To our Shareholders:

In 2009, Telanetix successfully completed our turnaround plan and is now positioned for strong growth and a profitable future. Throughout 2009, we continued to grow our core voice revenues at double digit rates and posted improving EBITDA results throughout the year, with our first positive EBITDA results in the fourth quarter of 2009. Meanwhile in 2009, we decreased our General and Administrative costs year-over-year by 28%, decreased our total operating expenses by over $5 Million, and increased our gross margins by 170 basis points. Clearly, the strategy that we put in place to deliver sustainable, profitable growth is being realized. Although we had very limited cash resources during this period, the team has executed successfully on our plan and we now have a clear path to accelerating our growth, our profitability, and our shareholder value.

We are very pleased with the financial results of our high-value, easy-to-use hosted voice offering we call Digital Phone Service (DPS), marketed under our AccessLine brand. DPS is built to address exactly what our small and medium business (SMB) target market is looking for; better communications solutions at a significant cost savings that delivers a simple buying and installation experience. Since our launch of DPS in mid-year 2008, the product has performed extremely well and we continue to be excited about its growth prospects. We believe we are truly disrupting the traditional business communication industry by offering the small to medium business an office voice solution that is easier to buy, easier to install and easier to use. Our solution is delivered to the market at less than half the price of the traditional landline service. With over 23 million small businesses in the U.S. spending over $37 billion annually on voice services for which they are often overpaying, it is no wonder that a disruptive paradigm shift in business voice communications is beginning. As the SMB market moves to these software based, hosted voice services with enhanced features and flexibility at half the price, Telanetix is well positioned to capture its fair share of this large recurring market spend. This is what makes us so excited about our future.

We believe that our DPS product is now in a position to scale successfully. We have received excellent market feedback from our first full year of service, and have made necessary adjustments not only to the product, but equally important, to the supporting sub- system processes and procedures within our operations that will support the scaling of this product. From order processing, where we have built a single point of entry in our sales process that automatically populates all other related sub systems (the voice network, the billing system, customer care), to the inventory management system that interfaces automatically with sales (allowing us to fulfill and ship multiple orders within 48 hours), to a customer service experience exceeding expectations for 8 consecutive months (by delivering an average speed of answer to our customers of less than 90 seconds), we have quite literally evaluated and continuously improved every step in the process of delivering DPS service, in scale, to this market. We strongly believe that we have the necessary operation support systems in place to deliver a great experience to our customer. The evidence of this customer satisfaction success can be found in our low churn rates in DPS, which confirms our customers overwhelming satisfaction.

During 2009, due to the financial resources required to continue in the enterprise video and telepresence categories, the company made the strategic decision to exit this business. We see this spin off and shut down as having several positive outcomes for the long-term success of Telanetix. First, we now can apply all of our financial resources, as well as management focus on our outstanding opportunity surrounding our next generation, hosted voice business. Second, we have successfully mitigated Telanetix's financial risk as it relates to further funding of this unprofitable video business.

What is in store for 2010? We will continue our focus on strictly managing financial resources, while growing our high-margin voice offerings and continuing to build relationships with other potential voice distribution partners. One of our strengths when we look at building channel is related to the advantage we have in service footprint. Because we deliver service in approximately 90% of the business markets in the United States, we are not limited to geographic constraints when we look at channel opportunities. We have been very successful with major retailers in generating leads. Now that we know we can successfully generate leads with top flight retailers, we will expand this model and drive leads through many other channels. This effort will be highly targeted to the small business owner.

In summary, our vision remains constant: to deliver to the SMB market a highly effective, next generation voice service that will drive long-term profitable growth to Telanetix and value to our shareholder. In this recent turbulent economy, our hosted voice product has performed very well because it delivers a great value to the end customer. We see this performance continuing, and with it, we will continue to deliver double digit annual revenue growth, strong gross margins, and be EBITDA positive in 2010.

The employees of Telanetix are enthusiastic about our company's future and the opportunities that lie ahead. We are mindful of our responsibility to enhance shareholder value, and believe through the dedication and talent of our employees, the trust of our customers, and the support of our shareholders; we can succeed in building a great company.

On behalf of the Telanetix team, we thank you for your support.

Doug Johnson

Chairman and Chief Executive Officer

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

FORM 10-K

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended **December 31, 2009**

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________to ________
Commission File No. **000-51995**

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

Delaware	**77-0622733**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11201 SE 8th Street, Suite 200, Bellevue, Washington	**98004**
(Address of principal executive offices)	(Zip Code)

(206) 621-3500
Registrant's telephone number

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, Par Value $0.0001	**None**

Securities registered pursuant to Section 12(g) of the Exchange Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. . Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐	Accelerated filer ☐
Non-accelerated filer ☐ (Do not check if a smaller company)	Smaller reporting company ☒

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

The aggregate market value of the shares of common stock held by non-affiliates of the issuer, based upon the closing price of the common stock as of the last business day of the registrant's most recently completed second fiscal quarter as reported on the OTC Bulletin Board ($0.14 per share), was approximately $4.4 million. Shares of common stock held by each executive officer and director and by each person who owned 10% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. The determination of who was a 10% stockholder and the number of shares held by such person is based on Schedule 13G filings with the Securities and Exchange Commission as of June 30, 2009.

As of March 5, 2010, there were 31,768,320 shares of the issuer's common stock outstanding. The common stock is the issuer's only class of stock currently outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement to be filed with the Securities and Exchange Commission within 120 days after registrant's fiscal year end December 31, 2009 are incorporated by reference into Part III of this report.

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In this report, unless the context indicates otherwise, the terms "Telanetix," "Company," "we," "us," and "our" refer to Telanetix, Inc., a Delaware corporation, and its wholly-owned subsidiaries.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, or the "Securities Act," and Section 21E of the Securities Exchange Act of 1934 or the "Exchange Act." These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical results or anticipated results.

In some cases, you can identify forward looking statements by terms such as "may," "intend," "might," "will," "should," "could," "would," "expect," "believe," "anticipate," "estimate," "predict," "potential," or the negative of these terms. These terms and similar expressions are intended to identify forward-looking statements. The forward-looking statements in this report are based upon management's current expectations and belief, which management believes are reasonable. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor or combination of factors, or factors we are aware of, may cause actual results to differ materially from those contained in any forward looking statements. You are cautioned not to place undue reliance on any forward-looking statements. These statements represent our estimates and assumptions only as of the date of this report. Except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

You should be aware that our actual results could differ materially from those contained in the forward-looking statements due to a number of factors, including:

- new competitors are likely to emerge and new technologies may further increase competition;
- our operating costs may increase beyond our current expectations and we may be unable to fully implement our current business plan;
- our ability to obtain future financing or funds when needed;
- our ability to successfully obtain a diverse customer base;
- our ability to protect our intellectual property through patents, trademarks, copyrights and confidentiality agreements;
- our ability to attract and retain a qualified employee base;
- our ability to respond to new developments in technology and new applications of existing technology before our competitors;
- acquisitions, business combinations, strategic partnerships, divestures, and other significant transactions may involve additional uncertainties; and
- our ability to maintain and execute a successful business strategy.

Other risks and uncertainties include such factors, among others, as market acceptance and market demand for our products and services, pricing, the changing regulatory environment, the effect of our accounting policies, potential seasonality, industry trends, adequacy of our financial resources to execute our business plan, our ability to attract, retain and motivate key technical, marketing and management personnel, and other risks described from time to time in periodic and current reports we file with the United States Securities and Exchange Commission, or the "SEC." You should consider carefully the statements under "Item 1A. Risk Factors" and other sections of this report, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect our business, operating results and financial condition. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the applicable cautionary statements.

PART I

ITEM 1. BUSINESS

History

Telanetix, Inc. was originally incorporated in the State of Nevada in November 2002 under the name "AER Ventures, Inc." On August 18, 2005, we entered into an exchange agreement with Telanetix, Inc., a California corporation, or "Telanetix-California," a company that had been engaged in the development of next generation telepresence videoconferencing solutions since 2001. Under the exchange agreement, we acquired all of the outstanding capital stock of Telanetix-California in exchange for our issuance to the stockholders of Telanetix-California an aggregate of 7,254,000 shares of our common stock. As a result of the exchange, Telanetix-California became our wholly-owned subsidiary. In connection with the exchange we experienced a change of control, and the exchange was treated as a "reverse merger" for accounting purposes. We reincorporated from a Nevada corporation to a Delaware corporation on March 15, 2006, and changed our name from "AER Ventures, Inc." to our current name, "Telanetix, Inc."

From 2002 until the second quarter of 2007, our sole business was the development and sale of telepresence solutions. During this time we developed our telepresence solution, established channel partner relationships and began selling our telepresence systems directly to end-users.

In April 2007, we acquired AVS Installation Limited Liability Company and Union Labor Force One Limited Liability Company (together, "AVS"). AVS provides integration, consultation and implementation solutions for customers desiring audio-visual and videoconferencing systems and products. AVS, as our wholly-owned subsidiary, operated as a sales and integration arm for our video products. With the acquisition of AVS, we expanded our business to provide integration, consultation and implementation solutions for customers desiring audio-visual, videoconferencing, and telepresence systems and products. Through September 2007, our revenues were derived solely from the sale of telepresence and audio-visual solutions.

In September 2007, we acquired AccessLine Holdings, Inc., or "AccessLine." AccessLine is a Bellevue, Washington-based provider of hosted VoIP solutions to the small-and-medium business marketplace. AccessLine's product offerings include VoIP phone lines and systems, conference calling, online fax services, toll free numbers, follow-me numbers, unified messaging and virtual receptionist. The AccessLine acquisition expanded our IP communications offerings to include a variety of voice and messaging solutions. Its revenues principally consist of monthly, activation, and usage fees from communication solutions, which include mobility solutions, PBX enhancements, single number solutions and unified messaging, voice messaging, paging, and bundled solutions of phone equipment and service

In October 2009, we transferred all of the issued and outstanding membership interests of AVS to an individual purchaser. The membership interests were transferred for nominal consideration. In connection with the transfer, all underlying assets and liabilities were retained by AVS. We determined that the total amount of consideration we received, along with strengthening of our balance sheet that we recognized by the transfer of the liabilities of AVS to the purchaser as a result of the transfer of the membership interests, represented fair value for the membership interests. We completed the disposition of the membership interests, and consequently the assets used in and liabilities arising from the business operations of AVS, on October 27, 2009. We no longer hold any ownership interest in either of AVS or ULF.

In December 2009, our board of directors made a decision to conclude efforts to seek strategic alternatives regarding the operations, assets and intellectual property relating to our Digital Presence product line so that we could focus on growing AccessLine’s business which has been experiencing year over year revenue growth. Our Digital Presence product line experienced a dramatic sales decline in both 2009 and 2008 as compared to prior years. Our board of directors directed management to finalize negotiations with interested parties, if any, to sell the assets related to our Digital Presence product line or cease incurring costs related to its development.

As a result of the sale of AVS, and the potential sale or ceasing of all activities related to the development our Digital Presence product line, we have reflected our video and telepresence activity as discontinued operations in our 2009 and 2008 consolidated financial statements. We are now solely focused on growing our AccessLine-branded Voice Services.

Our Business

Through our AccessLine-branded Voice Services, we provide customers with a range of business phone services and applications. At the core of these business phone services are proprietary software components, all of which are developed internally and loaded on standard commercial grade servers. The AccessLine phone services can be delivered with a variety of hosted features configured to meet the application needs of the customer. By delivering business phone service to the market in this manner, our Voice Services offers flexibility to customers and can serve a variety of business sizes.

AccessLine offers the following hosted VoIP services: Digital Phone Service, SIP Trunking Service and individual phone services. Digital Phone Service replaces a customer's existing telephone lines with a VoIP alternative. It is sold as a complete solution where we bundle our software applications and hosted network services with business-class phone equipment which is manufactured by third parties. This service is targeted at small businesses looking for a fully integrated solution that does not require expert assistance to install; the customer has the ability to select the number of phone stations (from 2 to 20), number of phone lines (from 2 to 8) and types of phone numbers. SIP Trunking Service is for larger businesses that already have their own PBX equipment and is targeted at those businesses with large calling volumes looking for cost effective alternatives to traditional carrier offerings. SIP Trunking Service does not include user equipment such as business phones, and can support businesses with hundreds of employees.

As part of our individual phone service product offerings, AccessLine offers a variety of other phone services, including, conferencing calling services, toll-free service plans, a virtual phone system with after hours answering service that routes calls based on specific business needs, find-me and follow-me services, a full featured voice mail system that instantly contacts a customer via an email or cell phone text message the moment such customer receives a new voice mail or fax, and the ability to manage faxes from virtually anywhere.

AccessLine also offers non-hosted solutions such as its SmartOffice™ product that provides a variety of communication services. A customer can select the SmartOffice features necessary to meet that customer's individual needs.

Our revenues principally consist of: monthly, activation, and usage fees from communication solutions, which include mobility solutions, PBX enhancements, single number solutions and unified messaging, voice messaging, paging, and bundled solutions of phone equipment and service.

Products and Services

Digital Phone System

Our Digital Phone System is designed specifically for small businesses and home offices. Configurations are available for the home office, supporting one to three phone lines, and for small businesses with systems supporting two to eight phone lines. Each system is sold with hardware including a network gateway and desktop phones or cordless phones. We have designed our Digital Phone Systems to be:

· Easy to purchase

· Easy to install

· Simple to use

· Fully featured

· Flexible and

· Affordable

We have designed the system to be easy to purchase. Ordering can be done through a phone call to one of our sales representatives and the system will be delivered to the customer's door within days.

Once the consumer has a Digital Phone System, the consumer simply plugs the network gateway devise onto a standard broadband (DSL or cable) modem for connection to the Internet. Our software automates the process of configuring the equipment and assigning the telephone numbers. There is no additional hardware or technical assistance needed to install the system.

Our Digital Phone service is an easy to use, full VOIP service. Accordingly, it has a full range of voice services. Features such as conference calling, voicemail, call transfer, call forwarding and over 40 other calling features come standard with the Digital Phone Service. Additional features, such as auto attendant, automated menus, webfax and more can be purchased to customize and upgrade the services to fit the consumer's individual requirements. Because the features are software based, they can be initialized from our network operations center; without the requirement for additional consumer equipment, installation or technical support.

Our Digital Phone VOIP services are designed to provide full featured small business and home office phone services, at significant savings compared to traditional telephone services. The Digital Phone Service centralizes most of the calling functions within the network, eliminating expensive customer premise equipment, such as a PBX. Unlike expensive systems designed for large corporations, our Digital Phone system lets the consumer purchase only the equipment and service that it needs, and affords the flexibility to add more lines, more phones, and more features as their business grows.

SIP Trunking Services

For the larger business customers we offer two services. Our SmartVoice Express services is a fully configured enterprise hardened service that is designed to provide more features at a lower cost than traditional phone service. Our SIP trunking product is a service we offer that allows us to provide our high quality voice service to large businesses that already have a PBX installed. Each of our enterprise services connects a customer's existing telephone infrastructure and PBX to our VoIP network. Each of our services provides the savings and flexibility of a VoIP service, but with the ability to scale to meet the needs of the larger business enterprise.

SmartVoice Express replaces existing telephone lines with a VoIP alternative, but allows the customer to keep using its current phone equipment. With SmartVoice Express a VoIP gateway is installed in each of the customer's offices. The gateway connects to the existing phone system and links to the customer's existing broadband connection.

Individual Phone Services

We also offer customers a variety of individual phone services. These services are integrated into our home office, small business and enterprise business phone services. They can also be purchased "a la carte", even if the customer is not using one of our complete phone systems.

· SMARTConference. Conference calling service includes instant access, toll free dial in, no setup fees, and web controls. Scheduled and reservationless conferencing options.

· SMART800. Provides quality product at great rates with toll free service plans for 800 numbers, including options such as voice mail and vanity 800 numbers.

· SMARTOffice. Virtual Phone System auto attendant with after hours answering service, Virtual Receptionist and Virtual PBX. Route calls based on specific business needs.

· SMARTNumber. Find-me & follow-me service provides the convenience of a single number which can be forwarded to reach any phone.

· SMARTMessage. Full featured voice mail system that instantly contacts the customer via an email or cell phone text message the moment a new voice mail or fax arrives.

· SMARTFax. Manage online faxes from virtually anywhere - freeing the customer to receive and view faxes at any time from any location.

All of the services are available individually or they can be combined to meet a particular customers needs.

Market

Our AccessLine Voice subsidiary has been offering business phone solutions and applications to the business market since 1998, and currently targets the small and mid-sized business market in the United States. According to Access Market International Partners Study, April 2007, there are over 15 million businesses in the U.S. with 50 employees or fewer, by far the largest share of the business marketplace for telephony services.

Distribution

The AccessLine Voice Services are brought to market through direct sales and through select channel partners. AccessLine has established channel partner relationships with two large business retailers in the United States, Office Depot and Costco. Both retailers market AccessLine's business phone service through online distribution, much of which is fully automated. In addition, the AccessLine Voice Division sells directly to the business market via online advertising and direct fulfillment.

Suppliers

All of AccessLine's primary software system components have been developed internally by the AccessLine product and software development team. AccessLine's software conforms to industry accepted telecommunications standards. Accordingly, AccessLine is able to leverage third-party components within its platform and to integrate with the wide variety of equipment employed by its customers.

AccessLine uses off-the-shelf generic products to construct the network on which AccessLine software operates and delivers its services. These components include VoIP gateways for IP switching and routing, standard high-quality servers and bulk storage solutions, standard operating systems and database software, various carrier suppliers for wide area transmission facilities, various suppliers for customer access, and various suppliers for its public telephony interconnections.

Competition

AccessLine competes with traditional phone service carriers, as well as cable companies and alternative voice and video communication providers, including those that also base their service on VoIP technology. The traditional phone service carriers, such as AT&T, Qwest Communications and Verizon Communications, are our primary competitors and have historically dominated their regional markets. These competitors are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. Cable companies, such as Cablevision, Comcast, Cox Communications and Time Warner Cable, have made and are continuing to make substantial investments in delivering broadband Internet access to their customers. As a result, they are offering bundled services, which include phone service. Cable companies are able to advertise on their local access channels with no significant out-of-pocket cost and through mailings in bills with little marginal cost. They also receive advertising time as part of their relationships with television networks, and they are able to use this time to promote their telephone service offerings.

Because most of our target VoIP customers are already purchasing communications services from one or more of these providers, our success depends upon our ability to attract these customers away from their existing providers. This will become more difficult as the early adopter market becomes saturated and mainstream customers make up more of our target market. We believe that we will be able to attract and retain customers based on the quality of our solutions and customer service, integration with a variety of legacy telephone systems, nationwide network, flexible feature set, network and operating architecture and support for industry standards.

Research and Development

We currently employ 14 individuals in research, development and engineering activities. Our research and development initiatives are directed at improving the efficiency and reliability of our network, development of enhancements to our existing products, and the design and development of new products and services. During 2009 and 2008, our research, development and engineering expenses were approximately $4.1 million and $4.2 million, respectively. Future research will focus on expansion of our current product lines to allow a greater variety of customer configurations. This is expected to allow us to address a greater number of market segments than we currently are able to address. In addition, we will focus on additional operational process automation and tools, to increase process efficiency and support scalability.

Employees

We have 105 full-time employees as of March 5, 2010, and 3 part-time employees. We also retain a limited number of independent contractors to perform software development projects. We currently have one independent contractor working on software development projects.

To implement our business strategy, we expect, over time, continued growth in our employee and infrastructure requirements, particularly as we expand our engineering, sales and marketing capacities.

We have never had a work stoppage, and none of our employees are represented by a labor organization or under any collective bargaining arrangements. We believe our relationships with our employees are good.

Available Information

Our annual and quarterly reports, along with all other reports and amendments filed with or furnished to the SEC are publicly available free of charge on the Investor section of our website at www.telanetix.com as soon as reasonably practicable after these materials are filed with or furnished to the SEC. Our board of directors' committee charters are also posted within this section of the website. The information on our website is not part of this or any other report we file with, or furnish to, the SEC. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is www.sec.gov.

ITEM 1A. RISK FACTORS

This report includes forward-looking statements about our business and results of operations that are subject to risks and uncertainties. See "Forward-Looking Statements," above. Factors that could cause or contribute to such differences include those discussed below. In addition to the risk factors discussed below, we are also subject to additional risks and uncertainties not presently known to us or that we currently deem immaterial. If any of these known or unknown risks or uncertainties actually occur, our business could be harmed substantially.

Risks Related To Our Financial Condition

The impact of the current economic climate and tight financing markets may impact consumer demand for our products and services.

Many of our existing and target customers are in the small and medium business sector. Although we believe our products and services are less costly than traditional telephone services, these businesses are more likely to be significantly affected by economic downturns than larger, more established businesses. Additionally, these customers often have limited discretionary funds, which they may choose to spend on items other than our products and services. If small and medium businesses experience economic hardship, it could negatively affect the overall demand for our products and services, could cause delay and lengthen sales cycles and could cause our revenue to decline.

Although we maintain allowances for returns and doubtful accounts for estimated losses resulting from product returns and the inability of our customers to make required payments, and such losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same return and bad debt rates that we have in the past, especially given the current economic conditions. Additionally, challenging economic conditions could have a negative impact on the results of our operations.

We have experienced significant losses to date and may require additional capital to fund our operations. The current financial climate may make it more difficult to secure financing, if we need it. If our business model is not successful, or if we are unable to generate sufficient revenue to offset our expenditures, we may not become profitable, and the value of your investment may decline.

We incurred a net loss of $8.1 million for the year ended December 31, 2009, and $9.7 million for the year ended December 31, 2008. We have an accumulated deficit of $40.3 million at December 31, 2009. Furthermore, we are experiencing the costs and uncertainties of a young operating company, including unforeseen costs and difficulties. We cannot be sure that we will be successful in meeting these challenges and addressing these risks and uncertainties. If we are unable to do so, our business will not be successful.

We believe our cash balance, together with anticipated cash flows from operations, is sufficient to fund our operations through fiscal 2010. However, if we are unable to generate sufficient revenues to pay our expenses, we will need to raise additional funds to continue our operations. We have historically financed our operations through private equity and debt financings. Recent economic turmoil and severe lack of liquidity in the debt capital markets together with volatility and rapidly falling prices in the equity capital markets have severely and adversely affected capital raising opportunities. We do not have any commitments for financing at this time, and financing may not be available to us on favorable terms, if at all. If we are unable to obtain debt or equity financing in amounts sufficient to fund our operations, if necessary, we will be forced to suspend or curtail our operations.

The sale of the shares of our common stock acquired in private placements could cause the price of our common stock to decline.

In our December 2006 and February 2007 private placements, in the aggregate, we issued a total of $5.2 million principal amount of convertible debentures and warrants to purchase 1,350,947 shares of our common stock. In our August 2007 private placement we issued 13,000 shares of our Series A preferred stock, $8.0 million principal amount of convertible debentures and warrants to purchase 2,584,198 shares of our common stock. In connection with our acquisition of AccessLine, we issued 3,939,565 shares of our common stock, and we issued an additional 2,045,662 shares upon the achievement of financial objectives. In our March 2008 private placement, in the aggregate, we issued a total of $3.4 million principal amount of convertible debentures and warrants to purchase 814,285 shares of our common stock. In our August 2008 private placement we issued $2.0 million principal amount of convertible debentures and warrants to purchase 608,000 shares of common stock. In our December 2008 private placement we issued $1.5 million principal amount of convertible debentures and warrants to purchase 456,000 shares of common stock. Generally, the holders of the securities convertible or exercisable into our common stock will be able to sell the common stock issued upon conversion or exercise under Rule 144 adopted under the Securities Act of 1933, as the Securities Act. As such, you should expect a significant number of such shares of common stock to be sold. Depending upon market liquidity at the time our common stock is resold by the holders thereof, such re-sales could cause the trading price of our common stock to decline. In addition, the sale of a substantial number of shares of our common stock, or anticipation of such sales, could make it more difficult for us to sell equity or equity-related securities in the future at a time and at a price that we might otherwise wish to effect sales.

We have significant indebtedness and agreed to certain restrictions on our operations.

We currently owe, in the aggregate, approximately $29.6 million in principal on our outstanding debentures, substantially all of which are held by one investor and its affiliates. The debentures carry covenants that impose significant restrictions on us, including restrictions against incurring additional indebtedness, creating any liens on our property, amending our certificate of incorporation or bylaws, redeeming or paying dividends on shares of our outstanding common stock, and entering into certain related party transactions.

Our ability to comply with these provisions may be affected by changes in our business condition or results of our operations, or other events beyond our control. The breach of any of these covenants could result in a default under the debentures, permitting the holders thereof to accelerate the maturity of the debentures and demand repayment in full. Such actions by such holders could impair our ability to operate or cause us to seek bankruptcy protection.

Our debentures contain covenants that may impair our ability to issue additional debt or equity.

Our outstanding debentures, impose significant covenants on us, some of which may impair our ability to issue additional debt or equity, if necessary. In addition, we may not, directly or indirectly, redeem, purchase or otherwise acquire any capital stock or set aside any monies for such redemption, purchase or other acquisition.

Substantially all of our debentures are held by a single investor and its affiliates, and that investor will be able to control any waivers or amendments to the terms of our debentures and exercise rights and remedies with respect to substantially all of our debentures.

One investor and its affiliates, holds over 97% of the principal amount of our outstanding debentures. Under the terms of the purchase agreement entered into in connection with the debentures, certain amendments or waivers must be approved by the holders of at least 90% of the outstanding principal amount of the debentures. Consequently, one investor, and its affiliates, will have sole authority to approve or not approve any amendment or waiver. In addition, the one investor, and its affiliates, without regard to the position or desires of other holders, will have the sole authority to exercise any rights or remedies available to it under the terms of the debentures that would affect substantially all of our outstanding debentures.

Our failure to repay the debentures could result in substantial penalties against us, and legal action which could substantially impair our operations.

Our debentures require quarterly interest payments starting in October 2011 and continuing through June 2014. Our debentures accrue interest at the rate of 0% through June 30, 2011, and 5% per annum from July 1, 2011 through June 30, 2014, and no principal payment is due until maturity in June 2014. We must pay interest payments in cash. If we are unable to repay the debentures when required, the holders could commence legal action against us. Any such action could impose significant costs on us and require us to curtail or cease operations.

In addition, the debentures define certain events of default, including without limitation failure to make a payment obligation, failure to observe other covenants of the debenture or related agreements (subject to applicable cure periods), breach of representation or warranty, bankruptcy, default under another significant contract or credit obligation, a change in control, or failure to deliver share certificates in a timely manner. In the event of default, which is not cured within specified grace periods, the holders of the debentures have the right to accelerate all amounts outstanding under the debentures and demand payment of a mandatory default amount equal to 130% of the amount outstanding under the debenture, plus accrued interest and expenses. If we were unable to repay the mandatory default amount when required, the holders could commence legal action against us. Any such action could impose significant costs on us and require us to curtail or cease operations.

If we need additional financing in the future and are required to issue securities which are priced at less than the conversion price of our debentures, it will result in additional dilution.

Our debentures contain provisions that require us to reduce their respective conversion price if we issue other securities at a lower purchase price or with a lower conversion or exercise price. When this occurs, generally stockholders sustain material dilution in their ownership interest.

Risks Related to Our Business

We face competition from much larger and well-established companies.

We face competition from much larger and well-established companies. In addition, our competition is not only from other independent VoIP providers, but also from traditional telephone companies, wireless companies, cable companies, competitive local exchange carriers and alternative voice communication providers. Some of our competitors have or may have greater financial resources, production, sales, marketing, engineering and other capabilities with which to develop, manufacture, market and sell their products, and more experience in research and development than we have. As a result, our competitors may have greater credibility with our existing and potential customers. Further, because most of our target market is already purchasing communications services from one or more of our competitors, our success is dependent upon our ability to attract customers away from their existing providers.

In addition, other established or new companies may develop or market technologies or products competitive with, or superior to, ours. We cannot assure you that our competitors will not succeed in developing or marketing technologies or products that are more effective or commercially attractive than ours or that would render our products and services obsolete. Our success will depend in large part on our ability to maintain a competitive position with our products and services.

Lower than expected market acceptance of our products or services would negatively impact our business.

We continue to develop and introduce new products. End-users will not begin to use our products or services unless they determine that our products and services are reliable, cost-effective and an effective means of communication. These and other factors may affect the rate and level of market acceptance of our products and services, including:

- our price relative to competing products or services or alternative means of communication;
- effectiveness of our sales and marketing efforts;
- perception by our targeted end-users of our systems' reliability, efficacy and benefits compared to competing technologies;
- willingness of our targeted end-users to adopt new technologies; and
- development of new products and technologies by our competitors.

If our products and services do not achieve market acceptance, our ability to achieve any level of profitability would be harmed and our stock price would decline.

Price competition would negatively impact our business.

Our profitability could be negatively affected as a result of competitive price pressures in the sale of unified communications products, which could cause us to reduce the price of our products or services. Any such reduction could have an adverse impact on our margins and profitability. Our competitors may also offer bundled service arrangements offering a more complete product despite the technical merits or advantages of our products. Moreover, our competitors' financial resources may allow them to offer services at prices below cost or even for free to maintain and gain market share or otherwise improve their competitive positions. Any of these competitive factors could make it more difficult for us to attract and retain customers, cause us to lower our prices in order to compete resulting in lower gross profit and lower profitability.

We depend on contract manufacturers to manufacture substantially all of our products, and any delay or interruption in manufacturing by these contract manufacturers would result in delayed or reduced shipments to our customers and may harm our business.

We bundle certain of our services with telephone and network hardware that we acquire from third parties. We do not have long-term purchase agreements with our contract manufacturers and we depend on a concentrated group of contract manufacturers for a substantial portion of manufacturing our products. There can be no assurance that our contract manufacturers will be able or willing to reliably manufacture our products, in volumes, on a cost-effective basis or in a timely manner. If we cannot compete effectively for the business of these contract manufacturers, or if any of the contract manufacturers experience financial or other difficulties in their businesses, our revenue and our business could be adversely affected. In particular, if one of our contract manufacturers decides to cease doing business with us or becomes subject to bankruptcy proceedings, we may not be able to obtain any of our products made by the contract manufacturer, which could be detrimental to our business

We could be liable for breaches of security on our web site, fraudulent activities of our users, or the failure of third-party vendors to deliver credit card transaction processing services.

A fundamental requirement for operating an Internet-based, worldwide voice communications service and electronically billing our customers is the secure transmission of confidential information and media over public networks. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, failure to mitigate such fraud or breaches may adversely affect our operating results. The law relating to the liability of providers of online payment services is currently unsettled and states may enact their own rules with which we may not comply. We rely on third party providers to process and guarantee payments made by our subscribers up to certain limits, and we may be unable to prevent our customers from fraudulently receiving goods and services. Our liability risk will increase if a larger fraction of our transactions involve fraudulent or disputed credit card transactions. Any costs we incur as a result of fraudulent or disputed transactions could harm our business. In addition, the functionality of our current billing system relies on certain third-party vendors delivering services. If these vendors are unable or unwilling to provide services, we will not be able to charge for our services in a timely or scalable fashion, which could significantly decrease our revenue and have a material adverse effect on our business, financial condition and operating results.

We have historically experienced losses due to subscriber fraud and theft of service and may again in the future.

In the past, subscribers have obtained access to our service without paying for monthly service and international toll calls by unlawfully using our authorization codes or by submitting fraudulent credit card information. To date, such losses from unauthorized credit card transactions and theft of service have not been significant. We have implemented anti-fraud procedures in order to control losses relating to these practices, but these procedures may not be adequate to effectively limit all of our exposure in the future from fraud. If our procedures are not effective, consumer fraud and theft of service could significantly decrease our revenue and have a material adverse effect on our business, financial condition and operating results.

System disruptions could cause delays or interruptions of our service, which could cause us to lose customers or incur additional expenses.

Our success depends on our ability to provide reliable service. Although we have designed our network service to minimize the possibility of service disruptions or other outages, our service may be disrupted by problems on our system, such as malfunctions in our software or other facilities, overloading of our network and problems with the systems of competitors with which we interconnect, such as physical damage to telephone lines and power surges and outages. Although we have experienced isolated power disruptions and other outages for short time periods, we have not had system-wide disruptions of a sufficient duration or magnitude that had a significant impact on our customers or our business. Any significant disruption in our ability to provide reliable service could cause us to lose customers and incur additional expenses.

Business disruptions, including disruptions caused by security breaches, extreme weather, terrorism or other disasters, could harm our future operating results.

The day-to-day operation of our business is highly dependent on the integrity of our communications and information technology systems, and on our ability to protect those systems from damage or interruptions by events beyond our control. Sabotage, computer viruses or other infiltration by third parties could damage our systems. Such events could disrupt our service, damage our facilities, damage our reputation, and cause us to lose customers, among other things, and could harm our results of operations. In addition, a catastrophic event could materially harm our operating results and financial condition. Catastrophic events could include a terrorist attack on the United States, or major natural disasters, extreme weather, earthquake, fire, or similar event that affects our central offices, corporate headquarters, network operations center or network equipment. We believe that communications infrastructures, such as the one on which we rely, may be vulnerable in the case of such an event, and our markets, which are metropolitan markets, or Tier 1 markets, may be more likely to be the targets of terrorist activity.

Our future operating results may vary substantially from period to period and may be difficult to predict.

On an annual and a quarterly basis, there are a number of factors that may affect our operating results, many of which are outside our control. These include, but are not limited to:

- changes in market demand;
- customer cancellations;
- competitive market conditions;
- new product introductions by us or our competitors;
- market acceptance of new or existing products;
- cost and availability of components;
- timing and level of expenditures associated with new product development activities;
- mix of our customer base and sales channels;
- mix of products sold;
- continued compliance with industry standards and regulatory requirements; and
- general economic conditions.

These factors are difficult to forecast and may contribute to substantial fluctuations in our quarterly revenues and substantial variation from our projections. Any failure to meet investor expectations regarding our operating results may cause our stock price to decline.

We may experience delays in introducing products or services to the market and our products or services may contain defects which could seriously harm our results of operations.

We may experience delays in introducing new or enhanced products or services to the market. Such delays, whether caused by factors such as unforeseen technology issues or otherwise, could negatively impact our sales revenue in the relevant period. In addition, we may terminate new product, service or enhancement development efforts prior to any introduction of a new product, service or enhancement. Any delays for new offerings currently under development or any product defect issues or product recalls could adversely affect the market acceptance of our products or services, our ability to compete effectively in the market, and our reputation, and therefore, could lead to decreased sales and could seriously harm our results of operations.

It may be difficult for us to identify the source of the problem when there is a network problem.

We must successfully integrate our service with products from third party vendors and carriers. When network problems occur, it may be difficult for us to identify its source. This may result in the loss of market acceptance of our products and we may incur expenses in connection with any necessary corrections.

Decreasing telecommunications rates may diminish or eliminate our competitive pricing advantage in the VoIP business.

Telecommunications rates in the markets in which we do business have and may continue to decrease, which may eliminate the competitive pricing advantage of our services. Customers who use our services to benefit from our current pricing advantage may switch to other providers if such pricing advantage diminishes. Further, continued rate decreases by our competitors may require us to lower our rates, which will reduce or possibly eliminate any gross profit from our services.

We rely on third party network service providers for certain aspects of our VoIP business.

Rather than deploying our own network, we leverage the infrastructure of third party service providers to provide telephone numbers, public switched telephone network, or PSTN, call termination and origination services, and local number portability for our customers. Though this has lowered our operating costs in the short term, it has also reduced our operating flexibility and ability to make timely service changes. If any of the third party service providers stop providing the services on which we depend, the delay in switching the underlying services to another service provider, if available, and qualifying this new service could adversely affect our business.

While we believe that we have good relationships with our current service providers, we can give no assurance that they will continue to supply cost-effective services to us in the future or that we will be successful in signing up alternative or additional providers. Although we believe we could replace our current providers, if necessary, our ability to provide service to our customers would be impacted during this timeframe, which could adversely affect our business.

Our growth may be limited by certain aspects of our VoIP service.

Our VoIP services are not the same in all respects as those provided by traditional telephone service providers. For example:

- In some cases, we utilize a data circuit rather than traditional wireline voice circuits to interconnect to existing customer equipment. This requires the additional use of a modem and gateway on the customer's premises, which is an unfamiliar concept for many of our customers.
- Our emergency calling service is different.
- Our customers may experience higher dropped-call rates and other call quality issues because our services depend on data networks rather than traditional voice networks and these services have more single points of failure than traditional wireline networks.
- Our customers cannot accept collect calls.
- Our services are interrupted in the event of a power outage or if Internet access is interrupted.

Because our continued growth depends on our target market adopting our services, our ability to adequately address significant differences through our technology, customer services, marketing and sales efforts is important. If potential customers do not accept the differences between our service and traditional telephone service, they may not subscribe to our VoIP services and our business would be adversely affected.

Our growth in the VoIP business may be negatively affected if we are unable to improve our process for local number portability provisioning.

Local number portability, which is considered an important feature by many customers, allows a customer to retain their existing telephone numbers when subscribing to our services. The customer must maintain their existing telephone service during the number transfer process. Although we are taking steps to reduce how long the process takes, currently the process of transferring numbers can take 20 business days or longer. By comparison, generally, transferring wireless telephone numbers among wireless service providers takes several hours, and transferring wireline telephone numbers among traditional wireline service providers takes a few days. The additional time our process takes is due to our reliance on third party carriers to transfer the numbers and any delay by the existing telephone service provider may contribute to the process. If we fail to reduce the amount of time the process takes, our ability to acquire new customers or retain existing customers may suffer.

Our success in the VoIP business also depends on our ability to handle a large number of simultaneous calls.

We expect the volume of simultaneous calls to increase significantly as our customer base grows. Our network hardware and software may not be able to accommodate this additional volume. This could result in a decreased level of operating performance, disruption of service and a loss of customers, any of which could adversely affect our business.

A higher rate of customer terminations would reduce our revenue or require us to spend more money to grow our customer base in the VoIP business.

We must acquire new customers on an ongoing basis to maintain our existing level of customers and revenues due to customers that terminate our service. As a result, marketing expense is an ongoing requirement of our business. If our churn rate increases, we will have to acquire even more new customers to maintain our existing revenues. We incur significant costs to acquire new customers, and those costs are an important factor in achieving future profitability. Therefore, if we are unsuccessful in retaining customers or are required to spend significant amounts to acquire new customers, our revenue could decrease and our net losses could increase.

Our success also depends on third parties in our distribution channels.

We currently sell our products both directly to customers and through resellers. We may not be successful in developing additional distribution relationships. Agreements with distribution partners generally provide for one-time or recurring commissions based on our list prices, and do not require minimum purchases or restrict development or distribution of competitive products. Therefore, entities that distribute our products may compete with us. In addition, distributors and resellers may not dedicate sufficient resources or give sufficient priority to selling our products. Our failure to develop new distribution channels, the loss of a distribution relationship or a decline in the efforts of a reseller or distributor could adversely affect our business.

We need to retain key personnel to support our products and ongoing operations.

The development and marketing of our products will continue to place a significant strain on our limited personnel, management, and other resources. Our future success depends upon the continued services of our executive officers and other key employees who have critical industry experience and relationships that we rely on to implement our business plan. None of our officers or key employees are bound by employment agreements for any specific term. The loss of the services of any of our officers or key employees could delay the development and introduction of, and negatively impact our ability to sell our products which could adversely affect our financial results and impair our growth. We currently do not maintain key person life insurance policies on any of our employees.

Risks Relating to Our Industry

We face risks associated with our products and services and their development, including new product or service introductions and transitions.

The communications market is going through a period of rapid technological changes and frequent introduction of new and enhanced products, which may result in products or services that are superior to ours. To compete successfully in this market, we must continue to design, develop, manufacture, and sell new and enhanced products and services that provide increasingly higher levels of performance and reliability at lower cost and respond to customer expectations. Our success in designing, developing, manufacturing, and selling such products and services will depend on a variety of factors, including:

- our ability to timely identify new technologies and implement product design and development;
- the scalability of our software products; and
- our ability to successfully implement service features mandated by federal and state law.

If we are unable to anticipate or keep pace with changes in the marketplace and the direction of technological innovation and customer demands, our products or services may become less useful or obsolete and our operating results will suffer. Additionally, properly addressing the complexities associated with compatibility issues, sales force training, and technical and sales support are also factors that may affect our success.

Because the communications industry is characterized by competing intellectual property, we may be sued for violating the intellectual property rights of others.

The communications industry is susceptible to litigation over patent and other intellectual property rights. Determining whether a product infringes a patent involves complex legal and factual issues, and the outcome of patent litigation actions is often uncertain. We have not conducted an extensive search of patents issued to third parties, and no assurance can be given that third party patents containing claims covering our products, parts of our products, technology or methods do not exist, have not been filed, or could not be filed or issued.

From time to time, we have received, and may continue to receive in the future, notices of claims of infringement, or potential infringement, of other parties' proprietary rights. If we become subject to a patent infringement or other intellectual property lawsuit and if the relevant patents or other intellectual property were upheld as valid and enforceable and we were found to infringe or violate the terms of a license to which we are a party, we could be prevented from selling our products unless we could obtain a license or were able to redesign the product to avoid infringement. If we were unable to obtain a license or successfully redesign our products, we might be prevented from selling our products. If there is an allegation or determination that we have infringed the intellectual property rights of a third party, we may be required to pay damages, or a settlement or ongoing royalties. In these circumstances, we may be unable to sell our products at competitive prices or at all, our business and operating results could be harmed and our stock price may decline.

Inability to protect our proprietary technology would disrupt our business.

We rely in part on patent, trademark, copyright, and trade secret law, and nondisclosure agreements to protect our intellectual property in the United States and abroad. As of March 5, 2010, we had two patents and one patent pending relating to telecommunications and security. We may not be able to protect our proprietary rights in the United States or abroad, and competitors may independently develop technologies that are similar or superior to our technology, duplicate our technology or design around any patent of ours. Moreover, litigation may be necessary in the future to enforce our intellectual property rights. Such litigation could result in substantial costs and diversion of management time and resources and could adversely affect our business.

Our VoIP products must comply with industry standards, which are evolving.

Market acceptance of VoIP is, in part, dependent upon the adoption of industry standards so that products from various manufacturers can interoperate. Currently, industry leaders do not agree on which standards should be used for a particular application, and the standards continue to change. Our VoIP telephony products rely significantly on communication standards (e.g., SIP and MGCP) and network standards (e.g., TCP/IP and UDP) to interoperate with equipment of other vendors. As standards change, we may have to modify our existing products or develop and support new versions of our products. The failure of our products and services to comply, or delays in compliance, with industry standards could delay or interrupt production of our VoIP products or harm the perception and adoption rates of our service, any of which would adversely affect our business.

Future regulation of VoIP services could limit our growth.

The VoIP industry may be subject to increased regulation. In addition, established telecommunication companies may devote substantial lobbying efforts to influence the regulation of the VoIP industry in a manner that is contrary to our interests. Increased regulation and additional regulatory funding obligations at the federal and state level could require us to either increase the retail price for our VoIP services, which would make us less competitive, or absorb such costs, which would decrease our profit margins.

Our emergency and 911 calling services differ from those offered by traditional telephone service providers and may expose us to significant liability in the VoIP business.

Traditional telephone service providers route emergency calls over a dedicated infrastructure directly to an emergency services dispatcher in the caller's area. Generally, the dispatcher automatically receives the caller's phone number and location information. Our 911 service, where offered, operates in a similar manner. However, the only location information that our 911 service can transmit to an emergency service dispatcher is the information that our customers have registered with us. A customer's registered location may be different from the customer's actual location at the time of the call, and the customer, in those instances, would have to verbally inform the emergency services dispatcher of his or her actual location at the time of the call.

The operation of our 911 service may vary depending on the specific location of the customer. In some areas, emergency calls are delivered with the caller's address or callback number. In other areas the emergency call may be delivered without the caller’s address or callback number. In some cases calls may be delivered to a call center that is run by a third-party provider, and the call center operator will coordinate connecting the caller to the appropriate Public Safety Answering Point or emergency services provider and providing the customer's service location and phone number to those local authorities. In late July 2008, the "New and Emerging Technologies 911 Improvement Act of 2008" was enacted. This law provides public safety, interconnected VoIP providers and others involved in handling 911 calls the same liability protections when handling 911 calls from interconnected VoIP users as from mobile or wired telephone service users. We do not know what effect this law will have on our 911 solution at this time. Also, we may be exposed to liability for 911 calls made prior to the adoption of this new law although we are unaware of any such liability.

Delays our customers encounter when making emergency services calls and any inability of the answering point to automatically recognize the caller's location or telephone number can result in life threatening consequences. In addition, if a customer experiences an Internet or power outage or network failure, the customer will not be able to reach an emergency services provider using our services. Customers may attempt to hold us responsible for any loss, damage, personal injury or death suffered as a result of any failure of our 911 services and, unlike traditional wireline and wireless telephone providers, with the exception of the 2008 Act mentioned above, we know of no other state or federal provisions that currently indemnify or limit our liability for connecting and carrying emergency 911 phone calls over IP networks.

If we fail to comply with FCC regulations requiring us to provide E911 services, we may be subject to significant fines or penalties in the VoIP business.

In May 2005, the FCC required VoIP providers that interconnect with the PSTN to provide E911 service. On November 7, 2005, the Enforcement Bureau of the FCC issued a notice stating the information required to be submitted to the FCC in E911 compliance letters due by November 28, 2005. In this notice, the Enforcement Bureau stated that, although it would not require providers that had not achieved full E911 compliance by November 28, 2005 to discontinue the provision of VoIP services to any existing customers, it did expect that such providers would discontinue marketing VoIP services, and accepting new customers for their services, in all areas where they are not transmitting 911 calls to the appropriate PSAP in full compliance with the FCC's rules. On November 28, 2005, we filed our E911 compliance report. On March 12, 2007, we received a letter from the Enforcement Bureau requesting that we file an updated E911 Status Report no later than April 11, 2007. On April 11, 2007, we responded to the FCC and indicated that (i) 95.4% of our VoIP subscribers receive 911 service in full compliance with the FCC’s rules, (ii) we do not accept new VoIP customers in areas where it is not possible to provide 911 service in compliance with the FCC rules, (iii) we currently serve only a very small number of existing subscribers in areas where we have not yet deployed a 911 network solution that is fully compliant with the FCC’s regulations and were provisioned with new service after November 28, 2005, and (iv) we have procedures in place to ensure that no new subscribers are being provisioned in non-compliant areas.

The FCC may determine that services we may offer based on nomadic emergency calling do not satisfy the requirements of its VoIP E911 order because, in some instances, a nomadic emergency calling solution may require that we route an emergency call to a national emergency call center instead of connecting subscribers directly to a local PSAP through a dedicated connection and through the appropriate selective router. The FCC may issue further guidance on compliance requirements in the future that might require us to disconnect those subscribers not receiving access to emergency services in a manner consistent with the VoIP E911 order. The effect of such disconnections, monetary penalties, cease and desist orders or other enforcement actions initiated by the FCC or other agency or task force against us could have a material adverse effect on our financial position, results of operations, cash flows or business reputation. On June 1, 2007, the FCC released a Notice of Proposed Rulemaking in which they tentatively conclude that all VoIP service providers that allow customers to use their service in more than one location (nomadic VoIP service providers) must utilize an automatic location technology that meets the same accuracy standards which apply to providers of commercial mobile radio services (mobile phone service providers). The outcome of this proceeding cannot be determined at this time and we may or may not be able to comply with any such obligations that may be adopted. At present, we currently have no means to automatically confirm the physical location of a subscriber if the service is such that the subscriber is connected via the Internet. The FCC's VoIP E911 order has increased our cost of doing business and may adversely affect our ability to deliver our service to new and existing customers in all geographic regions or to nomadic customers who move to a location where emergency calling services compliant with the FCC's mandates are unavailable. We cannot guarantee that emergency calling service consistent with the VoIP E911 order will be available to all of our subscribers. The FCC's current VoIP E911 order, follow-on orders or clarifications, or their impact on our customers due to service price increases or other factors, could have a material adverse affect on our business, financial position and results of operations.

Our inability to comply with the requirements of federal law enforcement agencies could adversely affect our VoIP business.

Broadband Internet access services and VoIP services are subject to CALEA. Currently, our CALEA solution is fully deployed in our network. However, we could be subject to an enforcement action by the FCC or law enforcement agencies for any delays related to meeting, or if we fail to comply with, any current or future CALEA obligations. Such enforcement actions could subject us to fines, cease and desist orders, or other penalties, any of which could adversely affect our business.

Our inability to comply with the requirements of federal and other regulations related to customer proprietary network information could adversely affect our VoIP business.

We are subject to the customer proprietary network information, or CPNI, rules. CPNI includes information such as the phone numbers called by a consumer; the frequency, duration, and timing of such calls; and services purchased by the consumer, such as call waiting, call forwarding, and caller ID. Under the current rules, generally, except in connection with providing existing services to a customer, carriers may not use CPNI without customer consent. We do not currently use our customer's CPNI in a manner which would require us to obtain consent, but if we do in the future, we will be required to adhere to specific CPNI rules. If we fail to comply with any current or future CPNI rules, we could be subject to enforcement action or other penalties, any of which could adversely affect our business.

Our VoIP business may suffer if we fail to comply with funding requirements of state or federal funds, or if our customers cancel service due to the impact of these price increases to their service.

Currently, VoIP providers must contribute to the federal USF. There is a risk that states may attempt to assert state USF contribution requirements and other state and local charges. In addition, VoIP providers are subject to Section 225 of the Communications Act, which requires contribution to the TRS fund and requires VoIP providers to offer 711 abbreviated dialing for access to relay services. Although we contribute to the TRS fund, we have not yet implemented a solution for the 711 abbreviated dialing requirement. We cannot predict the impact of these types of obligations on our business or our ability to comply with them. We will likely pass these additional costs on to our customers and the impact of this price increase or our inability to recoup our costs or liabilities or other factors could adversely affect our business. We may be subject to enforcement actions if we are not able to comply with these new requirements.

We may be subject to liabilities for past telecom taxes, sales taxes, surcharges and fees.

We collect telecom taxes, sales taxes, surcharges and fees from our customers. The amounts collected from our customers are remitted to the proper authorities. While we believe we have collected and remitted appropriately, it is possible that substantial claims for back taxes may be asserted against us, which could adversely affect our business financial condition or operating results. In addition, future expansion of our service, along with other aspects of our evolving business, may result in additional tax obligations. One or more taxing authorities may seek to impose sales, use or other tax collection obligations on us. We have received inquiries or demands from numerous state authorities and may be subjected to audit at any time. A successful assertion by one or more taxing authorities that we should collect sales, use or other taxes on the sale of our services could result in substantial tax liabilities for past sales, could decrease our ability to compete with traditional telephone companies, and could adversely affect our business.

Our ability to offer new VoIP services outside the United States is subject to the local regulatory environment.

The regulations and laws applicable to the VoIP market outside the United States are various and often complicated and uncertain. Because of our relationship with certain resellers, some countries may assert that we are required to register as a provider in their country. The failure by us, our customers or our resellers to comply with applicable laws and regulations could adversely affect our business.

Risks Related to the Market for Our Common Stock

We may experience significant fluctuations in the market price of our common stock.

The market price of our common stock may experience significant fluctuations. These fluctuations may be unrelated or out of proportion to our operating performance, and could harm our stock price. Any negative change in the public's perception of the prospects of companies that employ similar technology or sell into similar markets could also depress our stock price, regardless of our actual results.

The market price of our common stock may be significantly affected by a variety of factors, including:

- announcements of new products, product enhancements, new services or service enhancements by us or our competitors;
- announcements of strategic alliances or significant agreements by us or by our competitors;
- technological innovations by us or our competitors;
- quarterly variations in our results of operations;
- acquisition of one of our competitors by a significantly larger company;
- general market conditions or market conditions specific to technology industries;
- sales of large blocks of our common stock; and
- domestic and international macroeconomic factors.

Our board of directors has the right to issue additional shares of common stock or preferred stock, without stockholder consent, which could have the effect of creating substantial dilution or impeding or discouraging a takeover transaction.

Pursuant to our certificate of incorporation, our board of directors may issue additional shares of common or preferred stock. Any additional issuance of common stock or the issuance of preferred stock could have the effect of impeding or discouraging the acquisition of control of us by means of a merger, tender offer, proxy contest or otherwise, including a transaction in which our stockholders would receive a premium over the market price for their shares, thereby protecting the continuity of our management. Specifically, if in the due exercise of its fiduciary obligations, our board of directors was to determine that a takeover proposal was not in the best interest of the Company or our stockholders, shares could be issued by our board of directors without stockholder approval in one or more transactions that might prevent or render more difficult or costly the completion of the takeover by:

- diluting the voting or other rights of the proposed acquirer or insurgent stockholder group;
- putting a substantial voting block in institutional or other hands that might undertake to support the incumbent board of directors; or
- effecting an acquisition that might complicate or preclude the takeover

If the holders of our outstanding convertible securities convert or exercise such securities into common stock, we will issue up to 122,399,761 shares, which will materially dilute the voting power of our currently outstanding common stock and possibly result in a change of control of our company.

As of March 5, 2010, we had 31,768,320 shares of common stock outstanding. As of March 5, 2010, we also had debentures which convert into 98,831,000 shares of common stock (assuming conversion at their respective current conversion price), warrants which are exercisable for 12,695,718 shares of common stock and stock options that are exercisable for 10,873,043 shares of common stock. The conversion price of our debentures is subject to adjustment. If such conversion price is adjusted, this would lead to the issuance of additional shares upon conversion. If the holders of our debentures, warrants, and stock options convert or exercise their securities into common stock, it will materially dilute the voting power of our outstanding common stock and may result in a change of control of our company.

An investment in our company may be diluted in the future as a result of the issuance of additional securities, the conversion of debentures, or the exercise of options or warrants.

To raise additional capital to fund our business plan, we may issue additional shares of common stock or securities convertible, exchangeable or exercisable into common stock from time to time, which, as further explained in the risk factor above, could result in substantial dilution to current stockholders. The issuance of additional debt securities would result in increased expenses and could result in covenants that would restrict our operations. No arrangements for any such offering exist, and no assurance can be given concerning the terms of any future offering or that we will be successful in issuing common stock or other securities at all. If adequate funds are not available, we may not be able to continue our operations or implement our planned additional research and development activities, any of which would adversely affect our results of operations and financial condition.

We may be the subject of securities class action litigation due to future stock price volatility.

In the past, when the market price of a stock has been volatile, holders of that stock have often instituted securities class action litigation against the company that issued the stock. If any of our stockholders brought a lawsuit against us, we could incur substantial costs defending the lawsuit. The lawsuit could also divert the time and attention of our management.

We have never paid dividends on our common stock, and we do not anticipate paying any dividends in the foreseeable future.

We have paid no cash dividends on our common stock to date. In addition, we are currently restricted from paying any dividends on our common stock under the terms of our outstanding debentures. Even absent such restriction, we currently intend to retain our future earnings, if any, to fund the development and growth of our business. In addition, the terms of any future debt or credit facility, if any, may preclude us from paying dividends. As a result, capital appreciation, if any, of our common stock will be our stockholders' sole source of gain for the foreseeable future.

Our common stock is traded on the OTC Bulletin Board, which may be detrimental to investors.

Our common stock is currently traded on the OTC Bulletin Board. Stocks traded on the OTC Bulletin Board generally have limited trading volume and exhibit a wide spread between the bid/ask quotation. Accordingly, you may not be able to sell your shares quickly or at the market price if trading in our stock is not active.

Our common stock is subject to penny stock rules.

Our common stock is subject to Rule 15g-1 through 15g-9 under the Exchange Act, which imposes certain sales practice requirements on broker-dealers who sell our common stock to persons other than established customers and "accredited investors" (generally, individuals with a net worth in excess of $1,000,000 or annual incomes exceeding $200,000 (or $300,000 together with their spouse)). For transactions covered by this rule, a broker-dealer must make a special suitability determination for the purchaser and have received the purchaser's written consent to the transaction prior to the sale. This rule adversely affects the ability of broker-dealers to sell our common stock and purchasers of our common stock to sell their shares of such common stock. Additionally, our common stock is subject to the SEC regulations for "penny stock." Penny stock includes any non-NASDAQ equity security that has a market price of less than $5.00 per share, subject to certain exceptions. The regulations require that prior to any non-exempt buy/sell transaction in a penny stock, a disclosure schedule set forth by the SEC relating to the penny stock market must be delivered to the purchaser of such penny stock. This disclosure must include the amount of commissions payable to both the broker-dealer and the registered representative and current price quotations for the common stock. The regulations also require that monthly statements be sent to holders of penny stock which disclose recent price information for the penny stock and information of the limited market for penny stocks. These requirements adversely affect the market liquidity of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate offices are located at 11201 SE 8th Street, Suite 200 in Bellevue, Washington 98004, where we lease approximately 30,425 square feet of office space. The lease term, which began on January 1, 2008, is 62 months, and the average monthly rental payment including utilities and operating expenses for the facility is approximately $98,000 per month. We believe the leased facility is in good condition and adequate to meet our current and anticipated requirements.

ITEM 3. LEGAL PROCEEDINGS

From time to time and in the course of business, we may become involved in various legal proceedings seeking monetary damages and other relief. The amount of the ultimate liability, if any, from such claims cannot be determined. However, in the opinion of our management, there are no legal claims currently pending or threatened against us that would be likely to have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 4. (REMOVED AND RESERVED)

PART II

ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades publicly on the OTC Bulletin Board under the symbol "TNXI" The OTC Bulletin Board is a regulated quotation service that displays real-time quotes, last-sale prices and volume information in over-the-counter equity securities. The OTC Bulletin Board securities are traded by a community of market makers that enter quotes and trade reports.

The following table sets forth the high and low bid prices per share of our common stock by the OTC Bulletin Board for the periods indicated as reported on the OTC Bulletin Board.

For the year ended December 31, 2009	***High***	***Low***
Fourth Quarter	$ 0.10	$ 0.04
Third Quarter	$ 0.14	$ 0.08
Second Quarter	$ 0.18	$ 0.07
First Quarter	$ 0.11	$ 0.06
For the year ended December 31, 2008		
Fourth Quarter	$ 0.19	$ 0.06
Third Quarter	$ 0.65	$ 0.18
Second Quarter	$ 1.65	$ 0.35
First Quarter	$ 2.54	$ 1.59

The quotes represent inter-dealer prices, without adjustment for retail mark-up, markdown or commission and may not represent actual transactions. The trading volume of our securities fluctuates and may be limited during certain periods. As a result of these volume fluctuations, the liquidity of an investment in our securities may be adversely affected.

Holders of Record

As of March 5, 2010, 31,768,320 shares of our common stock were issued and outstanding, and held by approximately 123 stockholders of record.

Dividends

We have never declared or paid any cash dividends on our common stock. For the foreseeable future, we intend to retain any earnings to finance the development and expansion of our business, and we do not anticipate paying any cash dividends on our common stock. In addition, we are restricted from paying any dividends on our common stock under the terms of our outstanding debentures. Any future determination to pay dividends will be at the discretion of our board of directors.

Recent Sales of Unregistered Securities

None.

Equity Compensation Plans Information.

The information required by this item will be contained in our definitive proxy statement to be filed with the SEC in connection with our 2010 annual meeting of stockholders, which is expected to be filed not later than 120 days after the end of our fiscal year ended December 31, 2009, and is incorporated in this report by reference.

ITEM 6. SELECTED FINANCIAL DATA

As a smaller reporting company we are not required to provide the information required by this item.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended as a review of significant factors affecting our financial condition and results of operations for the periods indicated. The discussion should be read in conjunction with our consolidated financial statements and the notes presented herein. See "ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA." below. In addition to historical information, the following Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements that involve risks and uncertainties. Our actual results could differ significantly from those anticipated in these forward-looking statements as a result of certain factors discussed in this report. See "Forward-Looking Statements," above.

Overview

Business

We are an IP communications company, offering a range of communications solutions from hosted IP voice and conferencing products to text and data collaboration products and services..

Our subsidiary, AccessLine, offers the following hosted VoIP services: Digital Phone Service, SIP Trunking Service and individual phone services. Digital Phone Service replaces a customer's existing telephone lines with a VoIP alternative. It is sold as a complete solution where we bundle our software applications and hosted network services with business-class phone equipment which is manufactured by third parties. This service is targeted at small businesses looking for a fully integrated solution that does not require expert assistance to install; the customer has the ability to select the number of phone stations (from 2 to 20), number of phone lines (from 2 to 8) and types of phone numbers. SIP Trunking Service is for larger businesses that already have their own PBX equipment and is targeted at those businesses with large calling volumes looking for cost effective alternatives to traditional carrier offerings. SIP Trunking Service does not include user equipment such as business phones, and can support businesses with hundreds of employees.

As part of its individual phone service product offerings, AccessLine offers a variety of other phone services, including, conferencing calling services, toll-free service plans, a virtual phone system with after hours answering service that routes calls based on specific business needs, find-me and follow-me services, a full featured voice mail system that instantly contacts a customer via an email or cell phone text message the moment such customer receives a new voice mail or fax, and the ability to manage faxes from virtually anywhere.

Our revenues principally consist of: monthly, activation, and usage fees from communication solutions, which include mobility solutions, PBX enhancements, single number solutions and unified messaging, voice messaging, paging, and bundled solutions of phone equipment and service.

Recent Developments

Our overriding objective in 2009 was to grow revenue while achieving operating profitability and generating cash from operations.

We experienced growth in revenue and gross profit for our AccessLine division in both 2009 and 2008. We increased revenue during 2009 through, in part, more efficiency in our advertising and also through our success in selling our SIP Trunking Service through direct and agent channels. Our Digital Phone Service continues to grow month over month. We increased our year-to-date gross profit through our continued progress in optimizing our network configuration. Additionally, we have reduced operating expenses, in part, through reducing our staffing levels.

The business performed by AVS, a former subsidiary, was severely impacted by the down economy during 2009, resulting in a substantial decline in revenue. It was unclear when, if ever, this business would generate consistent growth in revenue and gross profit. In addition, it continued to generate negative earnings and was in a negative working capital position at the time we decided to offer it for sale. As a result, due to our commitment to grow profitability and to avoid seeking additional capital, in October 2009 we transferred all of our ownership interest in AVS. Our ownership interests were transferred for nominal consideration. In connection with the transfer, all underlying assets and liabilities were retained by AVS. We determined that the total amount of consideration we received, along with strengthening of our balance sheet that we will recognize by the transfer of the liabilities of AVS to the purchaser as a result of the transfer of our ownership interests, represented fair value for our ownership interests. The transfer related solely to our video integration business, and not our video product business. We did not transfer any assets or intellectual property relating to our Digital Presence product line.

In December 2009, our board of directors made a decision to conclude efforts to seek strategic alternatives regarding the operations, assets and intellectual property relating to our Digital Presence product line so that we could focus on growing AccessLine's business which has been experiencing year over year revenue growth. The Digital Presence product line experienced a dramatic sales decline in both 2009 and 2008 as compared to prior years. Our board of directors directed management to finalize negotiations to sell the assets related to our Digital Presence product line or cease incurring costs related to its development.

Outlook

We differentiate our VoIP services on the basis of the quality of our service, the comprehensiveness of our solutions and the quality of our customer support. Our engineers have refined our network infrastructure and our software to provide robust, scalable, and reliable solutions. Our engineers have written substantially all of the software used in our network and applications. As a result, we have greater visibility into the software, a greater understanding of its function, and believe that we can respond more quickly in the development of new features and functions or to customize an application to meet customer demand. This level of understanding has allowed us to simplify the user experience for our customers, such as our Digital Phone System which can be self-installed by the customer. Our network architecture is designed to provide redundancy, with multiple failover layers, and scalability. Finally, we have also written tools that augment and enhance our customer support functions, providing greater access to information and accelerating our call response rates.

Over the past two years we have introduced unique new product offerings such as our Digital Phone Service. We have also worked aggressively to cut expenses and have significantly reduced our net loss. 2009 was a year of mixed results. We experienced strong initial traction with our Digital Phone Services. We also experienced strong growth in our SIP trunking business. The results of our video segment were disappointing. In addition, subsequent to the end of the year, we received notice from two of our significant customers that they would be terminating our service during the course of 2010. This service is an older product offering, that had been in place with these customers for several years. We had known for some time that the customers would move away from the service eventually and the revenue generated by these customers had been declining over recent years. These services accounted for approximately 17% of our revenues in 2009.

Entering 2010 our focus is on driving our core business of next generation VOIP services. Our network infrastructure is scalable and capable of supporting significant additional services, without substantial capital expenditure. As we generate additional revenues, we can distribute the fixed costs elements of our business over a greater revenue base, and increase gross profit.

If our AccessLine division can continue to generate revenue and gross profit consistent with our growth in 2009 and we maintain control of our operating expenses, we believe that our existing capital will be sufficient to finance our operations through 2010. However, the uncertainties related to the global economic slowdown and the disruption in the financial markets has impacted our visibility on our business outlook. Weakening economic conditions may result in decreased demand for our products. In addition, we have limited financial resources. Unforeseen decreases in revenues or increases in operating costs could impact our ability to fund our operations. We do not currently have any sources of credit available to us. See "Liquidity and Capital Resources" below.

Recent Financings

June 2008 Financing

On June 30, 2008, we entered into a securities exchange agreement with the investors in our previous debenture and preferred stock financings and issued six-year, interest only debentures due June 30, 2014 in exchange for all of the then outstanding debentures we issued in December 2006, August 2007 and March 2008 and shares of our preferred stock we issued in August 2007. The debentures issued in June 2008 amend and restate the terms of the debentures we issued December 2006, August 2007 and March 2008. The debentures issued in this transaction (an aggregate principal amount of $26.1 million) were exchanged for all of the then outstanding debentures held by the investors (an aggregate principal amount of $10.7 million), accrued interest on the outstanding debentures of $0.1 million, all of the then outstanding shares of preferred stock held by the investors (stated value of $14.9 million), and accrued dividends on such preferred stock of $0.4 million. In connection with this transaction, the exercise prices of the outstanding warrants issued in the previous debenture and preferred stock financings were reduced from $1.25 per share to $1.00, which was subsequently reduced to $0.40 per share in connection with our December 2008 financing, discussed below. The number of common shares underlying these warrants was not adjusted in connection with this change in exercise price.

In December 2008, we amended certain terms of the debentures issued in June 2008 which are discussed below under the heading “December 2008 Amendment of Outstanding Debentures and Warrants.” And, in May 2009, we further restructured the terms of our outstanding debentures issued in June 2008, August 2008 and December 2008 (collectively, the "**PIPE Debentures**") and all of our outstanding warrants issued in December 2006, February 2007, August 2007, March 2008, August 2008 and December 2008 (the "**PIPE Warrants**"). See “May 2009 Amendment of Outstanding Debentures and Warrants,” below.

The following summarizes the terms of the debentures issued in June 2008, as amended in December 2008 and May 2009:

Term. The debentures are due and payable on June 30, 2014.

Interest. When originally issued, interest accrued at the rate of 12.0% per annum and was payable monthly, commencing on August 1, 2008. In December 2008, the parties agreed to amend the interest payment provisions to eliminate monthly interest payments at the rate of 12% per annum. Following this amendment, interest was payable quarterly at the rate of (i) 0% per annum from October 1, 2008 until September 30, 2009, (ii) 13.5% per annum from October 1, 2009 until September 30, 2012 and (iii) 18% per annum from October 1, 2012 until maturity. In May 2009, the parties again agreed to amend the interest payment provisions to reduce the interest rate to 0% through June 30, 2011 and then to 5% per annum thereafter.

Principal Payment. The principal amount of the debenture, if not paid earlier, is due and payable on June 30, 2014.

Payments of Interest. Interest payments, as amended in May 2009, are due quarterly on January 1, April 1, July 1 and October 1, commencing on October 1, 2011. Interest payments are required to be paid in cash.

Early Redemption. We have the right to redeem the debentures before their maturity by payment in cash of the then outstanding principal amount plus (i) accrued but unpaid interest, (ii) an amount equal to all interest that would have accrued if the principal amount subject to such redemption had remained outstanding through the maturity date and (iv) all liquidated damages and other amounts due in respect of the debenture. To redeem the debentures we must meet certain equity conditions. The payment of the debentures would occur on the 10th day following the date we gave the holders notice of our intent to redeem the debentures. We agreed to honor any notices of conversion received from a holder before the pay off date of the debentures.

Voluntary Conversion by Holder. When originally issued, the debentures were convertible at anytime at the discretion of the holder at a conversion price per share of $1.25, subject to adjustment including full-ratchet, anti-dilution protection. The conversion price was reduced to $0.40 with the December 2008 amendment and further reduced to $0.30 with the May 2009 amendment.

Forced Conversion. Subject to compliance with certain equity conditions, we also have the right to force conversion if the VWAP for its common stock exceeds 200% of the then effective conversion price for 20 trading days out of a consecutive 30 trading day period. Any forced conversion is subject to our meeting certain equity conditions and is subject to a 4.99% cap on the beneficial ownership of our common stock by the holder and its affiliates following such conversion, which cap may increase to 9.99% by the holder upon not less than 61 days notice.

Covenants. The debentures impose certain covenants on us, including restrictions against incurring additional indebtedness, creating any liens on our property, amending our certificate of incorporation or bylaws, redeeming or paying dividends on shares of our outstanding common stock, and entering into certain related party transactions. The debentures define certain events of default, including without limitation failure to make a payment obligation, failure to observe other covenants of the debenture or related agreements (subject to applicable cure periods), breach of representation or warranty, bankruptcy, default under another significant contract or credit obligation, delisting of our common stock, a change in control, failure to be in compliance with Rule 144(c)(1) for more than 20 consecutive days, or more than an aggregate of 45 days in any 12 month period, or if any other conditions exist for such a period of time that the holder is unable to sell the shares issuable upon conversion of the debenture pursuant to Rule 144 without volume or manner of sale restrictions, or failure to deliver share certificates in a timely manner. In the event of default, the holders of the debentures have the right to accelerate all amounts outstanding under the debenture and demand payment of a mandatory default amount equal to 130% of the amount outstanding plus accrued interest and expenses.

In addition, under the terms of the May 2009 amendment agreement we agreed to add certain covenants to the debentures, including a requirement to maintain at least $300,000 in cash at all times while the debentures are outstanding, to sustain a level of gross revenue each quarter equal to at least 80% of the average gross revenue for the trailing two quarters, and to maintain a positive adjusted EBITDA in each rolling two quarter period. See below under “May 2009 Amendment of Outstanding Debentures and Warrants.”

Security. The debentures we issued are secured by all of our assets under the terms of the amended and restated security agreement we and our subsidiaries entered into with the holders of the June 2008 debentures. Each of our subsidiaries also entered into guarantees in favor of the holders of the debentures, pursuant to which each subsidiary guaranteed the complete payment and performance by us of our obligations under the debentures and related agreements.

August 2008 Financing

On August 13, 2008, we entered into a debenture and warrant purchase agreement with one of the institutional investors that invested in the previous private placements. Under the terms of this purchase agreement we issued a senior secured convertible debenture in the principal amount of $2.0 million, along with a five year warrant to purchase 608,000 shares of our common stock at an exercise price of $1.00 per share, subject to adjustment, including full-ratchet anti-dilution protection. This financing transaction resulted in net proceeds to us of $2.0 million.The terms of the debentures we issued in this financing were also amended by the terms of the amendment agreement we entered into in December 2008 and were further amended by the terms of the amendment agreement we entered into in May 2009. See "December 2008 Amendment of Outstanding Debentures and Warrants," and "May 2009 Amendment of Outstanding Debentures and Warrants," below. Our rights and obligations, as well as those of the investor, with respect to the debenture we issued in this financing are identical to the rights and obligations of the debentures we issued in June 2008, as amended.

December 2008 Financing

On December 11, 2008, we entered into a debenture and warrant purchase agreement with an institutional investor and a holder of the debentures we issued in June 2008 and August 2008. Under the terms of this purchase agreement we issued a senior secured convertible debenture in the principal amount of $1.5 million, along with a warrant to purchase 456,000 shares of our common stock with an exercise price of $0.40 per share. This financing transaction resulted in net proceeds to us of $1.5 million. We may refer to this financing as our December 2008 financing in this report.

The terms of the debenture we issued in December 2008 are substantially similar to the terms of the debentures we issued in June 2008, as amended.

December 2008 Amendment of Outstanding Debentures and Warrants

In connection with our December 2008 financing, we entered into an amendment agreement with the holders of the debentures we issued in June 2008 and August 2008, and the warrants we issued in December 2006, February 2007, March 2008 and August 2008. With respect to the debentures, the parties agreed to amend the interest rate and interest payment provisions, which had called for monthly interest payments at the rate of 12% per annum. As amended in December 2008, interest is payable quarterly at the rate of (i) 0% per annum from October 1, 2008 until September 30, 2009, (ii) 13.5% per annum from October 1, 2009 until September 30, 2012 and (iii) 18% per annum from October 1, 2012 until maturity. In May 2009, the parties further agreed to amend the interest payment provisions to reduce the interest rate to 0% through June 30, 2011 and then to 5% per annum thereafter.

As a result of the issuance of the debenture and warrant in the December 2008 financing discussed above, the conversion price and exercise price, respectively, of the debentures issued in June 2008 and August 2008 and the warrants issued in December 2006, February 2007, March 2008 and August 2008 was reduced to $0.40. However, under the amendment agreement, the parties agreed to waive the adjustment provision of such warrants that would have increased the number of shares subject to such warrants as a result of the issuance of the debentures and warrants in the December 2008 financing.

May 2009 Amendment of Outstanding Debentures and Warrants

In May 2009, we restructured the terms of our PIPE Debentures and all of PIPE Warrants pursuant to the terms of an amendment agreement we entered into with the holders of the outstanding PIPE Debentures and PIPE Warrants (the "**Amendment Agreement**"). The Amendment Agreement revised the terms of the PIPE Debentures to:

- decrease the conversion price from $0.40 to $0.30;
- require that all future interest payments be made in cash;
- defer interest payments until October 1, 2011;
- reduce the interest rate to 0% through June 30, 2011 and then to 5% per annum thereafter;
- eliminate the requirement that, at the time of any conversion of principal, we pay the holders an amount in cash equal to the interest that would have accrued on such principal had such principal remained outstanding through the full term of the PIPE Debentures; and
- eliminate the 20% premium for voluntary prepayment.

Under the terms of the Amendment Agreement, the holders of the PIPE Warrants were granted the right to exchange their outstanding PIPE Warrants for shares of our common stock at the rate of 1.063 shares of common stock underlying the PIPE Warrants for one share of common stock, subject to adjustment for stock splits and dividends. In exchange, the anti-dilution protection feature of the PIPE Warrants was eliminated. Previously the exercise price of the PIPE Warrants would decrease, and the number of shares issuable upon exercise would increase, generally, each time we issued common stock or common stock equivalents at a price less than the exercise price of the PIPE Warrants. The Amendment Agreement eliminates the potential for future price-based dilution from the PIPE Warrants.

In addition, under the terms of the Amendment Agreement, we also agreed to add certain covenants to the PIPE Debentures, including a requirement to maintain at least $300,000 in cash at all times while the PIPE Debentures are outstanding, to sustain a level of gross revenue each quarter equal to at least 80% of the average gross revenue for the trailing two quarters, and commencing with the period ended June 30, 2009, to maintain a positive adjusted EBITDA in each rolling two quarter period. For example, ending December 31, 2009, the sum of the three-month adjusted EBITDA of the three months ended September 30 and December 31 must be at least $0.00 or greater. Adjusted EBITDA is calculated by taking our net income for the applicable period, and adding to that amount the sum of the following: (i) any provision for (or less any benefit from) income taxes, plus (ii) any deduction for interest expense, net of interest income, plus (iii) depreciation and amortization expense, plus (iv) non-cash expenses (such as stock-based compensation and warrant compensation), plus (v) expenses related to changes in fair market value of warrant and beneficial conversion features, plus (vi) expenses related to impairment of tangible and intangible assets. We were in compliance with all covenants at December 31, 2009.

Results of Operations

Year Ended December 31, 2009 Compared with Year Ended December 31, 2008

Revenues, Cost of Revenues and Gross Profit

	Fiscal Year Ended December 31,		Increase	
	2009	2008	Dollars	Percent
Revenues	$ 28,291,925	$ 26,093,551	$ 2,198,374	8.4%
Cost of revenues	11,815,701	11,360,629	455,072	4.0%
Gross profit	16,476,224	14,732,922	1,743,302	11.8%
Gross profit percentage	58.2%	56.5%		

Net revenues for 2009 were $28.3 million, an increase of $2.2 million, or 8.4%, over 2008. The increase in revenues is due, in part, to increased success in selling SIP Trunking Service through direct and agent channels, and strong growth in our Digital Phone Service products which were launched in mid-2008. We expect revenue growth in SIP Trunking Service and Digital Phone Service to continue to be strong in 2010. Subsequent to the end of the year, we received notice from two of our significant customers that they would be terminating our service during the course of 2010. This service is an older product offering, that had been in place with these customers for several years. We had known for some time that the customers would move away from the service eventually and the revenue generated by these customers had been declining over recent years. These services accounted for approximately 17% of our revenues in 2009.

Cost of revenues for 2009 were $11.8 million, an increase of $0.5 million, or 4.0%, over 2008. Cost of revenues increased as a result of the increased revenues, partially offset by several cost saving measures that we began implementing during 2009.

Gross profit for 2009 was $16.5 million, an increase of $1.7 million, or 11.8%, over 2008. Gross profit percentage was 58.2% for 2009 compared to 56.5% in 2008. The increase in gross profit is a result of improved purchasing power from network infrastructure providers allowing us to purchase network access at lower rates, as well as several cost saving measures that we began implementing during 2009, which more than offset the shift in revenue to our Digital Phone Service and SIP Trunking Service product lines, both of which have somewhat lower margins than our individual services and legacy products. We expect gross profit to be the mid to high 50 percent range in 2010.

Selling and Marketing Expenses

Selling and marketing expenses for 2009 were $6.3 million, slightly higher than the $6.2 million in 2008. The increase was primarily due to an increase in advertising and sales commission expense, partially offset by a reduction in our selling staff in late February 2009. We anticipate that selling and marketing expenses in 2010 will be higher than those incurred in 2009 as we increase our advertising expense in order to increase market share and to promote our Digital Phone Service product line.

General and Administrative Expenses

General and administrative expenses for 2009 were $8.1 million, a decrease of $3.2 million or 28.1%, over 2008. Approximately, 65% of the decrease is attributable to lower payroll and stock compensation expense as a result of a reduction in management staff that occurred in the second half of 2008 and February 2009 and the impact of related severance costs we incurred in 2008. Approximately, 13% of the decrease is attributable to lower accounting costs in 2009 as compared to 2008, which included costs associated with the first time consolidation of the activity of our Accessline and AVS subsidiaries that were acquired during 2007. Another 13% of the decrease is attributable to lower investor relations costs in 2009 as our contract with an investor relations firm ended in 2008. There was no such related expense in 2009. In addition, approximately 12% of the decrease is primarily attributable to lower consulting fees in 2009 as compared to 2008, which included costs associated with various valuations as a result of our acquisitions and various debt restructurings in 2007 and 2008. The above decreases were partially offset by higher board of director fees in 2009 as compared to 2008.

Research, Development and Engineering Expenses

Research, development and engineering expenses for 2009 were $2.9 million as compared to $3.0 million in 2008. The decrease is primarily a result of a reduction in our staff in late February 2009.

Depreciation Expense

Depreciation expense for 2009 was $0.9 million, an increase of $0.1 million, over 2008. The increase is primarily attributable to additions to fixed assets during 2009 and 2008.

Amortization of Purchased Intangibles

We recorded $2.2 million of amortization expense in both 2009 and 2008, related to the amortization of intangible assets acquired in the AccessLine acquisition.

Impairment of Intangibles

We do not amortize goodwill and intangible assets with indefinite useful lives. However, we do review these assets for impairment at least annually. We test goodwill for impairment using a two-step process. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any.

Other intangible assets with finite useful lives consist primarily of developed technology and customer relationships. These intangibles are amortized on the straight-line basis over the expected period of benefit which range from five to ten years.

Long-lived assets, including developed technology and customer relationships, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If an asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of that asset exceeds the fair value of that asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

We determined that goodwill, intangible assets and other long-lived assets were not impaired at December 31, 2009. However, at December 31, 2008, it was determined that there was a $2.4 million impairment of the indefinite-lived trade name intangible asset which amount was reflected as expense in the Consolidated Statement of Operations for 2008.

Interest Expense

Interest expense for 2009 was $4.1 million, a decrease of $2.1 million, as compared to $6.2 million in 2008. Interest expense includes stated interest, amortization of note discounts, amortization of deferred financing costs, and interest on capital leases. Interest expense decreased in 2009 primarily as a result of the reduced interest rate on our debentures that took effect in May 2009.

The debentures we issued prior to June 2008 had an interest rate of 6%, and we recorded discounts to the debentures for the beneficial conversion feature and for the value of the warrants granted in connection with those debentures. We also recorded deferred financing costs related to the private placements in which such debentures were issued.

On June 30, 2008, we exchanged our then outstanding debentures for new debentures with an aggregate face value of $26.1 million that have a six year term and, when originally issued, bore interest at 12%. As discussed in greater detail below, the interest rate on these debentures was amended in December 2008 and again in May 2009. During the second half of 2008, a portion of these debentures was converted into shares of our common stock. We recorded deferred financing costs of $0.2 million related to the issuance of the new debentures in June 2008. The unamortized discounts and deferred financing costs at June 30, 2008 related to the prior financing transactions will be amortized to interest expense in future periods over the term of the newly issued debentures, or through June 30, 2014.

In August 2008, we issued a debenture with a face value of $2.0 million that, when originally issued, bore interest at 12% per annum. As discussed in greater detail below, the interest rate on this debenture was amended in December 2008 and again in May 2009. We recorded discounts aggregating to $1.3 million which will be amortized to interest expense in future periods over the term of the debenture, or through June 30, 2014.

In December 2008, we issued a debenture with a face value of $1.5 million that, when originally issued, bore interest at a rate of (i) 0% per annum from the original issue date until the one year anniversary of the original issue date, (ii) 12% per annum from the one year anniversary of the original issue date until the four year anniversary of the original issue date, and (iii) 18% per annum from the four year anniversary of the original issue date until June 2014. The interest rate on this debenture was amended in May 2009.

In addition, in December 2008, with respect to the debentures we issued in June 2008 and August 2008, the parties agreed to amend the interest rate and interest payment provisions, which had called for monthly interest payments at the rate of 12% per annum. As amended in December 2008, interest is payable quarterly at the rate of (i) 0% per annum from October 1, 2008 until September 30, 2009, (ii) 13.5% per annum from October 1, 2009 until September 30, 2012 and (iii) 18% per annum from October 1, 2012 until maturity.

In May 2009, with respect to the debentures we issued in June 2008, August 2008 and December 2008, the parties agreed to amend the terms of such debentures to: (i) defer interest payments until October 1, 2011; (ii) reduce the interest rate to 0% through June 30, 2011 and then to 5% per annum thereafter; and (iii) require that all future interest payments be made in cash. This change in terms resulted in an effective interest rate for the period subsequent to May 8, 2009 of 1.5%. See "Recent Financings," above.

Change in Fair Value of Warrant and Beneficial Conversion Liabilities

We recorded the fair value of the warrants issued in connection with our various financings at the issuance dates as a warrant liability because the exercise price of the warrants can be adjusted if we subsequently issue common stock at a lower price and it is possible for us to not have enough authorized shares to settle the warrants and therefore would have to settle the warrants with cash.

The fair value of the then outstanding warrants was estimated at December 31, 2008 and again at each subsequent reporting date. However, as a result of the Amendment Agreement (see Recent Financings above), the anti-dilution protection feature of these warrants was removed, which eliminates the potential for future price-based dilution from these warrants. Accordingly, these warrants are no longer a derivative liability and their value as of May 8, 2009, was reclassed to equity.

The change in fair value of warrants in 2009 resulted in non-operating expense of $1.0 million compared to non-operating income of $8.7 million in 2008.

At December 31, 2008 and again at each subsequent reporting date, we assessed the then outstanding convertible debentures and determined that the beneficial conversion feature represented an embedded derivative liability. Accordingly, we bifurcated the embedded beneficial conversion feature and accounted for it as a derivative liability because the conversion price of the debentures could be adjusted if we subsequently issue common stock at a lower price and due to recent events it became possible that we could have to net cash settle the contract if there were not enough authorized shares to issue upon conversion.

The debentures we issued in December 2006, February 2007, August 2007 and March 2008 contained embedded derivative features which were accounted for at fair value as a compound embedded derivative up to June 30, 2008, the date we exchanged those debentures for debentures with a six year term and 12% interest rate. This compound embedded derivative included the following material features: (1) the standard conversion feature of the debentures; (2) a reset of the conversion price condition for subsequent equity sales; (3) our ability to pay interest in cash or shares of our common stock; (4) monthly redemption payments as per the debenture agreements; (5) optional redemption at our election; (6) forced conversion; (7) holder’s restriction on conversion; and (8) a default put.

The debentures we issued in June 2008, August 2008 and December 2008 contain embedded derivative features, which were accounted for at fair value as a compound embedded derivative at the issuance dates and at each subsequent reporting date. This compound embedded derivative included the following material features: (1) the standard conversion feature of the debentures; (2) a reset of the conversion price condition for subsequent equity sales; (3) our ability to pay interest in cash or shares of our common stock; (4) optional redemption at our election; (5) forced conversion; (6) holder’s restriction on conversion; and (7) a default put.

The change in the fair market value of the beneficial conversion feature liability on May 8, 2009 as a result of the decrease in the conversion price of all of our debentures from $0.40 to $0.30 per the Amendment Agreement (see Recent Financings above) was recorded as additional debt discount of $4.0 million.

We, with the assistance of an independent valuation firm, calculated the fair value of the compound embedded derivative associated with the convertible debentures utilizing a customized Monte Carlo simulation model suitable to value path dependant American options. The model uses the risk neutral methodology adapted to value corporate securities. This model utilized subjective and theoretical assumptions that can materially affect fair values from period to period.

We recorded non-operating income of $4.7 million in 2009 as compared to $2.5 million in 2008, which is primarily attributable to the decrease in the market price of our common stock.

Discontinued Operations

As a result of the sale of AVS in October 2009, and the potential sale of the Digital Presence product line (see “Recent Developments” above), we have reported our video segment results as discontinued operations in both 2009 and 2008. Although 2009 only reflects ten months of activity for AVS, versus a full year in 2008, the 2009 loss of $3.9 million is higher than the $3.6 million loss in 2008 due to a decline in revenue without a corresponding decline in expenses. We expect to incur nominal expenses in 2010 as we wind down the Digital Presence product line.

Provision for Income Taxes

No provision for income taxes has been recorded because we have experienced net losses from inception through December 31, 2009. As of December 31, 2009, we had net operating loss carryforwards ("NOL's"), net of section 382 limitations, of approximately $46 million, some of which, if not utilized, will begin expiring in the current year. Our ability to utilize the NOL carryforwards is dependent upon generating taxable income. We have recorded a corresponding valuation allowance to offset the deferred tax assets as it is more likely than not that the deferred tax assets will not be realized. We recognize interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2009 and 2008, we recognized no interest and penalties.

Liquidity and Capital Resources

Our cash balance as of December 31, 2009 was $0.5 million. At that time, we had accounts receivable of $1.9 million and a working capital deficit of $7.3 million. However, current liabilities include certain items that will likely settle without future cash payments or otherwise not require significant expenditures by the Company including: beneficial conversion liabilities of $4.1 million, deferred revenue of $0.9 million (primarily deferred up front customer activation fees), deferred rent of $0.2 million and accrued vacation of $0.5 million. In addition, current liabilities include accrued bonuses of $0.6 million, paid out only if certain minimum cash targets are met. The aforementioned items represent $6.3 million of total current liabilities as of December 31, 2009. We do not anticipate being in a positive working capital position in the near future. However, if we continue to generate revenue and gross profit consistent with our growth in 2009 and maintain control of our variable operating expenses, we believe that our existing capital, together with anticipated cash flows from operations, will be sufficient to finance our operations through at least January 1, 2011.

Cash generated by continuing operations during 2009 was $1.4 million. This was primarily the result of an increase in accounts payable and accrued liabilities of $0.8 million and cash from operations of $0.6 million as the net loss from continuing operations of $4.2 million was more than offset by the following non-cash charges: amortization of intangible assets of $2.2 million; amortization of note discounts of $2.2 million; depreciation expense of $2.0 million (which includes depreciation expense of $1.1 million in cost of sales); the change in accrued interest of $1.6 million; and stock compensation expense of $0.6 million, partially offset by non-cash income of $3.8 million from the change in fair value of the warrant and beneficial conversion liabilities.

Net cash used by investing activities during 2009 was $0.4 million, which consisted of purchases of property and equipment.

Net cash used by financing activities was $1.1 million during 2009, all of which was used for payments on our capital leases.

We do not currently have any unused credit arrangement or open credit facility available to us. Our outstanding debentures are secured by a lien on all of our assets, and the terms of those debentures restrict our ability to borrow funds and pledge our assets as security for any such borrowing, without the consent of the holders of the our outstanding debentures.

If our cash reserves prove insufficient to sustain operations, we plan to raise additional capital by selling shares of capital stock or other equity or debt securities.

In addition, if our cash flows from operations are not sufficient to make interest payments owed on our outstanding debentures in cash in 2011 or if we are unable to make the payments due on our outstanding debentures when they mature in 2014, we would be in default under those securities. If this were to occur, we plan to evaluate other equity financing opportunities, the proceeds of which could be used to make interest payment and/or repay the debentures. If we do not pay the debentures in accordance with their terms, the holders of our debentures would be entitled to demand that all amounts due thereunder be immediately paid in cash, and the holders would have the right to demand that we pay 130% of the outstanding principal amount and the interest rate accrues at a rate equal to the lesser of 18% per annum or the maximum rate permitted under applicable law. In addition, the holders would have the right to foreclose on all of our assets pursuant to the terms of the security agreement we entered into with such holders and they would have the right to take possession of our assets and operate our business.

There are no commitments or arrangements for future financings in place at this time, and we can give no assurance that such capital will be available on favorable terms or at all. We may need additional financing thereafter until we can achieve profitability. If we cannot, we will be forced to curtail our operations or possibly be forced to evaluate a sale or liquidation of our assets. Any future financing may involve substantial dilution to existing investors.

Commitments and Contingencies

Leases

We have non-cancelable operating and capital leases for corporate facilities and equipment. The leases expire through February 28, 2013 and include certain renewal options. Rent expense under the operating leases totaled $1.7 million and $1.8 million for the years ended December 31, 2009 and 2008, respectively.

Future minimum rental payments required under non-cancelable operating and capital leases are as follows for the years ending December 31:

	Operating Leases	Capital Leases
2010	$ 1,375,995	$ 776,669
2011	1,240,014	357,504
2012	1,278,394	85,443
2013	252,920	14,139
Total minimum lease payments	$ 4,147,323	1,233,755
Less amount representing interest		(128,724)
Present value of minimum lease payments		1,105,031
Less current portion		(683,249)
		$ 421,782

Debentures

As of December 31, 2009, the principal balance we owe on our outstanding debentures is $29.6 million, all of which is due June 30, 2014. In May 2009, the terms of our debentures were amended to defer interest payments until October 1, 2011. All interest payments must be paid in cash. In addition, at any time, the holders of the debentures have the right to convert the debentures into common stock at the then effective conversion price (currently $0.30). See "Recent Financings," above.

Minimum Third Party Network Service Provider Commitments

We have a contract with a third party network service provider that facilitates interconnectivity with a number of third party network service providers. The contract contains a minimum usage guarantee of $0.2 million per monthly billing cycle. The contract commenced on October 16, 2003 with an initial 24 month term. The contract was extended in July 2005 for a three year term that expired in July 2008. On October 24, 2008, the contract was extended for another three year term. The cancellation terms are a 90 day written notice prior to the then current term expiring.

Litigation Settlement

In January 2008, we issued 72,000 shares of our common stock valued at $0.2 million in settlement of compensation claims made by a former sales representative. The settlement amount was accrued at December 31, 2007, and was included in selling, general and administrative expenses in the Consolidated Statement of Operations for the year ended December 31, 2007. Pursuant to the terms of the settlement, we were required to issue additional shares of our common stock if our stock price declined during the six month period subsequent to the date of the settlement. In July 2008, pursuant to terms of the settlement, we issued an additional 60,000 shares of common stock valued at less than $0.1 million, which is included in selling, general and administrative expenses in the Consolidated Statement of Operations for the year ended December 31, 2008.

Critical Accounting Policies Involving Management Estimates and Assumptions

Our discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements. The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and equity and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include those related to the allowance for doubtful accounts; valuation of inventories; valuation of goodwill, intangible assets and property and equipment; valuation of stock based compensation expense, the valuation of warrants and conversion features; and other contingencies. On an on-going basis, we evaluate our estimates. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions.

The following is a discussion of certain of the accounting policies that require management to make estimates and assumptions where the impact of those estimates and assumptions may have a substantial impact on our financial position and results of operations.

Goodwill:

Goodwill is not amortized but is regularly reviewed for potential impairment. The identification and measurement of goodwill impairment involves the estimation of the fair value of our reporting units. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment, which primarily incorporate management assumptions about expected future cash flows. Future cash flows can be affected by changes in industry or market conditions or the rate and extent to which anticipated synergies or cost savings are realized with newly acquired entities.

Impairment of Long-Lived Assets:

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from five to ten years. Purchased intangible assets determined to have indefinite useful lives are not amortized. Long-lived assets, including intangible assets with finite lives, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets that management expects to hold and use is based on the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

Revenue Recognition:

Revenues from continuing operations are derived primarily from monthly recurring fees, which are recognized over the month the service is provided, activation fees, which are deferred and recognized over the estimated life of the customer relationship, and fees from usage which are recognized as the service is provided.

Revenues from our discontinued video segment were recognized when persuasive evidence of an arrangement existed, title was transferred, product payment was not contingent upon performance of installation or service obligation, the price was fixed or determinable, and collectability was reasonably assured. In instances where final acceptance of the product or service was specified by the customer, revenue was deferred until all acceptance criteria was met. Additionally, extended service revenue on hardware and software products was recognized ratably over the service period, generally one year.

Income Taxes:

We account for income taxes using the asset and liability method, which recognizes deferred tax assets and liabilities determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established to reduce deferred tax assets when, based on available objective evidence, it is more likely than not that the benefit of such assets will not be realized. In addition, FASB guidance requires us to recognize in the consolidated financial statements only those tax positions determined to be more likely than not of being sustained.

Derivative Financial Instruments

We do not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks.

We review the terms of convertible debt and equity instruments it issues to determine whether there are embedded derivative instruments, including the embedded conversion option, that are required to be bifurcated and accounted for separately as a derivative financial instrument. In circumstances where the convertible instrument contains more than one embedded derivative instrument, including the conversion option, that is required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument. Also, in connection with the sale of convertible debt and equity instruments, we may issue freestanding warrants that may, depending on their terms, be accounted for as derivative instrument liabilities, rather than as equity.

Bifurcated embedded derivatives are initially recorded at fair value and are then revalued at each reporting date with changes in the fair value reported as non-operating income or expense. When the convertible debt or equity instruments contain embedded derivative instruments that are to be bifurcated and accounted for as liabilities, the total proceeds allocated to the convertible host instruments are first allocated to the fair value of all the bifurcated derivative instruments. The remaining proceeds, if any, are then allocated to the convertible instruments themselves, usually resulting in those instruments being recorded at a discount from their face amount.

The discount from the face value of the convertible debt, together with the stated interest on the instrument, is amortized over the life of the instrument through periodic charges to income, using the effective interest method.

Stock Based Compensation:

We measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized in the Consolidated Statement of Operations over the period during which the employee is required to provide service in exchange for the award – the requisite service period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. The grant-date fair value of employee share options and similar instruments is estimated using option-pricing models adjusted for the unique characteristics of those instruments.

Recent Accounting Pronouncements

See "Note 1 – Description of Business and Summary of Significant Accounting Policies" of the Notes to Consolidated Financial Statements included in "Item 8. Financial Statements and Supplementary Data" of Part II of this report.

Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of the year ended December 31, 2009, nor do we have any as of March 17, 2010.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company we are not required to provide the information required by this item.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following consolidated financial statements are included beginning on page F-1 of this report:

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to provide reasonable assurances that material information related to our company is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our Chief Executive Officer and Chief Financial Officer have determined that as of December 31, 2009, our disclosure controls were effective at that "reasonable assurance" level.

Management's Annual Report on Internal Controls over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation under that framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2009.

This annual report does not include an attestation report of the company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the company's registered public accounting firm pursuant to temporary rules of the SEC that permit the company to provide only management's report in this annual report.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes In Internal Controls over Financial Reporting.

No changes were made in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Identification of Directors.

The information under the caption "Election of Directors," appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

Identification of Executive Officers.

The information under the caption "Certain Information with Respect to Executive Officers," appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

Compliance with Section 16(a) of the Exchange Act.

The information under the caption "Compliance with Section 16(a) of the Exchange Act," appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

Code of Ethics.

The information under the caption "Code of Ethics" appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

Audit Committee.

The information under the caption "Information Regarding the Board and its Standing Committees," appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information under the heading "Executive Compensation and Other Information" appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information under the heading "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information under the heading "Certain Relationships and Related Transactions and Director Independence," appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information under the heading "Principal Accountant Fees and Services," appearing in the Proxy Statement to be filed for the 2010 Annual Meeting of Stockholders is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this Report:

(1) Financial Statements—all consolidated financial statements of the Company as set forth under Item 8, on page 23 of this Report.

(2) Financial Statement Schedules— As a smaller reporting company we are not required to provide the information required by this item.

(3) Exhibits

Exhibit No.	Description
2.1	Agreement and Plan of Merger dated as of September 1, 2007, by and among Telanetix, Inc., a Delaware corporation, Endzone Acquisition Corp., a Delaware corporation, and AccessLine Holdings, Inc., a Delaware corporation (1)
3.1	Certificate of Incorporation (2)
3.2	Bylaws, as amended (15)
3.3	Certificate of Designation of Preferences, Rights and Limitations of Series A Convertible Preferred Stock (1)
4.1	Form of original issue discount 6% senior convertible debenture issued in connection with the December 28, 2006 financing (3)
4.2	Form of common stock purchase warrant issued in connection with the December 28, 2006 financing (3)
4.3	Form of original issue discount 6% senior convertible debenture issued in connection with the February 12, 2007 financing (4)
4.4	Form of common stock purchase warrant issued in connection with the February 12, 2007 financing (4)
4.5	Form of common stock purchase warrant issued in connection with the August 2007 financing (1)
4.6	Form of original issue discount 6.0% senior secured convertible debenture issued in connection with the August 2007 financing (1)
4.7	Form of common stock purchase warrant issued in connection with the March 2008 financing (8)
4.8	Form of original issue discount 6.0% senior secured convertible debenture issued in connection with the March 2008 financing (8)
4.9	Form of senior secured convertible debenture issued in connection with the June 2008 recapitalization (11)
4.10	Form of senior secured convertible debenture issued in connection with the August 2008 financing (13)
4.11	Form of warrant issued in connection with the August 2008 financing (13)
4.12	Form of original senior secured convertible debenture issued in connection with the December 2008 financing (14)
4.13	Form of warrant issued in connection with the December 2008 financing (14)
10.1#	2005 Equity Incentive Plan (2)
10.2	Securities Purchase Agreement by and among Telanetix, Inc., a Delaware corporation, and the purchasers identified therein dated as of December 28, 2006 (3)
10.3	Securities Purchase Agreement by and among Telanetix, Inc., a Delaware corporation, and the purchasers identified therein dated as of February 12, 2007 (4)
10.4	Waiver and Amendment Agreement by and among Telanetix, Inc., a Delaware corporation, and the purchaser identified therein dated as of February 12, 2007 (4)
10.5	Stock Purchase Agreement between Telanetix, Inc., a Delaware corporation, and the sellers identified therein dated as of March 30, 2007 (5)
10.6	Securities Purchase Agreement dated as of August 30, 2007 by and among Telanetix, Inc., a Delaware corporation, and the purchasers identified therein related to the Series A Convertible Preferred Stock offering (1)
10.7	Securities Purchase Agreement dated as of August 30, 2007 by and among Telanetix, Inc., a Delaware corporation, and the purchasers identified therein related to the original issue discount 6.0% senior secured convertible debenture offering (1)
10.8	Security Agreement dated as of August 30, 2007 by and among Telanetix, Inc., a Delaware corporation, all of its subsidiaries and the holders of the original issue discount 6.0% senior secured convertible debenture issued in connection with the August 2007 financing (1)
10.9	Securities Purchase Agreement dated as of March 27, 2008 by and among Telanetix, Inc., a Delaware corporation, and the purchasers identified therein related to the original issue discount 6.0% senior secured convertible debenture offering (9)
10.10#	Doug Johnson Employment Agreement dated April 28, 2008 (9)
10.11#	J. Paul Quinn Employment Agreement dated April 28, 2008 (9)
10.12#	Form of Indemnification Agreement for directors, officers and key employees of Telanetix, Inc. (10)
10.13	Securities Exchange Agreement dated June 30, 2008, by and among Telanetix, Inc., a Delaware corporation, and the purchasers identified therein (11)
10.14	Amended and Restated Security Agreement dated June 30, 2008, by and among Telanetix, Inc., a Delaware corporation, all of its subsidiaries and the holders of the senior secured convertible debentures issued in connection with the June 2008 recapitalization (11)
10.15#	Thomas A. Szabo Separation Agreement dated June 30, 2008 (12)
10.16	Debenture and Warrant Purchase Agreement dated August 13, 2008 (13)
10.17	Debenture and Warrant Purchase Agreement dated December 11, 2008 (14)
10.18	Amendment Agreement dated December 11, 2008 (14)
10.19	Amendment Agreement dated May 8, 2009 (16)
10.20#	Amendment No. 1 to Employment Agreement with Douglas N. Johnson dated July 1, 2009 (17)
10.21#	Amendment No. 1 to Employment Agreement with J. Paul Quinn dated July 1, 2009 (17)
10.22	Securities Purchase Agreement between Telanetix, Inc. and Mike Venditte dated October 27, 2009 (18)
11.1	Statement re Computation of Per Share Earnings (19)
14.1	Code of Business Conduct and Ethics (7)
21.1*	Listing of Subsidiaries
23.1*	Consent of Mayer Hoffman McCann P.C.
23.2*	Consent of Grant Thornton LLP
24.1	Power of Attorney (contained in the signature page of this report)

31.1*	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act, as amended, by Chief Executive Officer
31.2*	Certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act, as amended, by Chief Financial Officer
32.1*	Certification pursuant to 18 U.S.C. §1350 by Chief Executive Officer
32.2*	Certification pursuant to 18 U.S.C. §1350 by Chief Financial Officer
#	Management contract or compensatory plan or arrangement
*	Filed as an exhibit to this report
(1)	Incorporated herein by reference to the registrant's Form 8-K filed on September 4, 2007
(2)	Incorporated herein by reference to the registrant's Form 10-KSB filed on March 31, 2006
(3)	Incorporated herein by reference to the registrant's Form 8-K filed on January 3, 2007
(4)	Incorporated herein by reference to the registrant's Form 8-K filed on February 14, 2007
(5)	Incorporated herein by reference to the registrant's Form 8-K filed on April 4, 2007
(6)	Incorporated herein by reference to the registrant's Form 10-QSB filed on August 14, 2007
(7)	Incorporated herein by reference to the registrant's Form 8-K filed on June 13, 2007
(8)	Incorporated herein by reference to the registrant's Form 8-K filed on April 1, 2008
(9)	Incorporated herein by reference to the registrant's Form 8-K filed on May 8, 2008
(10)	Incorporated herein by reference to the registrant's Form 8-K filed on June 26, 2008
(11)	Incorporated herein by reference to the registrant's Form 8-K filed on July 1, 2008
(12)	Incorporated herein by reference to the registrant's Form 8-K filed on July 3, 2008
(13)	Incorporated herein by reference to the registrant's Form 8-K filed on August 13, 2008
(14)	Incorporated herein by reference to the registrant's Form 8-K filed on December 15, 2008
(15)	Incorporated herein by reference to the registrant's Form 8-K filed on April 29, 2009
(16)	Incorporated herein by reference to the registrant's Form 8-K filed on May 11, 2009
(17)	Incorporated herein by reference to the registrant's Form 8-K filed on July 2, 2009
(18)	Incorporated herein by reference to the registrant's Form 8-K filed on November 2, 2009
(19)	Included with the financial statements filed in this report

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Telanetix, Inc.
(Registrant)

Date: March 17, 2010

/s/ Douglas N. Johnson
By: Douglas N. Johnson
Title: Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS , that each of the undersigned, being a director or officer of Telanetix, Inc., a Delaware corporation, hereby constitutes and appoints Douglas N. Johnson and J. Paul Quinn, acting individually, as his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead in any and all capacities, to sign any and all amendments to this annual report on Form 10-KSB and to file the same, with all exhibits thereto and all other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done that such annual report and its amendments shall comply with the Securities Act, and the applicable rules and regulations adopted or issued pursuant thereto, as fully and to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them or their substitute or resubstitute, may lawfully do or cause to be done by virtue hereof.

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

Signature	Title	Date
s/ DOUGLAS N. JOHNSON Douglas N. Johnson	Chief Executive Officer and Director (Principal Executive Officer)	March 17, 2010
/s/ J. PAUL QUINN J. Paul Quinn	Chief Operating Officer and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 17, 2010
/s/ STEVEN J. DAVIS Steven J. Davis	Director	March 17, 2010
/s/ JAMES R. EVERLINE James R. Everline	Director	March 17, 2010
/s/ DAVID A. RANE David A. Rane	Director	March 17, 2010

TELANETIX, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Telanetix, Inc.

We have audited the accompanying consolidated balance sheets of Telanetix, Inc. and subsidiaries (the "Company") as of December 31, 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of Telanetix, Inc. and subsidiaries as of December 31, 2009, and the consolidated results of their operations and their consolidated cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Grant Thornton LLP

Seattle, Washington
March 16, 2010

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Telanetix, Inc.

We have audited the accompanying consolidated balance sheet of **Telanetix, Inc. and Subsidiaries** (the "Company") as of December 31, 2008, and the related consolidated statement of operations, stockholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of **Telanetix, Inc. and Subsidiaries** as of December 31, 2008, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements included in the 2008 Annual Report, the Company has experienced recurring losses and had a working capital deficit of approximately $8,000,000 at December 31, 2008. Those conditions raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Mayer Hoffman McCann P.C.

San Diego, California

March 27, 2009

TELANETIX, INC.
Consolidated Balance Sheets

	December 31, 2009	December 31, 2008
ASSETS		
Current assets		
Cash	$ 493,413	$ 975,137
Accounts receivable, net of allowance of $220,499 and $489,809, respectively	1,888,393	1,547,911
Inventory	253,563	226,348
Prepaid expenses and other current assets	465,348	571,355
Assets of discontinued operations	—	4,205,728
Total current assets	3,100,717	7,526,479
Property and equipment, net	3,733,120	4,876,709
Goodwill	7,044,864	6,958,293
Purchased intangibles, net	13,378,337	15,578,337
Other assets	870,476	968,098
Total assets	$ 28,127,514	$ 35,907,916
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 1,614,382	$ 1,371,935
Accrued liabilities	3,141,315	2,610,343
Accrued interest	—	888,242
Deferred revenue	897,453	767,222
Capital lease obligations	683,249	939,603
Warrant and beneficial conversion liabilities	4,052,071	5,398,724
Liabilities of discontinued operations	—	1,682,907
Total current liabilities	10,388,470	13,658,976
Non-current liabilities		
Accrued interest	2,477,021	—
Deferred revenue, less current portion	264,271	188,134
Capital lease obligations, less current portion	421,782	814,052
Convertible debentures	18,518,487	20,302,430
Total non-current liabilities	21,681,561	21,304,616
Total liabilities	32,070,031	34,963,592
Commitments and Contingencies – See Note 13		
Stockholders' equity (deficit)		
Cumulative preferred stock, $.0001 par value; $1,000 stated value; Authorized:10,000,000; Issued and outstanding: none at December 31, 2009 and December 31, 2008	—	—
Common stock, $.0001 par value; Authorized: 300,000,000 shares; Issued and outstanding: 31,768,320 at December 31, 2009 and 31,384,374 at December 31, 2008	3,177	3,139
Additional paid in capital	34,848,164	33,211,274
Warrants	1,551,802	10,000
Accumulated deficit	(40,345,660)	(32,280,089)
Total stockholders' equity (deficit)	(3,942,517)	944,324
Total liabilities and stockholders' equity (deficit)	$ 28,127,514	$ 35,907,916

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

TELANETIX, INC.
Consolidated Statements of Operations

	Years ended December 31, 2009	2008
Revenues	$ 28,291,925	$ 26,093,551
Cost of revenues	11,815,701	11,360,629
Gross profit	16,476,224	14,732,922
Operating expenses		
Selling and marketing	6,283,628	6,150,235
General and administrative	8,142,528	11,322,942
Research, development and engineering	2,901,185	2,957,944
Depreciation	861,779	723,222
Amortization of purchased intangibles	2,200,000	2,199,999
Impairment of intangibles	—	2,380,000
Total operating expenses	20,389,120	25,734,342
Operating loss	(3,912,896)	(11,001,420)
Other income (expense)		
Interest income	1,391	17,819
Interest expense	(4,083,058)	(6,211,261)
Change in fair market value of warrant and beneficial conversion liabilities	3,782,799	11,143,975
Total other income (expense)	(298,868)	4,950,533
Loss from continuing operations before income taxes	(4,211,764)	(6,050,887)
Provision for income taxes	—	—
Loss from continuing operations	(4,211,764)	(6,050,887)
Loss from discontinued operations, net of taxes	(3,853,807)	(3,632,743)
Net loss	(8,065,571)	(9,683,630)
Series A preferred stock dividends and accretion	—	(3,178,003)
Net loss applicable to common stockholders	$ (8,065,571)	$ (12,861,633)
Loss per common share:		
Basic and diluted		
Continuing operations	$ (.14)	$ (.34)
Discontinued operations	(.12)	(.14)
Net loss	$ (.26)	$ (.48)
Weighted average shares outstanding:		
Basic and diluted	31,494,707	26,717,514

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

TELANETIX, INC.
Consolidated Statements of Stockholders' Equity (Deficit)

	Preferred Stock		Common Stock		Additional Paid-In		Accumulated	
	Shares	Amount	Shares	Amount	Capital	Warrants	Deficit	Total
Balance, December 31, 2007	13,000	$ 1	23,079,576	$ 2,308	$ 39,011,923	$ 10,000	$ (20,646,459)	$ 18,377,773
Common stock issued for conversion of debentures			1,109,945	112	1,490,028			1,490,140
Common stock issued for interest			3,278,208	328	838,210			838,538
Common stock issued as part of Elliston settlement			132,000	13	189,227			189,240
Common stock issued for services			1,200,000	120	479,880			480,000
Warrants issued for services					294,847			294,847
Exercise of warrants			100,000	10	124,990			125,000
Exercise of stock options – non cash			1,712,095	171	511,661			511,832
Repurchase of common stock			(355,832)	(36)	36			—
Dividend on Series A preferred stock					(394,675)			(394,675)
Stock based compensation					2,777,835			2,777,835
Common stock issued for earn out			1,128,382	113	887,311			887,424
Conversion of Series A preferred stock to debentures	(13,000)	(1)			(12,999,999)		(1,950,000)	(14,950,000)
Net loss							(9,683,630)	(9,683,630)
Balance, December 31, 2008	—	—	31,384,374	3,139	33,211,274	10,000	(32,280,089)	944,324
Repurchase of common stock			(533,334)	(53)	53			—
Stock based compensation					1,550,357			1,550,357
Common stock issued for earn out			917,280	91	86,480			86,571
Warrants reclassed from debt to equity						1,541,802		1,541,802
Net loss							(8,065,571)	(8,065,571)
Balance, December 31, 2009	—	$ —	31,768,320	$ 3,177	$ 34,848,164	$ 1,551,802	$ (40,345,660)	$ (3,942,517))

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

TELANETIX, INC.
Consolidated Statements of Cash Flows

	Years ended December 31, 2009	Years ended December 31, 2008
Cash flows from operating activities:		
Net loss	$ (8,065,571)	$ (9,683,630)
Adjustments to reconcile net loss to cash provided (used) by operating activities:		
Provision for doubtful accounts	(269,310)	297,103
Depreciation	1,968,340	1,697,770
Loss on discontinued operations	3,853,807	3,632,743
(Gain) / loss on disposal of fixed assets	5,652	(22,825)
Amortization of deferred financing costs	114,967	272,202
Impairment of intangible assets	—	2,380,000
Amortization of intangible assets	2,200,000	2,199,999
Stock based compensation	584,032	1,899,197
Amortization of note discounts	2,194,005	3,128,543
Exercise of stock options in lieu of cash severance payments	—	404,582
Interest paid with additional debentures	—	585,181
Interest paid in common stock	—	838,538
Common stock issued for services	—	509,400
Value of warrants issued as compensation	—	227,113
Change in fair value of warrant liabilities	(3,782,799)	(11,143,975)
Changes in assets and liabilities:		
Accounts receivable	(71,172)	(250,060)
Inventory	(27,215)	(226,348)
Prepaid expenses and other assets	88,662	(154,701)
Accounts payable and accrued liabilities	794,697	(146,029)
Accrued Interest	1,588,779	821,212
Deferred revenue	206,368	358,356
Net cash provided (used) by operating activities	1,383,242	(2,375,629)
Cash flows from investing activities:		
Purchase of property and equipment	(496,746)	(863,805)
Proceeds from disposal of fixed assets	49,462	87,632
Net cash used by investing activities	(447,284)	(776,173)
Cash flows from financing activities:		
Proceeds from sale of convertible debentures	—	6,500,000
Deferred financing costs	—	(175,025)
Proceeds from exercise of warrants	—	125,000
Payments on capital leases	(1,053,021)	(1,248,534)
Payment of convertible debentures	—	(1,225,295)
Payments on lines of credit	—	(500,000)
Net cash (used) provided by financing activities	(1,053,021)	3,476,146
Cash flows from discontinued operations:		
Net cash used by operating activities of discontinued operations	(364,661)	(3,071,519)
Net cash used by investing activities of discontinued operations	—	(57,509)
Net cash used by discontinued operations	(364,661)	(3,129,028)
Net decrease in cash	(481,724)	(2,804,684)
Cash at beginning of the period	975,137	3,779,821
Cash at end of the period	$ 493,413	$ 975,137
Supplemental disclosures of cash flow information:		
Interest paid	$ 185,304	$ 467,882
Non cash investing and financing activities		
Common stock issued in connection with the acquisition of subsidiaries	$ 86,571	$ 887,424
Accrued dividend on Series A Preferred Stock	$ —	$ 394,675
Convertible debentures converted into common stock	$ —	$ 1,490,140
Preferred stock and accrued dividends converted into debentures	$ —	15,344,675
Convertible debentures converted into debentures	$ —	10,654,659
Warrant liabilities and beneficial conversion features	$ —	$ 7,438,775
Property and equipment acquired through capital leases	$ 422,730	$ 367,506
Warrants reclassed from debt to equity	$ 1,541,802	$ —

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

TELANETIX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Summary of Significant Accounting Policies

Description of Business:

Telanetix, Inc. (the "Company") is an IP communications company, offering a range of communications solutions from hosted IP voice and conferencing products, to text and data collaboration, to telepresence videoconferencing products. The Company's subsidiary, AccessLine Holdings Inc. ("AccessLine"), is a Bellevue, Washington-based provider of hosted VoIP solutions to the small-and-medium business marketplace. The Company's Digital Presence™ product line provides its customers with a complete system for telepresence video conferencing.

Prior to October 27, 2009, the Company also had two additional subsidiaries: AVS Installation Limited Liability Company and Union Labor Force One Limited Liability Company (together, "AVS"). AVS provided a full range of audio visual solutions to clients and end-users as the single point of contact during design and project implementation. On October 27, 2009, the Company entered into a securities purchase agreement pursuant to which it transferred all of the issued and outstanding membership interests of AVS to an individual purchaser. The purchaser was an employee of AVS. The transfer related solely to the Company's video integration business, and not the Company's video product business. The Company did not transfer any assets or intellectual property relating to its Digital Presence product line.

In December 2009, the Company's board of directors made a decision to conclude efforts to seek strategic alternatives regarding the operations, assets and intellectual property relating to the Company's Digital Presence product line so that the Company could focus on growing the business of its AccessLine subsidiary which has been experiencing year over year revenue growth. The Digital Presence product line experienced a dramatic sales decline in both 2009 and 2008 as compared to prior years. The board of directors directed management to finalize negotiations with interested parties, if any, to sell the assets related to the Digital Presence product line or cease incurring costs related to its development.

As a result of the sale of AVS, and the potential sale of the Digital Presence product line, the Company has reflected its video segment as discontinued operations in its 2009 and 2008 consolidated financial statements. See Note 2 – Discontinued Operations.

Liquidity:

Our cash balance as of December 31, 2009 was $0.5 million. At that time, we had accounts receivable of $1.9 million and a working capital deficit of $7.3 million. However, current liabilities include certain items that will likely settle without future cash payments or otherwise not require significant expenditures by the Company including: beneficial conversion liabilities of $4.1 million, deferred revenue of $0.9 million (primarily deferred up front customer activation fees), deferred rent of $0.2 million and accrued vacation of $0.5 million. In addition, current liabilities include accrued bonuses of $0.6 million, paid out only if certain minimum cash targets are met. The aforementioned items represent $6.3 million of total current liabilities as of December 31, 2009. We do not anticipate being in a positive working capital position in the near future. However, if we continue to generate revenue and gross profit consistent with our growth in 2009 and maintain control of our variable operating expenses, we believe that our existing capital, together with anticipated cash flows from operations, will be sufficient to finance our operations through at least January 1, 2011.

Principles of Accounting and Consolidation:

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Use of Estimates:

The preparation of the 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, liabilities and equity and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include those related to the allowance for doubtful accounts; valuation of inventories; valuation of goodwill, intangible assets and property and equipment; valuation of stock based compensation expense, the valuation of warrants and conversion features; and other contingencies. On an on-going basis, the Company evaluates its estimates. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions.

Reclassifications:

As described above, previously reported amounts related to the Company's video segment have been reclassified to reflect the discontinuance of the video segment. See Note 2 – Discontinued Operations. Certain other previously reported amounts have been reclassified to conform to the current year's presentation. The reclassifications had no effect on previously reported net loss.

Cash and Cash Equivalents:

The Company considers all highly liquid investments with original or remaining maturities of 90 days or less at the time of purchase to be cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts:

Sales are made to approved customers on an open account basis, subject to established credit limits, and generally, no collateral is required. Accounts receivable are stated at the amount management expects to collect.

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of the Company's customers to make required payments. The Company reviews its allowance for doubtful accounts at least quarterly by assessing individual accounts receivable over a specific aging and amount, and all other balances on a pooled basis based on historical collection experience. Delinquent account balances are written-off after management has determined that the likelihood of collection is remote.

The Company has recorded an allowance for doubtful accounts of $0.2 million and $0.5 million at December 31, 2009 and 2008, respectively.

Inventories:

Inventories, which consist primarily of finished goods, are valued at the lower of cost or market with cost computed on a first-in, first-out (FIFO) basis. Consideration is given to obsolescence, excessive levels, deterioration and other factors in evaluating net realizable value. The Company records write downs for excess and obsolete inventory equal to the difference between the cost of inventory and the estimated net realizable value based upon assumptions about future product life-cycles, product demand and market conditions, which totaled less than $0.1 million in both 2009 and 2008.

Property and Equipment:

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Estimated useful lives are two to seven years. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful lives of the assets. Disposals of capital equipment are recorded by removing the costs and accumulated depreciation from the accounts and gains or losses on disposals are included in operating expenses in the Consolidated Statement of Operations.

Internally Developed Software:

The Company capitalizes payroll and related costs that are directly attributable to the design, coding, and testing of the Company's software developed for internal use. The Company capitalized $0.3 million and $0.6 million related to the development of internal use software during the years ended December 31, 2009 and 2008, respectively. Internally developed software costs, which are included in property and equipment, are amortized on a straight-line basis over an estimated useful life of two years. Amortization of these costs was $0.7 million for both years ended December 31, 2009 and 2008.

Goodwill:

Goodwill is not amortized but is reviewed for potential impairment at least annually. The identification and measurement of goodwill impairment involves the estimation of the fair value of the Company's reporting units. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment, which primarily incorporate management assumptions about expected future cash flows. Future cash flows can be affected by changes in industry or market conditions or the rate and extent to which anticipated synergies or cost savings are realized with newly acquired entities.

Impairment of Long-Lived Assets:

Purchased intangible assets with finite lives are amortized using the straight-line method over the estimated economic lives of the assets, which range from five to ten years. Purchased intangible assets determined to have indefinite useful lives are not amortized but are reviewed for potential impairment at least annually. Long-lived assets, including intangible assets with finite lives, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets that management expects to hold and use is based on the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

Revenue Recognition:

Revenue from the Company's continuing operations is derived primarily from monthly recurring fees, which are recognized over the month the service is provided, activation fees, which are deferred and recognized over the estimated life of the customer relationship, and fees from usage which are recognized as the service is provided.

Revenues from its discontinued video segment were recognized when persuasive evidence of an arrangement existed, title was transferred, product payment was not contingent upon performance of installation or service obligation, the price was fixed or determinable, and collectability was reasonably assured. In instances where final acceptance of the product or service was specified by the customer, revenue was deferred until all acceptance criteria was met. Additionally, extended service revenue on hardware and software products was recognized ratably over the service period, generally one year.

Shipping and Handling Costs:

The Company includes amounts charged to customers for shipping and handling in product revenues, and includes amounts paid to vendors for shipping and handling in product cost of sales.

Sales Tax:

Sales tax is collected when appropriate and is not included in revenues in the Consolidated Statements of Operations.

Research and Development Expenditures:

Research and development expenditures are charged to operations as incurred and consist primarily of compensation costs, including stock compensation, outside services, and expensed materials.

Advertising:

The Company expenses direct advertising as the costs are incurred. The costs of advertising consist primarily of E-commerce advertisements and other direct costs. Advertising expense was $2.0 million for both years ended December 31, 2009 and 2008.

Income Taxes:

The Company accounts for income taxes using the assets and liability method, which recognizes deferred tax assets and liabilities determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established to reduce deferred tax assets when, based on available objective evidence, it is more likely than not that the benefit of such assets will not be realized. The Company recognizes in the consolidated financial statements only those tax positions determined to be more likely than not of being sustained.

Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks.

The Company reviews the terms of convertible debt and equity instruments it issues to determine whether there are embedded derivative instruments, including the embedded conversion option, that are required to be bifurcated and accounted for separately as a derivative financial instrument. In circumstances where the convertible instrument contains more than one embedded derivative instrument, including the conversion option, that is required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument. Also, in connection with the sale of convertible debt and equity instruments, the Company may issue freestanding warrants that may, depending on their terms, be accounted for as derivative instrument liabilities, rather than as equity.

Bifurcated embedded derivatives are initially recorded at fair value and are then revalued at each reporting date with changes in the fair value reported as non-operating income or expense. When the convertible debt or equity instruments contain embedded derivative instruments that are to be bifurcated and accounted for as liabilities, the total proceeds allocated to the convertible host instruments are first allocated to the fair value of all the bifurcated derivative instruments. The remaining proceeds, if any, are then allocated to the convertible instruments themselves, usually resulting in those instruments being recorded at a discount from their face amount.

The discount from the face value of the convertible debt, together with the stated interest on the instrument, is amortized over the life of the instrument through periodic charges to income, using the effective interest method.

Computation of Net Loss Per Share:

Basic net loss per share is based upon the weighted average number of common shares outstanding. Diluted net loss per share is based on the assumption that all potential common stock equivalents (convertible preferred stock, convertible debentures, stock options, and warrants) are converted or exercised. The calculation of diluted net loss per share excludes potential common stock equivalents if the effect is anti-dilutive. The Company's weighted average common shares outstanding for basic and dilutive are the same because the effect of the potential common stock equivalents is anti-dilutive.

The Company has the following dilutive common stock equivalents as of December 31, 2009 and 2008 which were excluded from the calculation because their effect is anti-dilutive.

	December 31,	
	2009	**2008**
Convertible Debentures	98,831,000	74,123,251
Preferred Stock	—	—
Stock Options	10,873,043	11,486,293
Warrants	12,695,718	12,695,718
Total	122,399,761	98,305,262

Fair Value of Financial Instruments:

Certain financial instruments are carried at cost on the consolidated balance sheets, which approximates fair value due to their short-term, highly liquid nature. These instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, other short-term liabilities, and capital lease obligations. In addition, as the Company recently amended its debentures in May 2009, it believes that the carrying amount of its debentures approximates their fair value as of December 31, 2009.

Stock Based Compensation:

The Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized in the Consolidated Statement of Operations over the period during which the employee is required to provide service in exchange for the award – the requisite service period. No compensation cost is recognized for equity instruments for which employees do not render the requisite service. The grant-date fair value of employee share options and similar instruments is estimated using option-pricing models adjusted for the unique characteristics of those instruments.

Recent Pronouncements:

In May 2008, the Financial Accounting Standards Board ("FASB") issued guidance on accounting for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement. The guidance requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. The guidance is effective for fiscal years beginning after December 15, 2008 on a retroactive basis and was adopted by the Company in the first quarter of fiscal 2009. The adoption of this guidance did not materially impact the Company's consolidated financial position and results of operations.

In June 2008, the FASB approved guidance on determining whether an instrument (or embedded feature) is indexed to an entity's own stock. The guidance instructs an entity to use a two-step approach to evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock, including evaluating the instrument's contingent exercise and settlement provisions. The adoption of this guidance on January 1, 2009, required the Company to perform additional analyses on both its freestanding equity derivatives and embedded equity derivative features. The adoption of this guidance did not have a material effect on the Company's consolidated financial statements in 2009.

In September 2006, the FASB provided enhanced guidance for using fair value to measure assets and liabilities, with further clarification of how to measure certain nonfinancial assets and liabilities in February 2008. This guidance became effective at the beginning of the Company's fiscal 2009. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements in 2009.

In October 2008, the FASB issued guidance which clarifies how to determine the fair value of a financial asset when the market that is not active. Additional guidance is provided regarding how the reporting entity's own assumptions should be considered when relevant observable inputs do not exist, how available observable inputs in a market that is not active should be considered when measuring fair value, and how the use of market quotes should be considered when assessing the relevance of inputs available to measure fair value. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements in 2009.

In April 2009, the FASB issued guidance on how to determine the fair value of assets and liabilities when the volume and level of activity for the asset/liability has significantly decreased and on identifying circumstances that indicate a transaction is not orderly. In addition, the guidance requires disclosure in interim and annual periods of the inputs and valuation techniques used to measure fair value and a discussion of changes in valuation techniques. The adoption of the guidance did not have a material impact on our consolidated financial statements.

In May 2009, the FASB issued guidance establishing general standards for accounting and disclosure of events that occur after the balance sheet date but before financial statements are available to be issued. More specifically, the guidance sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition in the financial statements, identifies the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures that should be made about events or transactions that occur after the balance sheet date. The adoption of the guidance did not have a material impact on our consolidated financial statements.

In June 2009, the FASB issued guidance to establish a single source of authoritative nongovernmental Generally Accepted Accounting Principles ("GAAP") in the United States. The guidance is effective for interim and annual periods ending after September 15, 2009, or as of July 1, 2009 for the Company. Adoption of the guidance did not have an impact on the Company's consolidated financial statements.

In September 2009, FASB's Emerging Issues Task Force ("EITF") issued authoritative guidance addressing certain revenue arrangements with multiple deliverables. This guidance states that tangible products with hardware and software components that work together to deliver the product functionality are considered non-software products, and the accounting guidance under the revenue arrangements with multiple deliverables is to be followed. This guidance is effective for the Company's future interim reporting period ending on September 30, 2010. The Company is currently evaluating the impact of the implementation of this guidance on its financial position, results of operations and cash flows.

In January 2010, the FASB issued guidance which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair- value measurements. The guidance is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. The Company does not expect the adoption this guidance to have a material impact on its consolidated financial statements.

2. Discontinued Operation

On October 27, 2009, the Company entered into a securities purchase agreement pursuant to which it transferred all of the issued and outstanding membership interests of two of its subsidiaries: AVS Installation Limited Liability Company, or AVS, and Union Labor Force One Limited Liability Company, or ULF, to an individual purchaser. AVS and ULF operated the system integration, design, build-out and installation aspects of the Company's video solutions business. The purchaser was an employee of AVS. The transfer related solely to the Company's video integration business, and not the Company's video product business. The Company did not transfer any assets or intellectual property relating to its Digital Presence product line.

The membership interests were transferred for nominal consideration. In connection with the transfer, all underlying assets and liabilities were retained by AVS and ULF. The Company determined that the total amount of consideration it received represented fair value for the membership interests. The Company completed the disposition of the membership interests, and consequently the assets used in and liabilities arising from the business operations of AVS and ULF, on October 27, 2009. The Company no longer holds any ownership interest in either of AVS or ULF.

In December 2009, the Company's board of directors made a decision to conclude efforts to seek strategic alternatives regarding the operations, assets and intellectual property relating to the Company's Digital Presence product line so that the Company could focus on growing the business of its AccessLine subsidiary which has been experiencing year over year revenue growth. The Digital Presence product line experienced a dramatic sales decline in both 2009 and 2008 as compared to prior years. The Company's board of directors directed management to finalize negotiations with interested parties, if any, to sell the assets related to the Digital Presence product line or cease incurring costs related to its development.

The Company's offerings were organized along two product categories: Video Solutions and Voice and Network Solutions, which were considered segments for reporting purposes. The segments were determined in accordance with how management views and evaluates the Company's business. The Company's Video Solutions segment included both telepresence solutions and other supporting audio-visual applications. As a result of the sale of AVS on October 27, 2009 and the potential sale or ceasing of expending resources for the development of the Digital Presence product line, the Company has reflected its video segment as discontinued operations in its 2009 and 2008 consolidated financial statements.

As of December 31, 2009, all of the assets and liabilities related to the Video Solutions segment had been disposed of, written off or collected.

The following table summarizes certain operating data for discontinued operations for the years ended December 31:

	2009	2008
Revenues	$ 3,465,150	$ 6,532,431
Cost of revenues	(2,903,481)	(5,328,285)
Other expenses	(4,415,476)	(4,836,889)
Loss from discontinued operations	$ (3,853,807)	$ (3,632,743)

The following table summarizes the components of the assets and liabilities from discontinued operations for the years ended December 31:

	2009	2008
Accounts receivable	$ —	$ 2,043,948
Inventory	—	329,973
Property and equipment, net	—	301,485
Goodwill	—	863,435
Purchased intangibles, net	—	655,000
Other assets	—	11,887
Total assets	$ —	$ 4,205,728

	2009	2008
Accounts payable	$ —	$ 1,084,771
Accrued expenses	—	343,969
Deferred revenue	—	254,167
Total liabilities	$ —	$ 1,682,907

3. Property and Equipment

Property and equipment consists of the following at December 31, 2009 and 2008:

	Estimated Useful Life	December 31, 2009	December 31, 2008
Communications equipment	2-5 years	$ 5,617,256	$ 5,196,585
Capitalized software development costs	2 years	1,888,286	1,550,687
Software and computer equipment	3-5 years	243,469	186,615
Furniture and fixtures	5-7 years	12,704	12,704
Leasehold improvements	Life of lease	17,044	19,092
		7,778,759	6,965,683
Accumulated depreciation and amortization		(4,045,639)	(2,088,974)
		$ 3,733,120	$ 4,876,709

As of December 31, 2009, property and equipment with a cost of $4.5 million was financed through capital lease obligations with $1.9 million of accumulated amortization associated with these assets. As of December 31, 2008, property and equipment with a cost of $4.2 million was financed through capital lease obligations with $1.0 million of accumulated amortization associated with these assets

As of December 31, 2009, capitalized software development costs had a net book value of $0.4 million which will be amortized to depreciation expense in future periods as follows: $0.3 million in 2010 and $0.1 million in 2011.

4. Goodwill and Purchased Intangibles

Goodwill is separately disclosed from other intangible assets on the consolidated balance sheet and results from the Company's acquisition of Accessline in 2007. In addition to the goodwill recorded at the time of purchase, the acquisition agreement required the Company to pay up to an additional $9.0 million in the form of 2,500,000 shares of its restricted common stock upon the achievement of certain future financial objectives, the value of which would increase the amount of goodwill recorded in the transaction. The first earn out period ended December 31, 2007. In April 2008, when the contingency related to the first earn out period was resolved, the Company issued 599,130 shares valued at $0.6 million, resulting in increases to goodwill and equity. The second earn out period ended June 30, 2008, and the Company issued 529,252 shares valued at $0.3 million in July 2008 when the contingency was resolved. The increase in goodwill and equity were recorded in the third fiscal quarter of 2008. The third earn out period ended December 31, 2008, and the Company issued 515,622 shares valued at $0.04 million in February 2009. The increase in goodwill and equity was recorded in the first quarter of fiscal 2009. The final earn out period ended on June 30, 2009 and the Company issued 401,658 shares valued at $0.04 million in July 2009. The increase in goodwill and equity was recorded in the third quarter of 2009.The Company has recorded goodwill of $7.0 million at both December 31, 2009 and 2008. Goodwill is not amortized.

The Company tests goodwill for impairment using a two-step process on at least an annual basis. The first step is a screen for potential impairment, while the second step measures the amount of the impairment, if any. The Company has determined that no impairments related to goodwill existed as of December 31, 2009 and 2008.

Other intangible assets with finite useful lives consist primarily of developed technology and customer relationships. Developed technology and customer relationships are amortized on the straight-line basis over the expected period of benefit which range from five to ten years.

Long-lived assets, including developed technology and customer relationships are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. There was no impairment losses related to long-lived intangible assets recorded for the year ended December 31, 2009. However, during the year ended December 31, 2008, the Company determined that its trademarks and trade names associated with its Voice and Network Solutions segment were impaired and reflected $2.4 million of expense related to the impairment in its Consolidated Statement of Operations for the year ended December 31, 2008.

The following table presents details of the Company's total purchased intangible assets as of December 31, 2009:

Purchased Intangible Assets	Gross Value	Accumulated Amortization	Impairment	Net Value
Developed technology	$ 7,600,000	$ (1,741,663)	$ —	$ 5,858,337
Trademarks and trade names	6,000,000	—	(2,380,000)	3,620,000
Customer-related intangibles	7,200,000	(3,300,000)	—	3,900,000
Total	$ 20,800,000	$ (5,041,663)	$ (2,380,000)	$ 13,378,337

The Company recorded amortization expense related to purchased intangibles of $2.2 million for both the year ended December 31, 2009 and 2008, which is included in amortization of purchased intangible assets in the Consolidated Statement of Operations.

The Company determined that purchased trademarks and trade names have an indefinite life as the Company expects to generate cash flows related to this asset indefinitely. Consequently, the trademarks and trade names are not amortized, but are reviewed for impairment annually or sooner.

The estimated future amortization expense of purchased intangible assets as of December 31, 2009 is as follows:

Year ending December 31,	Amount
2010	$ 2,200,000
2011	2,200,000
2012	1,780,000
2013	760,000
2014	760,000
Thereafter	2,058,337
Total	$ 9,758,337

5. Other Assets

Other assets consist of the following at December 31, 2009 and 2008:

	December 31, 2009	December 31, 2008
Restricted cash	$ 100,000	$ 120,000
Deposits	253,127	215,782
Deferred financing costs, net	517,349	632,316
	$ 870,476	$ 968,098

Restricted cash consists of certificates of deposit held as collateral in favor of certain creditors. Deposits represent cash paid as collateral in favor of certain creditors and lessors. Deferred financing costs consist of capitalized fees and expenses associated with the Company's debt financings, and are amortized over the terms of the debentures using the straight-line method. The Company recorded amortization expense related to deferred financing costs of $0.1 million and $0.3 million in the fiscal years ended December 31, 2009 and 2008, respectively.

6. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31, 2009	December 31, 2008
Accrued payroll, benefits and taxes	$ 1,437,779	$ 1,418,774
Telecom taxes payable	1,137,197	704,495
Deferred Rent	194,948	189,660
Other	371,391	297,414
	$ 3,141,315	$ 2,610,343

7. Deferred Revenue

Deferred Revenue consist of the following:

	December 31,	
	2009	2008
Monthly recurring fees	$ 652,821	$ 599,733
Unearned activation fees	506,403	330,956
Other	2,500	24,667
Total deferred revenue	1,161,724	955,356
Less non-current portion	(264,271)	(188,134)
Deferred revenue, current portion	$ 897,453	$ 767,222

The unearned activation fees will be recognized over the next three years, and all other deferred revenue is expected to be recognized over the next year.

8. Securities Exchange and Amendment Agreements

On June 30, 2008, the Company entered into a Securities Exchange Agreement with the investors in its previous debenture and preferred stock financings. Under this Securities Exchange Agreement the Company issued six-year, interest only debentures due June 30, 2014 in exchange for all of the outstanding debentures the Company issued in December 2006, August 2007 and March 2008 and shares of preferred stock the Company issued in August 2007. The debentures issued in this transaction amend and restate the terms of the debentures issued in December 2006, August 2007 and March 2008. The debentures issued in this transaction (an aggregate principal amount of $26.1 million) were exchanged for all of the then outstanding debentures held by the investors (an aggregate principal amount of $10.7 million), accrued interest on the outstanding debentures of $0.1 million, all of the then outstanding shares of preferred stock held by the investors (stated value of $14.9 million), and accrued dividends on such preferred stock of $0.4 million. In connection with this transaction, the exercise prices of the outstanding warrants issued in the previous debenture and preferred stock financings were reduced from $1.25 per share to $1.00 per share. The number of common shares underlying these warrants was not adjusted in connection with this change in exercise price.

In May 2009, the Company restructured the terms of its outstanding debentures issued in June 2008, August 2008 and December 2008 (collectively, the "PIPE Debentures") and all of the Company's outstanding warrants issued in December 2006, February 2007, August 2007, March 2008, August 2008 and December 2008 (the "PIPE Warrants") pursuant to the terms of an Amendment Agreement dated May 8, 2009 entered into between the Company and the holders of the outstanding PIPE Debentures and PIPE Warrants (the "Amendment Agreement").

See Note 9 – Convertible Debentures, Note 11 – Warrants and Warrant Liabilities, and Note 14 – Preferred Stock, Common Stock and Dividends.

9. Convertible Debentures

As discussed in Note 8 – Securities Exchange and Amendment Agreements pursuant to the terms of the Securities Exchange Agreement the Company entered into with certain investors on June 30, 2008, the Company exchanged the outstanding debentures it issued in December 2006, August 2007 and March 2008 for newly issued debentures, the terms of which are discussed below under the heading "June 2008." Prior to entering into the Securities Exchange Agreement, the conversion prices on the December 2006, August 2007 and March 2008 debentures were reduced to $1.25 per share pursuant to the anti-dilution provisions of such debentures.

In August 2008, the Company issued $2.0 million principal amount of debentures, the terms of which are discussed below under the heading "August 2008."

In December 2008, the Company issued $1.5 million principal amount of debentures and amended certain terms of the debentures issued in June 2008 and August 2008. See the discussion below under the heading "December 2008."

In May 2009, the Company restructured the terms of its outstanding PIPE Debentures and all of the Company's outstanding PIPE Warrants pursuant to the terms of the Amendment Agreement. See the discussion below under the heading "May 2009."

As of December 31, 2009, the Company had reserved 98,831,000 shares of common stock for the conversion of the outstanding PIPE Debentures.

<u>June 2008</u>

On June 30, 2008, the Company entered into a Securities Exchange Agreement with the holders of all of the then outstanding debentures and shares of preferred stock of the Company, pursuant to which the Company issued six-year, interest only debentures due June 30, 2014 in exchange for all of the outstanding debentures the Company issued in December 2006, August 2007 and March 2008 and shares of preferred stock the Company issued in August 2007. See Note 8 – Securities Exchange and Amendment Agreements. The debentures issued in this transaction amended and restated the terms of the previously outstanding debentures held by the investors.

In December 2008, the Company amended certain terms of the debentures issued in June 2008, the terms of which are discussed below under the heading "December 2008." And, in May 2009, the Company restructured the terms of all of its outstanding debentures, the terms of which are discussed below under the heading "May 2009."

The following summarizes the terms of the debentures issued in June 2008, as amended in December 2008 and May 2009:

Term. The debentures are due and payable on June 30, 2014.

Interest. When originally issued, interest accrued at the rate of 12.0% per annum and was payable monthly, commencing on August 1, 2008. In December 2008, the parties agreed to amend the interest payment provisions to eliminate monthly interest payments at the rate of 12% per annum. Following this amendment, interest was payable quarterly at the rate of (i) 0% per annum from October 1, 2008 until September 30, 2009, (ii) 13.5% per annum from October 1, 2009 until September 30, 2012 and (iii) 18% per annum from October 1, 2012 until maturity. In May 2009, the parties again agreed to amend the interest payment provisions to reduce the interest rate to 0% through June 30, 2011 and then to 5% per annum thereafter.

Principal Payment. The principal amount of the debenture, if not paid earlier, is due and payable on June 30, 2014.

Payments of Interest. Interest payments, as amended in May 2009, are due quarterly on January 1, April 1, July 1 and October 1, commencing on October 1, 2011. Interest payments are required to be paid in cash.

Early Redemption. The Company has the right to redeem the debentures before their maturity by payment in cash of the then outstanding principal amount plus (i) accrued but unpaid interest, (ii) an amount equal to all interest that would have accrued if the principal amount subject to such redemption had remained outstanding through the maturity date and (iii) all liquidated damages and other amounts due in respect of the debenture. To redeem the debentures the Company must meet certain equity conditions. The payment of the debentures would occur on the 10th day following the date the Company gave the holders notice of the Company's intent to redeem the debentures. The Company agreed to honor any notices of conversion received from a holder before the pay off date of the debentures.

Voluntary Conversion by Holder. When originally issued, the debentures were convertible at anytime at the discretion of the holder at a conversion price per share of $1.25, subject to adjustment including full-ratchet, anti-dilution protection. The conversion price was reduced to $0.40 with the December 2008 amendment and further reduced to $0.30 with the May 2009 amendment.

Forced Conversion. Subject to compliance with certain equity conditions, the Company also has the right to force conversion if the VWAP for its common stock exceeds 200% of the then effective conversion price for 20 trading days out of a consecutive 30 trading day period. Any forced conversion is subject to the Company meeting certain equity conditions and is subject to a 4.99% cap on the beneficial ownership of the Company's shares of common stock by the holder and its affiliates following such conversion.

Covenants. The debentures impose certain covenants on the Company, including restrictions against incurring additional indebtedness, creating any liens on the Company's property, amending its certificate of incorporation or bylaws, redeeming or paying dividends on shares of its outstanding common stock, and entering into certain related party transactions. The debentures define certain events of default, including without limitation failure to make a payment obligation, failure to observe other covenants of the debenture or related agreements (subject to applicable cure periods), breach of representation or warranty, bankruptcy, default under another significant contract or credit obligation, delisting of the Company's common stock, a change in control, failure to be in compliance with Rule 144(c)(1) for more than 20 consecutive days, or more than an aggregate of 45 days in any 12 month period, or if any other conditions exist for such a period of time that the holder is unable to sell the shares issuable upon conversion of the debenture pursuant to Rule 144 without volume or manner of sale restrictions, or failure to deliver share certificates in a timely manner. In the event of default, the holders of the debentures have the right to accelerate all amounts outstanding under the debenture and demand payment of a mandatory default amount equal to 130% of the amount outstanding plus accrued interest and expenses.

In addition, under the terms of the May 2009 amendment agreement we agreed to add certain covenants to the debentures, including a requirement to maintain at least $300,000 in cash at all times while the debentures are outstanding, to sustain a level of gross revenue each quarter equal to at least 80% of the average gross revenue for the trailing two quarters, and to maintain a positive adjusted EBITDA in each rolling two quarter period. See below under "May 2009."

Security. The debentures the Company issued are secured by all of the Company's assets under the terms of the amended and restated security agreement the Company and its subsidiaries entered into with the holders of the June 2008 debentures. Each of the Company's subsidiaries also entered into guarantees in favor of the investors, pursuant to which each subsidiary guaranteed the complete payment and performance by the Company of its obligations under the debentures and related agreements.

August 2008

On August 13, 2008, the Company entered into a debenture and warrant purchase agreement with one of the institutional investors that invested in the previous private placements. Under the terms of this purchase agreement, the Company issued a senior secured convertible debenture with a principal amount of $2.0 million, along with five year warrants to purchase 608,000 shares of common stock at a price of $1.00 per share, subject to adjustment, including full-ratchet anti-dilution protection. The rights and obligations of the investor and of the Company with respect to the debenture and the underlying common shares are identical to the debentures and underlying common shares issued pursuant to the Securities Exchange Agreement dated June 30, 2008, as amended.

December 2008

On December 11, 2008, the Company entered into an amendment agreement with the holders of the debentures issued in June 2008 and August 2008, and the warrants the Company issued in December 2006, February 2007, March 2008 and August 2008. With respect to the debentures, the parties agreed to amend the interest rate and interest payment provisions, which had called for monthly interest payments at the rate of 12% per annum. As amended in December 2008, interest is payable quarterly at the rate of (i) 0% per annum from October 1, 2008 until September 30, 2009, (ii) 13.5% per annum from October 1, 2009 until September 30, 2012 and (iii) 18% per annum from October 1, 2012 until maturity. In May 2009, the parties again agreed to amend the interest payment provisions to reduce the interest rate to 0% through June 30, 2011 and then to 5% per annum thereafter.

On the same date, the Company entered into a debenture and warrant purchase agreement with an institutional investor and a holder of the Company's other outstanding debentures and warrants pursuant to which the Company issued a senior secured convertible debenture in the principal amount of $1.5 million, along with a warrant to purchase 456,000 shares of the Company's common stock with an exercise price of $0.40 per share. The terms of the debenture issued in December 2008 are substantially similar to the terms of the debentures issued in June 2008 and August 2008, as amended.

As a result of the issuance of the debenture and warrant in December 2008, the conversion price and exercise price, respectively, of the debentures issued in June 2008 and August 2008 and the warrants issued in December 2006, February 2007, March 2008 and August 2008 was reduced to $0.40. However, under the December 2008 amendment agreement, the parties agreed to waive the adjustment provision of such warrants that would have increased the number of shares subject to such warrants as a result of the issuance of the debentures and warrants in the December 2008 financing.

May 2009

In May 2009, the Company restructured the terms of its outstanding PIPE Debentures and all of the Company's outstanding PIPE Warrants pursuant to the terms of the Amendment Agreement. The Amendment Agreement revised the terms of the PIPE Debentures to:

- decrease the conversion price from $0.40 to $0.30;
- require that all future interest payments be made in cash;
- defer interest payments until October 1, 2011;
- reduce the interest rate to 0% through June 30, 2011 and then to 5% per annum thereafter;
- eliminate the requirement that, at the time of any conversion of principal, the Company pay the holders an amount in cash equal to the interest that would have accrued on such principal had such principal remained outstanding through the full term of the PIPE Debentures; and
- eliminate the 20% premium for voluntary prepayment.

In addition, under the terms of the Amendment Agreement, the holders of the PIPE Warrants were granted the right to exchange their outstanding PIPE Warrants for shares of the Company's common stock at the rate of 1.063 shares of common stock underlying the PIPE Warrants for one share of common stock, subject to adjustment for stock splits and dividends. In exchange, the anti-dilution protection under the PIPE Warrants was eliminated. Previously the exercise price of the PIPE Warrants would decrease, and the number of shares issuable upon exercise would increase, generally, each time the Company issued common stock or common stock equivalents at a price less than the exercise price of the PIPE Warrants. The Amendment Agreement eliminates the potential for future dilution from the PIPE Warrants.

Under the terms of the Amendment Agreement, the Company also agreed to add certain covenants to the PIPE Debentures, including a requirement to maintain at least $300,000 in cash at all times while the PIPE Debentures are outstanding, to sustain a level of gross revenue each quarter equal to at least 80% of the average gross revenue for the trailing two quarters, and commencing with the period ended June 30, 2009, to maintain a positive adjusted EBITDA in each rolling two quarter period. For example, ending December 31, 2009, the sum of the three-month adjusted EBITDA of the three months ended September 30 and December 31 must be at least $0.00 or greater. Adjusted EBITDA is calculated by taking the Company's net income for the applicable period, and adding to that amount the sum of the following: (i) any provision for (or less any benefit from) income taxes, plus (ii) any deduction for interest expense, net of interest income, plus (iii) depreciation and amortization expense, plus (iv) non-cash expenses (such as stock-based compensation and warrant compensation), plus (v) expenses related to changes in fair market value of warrant and beneficial conversion features, plus (vi) expenses related to impairment of tangible and intangible assets. The Company was in compliance with all covenants at December 31, 2009.

General

The unamortized discounts on the debentures issued in December 2006, August 2007 and March 2008 were carried forward as discounts on the debentures issued in June 2008, and will be amortized to interest expense through June 30, 2014. The discounts on the debentures issued in August 2008 and December 2008 will be amortized to interest expense through June 30, 2014. The change in the fair market value of the beneficial conversion feature liability as a result of the decrease of the conversion price of the debentures from $0.40 to $0.30 per the Amendment Agreement was recorded as additional debt discount of $4.0 million on May 8, 2009. See Note 8 – Securities Exchange and Amendment Agreements.

The amendment agreement entered into in December 2008, provided for 0% interest until September, 30, 2009. The amendment agreement entered into in May 2009, provided for a further deferral of interest payments until October 1, 2011 and a reduction in the interest rate to 0% through June 30, 2011 and then to 5% per annum thereafter. However, the Company has recorded interest expense for the year ended December 31, 2009, at the effective interest rate of the debentures during that period.

The following table summarizes information relative to the outstanding debentures at December 31, 2009 and December 31, 2008:

	December 31, 2009	December 31, 2008
Convertible debentures	$ 29,649,300	$ 29,649,300
Less unamortized discounts:		
Original issue discount	(4,190,903)	(864,758)
Detachable warrants discount	(2,100,996)	(2,567,884)
Beneficial conversion feature discount	(4,838,914)	(5,914,228)
Convertible debentures, net of discounts	18,518,487	20,302,430
Less current portion	—	—
Convertible debentures, long term portion	$ 18,518,487	$ 20,302,430

The convertible debentures outstanding at December 31, 2009 are due June 30, 2014.

At each reporting period the Company assesses the value of its convertible debentures that are accounted for as derivative financial instruments indexed to and potentially settled in its own stock. At December 31, 2009 and December 31, 2008, the Company determined that the beneficial conversion feature in the convertible debentures represented an embedded derivative liability. Accordingly, the Company bifurcated the embedded conversion feature and accounted for it as a derivative liability because the conversion price and ultimate number of shares can be adjusted if the Company subsequently issues common stock at a lower price and it was deemed possible the Company could have to net cash settle the contract if there were not enough authorized shares to issue upon conversion.

The convertible debentures contain embedded derivative features, which are accounted for at fair value as a compound embedded derivative at December 31, 2009 and December 31, 2008. This compound embedded derivative includes the following material features: (1) the standard conversion feature of the debentures; (2) a reset of the conversion price condition for subsequent equity sales; (3) the Company's ability to pay interest in cash or shares of its common stock; (4) optional redemption at the Company's election; (5) forced conversion; (6) holder's restriction on conversion; and (7) a default put.

The Company, with the assistance of an independent valuation firm, calculated the fair value of the compound embedded derivative associated with the convertible debentures utilizing a complex, customized Monte Carlo simulation model suitable to value path dependant American options. The model uses the risk neutral methodology adapted to value corporate securities. This model utilized subjective and theoretical assumptions that can materially affect fair values from period to period.

At December 31, 2009 and December 31, 2008, the Company recorded beneficial conversion liabilities of $4.1 million and $4.8 million, respectively. The Company recognized other income of $4.7 million and $2.5 million for the year ended December 31, 2009 and 2008, respectively, related to the change in fair market value of the beneficial conversion liabilities.

10. Fair Value Measurements

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the authoritative guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require us to develop our own assumptions. This hierarchy requires companies to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value, including its convertible debentures.

At December 31 2009, the Company recorded a liability related to the beneficial conversion feature of its convertible debentures (See Note 9 – Convertible Debentures) at its fair market value of $4.1 million utilizing unobservable inputs (Level 3). The change in fair market value of the beneficial conversion feature liability is included in Other Income (Expense) in the Condensed Consolidated Statements of Operations.

The change in the fair market value of the beneficial conversion feature liability as a result of the decrease the conversion price of the PIPE Debentures from $0.40 to $0.30 per the Amendment Agreement (see Note 8 - Securities Exchange and Amendment Agreements) was recorded as additional debt discount of $4.0 million on May 8, 2009. In addition, as a result of the Amendment Agreement (see Note 8 - Securities Exchange and Amendment Agreements), the anti-dilution protection feature of the PIPE Warrants was removed, which eliminates the potential for future price-based dilution from the PIPE Warrants. Accordingly, the PIPE Warrants, previously reported as a derivative liability, are no longer a derivative liability and their value as of May 8, 2009, was reclassed to equity

The following table provides a reconciliation of the beginning and ending balances of the derivative liabilities as of December 31, 2009:

	Warrant liability	Beneficial conversion feature liability	Total
Beginning balance January 1, 2009	$ 580,712	$ 4,818,012	$ 5,398,724
Change in fair market value of beneficial conversion liabilities due to change in conversion factor	—	3,977,948	3,977,948
Conversion of warrants to equity	(1,541,802)	—	(1,541,802)
Change in fair market value of warrant and beneficial conversion liabilities	961,090	(4,743,889)	(3,782,799)
Ending balance December 31, 2009	$ —	$ 4,052,071	$ 4,052,071

Certain financial instruments are carried at cost on the consolidated balance sheets, which approximates fair value due to their short-term, highly liquid nature. These instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, other short-term liabilities, and capital lease obligations. In addition, as the Company amended its debentures in May 2009, it believes that the carrying amount of its debentures approximates their fair value as of December 31, 2009.

11. Warrants and Warrant Liabilities

In connection with its various financings through June 30, 2008, the Company issued warrants to purchase shares of common stock in conjunction with the sale of its debentures. Prior to the Securities Exchange Agreement executed on June 30, 2008, the exercise prices of the warrants were reduced to $1.25 per share, resulting in an increase in the number of aggregate shares of common stock underlying the warrants to 11,205,809. On June 30, 2008 in connection with the Securities Exchange Agreement, the exercise prices of the warrants discussed above were further reduced to $1.00 per share. The number of shares of common stock underlying the warrants remained at 11,205,809. The Company recorded $0.2 million of deferred financing costs related to the change in exercise price discussed above. See Note 8 – Securities Exchange and Amendment Agreements.

On August 13, 2008, the Company issued warrants to purchase 608,000 shares of common stock at $1.00 per share in connection with the sale of its debentures. The warrant is immediately exercisable and expires five years from the date of issuance.

On December 11, 2008, the Company issued warrants to purchase 456,000 shares of common stock at $0.40 per share in connection with the sale of its debentures. In addition, the exercise price of all previously issued warrants was reduced to $0.40. However, under the terms of the December 11, 2008 amendment, the parties agreed to waive the adjustment provision of the PIPE Warrants that would have increased the number of shares subject to the PIPE Warrants as a result of the issuance of the debentures and warrants in December 2008. Pursuant to FASB guidance, the fair value of the warrants at the issuance was recorded as a warrant liability because the exercise price of the warrants can adjust if the Company subsequently issues common stock at a lower price and it is possible for the Company to not have enough authorized shares to settle the warrants and therefore would have to settle the warrants with cash.

In addition, the Company issued warrants to purchase 413,125 shares of common stock to various entities as compensation for services provided to the Company during 2008.

In May 2009, under the terms of the Amendment Agreement, the holders of the PIPE Warrants were granted the right to exchange their outstanding PIPE Warrants for shares of the Company's common stock at the rate of 1.063 shares of common stock underlying the PIPE Warrants for one share of common stock, subject to adjustment for stock splits and dividends. In exchange, the price-based anti-dilution protection under the PIPE Warrants was eliminated. Previously the exercise price of the PIPE Warrants would decrease, and the number of shares issuable upon exercise would increase, generally, each time the Company issued common stock or common stock equivalents at a price less than the exercise price of the PIPE Warrants. The Amendment Agreement eliminates the potential for future price-based dilution from the PIPE Warrants. Accordingly, the warrants are no longer a derivative liability and their value as of May 8, 2009, was reclassed to equity.

The fair value of the warrants was estimated at their various issuance dates and revalued at May 8, 2009, using the Monte Carlo model discussed in Note 9 – Convertible Debentures, above. As a result of the reclass of the warrants to equity on May 8, 2009, the Company recorded no warrant liabilities at December 31, 2009. At December 31, 2008, the Company recorded warrant liabilities of $0.6 million. Prior to the reclass of the warrants to equity in May 2009, the Company recognized other expense of $1.0 million related to the change in fair market value of the warrants. The Company recognized other income of $8.7 million related to the change in fair market value of the warrants for the year ended December 31, 2008.

There were 12,695,718 shares subject to warrants at a weighted average exercise price of $0.45 at December 31, 2009 and December 31, 2008.

The following table summarizes information about warrants outstanding at December 31, 2009:

Exercise Prices		Number of Shares Subject to Outstanding Warrants and Exercisable	Weighted Average Remaining Contractual Life (years)
$	0.40	12,269,809	2.75
$	1.25	105,000	3.42
$	1.73	200,000	3.24
$	1.92	78,125	3.24
$	3.52	12,784	0.60
$	4.00	30,000	3.13
		12,695,718	

As of December 31, 2009, the Company had reserved 12,695,718 shares of common stock for the exercise of outstanding warrants.

12. Business Risks and Credit Concentration

The Company's cash is maintained with a limited number of commercial banks, and are invested in the form of demand deposit accounts. Deposits in these institutions may exceed the amount of insurance provided on such deposits.

The Company markets its products to resellers and end-users primarily in the United States. Management performs ongoing credit evaluations of the Company's customers and maintains an allowance for potential credit losses. There can be no assurance that the Company's credit loss experience will remain at or near historic levels. At both December 31, 2009 and 2008, one customer accounted for 11% of gross accounts receivable.

One customer accounted for 11% of the Company's revenue in 2009 and 15% in 2008. Any factor adversely affecting demand or supply for these products or services could materially adversely affect the Company's business and financial performance.

Subsequent to the end of the year, the Company received notice from two of its customers that they would be terminating service during the course of 2010. This service is an older product offering, that had been in place with these customers for several years. The Company had known for some time that the customers would move away from the service eventually and the revenue generated by these customers had been declining over recent years. These services accounted for approximately 17% of the Company's revenues in 2009.

The Company relies on primarily one third party network service provider for network services. If this service provider failed to perform on its obligations to the Company, such failure could materially impact future operating results, financial position and cash flows.

13. Commitments and contingencies

Leases

The Company has non-cancelable operating and capital leases for corporate facilities and equipment. The leases expire through February 28, 2013 and include certain renewal options. Rent expense under the operating leases totaled $1.7 million and $1.8 million for the years ended December 31, 2009 and 2008.

Future minimum rental payments required under non-cancelable operating and capital leases are as follows for the years ending December 31:

		Operating Leases		Capital Leases
2010	$	1,375,995	$	776,669
2011		1,240,014		357,504
2012		1,278,394		85,443
2013		252,920		14,139
Total minimum lease payments	$	4,147,323		1,233,755
Less amount representing interest				(128,724)
Present value of minimum lease payments				1,105,031
Less current portion				(683,249)
			$	421,782

Minimum Third Party Network Service Provider Commitments

The Company has a contract with a third party network service provider that facilitates interconnects with a number of 3rd party network service providers. The contract contains a minimum usage guarantee of $0.2 million per monthly billing cycle. The contract commenced on October 16, 2003 with an initial 24 month term. The contract was extended in July 2005 for a 3 year term that expired in July 2008. On October 24, 2008, the contract was extended for another 3 year term. The cancellation terms are a ninety (90) day written notice prior to the extended term expiring.

Litigation Settlement

From time to time and in the course of business, we may become involved in various legal proceedings seeking monetary damages and other relief. The amount of the ultimate liability, if any, from such claims cannot be determined. However, in the opinion of our management, there are no legal claims currently pending or threatened against us that would be likely to have a material adverse effect on our financial position, results of operations or cash flows.

14. Preferred Stock, Common Stock and Dividends

Pursuant to terms of the Company's Series A preferred stock (the "Series A Stock"), effective April 1, 2008, the stated value of such stock increased by 15%, or $1.95 million, because the Company's common stock was not listed on an exchange other than the OTC Bulletin Board by March 31, 2008. The Company recorded a dividend of $1.95 million during the year ended December 31, 2008 related to the increase in stated value of the Series A Stock.

Pursuant to the Securities Exchange Agreement the Company entered into on June 30, 2008, all shares of the Series A Stock, which had a stated value of $14.95 million, and accrued dividends of $0.4 million were converted into the debentures issued on June 30, 2008. See Note 8 – Securities Exchange and Amendment Agreements. As of December 31, 2009, the Company has no shares of preferred stock issued or outstanding.

Pursuant to the terms of a consultant agreement dated July 23, 2008, the Company issued 1.2 million shares of its common stock, valued at $0.5 million, to a consultant in exchange for services during the year ended December 31, 2008.

15. Stock Based Compensation

<u>*Stock Option Plan*</u>

The 2005 Equity Incentive Plan (the "2005 Plan"), which was approved by the shareholders in August 2006, permits the Company to grant shares of common stock and options to purchase shares of common stock to the Company's employees for up to 5 million shares of common stock. The Company believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price that equals the market price of the Company's stock at the date of grant; these option awards generally vest based on 3 years of continuous service and have 10-year contractual terms. On November 8, 2007, the Board of Directors approved an amendment to the 2005 Plan to increase the number of shares of common stock available for grant to 8.5 million shares. On December 11, 2008, the Board of Directors approved an additional amendment to the 2005 Plan to increase the number of shares of common stock available for grant to 15.5 million shares.

A summary of option activity under the 2005 Plan as of December 31, 2009 and 2008, and changes during the years then ended is presented below:

	Shares	Weighted-Average Exercise Price
Outstanding at January 1, 2008	6,206,222	$ 1.83
Granted	7,940,834	0.08
Exercised	(1,712,095)	0.30
Forfeited or expired	(948,668)	2.53
Outstanding at December 31, 2008	11,486,293	$ 0.28
Granted	1,148,500	0.07
Exercised	—	—
Forfeited or expired	(1,761,750)	0.16
Outstanding at December 31, 2009	10,873,043	$ 0.27

The intrinsic value of options exercised was zero for both the years ended December 31, 2009 and 2008.

The options outstanding and currently exercisable by exercise price at December 31, 2009 are as follows:

	Stock Options Outstanding			Stock Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Term (Years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Remaining Contractual Term (Years)	Weighted-Average Exercise Price
$ 0.06 to 0.15	10,118,084	8.48	$ 0.07	4,738,136	7.91	$ 0.07
$ 2.55 to 3.50	754,959	5.91	$ 2.99	678,397	6.22	$ 2.93
	10,873,043	8.30	$ 0.27	5,416,533	7.70	$ 0.43

As of December 31, 2009 and 2008, 5,416,533 and 2,999,335 outstanding options, respectively, were exercisable at an aggregate average exercise price of $0.43 and $0.75, respectively. The aggregate intrinsic value of both stock options outstanding and stock options exercisable at December 31, 2009 was less than $0.1 million.

As of December 31, 2009, total compensation cost related to non-vested stock options not yet recognized was $1.2 million, which is expected to be recognized over the next two years on a weighted-average basis.

Valuation and Expense Information

The Company measures and recognizes compensation expense for all share-based payment awards made to employees and directors based upon estimated fair values. The following table summarizes stock-based compensation expense recorded for the years ended December 31, 2009 and 2008, and its allocation within the Consolidated Statements of Operations:

	December 31,	
	2009	**2008**
Selling and marketing	$ 125,487	$ 142,065
General and administrative	278,342	1,575,302
Research and development	180,203	181,831
Stock based compensation included in continuing operations	584,032	1,899,198
Stock based compensation in discontinued operations	966,325	878,637
Total stock-based compensation expense related to employee equity awards	$ 1,550,357	$ 2,777,835

Stock-based compensation expense in discontinued operations for the year ended December 31, 2009 includes approximately $0.5 million of expense related to accelerated vesting of options held by AVS employees at the time of the sale of that subsidiary (see Note 2 – Discontinued Operations).

Stock-based compensation expense for the year ended December 31, 2008 includes $1.4 million of expense related to accelerated vesting and option modifications for former officers of the Company. In addition, in December 2008, the Company modified the exercise price on all options outstanding for active employees and contractors that had an exercise price greater than $0.15. The exercise price was reduced to $0.07 on approximately 164 stock options, and the Company recorded expense of less than $0.1 million related to the modifications in the Consolidated Statement of Operations for the year ended December 31, 2008. Expense related to both modifications is included in the table above.

Valuation Assumptions:

The Company uses the Black Scholes option pricing model in determining its option expense. The weighted-average estimated fair value of employee stock options granted during the years ended December 31, 2009 and 2008 was $0.05 per share and $0.14 per share, respectively. The fair value of each option is estimated on the date of grant using the Black Scholes option pricing model and is recognized as expense using the straight-line method over the requisite service period:

	December 31,	
	2009	**2008**
Expected volatility	90.7% to 114.7%	63.90% to 102.32%
Risk-free interest rate	2.22% to 3.00%	3.05% to 3.90%
Expected dividends	—	—
Expected life (yrs)	5.27 to 6.10	5.85 to 6.10

The expected volatility is based on the weighted average of the historical volatility of publicly traded surrogates in the Company's peer group.

The risk-free interest rate assumption is based upon published interest rates appropriate for the expected life of the Company's employee stock options.

The dividend yield assumption is based on the Company's history of not paying dividends and no future expectations of dividend payouts.

The expected life of employee stock options represents the weighted-average period that the stock options are expected to remain outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of its stock-based awards.

As the stock-based compensation expense recognized in the Consolidated Statements of Operations is based on awards ultimately expected to vest, such amounts have been reduced for estimated forfeitures estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

16. Income Taxes

The Company did not record a provision for income taxes in the fiscal years ended December 31, 2009 and 2008, as it has experienced net losses from inception through December 31, 2009.

The following reconciles the provision for income taxes reported in the financial statements to expected taxes that would be obtained by applying the statutory federal tax rate of 34% to loss before income taxes:

	2009	**2008**
Expected tax benefit at statutory rate	$ (2,740,000)	$ (3,290,000)
Effects of permanent differences	630,000	(2,030,000)
State tax	(330,000)	(1,370,000)
Change in valuation allowance	1,780,000	6,690,000
True-up of deferreds	660,000	—
Other	—	—
Tax Provision	$ —	$ —

A valuation allowance has been provided to reduce the net deferred tax asset to the amount that is more likely than not to be realized. The deferred tax assets and liabilities consist of the following components:

	2009	2008
Deferred tax assets:		
Net operating loss carryforwards	$ 17,680,000	15,840,000
Other	1,460,000	2,235,000
	19,140,000	18,075,000
Deferred tax liabilities:		
Purchased intangibles, net	(5,340,000)	(6,055,000)
Other	—	—
	(5,340,000)	(6,055,000)
Net deferred tax asset	13,800,000	12,020,000
Less valuation allowance	(13,800,000)	(12,020,000)
	$ —	$ —

The valuation allowance increased by $1.8 million in 2009 and $6.7 million in 2008. The increase in the valuation allowance of $1.8 million in 2009 is primarily due to the increase in net operating loss carryforwards. The increase in the valuation allowance of $6.7 million in 2008 is primarily due to the increase in net operating loss carryforwards of $4.6 million and the effect of the change in purchased intangibles of $2.1 million.

The Company has federal net operating loss carryforwards, net of section 382 limitations, totaling approximately $46 million that may be offset against future federal income taxes. If not used, the carryforwards will begin expiring in fiscal 2009. The Company has net operating loss carryforwards in various states totaling approximately $32 million which expire if not used within statutory periods which vary from state to state.

The use of federal and state net operating loss carryforwards may be limited as a result of certain ownership changes.

The Company reviews whether the benefits of tax positions are more likely than not of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, the Company recognizes the largest amount of the benefits that are more likely than not of being sustained in the financial statements. For tax positions that are not more likely than not of being sustained upon audit, the Company does not recognize any portion of the benefit in the financial statements.

We have historically classified interest and penalties on income tax liabilities as additional income tax expense. As of December 31, 2009, our Consolidated Balance Sheet included no accrued interest or penalties.

The Company and its subsidiaries file income tax returns in the United States and various state and local jurisdictions. As of December 31, 2009, we were not under examination by any major tax jurisdiction. The Company is no longer subject to U.S. federal tax examinations for years before fiscal 2006 and it is no longer subject to state tax examinations for years prior to 2005. However, due to our net operating loss carryforwards, the statute generally remains open to examination.

17. Related party transactions

On June 30, 2008, the Company entered into a separation agreement with Mr. Thomas A. Szabo, who at the time was an officer of the Company and chairman of the board of directors. Under the terms of the separation agreement, Mr. Szabo waived his right to collect cash severance compensation owed to him upon termination of employment under the terms of his employment agreement, executed a general waiver and release of claims against the Company, and agreed to apply his severance compensation and other deferred compensation owed to him to the exercise of stock options to acquire 822,929 shares of common stock. In exchange, we paid Mr. Szabo, as additional severance, an amount equal to 25% of his severance, accelerated the vesting of certain stock options and amended the provisions of his option agreements that provide that his unexercised options terminate 90 days following termination of service.

18. Quarterly Financial Data (unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year ended December 31, 2009				
Revenue	$ 7,024,192	$ 6,904,963	$ 7,165,500	$ 7,197,270
Income (loss) from continuing operations	$ (1,757,967)	$ (6,449,200)	$ 2,035,819	$ 1,959,584
Loss from discontinued operations	$ (499,333)	$ (585,553)	$ (1,957,412)	$ (811,509)
Net income (loss) applicable to common shareholders	$ (2,257,300)	$ (7,034,753)	$ 78,407	$ 1,148,075
Income (loss) per common share – basic and diluted				
Continuing operations	$ (0.05)	$ (0.20)	$ 0.06	$ 0.06
Discontinued operations	$ (0.02)	$ (0.02)	$ (0.06)	$ (0.02)
Net loss	$ (0.07)	$ (0.22)	$ (0.00)	$ 0.04
Year ended December 31, 2008				
Revenue	$ 6,248,858	$ 6,352,520	$ 6,786,712	$ 6,705,461
Income (loss) from continuing operations	$ (5,806,656)	$ 5,987,079	$ (56,122)	$ (6,175,193)
Loss from discontinued operations	$ (803,494)	$ (1,558,789)	$ (563,376)	$ (707,084)
Net income (loss) applicable to common shareholders	$ (9,164,393)	$ 3,804,530	$ (619,498)	$ (6,882,272)
Income (loss) per common share – basic and diluted				
Continuing operations	$ (0.36)	$ 0.21	$ (0.00)	$ (0.21)
Discontinued operations	$ (0.03)	$ (0.06)	$ (0.02)	$ (0.01)
Net loss	$ (0.39)	$ 0.15	$ (0.02)	$ (0.22)

19. Subsequent Events

The Company evaluated subsequent events and transactions for potential recognition or disclosure in the financials statements through the date of issuance of its December 31, 2009 consolidated financial statements. No such events requiring disclosure occurred.

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