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THINKENGINE NETWORKS, INC.

Form 10-Q

August 09, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2007

or

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

For the transition period from _____ to _____

Commission file number 1-8496

THINKENGINE NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-8058881
(I.R.S. Employer
Identification No.)

100 Nickerson Road, Marlborough, MA
(Address of principal executive offices)

01752
(Zip Code)

Registrant's telephone number, including area code: 508-624-7600

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

The Registrant has 6,707,367 shares of common stock outstanding at August 8, 2007.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THINKENGINE NETWORKS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

| ASSETS | June 30, 2007 | December 31, 2006 |
|---------------------------|------------------|----------------------|
| | ----- | ----- |
| Current assets | | |
| Cash and cash equivalents | \$ 2,909 | \$ 2,764 |
| Accounts receivable, net | 562 | 1,354 |
| Inventories, net | 818 | 1,439 |
| Other current assets | 156 | 270 |
| | ----- | ----- |

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| | | |
|---|----------|-----------|
| Total current assets | 4,445 | 5,827 |
| Loans to officers | -- | 444 |
| Property, plant and equipment, net | 872 | 970 |
| Intangible assets, net | 3,121 | 3,356 |
| Other assets, net | 148 | 49 |
| | ----- | ----- |
| Total assets | \$ 8,586 | \$ 10,646 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 263 | \$ 114 |
| Notes payable - current portion | 731 | -- |
| Accrued compensation and benefits | 833 | 932 |
| Deferred service revenues | 401 | 522 |
| Other accrued expenses | 853 | 966 |
| | ----- | ----- |
| Total current liabilities | 3,081 | 2,534 |
| Long-term debt, less current portion | 1,028 | 300 |
| Other liabilities | 679 | 664 |
| Commitments and contingencies | -- | -- |
| Stockholders' equity | | |
| Common stock, par value \$.001 per share; authorized 20,000,000 shares, issued 6,957,183 | 7 | 7 |
| Additional paid-in capital | 15,032 | 14,938 |
| Accumulated deficit | (10,027) | (6,876) |
| Accumulated other comprehensive loss | (529) | (529) |
| | ----- | ----- |
| | 4,483 | 7,540 |
| Less cost of 249,816 and 179,356 common shares in treasury | (685) | (392) |
| | ----- | ----- |
| Total stockholders' equity | 3,798 | 7,148 |
| | ----- | ----- |
| Total liabilities and stockholders' equity | \$ 8,586 | \$ 10,646 |
| | ===== | ===== |

See Notes to the Consolidated Interim Financial Statements

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THINKENGINE NETWORKS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(in thousands except per share data)

| | Three Months Ended June 30, | |
|------------------|--------------------------------|----------|
| | 2007 | 2006 |
| | ----- | ----- |
| Revenues: | | |
| Product | \$ 542 | \$ 1,159 |
| Service | 1,131 | 417 |
| | ----- | ----- |
| | 1,673 | 1,576 |
| Cost of revenues | 745 | 1,381 |

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| | | |
|---|------------|------------|
| Gross margin | 928 | 195 |
| Other costs and expenses: | | |
| Research and development | 1,247 | 1,535 |
| Selling, general and administrative | 1,282 | 1,291 |
| Interest expense | 94 | -- |
| Other (income) expense, net | (39) | (74) |
| | ----- | ----- |
| | 2,584 | 2,752 |
| | ----- | ----- |
| Pretax loss | (1,656) | (2,557) |
| Provision for income taxes | -- | 15 |
| | ----- | ----- |
| Net loss before cumulative effect of change in accounting principle | (1,656) | (2,572) |
| Cumulative effect of change in accounting principle, net of tax | -- | -- |
| | ----- | ----- |
| Net loss and comprehensive loss | \$ (1,656) | \$ (2,572) |
| | ===== | ===== |
| Loss per share - basic and diluted: | | |
| Net loss before cumulative effect of change in accounting principle | \$ (0.25) | \$ (0.36) |
| Cumulative effect of change in accounting principle, net of tax | -- | -- |
| | ----- | ----- |
| Net loss | \$ (0.25) | \$ (0.36) |
| | ===== | ===== |
| Weighted average number of basic and diluted shares outstanding | 6,714,980 | 7,231,053 |

See Notes to the Consolidated Interim Financial Statements.

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THINKENGINE NETWORKS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in thousands)

| | Six Month 2007 ----- |
|---|----------------------------|
| Operating Activities | |
| Net loss | \$ (3,151) |
| Adjustments to reconcile loss from operations to net cash used by operating activities: | |
| Depreciation and amortization | 542 |
| Amortization of deferred financing costs | 23 |
| Amortization of debt discount | 8 |
| Loss on disposition of assets | -- |
| Cumulative effect of change in accounting principle | -- |
| Stock-based compensation | 332 |
| Net (increase) decrease in: | |
| Accounts receivable | 792 |
| Inventories | 621 |
| Other assets | 134 |
| Net increase (decrease) in: | |

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| | |
|--|----------|
| Accounts payable | 149 |
| Accrued compensation and benefits and other liabilities | (234) |
| Deferred service revenues | (121) |
| Other accrued expenses | (113) |
| Net cash used by operating activities | (1,018) |
| Investing Activities | |
| Purchases of marketable securities | -- |
| Sale of marketable securities | -- |
| Repayment of officer's loans | -- |
| Additions to property, plant and equipment | |
| Net cash provided (used) by investing activities | (211) |
| Financing Activities | |
| Payment for shares purchased for treasury | (157) |
| Proceeds from shares issued pursuant to stock plans | 31 |
| Proceeds from term loan | 1,500 |
| Net cash provided (used) by financing activities | 1,374 |
| Increase (decrease) in cash and cash equivalents | 145 |
| Cash and cash equivalents - beginning of year | 2,764 |
| Cash and cash equivalents - end of period | \$ 2,909 |
| Supplemental Disclosures of Cash Flow Information Cash paid during the year for: | |
| Interest | \$ 77 |
| Income taxes, net | \$ 16 |
| Non-cash activity: | |
| Repayment of loans to officers and accumulated interest with common stock | \$ 465 |
| Cashless exercise of stock options in satisfaction of loans due from officers | \$ 46 |
| Increase in deferred financing fees and other liabilities in connection with term loan financing fee | \$ 150 |
| Debt discount - stock warrants issued in connection with term loan | \$ 49 |

See Notes to Consolidated Interim Financial Statements.

THINKENGINE NETWORKS, INC.
 NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS
 (UNAUDITED)
 JUNE 30, 2007

(dollars in thousands except per share data)

NOTE 1. BASIS OF PRESENTATION

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The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ended June 30, 2007 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 2007. The balance sheet at December 31, 2006 has been derived from the audited consolidated financial statements at that date. For further information, refer to the consolidated financial statements and footnotes thereto and the quarterly financial data included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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

NOTE 2. CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make critical decisions regarding accounting policies and judgments regarding their application. Materially different amounts could be reported under different circumstances and conditions.

REVENUE

The Company generally recognizes product revenue, net of sales discounts and allowances, when persuasive evidence of an arrangement exists, shipment or delivery (dependent upon the terms of the sale) has occurred, all significant contractual obligations have been satisfied, the amount is fixed or determinable and collection is considered probable. Sales of services and system support are deferred and recognized ratably over the contract period.

INVENTORIES

| | June 30, 2007 ----- | December 31, 2006 ----- |
|----------------|---------------------------|-------------------------------|
| Finished goods | \$ 318 | \$ 579 |
| Raw materials | 500 | 860 |
| | ----- | ----- |
| | \$ 818 | \$1,439 |
| | ===== | ===== |

Netted in the above amounts is the Company's reserve for slow-moving and obsolete inventories totaling \$3,419 and \$3,337 at June 30, 2007 and December 31, 2006, respectively.

NON-CURRENT LIABILITIES

| | June 30, 2007 ----- | December 31, 2006 ----- |
|-----------------------------------|---------------------------|-------------------------------|
| Accrued supplemental pension plan | \$ 229 | \$ 254 |
| Accrued deferred compensation | 123 | 139 |
| Accrued pension expense | 571 | 634 |
| Financing fee payable | 150 | -- |
| | ----- | ----- |
| | 1,073 | 1,027 |

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| | | |
|----------------------|--------|--------|
| Less current portion | 394 | 363 |
| | ----- | ----- |
| | \$ 679 | \$ 664 |
| | ===== | ===== |

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BORROWINGS

On January 16, 2007, the Company borrowed \$1,500 under a term loan agreement. The loan bears interest at the rate of 13% per annum, matures on February 10, 2010 and requires an additional \$150 payment to the lender on the maturity date. The loan is to be repaid in six interest-only monthly installments followed by thirty monthly installments of principal and interest. The Company pledged as collateral substantially all of its non-intellectual property assets. In connection with the loan agreement, the Company issued a ten-year common stock warrant to the lender to purchase 35,000 shares of the Company's common stock at an exercise price of \$3.47 which was the closing market price on January 16, 2007. The fair value of the warrants is estimated to be \$49, based on the assumption that they will be exercised at the termination of the loan and thus have an estimated life of three years.

INCOME PER SHARE

In computing basic earnings per share, the dilutive effect of stock options and warrants are excluded, whereas for diluted earnings per share they are included. For all periods presented herein, options and warrants were anti-dilutive and therefore were not included in the determination of net loss per share.

STOCK-BASED COMPENSATION

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R) "Share-Based Payment", which establishes accounting for equity instruments exchanged for employee services. Under the provisions of SFAS No. 123(R), share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant).

The Company has recognized compensation expense for its restricted stock grants. In the first quarter of 2006, upon adoption of SFAS 123(R), using the modified prospective method, the Company recognized a benefit of \$36 as a cumulative effect of a change in accounting principle resulting from the requirement to estimate forfeitures of the Company's restricted stock grants at the date of grant instead of recognizing them as incurred. The estimated forfeiture rate was applied to the previously recorded compensation expense of the Company's unvested restricted stock in determining the cumulative effect of a change in accounting principle.

The Company has stock-based compensation plans under which directors, officers and other eligible employees receive stock options and other equity-based awards. The plans provide for the grant of stock options and restricted stock awards.

Stock options are granted with an exercise price equal to the market value of a share of common stock on the date of grant. Stock option grants generally expire in 10 years. Restricted stock awards generally vest over four years.

The following table summarizes stock option activity:

Inducement

1990 Stock

Director

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| | Options | | Option Plan | | Option Plan |
|-----------------------------------|-----------|---------------------------------|-------------|---------------------------------|-------------|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price | Shares |
| Outstanding at December 31, 2006 | 566,666 | \$2.62 | 973,133 | \$3.62 | 166,750 |
| Granted | -- | | 349,000 | \$2.76 | 2,500 |
| Exercised | -- | | (58,166) | \$1.97 | (35,000) |
| Forfeited/expired | (90,000) | \$2.55 | (161,261) | \$4.98 | -- |
| Outstanding at June 30, 2007 | 476,666 | \$2.62 | 1,102,706 | \$3.24 | 134,250 |
| Shares available for future grant | 0 | | 402,994 | | 168,250 |
| Weighted average remaining term | 7.7 years | | 6.4 years | | 2.4 years |
| Intrinsic value: | | | | | |
| Outstanding | \$0 | | \$72 | | \$12 |
| Exercisable | \$0 | | \$71 | | \$11 |

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The intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the market price of our common stock as of the reporting date.

The following table summarizes non-vested restricted stock activity:

| | Stock Plan Shares | Inducement Shares |
|-----------------------------------|-------------------|-------------------|
| Unvested as of December 31, 2006 | 22,500 | 275,000 |
| Granted | -- | -- |
| Vested | (1,100) | -- |
| Forfeited | (17,200) | -- |
| Unvested as of June 30, 2007 | 4,200 | 275,000 |
| Shares available for future grant | 380,400 | 0 |

The following table summarizes the components and classification of stock-based compensation expense included in the Statement of Operations:

| Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------|------|---------------------------|------|
| 2007 | 2006 | 2007 | 2006 |
| | | | |

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| | | | | |
|--|--------|--------|--------|--------|
| Stock options | \$ 191 | \$ 146 | \$ 265 | \$ 390 |
| Restricted stock | 36 | 21 | 66 | 50 |
| | ----- | ----- | ----- | ----- |
| Total stock-based compensation expense | \$ 227 | \$ 167 | \$ 331 | \$ 440 |
| | ===== | ===== | ===== | ===== |
| | | | | |
| Cost of revenues | \$ 12 | \$ 14 | \$ 24 | \$ 26 |
| Research and development | (23) | 67 | 37 | 181 |
| Selling, general and administrative | 238 | 86 | 270 | 233 |
| | ----- | ----- | ----- | ----- |
| Total stock-based compensation expense | \$ 227 | \$ 167 | \$ 331 | \$ 440 |
| | ===== | ===== | ===== | ===== |

No tax benefits were attributed to the stock-based compensation expense because a valuation allowance is maintained for substantially all net deferred tax assets. We elected to adopt the alternative method of calculating the historical pool of windfall tax benefits as permitted by FASB Staff Position (FSP) No. SFAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." This is a simplified method to determine the pool of windfall tax benefits that is used in determining the tax effects of stock compensation in the results of operations and cash flow reporting for awards that were outstanding as of the adoption of SFAS 123(R).

The Company estimates the fair value of stock options using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Company's stock over the option's expected term, the risk-free interest rate over the option's expected term, and the Company's expected annual dividend yield. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the Company's stock options granted during the six months ended June 30, 2007. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards. The following table summarizes the assumptions used to compute the weighted average fair value of stock option grants of \$1.02 and \$1.27, respectively, for the three-month and six-month periods ended June 30, 2007.

| | Three Months | Six Months |
|------------------------------------|--------------|------------|
| | ----- | ----- |
| Dividend yield | 0.0% | 0.0% |
| Weighted average volatility | 41.1% | 40.3% |
| Risk-free interest rate | 4.8% | 4.8% |
| Expected holding period (in years) | 4.0 | 4.0 |

No dividend yield was assumed because the Company has never paid a cash dividend, and has no plans at this time to pay any dividends in the future.

The weighted average volatility for the current period was developed using historical volatility.

The risk-free interest rate was developed using the U.S. Treasury yield for periods equal to the expected life of the options on the grant date. An increase in the risk-free interest rate will increase stock compensation expense.

This expected holding period was developed after considering vesting schedules, life of the options, historical experience and estimates of future exercise behavior patterns. An increase in the expected holding period will increase stock compensation expense.

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SFAS 123R requires the recognition of stock-based compensation for the number of awards that are ultimately expected to vest. As a result, for most awards, recognized stock compensation was reduced for estimated forfeitures prior to vesting based on estimated annual forfeiture rates of approximately 15%. Estimated forfeitures will be reassessed in subsequent periods and may change based on new facts and circumstances.

As of June 30, 2007, approximately \$1.1 million of unrecognized stock compensation related to unvested awards (net of estimated forfeitures) is expected to be recognized over a period of 3.5 years.

PENSION PLAN

The Company's defined benefit pension plan is reported in accordance with Statement of Financial Accounting Standards ("SFAS") No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of SFAS No.'s 87, 88, 106 and 132(R)", issued in September 2006. This statement requires balance sheet recognition of the over-funded or under-funded status of pension and postretirement benefit plans. Under SFAS 158, actuarial gains and losses, prior service costs or credits, and any remaining transition assets or obligations that have not been recognized under previous accounting standards must be recognized in accumulated other comprehensive loss, net of tax effects, until they are amortized as a component of net periodic benefit cost. In addition, the measurement date, the date at which plan assets and the benefit obligation are measured, is required to be the Company's fiscal year end. The Company adopted the recognition and measurement provisions of SFAS 158 effective December 31, 2006. The adoption of SFAS 158 did not have a material effect on the consolidated financial statements since all future benefit accruals under the Company's defined benefit plan were curtailed as of 1994.

The Company's funding policy is to contribute amounts to the plan sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as the Company may determine to be appropriate from time to time.

The components of net periodic benefit cost of the plan for the three-month and six-month periods ended June 30 are as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-------|------------------------------|-------|
| | 2007 | 2006 | 2007 | 2006 |
| | ---- | ---- | ---- | ---- |
| Interest cost on projected benefit obligation | \$ 22 | \$ 19 | \$ 44 | \$ 42 |
| Expected return on plan assets | (22) | (18) | (41) | (33) |
| Amortization of net loss | 10 | 14 | 22 | 21 |
| | ---- | ---- | ---- | ---- |
| Net periodic pension cost | \$ 10 | \$ 15 | \$ 25 | \$ 30 |
| | ==== | ==== | ==== | ==== |

The Company expects funding requirements of \$229 in 2007 of which \$47 was funded during the quarter ended June 30, 2007, and \$135 during the six months ended June 30, 2007.

INCOME TAXES

We adopted the provisions of FASB Interpretation No. 48, ACCOUNTING FOR UNCERTAINTY IN INCOME TAXES - AN INTERPRETATION OF FASB STATEMENT NO. 109, or FIN 48, on January 1, 2007. We did not have any unrecognized tax benefits and there was no effect on our financial condition or results of operations as a

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result of implementing FIN 48.

We file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. We are no longer subject to U.S. federal tax examinations for years before 2005. State jurisdiction returns that remain subject to examination range from 2000 to 2004. We do not believe there will be any material changes in our unrecognized tax positions over the next 12 months.

Our policy is that we recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, we did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor

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was any interest expense recognized during the quarter. Our effective tax rate differs from the federal statutory rate primarily due to non-deductible expenses and is offset somewhat by state tax credits.

RELATED PARTY TRANSACTIONS

In February 2007, a former officer repaid loans and accumulated interest of \$431. Repayment consisted of 140,813 shares of the Company's common stock, valued at the closing market price at the date of the repayment of the loans. In May 2007, a former officer repaid loans and accumulated interest of \$34. Repayment consisted of 15,159 shares of the Company's common stock, valued at the closing market price at the date of the repayment of the loans.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes--an interpretation of FASB Statement No. 109" (SFAS No. 109). The interpretation contains a two step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The provisions are effective for the Company beginning in the first quarter of fiscal 2007. The adoption of this statement by the Company did not have any material impact on its financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159 (SFAS No. 159), "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB statement No. 115" which is effective for fiscal years beginning after November 15, 2007. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is expected to expand the use of fair value measurement, which is consistent with the long-term measurement objectives for accounting for financial instruments. The Company is currently evaluating the potential impact of this statement.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Factors That May Affect Future Results

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This Form 10-Q contains forward-looking statements that involve risks and uncertainties. These forward-looking statements include management's expectations for future operations, financial position and operating results, as well as statements regarding the strategy, plans and objectives of the Company. Our actual experience may differ materially from that discussed in the forward-looking statements. Factors that might cause such a difference or otherwise affect our future results of operations include limited customers and products; developments with our primary customers' business, networks and multi-vendor relationships; development of our direct sales capabilities and channel relationships; restructuring effects; risks associated with competition and competitive pricing pressures; our ability to stabilize revenues and manage costs; our ability to obtain component parts; our reliance on contract manufacturers and our ability to forecast manufacturing requirements; customer purchasing patterns and commitments; potential liability for defects or errors in our products; the size, timing and recognition of revenue from customers; our ability to develop new products and product enhancements; market acceptance of new product offerings and enhancements to our products and our ability to predict and respond to market developments; failure to keep pace with the rapidly changing requirements of our customers; our ability to attract and retain key personnel; risks associated with international sales and operations; our ability to identify, analyze and consummate strategic alternatives; the sufficiency of our intellectual property rights; our ability to obtain additional financing; inability to maintain the continued listing of our common stock on the American Stock Exchange; any failure to comply with the internal control requirements of Sarbanes-Oxley; as well as risks of a downturn in economic conditions generally, and in the telecommunications and cable broadband industries specifically. For a more detailed description of the risk factors associated with the Company, please refer to its Annual Report on Form 10-K for the fiscal year ended December 31, 2006 as filed with the Securities and Exchange Commission on March 27, 2007.

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Results of Operations

Total revenue was \$1.7 million in the second quarter of 2007 versus \$1.6 million in the second quarter of 2006. Product revenue for the second quarter of 2007 decreased \$0.6 million versus 2006 primarily due to lower shipments of the CX4000 product. Total revenue was \$3.7 million in 2007 versus \$5.0 million in 2006 for the six-month period ended June 30. Product revenue for the six months ended June 30, 2007 decreased \$2.7 million primarily due to the fact that 2006 included \$1.9 million related to shipments made to one customer in August 2005 that were not recognized as revenue until the first quarter of 2006, and also due to lower shipments of the CX4000 product.

Service revenue increased \$0.7 million and \$1.4 million, for the three and six months ended June 30, 2007, due to increased sales of spare parts, an increase in maintenance related revenues, and the recognition in the second quarter of 2007 of \$0.2 million for a custom development project.

Gross margin was 55% in the quarter ended June 30, 2007 versus 12% in second quarter of the prior year, and was 62% for the six-month period ended June 30, 2007 versus 45% for the corresponding six-month period in 2006. The 2007 increase was primarily due to lower personnel costs in 2007 than in 2006, and the incurrence of \$0.4 million of contract cancellation fees in the second quarter of 2006.

Research and development expense decreased \$0.3 million (19%) and \$0.4 million (14%) for the three and six month periods ended June 30, 2007 versus the corresponding periods in 2006, primarily due to severance costs of \$0.2 million

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included in the three and six-month periods ended June 30, 2006, and also due to lower personnel costs.

Selling, general and administrative expenses decreased slightly for the three-month period ended June 30, 2007 compared to 2006, and increased by \$0.1 million (3%) for the six-month period ended June 30, 2007 versus the corresponding period in 2006.

Interest expense reflects interest incurred on the term loan which the Company borrowed in January 2007. Other income decreased due to lower interest income earned as a result of lower balances available for investment in 2007 versus 2006.

No tax benefits were provided for losses incurred in 2007 or 2006 since the Company cannot determine that the realization of the net deferred tax asset is more likely than not.

Liquidity and Sources of Capital

Net cash used by operations for the six months ended June 30, 2007 was \$1.1 million versus \$2.7 million used in the comparable period of 2006. Cash used by investing activities in 2007 versus 2006 reflects the absence of any net proceeds from the sale of marketable securities. The decrease in cash and investments from the prior year is primarily attributable to the Company's continued losses. Cash provided by financing activities of \$1.5 million in 2007 is due to the Company borrowing \$1.5 million under a term loan agreement.

Working capital and the ratio of current assets to current liabilities were \$1.4 million and 1.4:1 at June 30, 2007 compared to \$3.3 million and 2.3:1 at December 31, 2006. The decrease in working capital is primarily due to the net losses incurred over the last six months, partially offset by the proceeds from the \$1.5 million term loan which the Company borrowed in January 2007.

During the remainder of 2007, the Company anticipates making capital expenditures of less than \$0.1 million. The Company borrowed \$1.5 million in January 2007 under a three-year term loan agreement. Management believes that with the funds provided by this loan the Company should have sufficient funds to meet the Company's cash requirements for the remainder of 2007. We have not been able to obtain operating profitability during the past five years from continuing operations and may not be able to be profitable on a quarterly or annual basis in the future. Management's initiatives over the last two years, including the cost reductions and securing additional debt financing in 2007 have been designed to improve operating results and liquidity and better position ThinkEngine Networks to compete under current market conditions. However, we may in the future be required to seek new sources of financing or future accommodations from our existing lender or other financial institutions, or we may seek equity infusions from private investors. Our ability to fund our operations is heavily dependent on the growth of our revenues over current levels to achieve profitable operations. We may be required to further reduce operating costs in order to meet our obligations. If we are unable to achieve profitable operations or secure additional sources of capital, there would be substantial doubt about our long term ability to fund future operations. No assurance can be given that management's initiatives will be successful or that any such additional sources of financing, lender accommodations or equity infusions will be available. The Company cannot provide assurances that these additional sources of funds will be available or, if available, what the terms would be.

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Contractual Obligations

At June 30, 2007, the Company's contractual obligations were as follows:

| | PAYMENTS DUE BY PERIOD | | |
|----------------------|------------------------|-----------|-----------|
| | LESS THAN 1 YEAR | 1-3 YEARS | 4-5 YEARS |
| Operating Leases | \$ 307 | \$ 291 | \$ 0 |
| Purchase Commitments | \$ 673 | \$ 108 | \$ 97 |

Payments made under operating leases are treated as rent expense. Purchase commitments are primarily in relation to purchasing inventory from an outsource manufacturer of certain of the Company's products, or purchases from components vendors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not use derivatives and has no financial instruments subject to fluctuations in market rates.

ITEM 4T. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based on the definition of "disclosure controls and procedures" in Rule 13a-15(e). In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2007. Based upon the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2007.

During the quarterly period covered by this Form 10-Q, the Company made changes to its internal controls, designed to centralize its financial reporting in light of recent changes made to the organizational structure of the Company as reported in Form 10-K for the year-ended December 31, 2006. There were no other changes in the Company's internal control over financial reporting that have materially affected, or reasonably likely to materially affect the Company's internal controls over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

For a detailed description of the risk factors associated with the Company, please refer to its Annual Report on Form 10-K for the fiscal year ended December 31, 2006 as filed with the Securities and Exchange Commission on March

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27, 2007.

THE COMPANY'S COMMON STOCK MAY BE DELISTED FROM THE AMERICAN STOCK EXCHANGE.

On May 22, 2007 the Company received notice from the American Stock Exchange ("AMEX" or "Exchange") indicating that the Company is below certain of the Exchange's continued listing standards, as set forth in Section 1003 (a) (iii) of the AMEX Company Guide, in that the Company, as of March 31, 2007, had Stockholders' Equity of less than \$6,000,000 and also had sustained losses from continuing operations and/or net losses in its five most recent fiscal years.

In accordance with AMEX rules, the Company submitted for review by the Exchange a plan to demonstrate the Company's ability to regain compliance by November 21, 2008. The plan is presently being reviewed by the Exchange, and the Company's listing has been continued during the review period. If the plan is not accepted or the Company is unable to meet the objectives of the plan, then the Company will be subject to immediate delisting procedures as set forth in the AMEX Company Guide.

If ThinkEngine's common stock were to be de-listed by the American Stock Exchange, we might be unable to list our common stock with another stock exchange. In that event, trading of our common stock might be limited to the OTC Bulletin Board or similar quotation system. Inclusion of our common stock on the OTC Bulletin Board or similar quotation system could adversely affect the liquidity and price of our common stock and make it more difficult for ThinkEngine Networks to raise additional capital on favorable terms, if at all. In addition, de-listing by the American Stock Exchange might negatively impact ThinkEngine's reputation and, as a consequence, its business.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On May 24, 2007, the Company accepted 15,159 shares of its common stock (valued at \$2.24 a share) in repayment of loans to a former officer of \$34,000.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the 2007 annual meeting of stockholders of the Company, held on May 10, 2007, two proposals were voted upon and approved by the Company's stockholders. A brief discussion of each proposal voted upon at the annual meeting, and the number of votes cast for or against is set forth below. There were no broker non-votes with respect to these proposals.

1) A vote was taken for the election of five directors of the Company to hold office until their respective successors shall have been duly elected. The aggregate numbers of shares of common stock voted in person or by proxy were as follows:

| Nominee ----- | For --- | Withheld ----- | Abstain ----- |
|---------------------|------------|-------------------|------------------|
| Robert C. Fleming | 6,070,389 | 126,857 | 365,927 |
| Michael G. Mitchell | 6,070,389 | 126,857 | 365,927 |
| Robert H. Scott | 6,084,889 | 112,357 | 365,927 |
| William J. Stuart | 6,070,389 | 126,857 | 365,927 |
| John E. Sweeney | 6,084,834 | 112,412 | 365,927 |

2) A vote was taken to ratify the selection of Carlin, Charron & Rosen, LLP, an independent registered public accounting firm, as independent auditors for the Company for the year ending December 31, 2007. The aggregate numbers of shares of Common Stock voted in person or by proxy were as follows:

| For --- | Against ----- | Abstain ----- |
|------------|------------------|------------------|
|------------|------------------|------------------|

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6,150,233

39,010

373,930

The foregoing proposals are described more fully in the Company's proxy statement filed with the Securities and Exchange Commission on April 5, 2007 pursuant to Section 14 (a) of the Securities Act of 1934, as amended, and the rules and regulations promulgated thereunder.

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ITEM 6. EXHIBITS

Index to Exhibits

Exhibit

- 31.1 Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ThinkEngine Networks, Inc.
(Registrant)

Date: August 9, 2007

By /s/ John E. Steinkrauss

John E. Steinkrauss
Vice President, Treasurer
and Chief Financial Officer

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