to the integration services (discussed in the Revenue section above) and \$36,000 of depreciation and amortization. These savings were partially offset by \$112,000 of increased salaries, benefits and other costs related to the expansion of our services to encompass 24/7 staffing.

Gross margin - Gross margin for the 2008 quarter increased by \$565,000, or 30.2%, to \$2,436,000 from \$1,871,000 in the 2007 quarter. The savings discussed in Cost of Revenue section caused along with \$178,000 of additional gross margin generated by elimination of network costs and our on-going activity involving the renegotiation of rates and the migration of service to lower cost providers where possible caused our gross margin to increase to 40.2% in the 2008 quarter from 32.2% in the 2007 quarter. The rate of increase in our gross margin percentage is not indicative of results expected to be achieved in subsequent quarters.

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 \$55,000, or 25.5% in the 2008 quarter to \$271,000 from \$216,000 in the 2007 quarter. This increase was primarily related to accelerating our VNOc Support Services and included contract employee cost increases of \$36,000. In the 2008 and 2007 quarters we capitalized \$0 and \$14,000, respectively, of software development costs related to our Customer Connect software which had the effect of reducing our costs. The capitalization of these software development costs ceased in the third quarter of 2007. Research and development expense, as a percentage of revenue, was 4.5% for the 2008 quarter and 3.7% for the 2007 quarter.

Sales and marketing - Sales and marketing expenses, which include sales salaries, commissions, overhead and marketing costs, increased by \$80,000, or 10.9%, in the 2008 quarter to \$811,000 from \$731,000 in the 2007 quarter. The primary components of the increase were \$64,000 for agent commissions and \$33,000 of travel expenses. These increases were reduced by a \$20,000 decrease in advertising and marketing. Sales and marketing expense, as a percentage of revenue, was 13.4% for the 2008 quarter and 12.6% for the 2007 quarter.

General and administrative - General and administrative expenses increased by \$191,000, or 10.6%, in the 2008 quarter to \$1,998,000 from \$1,807,000 in the 2007 period. The primary components of this increase were \$181,000 in salaries and benefits and contract employee costs incurred to prepare the Company for our VNOc Support Services and \$58,000 of professional fees and \$30,000 in bad debts. These increases were partially reduced by decreases of \$33,000 of SEC filing fees, \$29,000 for Board of Director fees and \$26,000 for taxes and licenses. General and administrative expenses as a percentage of revenue were 32.9% in the 2008 quarter and 31.2% in the 2007 quarter.

Loss from operations - Loss from operations decreased by \$239,000, or 27.1%, to \$644,000 in the 2008 quarter from \$883,000 in the 2007 quarter.

Other expense (income) - Other expense in the 2008 quarter of \$1,209,000 principally reflects interest expense of \$1,293,000 which is comprised of \$822,000 for the accretion of the discount related to the Senior Secured Notes, \$401,000 of accrued interest expense related to the Senior Secured Notes, \$38,000 of interest related to sales and use taxes and regulatory fees and \$32,000 of other interest. Amortization of deferred financing costs incurred in connection with the Senior Secured Notes was \$130,000. Those expenses are partially offset by the

\$211,000 net decrease in fair value of derivative financial instruments was comprised of decreases in the fair value of derivative financial instruments related to warrants issued in connection with the March and April 2006 and September 2007 private placements and the February 2004 capital raise and \$3,000 of interest income. Other expense in the 2007 quarter of \$5,778,000 principally reflects interest expense of \$3,135,000 which is comprised of \$952,000 for the accretion of the discount related to the Senior Secured Notes, \$226,000 of accrued interest expense related to the Senior Secured Notes, \$1,881,000 for the expensing of the beneficial conversion feature related to additional Senior Secured Notes, \$75,000 of interest related to sales and use taxes and regulatory fees and \$1,000 of other interest. The \$2,507,000 net increase in fair value of derivative financial instruments was comprised of an increase in the fair value of derivative financial instruments related to the Series A warrants. Amortization of deferred financing costs incurred in connection with the Senior Secured Notes was \$143,000. Those expenses are partially offset by \$7,000 of interest income.

Income taxes - As a result of our losses we recorded no provision for incomes taxes in the three months ended September 30, 2008 and 2007. Any deferred tax asset that would be related to our losses has been fully reserved under a valuation allowance, reflecting the uncertainties as to realization evidenced by the Company's historical results and restrictions on the usage of the net operating loss carryforwards.

Net loss - Net loss decreased by \$4,808,000, or 72.2%, to \$1,853,000 in the 2008 quarter from \$6,661,000 in the 2007 quarter.

Gain on redemption of preferred stock - As a result of the Preferred Stock Exchange in September 2007 we recognized a gain for the \$799,000 excess of Series B Carrying Amount over the Series C Fair Value in the 2007 quarter.

Preferred stock dividends - We recognized preferred stock dividends of \$0 for the 2008 quarter and \$80,000 for the 2007 quarter. The elimination of preferred stock dividends in 2008 resulted from the September 2007 issuance of 474.8126 shares of a new Series C Preferred Stock, which does not pay dividends, in exchange for all of our then issued and outstanding Series B Preferred Stock, which bore 12% dividends.

Net loss attributable to common stockholders - Net loss attributable to common stockholders decreased by \$4,089,000, or 68.8% in the 2008 quarter to \$1,853,000, or \$0.04 per basic and diluted share from \$5,942,000, or \$0.13 per basic and diluted share, in the 2007 quarter.

Liquidity and Capital Resources

Our condensed consolidated financial statements have been prepared assuming we will continue as a going concern. We have incurred recurring operating losses and negative operating cash flows since our inception including a net loss attributable to common stockholders of \$5,103,000 for the nine months ended September 30, 2008. At September 30, 2008, we had a working capital deficit of \$20,070,000. We have \$1,715,000 in cash and cash equivalents at September 30, 2008 and cash and cash equivalents provided by operating activities of \$341,000 for the nine months ended September 30, 2008. Additionally, the Senior Secured Notes (see Note 6) which mature in March 2009 along with the recurring operating losses, negative operating cash flows and sales and use tax and regulatory fee liability raise substantial doubt as to our ability to continue as a going concern. Assuming we are able to renegotiate or refinance the Senior Secured Notes and negotiate favorable terms with the authorities regarding our sales and use taxes and regulatory fees and we are able to achieve positive operating cash flows, we believe that our available capital as of September 30, 2008, will enable us to continue as a going concern through September 30, 2009. We have initiated discussions with the holders of the Senior Secured Notes to identify terms for the extension of the maturity date beyond March 2009 and/or the conversion of the Senior Secured Notes into a new equity security. Additionally, we have initiated efforts to raise additional capital with the sale of additional shares of the new equity security. There can be no assurances, however, that we will be able to raise additional capital as needed or upon acceptable terms nor any assurances that we will be able to renegotiate the terms and maturity date of the Senior Secured Notes. If we are

unable to renegotiate the maturity of the Senior Secured Notes or issue new securities on favorable terms to repay them, it would have a material adverse effect on the Company. The accompanying condensed consolidated financial statements do not include any adjustments that might result from this uncertainty.

Net cash provided by operating activities was \$341,000 for the 2008 period. The cash components provided by operations were \$2,135,000 for an increase in accounts payable, accrued expenses, and sales taxes and regulatory fees, \$10,000 for an increase in deferred revenue and \$3,000 for an increase in other assets. These sources of cash were partially offset by \$357,000 for an increase in accounts receivable, \$114,000 for a decrease in customer deposits and \$18,000 for an increase in prepaid expenses and other current assets.

During the period ended September 30, 2008, there were no material changes in our contractual obligations.

Cash used in investing activities in the 2008 period for the purchase of property, equipment and leasehold improvements was \$847,000. We anticipate capital expenditures in 2008 to be at a similar level as 2007.

In connection with the Senior Secured Notes (see Note 6) if the Company does not achieve the minimum Adjusted EBITDA the per annum interest rate on the unpaid principal balance of the Senior Secured Notes then in effect shall increase by 200 basis points, and such increase will be cumulative for each subsequent period; provided, however, that the per annum interest rate shall revert to the lower interest rate in the event the Company achieves or exceeds the cumulative minimum Adjusted EBITDA for any subsequent determination date. Failure to maintain the minimum Adjusted EBITDA however, shall not constitute an Event of Default as defined in the Senior Secured Notes agreements. The Company achieved the minimum Adjusted EBITDA for the quarter ended March 31, 2008 but did not achieve the minimum Adjusted EBITDA for the nine months ended September 30, 2008 and the six months ended June 30, 2008. Therefore, the interest rate on the unpaid principal balance of the Senior Secured Notes increased by 200 basis points beginning July 1, 2008 and an additional 200 basis points on October 1, 2008.

Commitments and Contingencies

During the three months ended September 30, 2008, there were no other items except as shown below that significantly impacted our commitments and contingencies as discussed in our consolidated financial statements and the footnotes thereto for the fiscal year ended December 31, 2007 as filed with the Securities and Exchange Commission as an exhibit to Form 10-K on March 27, 2008. The following table summarizes our contractual cash obligations and commercial commitments at September 30, 2008, and the effect such obligations are expected to have on liquidity and cash flow in future periods (in thousands).

| Contractual Obligations: | Total | Less Than | 1-3 | 3-5 | More than |
|-----------------------------|-----------|-----------|--------|-------|-----------|
| | | 1 Year | Years | Years | 5 Years |
| Derivative liabilities | \$ 5,694 | \$ 5,694 | \$ | \$ | \$ |
| Senior Secured Notes | 12,026 | 12,026 | | | |
| Operating lease obligations | 206 | 132 | 74 | | |
| Capital lease obligations | 325 | 203 | 122 | | |
| Commercial commitments | 1,969 | 1,969 | | | |
| Total | \$ 20,220 | \$ 20,024 | \$ 196 | \$ | \$ |

Inflation

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

Item 3.

Quantitative and Qualitative Disclosures about Market Risk

Derivative Financial Instruments

We have certain derivative financial instruments related to the 2004 Financing and the Placement Agent, Series A and Series A-2 warrants issued in connection with the March and April 2006 and September 2007 private placements (collectively, the 2006/2007 Warrants). The derivative financial instruments are revalued each period, which causes fluctuations in our results from operations. As a result of this volatility, the Company is presenting proforma information which shows the effect on the derivative liability if our common stock price of \$0.50 on September 30, 2008 had been increased or decreased by \$0.25.

Edgar Filing: GLOWPOINT INC - Form 10-Q

The following table shows the effect of those common stock prices on the derivative financial instruments shown in the condensed consolidated balance sheets and the increase in fair value of derivative financial instruments and net loss attributable to common stockholders shown in the condensed consolidated statement of operations as of September 30, 2008.

| | | Proforma Information | | |
|---|---|---|---|--|
| | | As Reported September 30, 2008 | Common Stock Price Reduction | Common Stock Price Increase |
| Common stock price | | \$ 0.50 | \$ 0.25 | \$ 0.75 |
| Condensed Consolidated Balance Sheet: | | | | |
| Derivative financial instrument | 2004 Financing | \$ 1,116 | \$ 1,116 | \$ 1,116 |
| 2006/2007 Warrants: | | | | |
| Derivative financial instrument | Placement Agent Warrants | 453 | 179 | 755 |
| Derivative financial instrument | Series A Warrants | 1,708 | 626 | 2,946 |
| Derivative financial instrument | Series A-2 Warrants | 2,545 | 1,030 | 4,206 |
| Derivative financial instrument | Series A-2 Warrants, Insider Purchasers | 142 | 57 | 234 |
| Derivative financial instruments | 2006/2007 Warrants | 4,848 | 1,892 | 8,141 |
| Derivative financial instruments | | \$ 5,964 | \$ 3,008 | \$ 9,257 |
| Change in fair value of derivative financial instruments | | \$ | \$ (2,956) | \$ 3,293 |
| Condensed Consolidated Statement of Operations: | | | | |
| Increase (decrease) in fair value of derivative financial instruments | | \$ (153) | \$ (3,109) | \$ 3,140 |
| Net loss attributable to common stockholders | | \$ (5,103) | \$ (2,147) | \$ (8,396) |

The derivative financial instrument related to the 2004 Financing is not affected by changes in the Company's common stock price but is affected by the number of shares of common stock currently held by the original investors in the 2004 Financing. Had 61,000 shares, which are 10% of the shares currently held by the original investors, been sold as of September 30, 2008, then the fair value of the related derivative financial instrument would have been reduced by \$40,000 and we would have recognized that amount as income in the condensed consolidated statement of operations.

The 2006/2007 Warrants require that we deliver, under certain circumstances, shares registered pursuant to the Securities Act of 1934. Management determined that certain events or actions necessary to satisfy the requirement to deliver registered shares are not controlled by the Company. These events which are outside the control of the Company are what give rise to the derivative liability. For example, if the Company is sold to or merged with a non-public company, some or all of the purchase price may include the stock of the non-public company. In such an instance, the holders of the 2006/2007 Warrants are entitled to a cash payment, calculated in accordance with the terms of the 2006/2007 Warrants. Additionally, if the purchase price is less than the warrant strike price of the

2006/2007 Warrants, we are required to make a cash payment to the 2006/2007 Warrant holders, which also causes a derivative liability.

The potential cash payments that the Company would be required to make for the derivative liabilities associated with the 2006/2007 Warrants are determined based on:

.

whether the value of the consideration (which includes stock, cash, and/or property) to be received by the stockholders is greater or less than warrant strike price, and

.

whether or not any securities received are of a public company.

The following table summarizes transactions under which the derivative liability would be paid:

| Type of Consideration Received by our Stockholders in a Sale | | | |
|---|---|---|---|
| | Securities of a Non-Public Company, then 2006/2007 Warrants holders will receive | Cash, then 2006/2007 Warrants holders will receive | Securities of a Public Company, then 2006/2007 Warrants holders will receive |
| Consideration is greater than the warrant strike price ** | Payment of the amount accrued for the derivative liability | Cash * | Securities of such Public Company * |
| Consideration is less than the warrant strike price ** | Payment of the amount accrued for the derivative liability | Payment of the amount accrued for the derivative liability | Payment of the amount accrued for the derivative liability |

* The 2006/2007 Warrant holders will receive the difference between the Consideration received per share and the then current warrant strike price. The remaining derivative liability related to the 2006/2007 Warrants issued in connection with the Senior Secured Notes will not be paid and will be credited to equity.

** The current warrant strike prices range from \$0.50 to \$0.65.

Solely for purposes of illustration, if the Company were sold for \$0.75 per share and that purchase price was paid in cash or the securities of a public company, the Aggregate Derivative Liability for the 2006/2007 Warrants of \$8,141,000 (see first table in this Quantitative and Qualitative Disclosures about Market Risk section) would not be paid, but would be credited to equity.

The derivative liability related to the February 2004 Financing is not affected by a sale, merger or other transaction.

Current Economic Conditions

Current economic conditions may cause a decline in business and consumer spending which could adversely affect our business and financial performance. Our operating results are impacted by the health of the North American economy. Our business and financial performance, including collection of our accounts receivable, recoverability of assets, may be adversely affected by current and future economic conditions, such as a reduction in the availability of credit, financial market volatility, recession, etc.

Additionally, we may experience difficulties in scaling our operations to react to economic pressures in the U.S.

Item 4.

Controls and Procedures

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed by Glowpoint in the reports it files or submits under the Securities Exchange Act of 1934, as amended (the Exchange Act) is recorded, processed, summarized, and reported within the time periods specified by the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by Glowpoint in the reports it files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, Glowpoint has evaluated the effectiveness of its disclosure controls and procedures (as such term is defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2008, and, based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective in providing reasonable assurance of compliance.

Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting occurred during the three months ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1.

Legal Proceedings

We are not currently defending any suit or claim.

Item 1A.

Risk Factors

The risk factors set forth in Item 1A of our 2007 Form 10-K filed on March 27, 2008, are incorporated herein by reference.

Item 2.

Unregistered Sales of Equity Securities and Use of Proceeds

There have been no sales of securities in the past three years that have not been previously reported in a Quarterly Report on Form 10-Q or in a Current Report on Form 8-K.

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

31.1 Rule 13a-14(a)/15d-14(a) Certificate of Chief Executive Officer

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer

32.1 Certificate of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sar

32.2 Certificate of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sar

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: November 12, 2008

By:

/s/ MICHAEL BRANDOFINO

Michael Brandofino,

Chief Executive Officer

(principal executive officer)

Date: November 12, 2008

By:

/s/ EDWIN F. HEINEN

Edwin F. Heinen,

Chief Financial Officer

(principal financial and accounting officer)