

8X8 INC /DE/  
Form 10-Q  
February 05, 2010

---

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 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 December 31, 2009

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 000-21783

[8X8, INC.](#)

(Exact name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

77-0142404

(I.R.S. Employer Identification Number)

810 West Maude Avenue  
Sunnyvale, CA 94085

(Address of Principal Executive Offices, including Zip Code)

(408) 727-1885

(Registrant's Telephone Number, including Area Code)

Edgar Filing: 8X8 INC /DE/ - Form 10-Q

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 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 (§232.405 of this chapter) 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The number of shares of the Registrant's Common Stock outstanding as of February 3, 2010 was 63,130,350.

---

---

FORM 10-Q [PDF](#)  
TABLE OF CONTENTS

<b>PART I. FINANCIAL INFORMATION</b>	<b><u>Page No.</u></b>
Item 1. Financial Statements:	
Condensed Consolidated Balance Sheets at December 31, 2009 and March 31, 2009	<u>3</u>
Condensed Consolidated Statements of Income for the three and nine months ended December 31, 2009 and 2008	<u>4</u>
Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2009 and 2008	<u>5</u>
Notes to Unaudited Condensed Consolidated Financial Statements	<u>6</u>
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	<u>18</u>
Item 3. Quantitative and Qualitative Disclosures About Market Risk	<u>25</u>
Item 4. Controls and Procedures	<u>25</u>
<b>PART II. OTHER INFORMATION</b>	
Item 1. Legal Proceedings	<u>26</u>
Item 1A. Risk Factors	<u>26</u>
Item 6. Exhibits	<u>29</u>
<b>Signature</b>	<u>30</u>

## Part I -- FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

8X8, Inc.  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, unaudited)

	<b>December 31, 2009</b>	<b>March 31, 2009</b>
	<u>                    </u>	<u>                    </u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 17,070	\$ 16,376
Accounts receivable, net	476	414
Inventory	2,789	2,297
Deferred cost of goods sold	94	193
Other current assets	624	648
	<u>                    </u>	<u>                    </u>
Total current assets	21,053	19,928
Long-term investments	-	-
Property and equipment, net	1,617	1,485
Other assets	405	443
	<u>                    </u>	<u>                    </u>
Total assets	\$ 23,075	\$ 21,856
	<u>                    </u>	<u>                    </u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 4,008	\$ 4,810
Accrued compensation	1,491	1,264
Accrued warranty	356	328
Accrued taxes	1,724	1,777
Deferred revenue	1,657	2,254
Other accrued liabilities	1,290	2,081
	<u>                    </u>	<u>                    </u>
Total current liabilities	10,526	12,514
Other liabilities	112	291
Fair value of warrant liability	382	21
	<u>                    </u>	<u>                    </u>
Total liabilities	11,020	12,826
	<u>                    </u>	<u>                    </u>
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock	63	63
Additional paid-in capital	211,947	211,686
Accumulated deficit	(199,955)	(202,719)
	<u>                    </u>	<u>                    </u>
Total stockholders' equity	12,055	9,030
	<u>                    </u>	<u>                    </u>
Total liabilities and stockholders' equity	\$ 23,075	\$ 21,856
	<u>                    </u>	<u>                    </u>

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

8X8, Inc.  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except per share amounts; unaudited)

	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2009	2008	2009	2008
Service revenues	\$ 14,737	\$ 14,366	\$ 44,095	\$ 44,288
Product revenues	1,207	1,837	3,434	4,621
	15,944	16,203	47,529	48,909
Operating expenses:				
Cost of service revenues	3,254	3,699	10,290	11,535
Cost of product revenues	1,925	1,681	5,432	4,786
Research and development	1,239	1,183	3,741	3,674
Selling, general and administrative	8,251	9,562	24,980	27,980
	14,669	16,125	44,443	47,975
Income from operations	1,275	78	3,086	934
Other income, net	7	74	50	266
Income (loss) on change in fair value of warrant liability	(265)	66	(362)	325
	1,017	218	2,774	1,525
Provision for income taxes	3	38	10	113
Net income	\$ 1,014	\$ 180	\$ 2,764	\$ 1,412
Net income per share:				
Basic	\$ 0.02	\$ 0.00	\$ 0.04	\$ 0.02
Diluted	\$ 0.02	\$ 0.00	\$ 0.04	\$ 0.02
Weighted average number of shares:				
Basic	62,852	62,332	62,768	62,236
Diluted	63,393	62,394	62,978	62,428

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

8X8, Inc.  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands, unaudited)

	<b>Nine Months Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,764	\$ 1,412
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	775	976
Stock-based compensation	182	870
Income (loss) on change in fair value of warrant liability	361	(325)
Change in inventory reserve	(347)	57
Other	69	118
Changes in assets and liabilities:		
Accounts receivable, net	(135)	997
Inventory	(145)	(419)
Other current and noncurrent assets	(39)	12
Deferred cost of goods sold	99	291
Accounts payable	(731)	(1,010)
Accrued compensation	227	387
Accrued warranty	28	13
Accrued taxes and fees	(53)	(1,307)
Deferred revenue	(597)	73
Other current and noncurrent liabilities	(974)	(38)
Net cash provided by operating activities	<u>1,484</u>	<u>2,107</u>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(929)	(677)
Sale of property and equipment	2	-
Restricted cash decrease	100	-
Maturities of short-term investments	-	3,385
Net cash provided by (used in) investing activities	<u>(827)</u>	<u>2,708</u>
<b>Cash flows from financing activities:</b>		
Capital lease payments	(42)	(28)
Repurchase of common stock	(212)	-
Proceeds from issuance of common stock under employee stock plans	291	223
Net cash provided by financing activities	<u>37</u>	<u>195</u>
Net increase in cash and cash equivalents	694	5,010
Cash and cash equivalents at the beginning of the period	<u>16,376</u>	<u>11,185</u>
Cash and cash equivalents at the end of the period	<u>\$ 17,070</u>	<u>\$ 16,195</u>

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

8X8, Inc.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS

## 1. DESCRIPTION OF THE BUSINESS

### THE COMPANY

8x8, Inc. ("8x8" or the "Company") develops and markets communication technology and services for Internet protocol, or IP, telephony and video applications. The Company was incorporated in California in February 1987, and in December 1996 was reincorporated in Delaware.

The Company offers a suite of voice and video communications services that work over existing high speed Internet connections. In November 2002, the Company launched the 8x8 residential service offering and in March 2004, the Company launched its first business service offering. 8x8's primary product focus is on replacing private branch exchange, or PBX, telephone systems in the small and medium-sized business marketplace with a hosted business solution. To accomplish this 8x8 sells a business service called 8x8 Virtual Office that offers feature-rich communications services to small and medium-sized business, eliminating the need for traditional telecommunications services and business phone systems. The service typically consists of IP telephony equipment which is purchased upfront, and a monthly subscription to a service plan that provides dialtone, voice service and other features to the telephone equipment. Between November 2002 and April 2009, the Company marketed its services under the Packet8 brand. In May 2009, the Company began marketing its services under the 8x8 brand.

The Company's fiscal year ends on March 31 of each calendar year. Each reference to a fiscal year in these notes to the consolidated financial statements refers to the fiscal year ending March 31 of the calendar year indicated (for example, fiscal 2010 refers to the fiscal year ending March 31, 2010).

### LIQUIDITY

The Company generated positive cash flows from operating activities for the fiscal years ended March 31, 2009 and 2008 and the nine months ended December 31, 2009. Management believes that current cash and cash equivalents will be sufficient to finance the Company's operations for at least the next twelve months. However, the Company continually evaluates its cash needs and may pursue additional equity or debt financing in order to achieve the Company's overall business objectives. There can be no assurance that such financing will be available, or, if available, at a price that is acceptable to the Company. Failure to generate sufficient revenue, raise additional capital or reduce certain discretionary spending could have an adverse impact on the Company's ability to achieve its longer term business objectives.

## 2. BASIS OF PRESENTATION

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared on substantially the same basis as our annual financial statements for the fiscal year ended March 31, 2009. In the opinion of the Company's management, these financial statements reflect all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of our financial position, results of operations and cash flows for the periods presented. The Company has evaluated subsequent events through February 4, 2010, which is the day preceding the date on which this report was filed with the Securities and Exchange Commission or SEC. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from these estimates.

The March 31, 2009 year-end condensed consolidated balance sheet data was derived from audited consolidated financial statements and does not include all of the disclosures required by U.S. generally accepted accounting principles. These financial statements should be read in conjunction with the Company's audited consolidated financial statements as of and for the fiscal year ended March 31, 2009 and notes thereto included in the Company's fiscal 2009 Annual Report on Form 10-K.

The results of operations and cash flows for the interim periods included in these financial statements are not necessarily indicative of the results to be expected for any future period or the entire fiscal year.



## Investments

The Company's investments are comprised of money market funds. All short-term investments are classified as available-for-sale.

## 8x8 Service Revenue

The Company recognizes new subscriber revenue in the month the new order is shipped, net of an allowance for expected cancellations. The allowance for expected cancellations is based on the Company's history of subscriber cancellations within the 30-day trial period.

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 605-25 (formerly Emerging Issues Task Force consensus No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables") requires that revenue arrangements with multiple deliverables be divided into separate units of accounting if the deliverables in the arrangement meet specific criteria. In addition, arrangement consideration must be allocated among the separate units of accounting based on their relative fair values, with certain limitations. The provisioning of the 8x8 service with the accompanying desktop terminal or videophone adapter constitutes a revenue arrangement with multiple deliverables. In accordance with the guidance of ASC 605-25, the Company allocates 8x8 revenue from new subscriptions, including activation fees, between the desktop terminal adapter or videophone and subscriber services. Revenue allocated to the desktop terminal adapter or videophone is recognized as product revenue during the period of the sale less the allowance for estimated returns during the 30-day trial period. All other revenue is recognized when the related services are provided.

## Product revenue

The Company recognizes revenue from product sales for which there are no related services to be rendered upon shipment to partners and end users provided that persuasive evidence of an arrangement exists, the price is fixed, title has transferred, collection of resulting receivables is reasonably assured, there are no customer acceptance requirements, and there are no remaining significant obligations. Gross outbound shipping and handling charges are recorded as revenue, and the related costs are included in cost of goods sold. Reserves for returns and allowances for partner and end user sales are recorded at the time of shipment. In accordance with the ASC 985-605, the Company records shipments to distributors, retailers, and resellers, where the right of return exists, as deferred revenue. The Company defers recognition of revenue on sales to distributors, retailers, and resellers until products are resold to the end user.

## Deferred Cost of Goods Sold

Deferred cost of goods sold represents the cost of products sold for which the customer has a right of return. The cost of the products sold is recognized contemporaneously with the recognition of revenue.

## Warrant Liability

The Company accounts for its warrants in accordance with ASC 480-10 (formerly Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock") which requires warrants to be classified as permanent equity, temporary equity or as assets or liabilities. In general, warrants that either require net-cash settlement or are presumed to require net-cash settlement are recorded as assets and liabilities at fair value and warrants that require settlement in shares are recorded as equity instruments. The Company has two investor warrants that are classified as liabilities because they include a provision that specifies that the Company must deliver freely tradable shares upon exercise by the warrant holder. Because there are circumstances, irrespective of likelihood, that may not be within the control of the Company that could prevent delivery of registered shares, ASC 480-10 requires the warrants be recorded as a liability at fair value, with subsequent

changes in fair value recorded as income (loss) in change in fair value of warrant liability. The fair value of the warrant is determined using a Black-Scholes option pricing model, and is affected by changes in inputs to that model including our stock price, expected stock price volatility and contractual term.

#### Accounting for Stock-Based Compensation

The Company accounts for stock-based compensation under ASC 718 - Stock Compensation (formerly Statement of Financial Accounting Standards ("SFAS") No. 123(R), "Share-Based Payment"), which establishes standards for the accounting for equity instruments exchanged for employee services. Under the provisions of ASC 718, share-based compensation cost is measured at the grant date, based on the estimated 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), net of estimated forfeitures.

Stock-based compensation expense recognized in the Company's condensed consolidated statements of income for the three and nine months ended December 31, 2009 included the unvested portion of stock-based awards granted subsequent to January 29, 2009. Stock-based awards granted in periods subsequent to April 1, 2006 were measured based on ASC 718 criteria and the compensation expense for all share-based payment awards granted is recognized using the straight-line single-option method. Stock-based compensation expense includes the impact of estimated forfeitures. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

#### Stock-based Compensation Plans

The Company has several stock-based compensation plans (the "Plans") that are described in Note 4 "Stockholders' Equity" of the Notes to Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2009. The Company, under its various equity plans, grants stock-based awards for shares of common stock to employees, non-employee directors and consultants.

As of December 31, 2009, the 1992 Stock Plan, 1996 Stock Plan and 1996 Director Option Plan had expired and the 1999 Nonstatutory Stock Option Plan was cancelled by the Board, but there are still options outstanding under these plans. Options generally vest over four years, are granted at fair market value on the date of the grant and expire ten years from that date.

The Company has reserved a total of 7,000,000 shares of common stock for issuance under its 2006 Stock Plan (the "2006 Plan") of which 6,797,410 shares remain available for issuance as of December 31, 2009. The 2006 Plan is the Company's only active plan for providing stock-based incentive compensation ("awards") to our eligible employees, non-employee directors or consultants. Awards that may be granted under the 2006 Plan include incentive stock-based awards, nonstatutory stock options and stock purchase rights. The stock option price of incentive stock options granted and stock purchase rights may not be less than the fair market value on the effective date of the grant. Other types of options and awards under the 2006 Plan may be granted at any price approved by the administrator, which generally will be the compensation committee of the board of directors. Options and stock purchase rights generally vest over four years and expire ten years after grant. The 2006 Plan expires in May 2016.

#### Option and Stock Purchase Right Activity

Stock purchase right activity since March 31, 2009 is summarized as follows:

	Number of Shares	Weighted Average Grant-Date Fair Market Value	Weighted Average Remaining Contractual Term (in Years)
Balance at March 31, 2009	100,000	\$ 0.57	
Granted	326,464	0.74	
Vested	(32,965)	0.74	
Forfeited	-	-	
Balance at December 31, 2009	393,499	\$ 0.70	3.49

Option activity since March 31, 2009 is summarized as follows:

	Shares Available for Grant	Shares Subject to Options Outstanding	Weighted Average Exercise Price Per Share
Balance at March 31, 2009	2,415,875	10,736,279	\$ 1.85
Stock purchase rights	(326,464)	-	
Exercised	-	(172,000)	0.75
Canceled/forfeited	1,035,376	(1,035,376)	1.75
Termination of plans	(467,376)	-	-
Balance at December 31, 2009	2,657,411	9,528,903	\$ 1.88

The following table summarizes the stock options outstanding and exercisable at December 31, 2009:

	Options Outstanding			Options Exercisable			
	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value	Shares	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value
\$0.55- \$1.18	2,065,262	\$ 0.91	7.10	\$ 1,217,145	2,065,262	\$ 0.91	\$ 1,217,145
\$1.19 - \$1.27	2,030,500	\$ 1.26	7.41	484,605	2,030,500	\$ 1.26	484,605
\$1.28 - \$1.72	2,179,210	\$ 1.55	5.34	86,105	2,179,210	\$ 1.55	86,105
\$1.73 - \$2.31	1,991,431	\$ 1.89	2.93	-	1,991,431	\$ 1.89	-
\$2.32 - \$14.94	1,262,500	\$ 5.02	2.28	-	1,262,500	\$ 5.02	-
	9,528,903			\$ 1,787,855	9,528,903		\$ 1,787,855

#### Stock-based Compensation Expense

As of December 31, 2009, there was \$261,000 of total unrecognized compensation cost related to stock options and stock purchase rights. These costs are expected to be recognized over a weighted average period of 3.49 years.

To value option grants and other awards for actual and pro forma stock-based compensation, the Company has used the Black-Scholes option valuation model. When the measurement date is certain, the fair value of each option grant is estimated on the date of grant. Fair value determined using Black-Scholes varies based on assumptions used for the expected stock price volatility, expected life, risk-free interest rates and future dividend payments. During the three and nine-month periods ended December 31, 2009 and 2008, the Company used historical volatility of the common stock over a period equal to the expected life of the options to estimate their fair value. The expected life assumption represents the weighted-average period stock-based awards are expected to remain outstanding. These expected life assumptions are established through the review of historical exercise behavior of stock-based award grants with similar vesting periods. The risk-free interest rate is based on the closing market bid yields on actively traded U.S. treasury securities in the over-the-counter market for the expected term equal to the expected term of the option. The dividend yield assumption is based on the Company's history and expectation of future dividend payouts.

The following table summarizes the assumptions used to compute stock-based compensation to employees and directors for the three and nine months ended December 31, 2009 and 2008:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Expected volatility	-	77%	-	79%
Expected dividend yield	-	-	-	-
Risk-free interest rate	-	2.07%	-	2.79%
Weighted average expected option term	-	4.74 years	-	4.69 years
Weighted average fair value of options granted	\$ -	\$ 0.37	\$ -	\$ 0.54

In accordance with ASC 718, the Company recorded compensation expense relative to stock options and stock purchase rights collectively of \$19,000 and \$176,000 for the three months ended December 31, 2009 and 2008, respectively, and \$37,000 and \$787,000 for the nine months ended December 31, 2009 and 2008, respectively.

### Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan, eligible employees can participate and purchase common stock semi-annually through payroll deductions at a price equal to 85% of the fair market value of the common stock at the beginning of each one year offering period or the end of a six month purchase period, whichever is lower. The contribution amount may not exceed ten percent of an employee's base compensation, including commissions but not including bonuses and overtime. The Company accounts for the Employee Stock Purchase Plan as a compensatory plan and recorded compensation expense of \$51,000 and \$30,000 for the three months ended December 31, 2009 and 2008, respectively, and \$145,000 and \$83,000 for the nine months ended December 31, 2009 and 2008, respectively, in accordance with ASC 718.

The estimated fair value of stock purchase rights granted under the Employee Stock Purchase Plan were estimated at the date of grant using the Black-Scholes pricing model with the following weighted-average assumptions:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Expected volatility	90%	47%	90%	47%
Expected dividend yield	-	-	-	-
Risk-free interest rate	0.33%	1.69%	0.33%	1.69%
Weighted average expected option term	0.83 years	0.75 years	0.83 years	0.75 years
Weighted average fair value of options granted	\$ 0.34	\$ 0.35	\$ 0.34	\$ 0.35

As of December 31, 2009, there was \$55,000 of total unrecognized compensation cost related to employee stock purchases. These costs are expected to be recognized over a weighted average period of 0.2 years.

ASC 718 requires the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow. The future realizability of tax benefits related to stock compensation is dependent upon the timing of employee exercises and future taxable income, among other factors. The Company did not realize any tax benefit from the stock compensation charge incurred during the three months ended December 31, 2009 and 2008 as the Company believes that it is more likely than not that it will not realize the benefit from tax deductions related to equity compensation.

The following table summarizes the distribution of stock-based compensation expense related to employee stock options and employee stock purchases under ASC 718 among the Company's operating functions for the three and nine months ended December 31, 2009 and 2008 which was recorded as follows (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Cost of service revenues	\$ 7	\$ 9	\$ 18	\$ 16
Cost of product revenues	-	7	-	16
Research and development	23	12	60	137
Selling, general and administrative	40	178	104	701
Total stock-based compensation expense related to employee stock options and employee stock purchases, pre-tax	70	206	182	870
Tax benefit	-	-	-	-
Stock based compensation expense related to employee stock options and employee stock purchases, net of tax	\$ 70	\$ 206	\$ 182	\$ 870

### Recent Accounting Pronouncements

In July 2009, the FASB issued Accounting Standards Update ("ASU") No. 2009-1, "Topic 105 - Generally Accepted Accounting Principles," ("ASU 2009-1") which amended ASC 105, "Generally Accepted Accounting Principles," to establish the Codification as the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date, the Codification superseded all then-existing non-SEC accounting and reporting standards. The adoption of ASU 2009-1 did not have a material impact on the Company's financial position or results of operation.

In May 2009, the FASB issued ASC 855 - *Subsequent Events* (formerly SFAS No. 165, "Subsequent Events"). The statement is to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. SFAS No. 165 is effective for interim and annual periods ending after June 15, 2009. The adoption of ASC 855 did not have a material impact on the Company's financial position or results of operation.

### 3. BALANCE SHEET DETAIL

	December 31, 2009	March 31, 2009
Inventory (in thousands):		
Work-in-process	\$ 2,244	\$ 1,695
Finished goods	545	602
	\$ 2,789	\$ 2,297

## 4. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income available to common stockholders (numerator) by the weighted average number of vested, unrestricted common shares outstanding during the period (denominator). Diluted net income per share is computed on the basis of the weighted average number of shares of common stock outstanding plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include shares issuable upon exercise of outstanding stock options and warrants and under the employee stock purchase plan.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Numerator:				
Net income available to common stockholders	\$ 1,014	\$ 180	\$ 2,764	\$ 1,412
Denominator:				
Common shares	62,852	62,332	62,768	62,236
Denominator for basic calculation	62,852	62,332	62,768	62,236
Employee stock options	515	38	193	71
Employee stock purchase plan	26	24	17	121
Warrants	-	-	-	-
Denominator for diluted calculation	63,393	62,394	62,978	62,428
Net income per share				
Basic	\$ 0.02	\$ 0.00	\$ 0.04	\$ 0.02
Diluted	\$ 0.02	\$ 0.00	\$ 0.04	\$ 0.02

The following shares attributable to outstanding stock options and warrants were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Common stock options	7,471	11,365	8,553	10,588
Warrants	1,786	5,445	1,786	5,445
	9,257	16,810	10,339	16,033

## 5. COMPREHENSIVE INCOME

Comprehensive income includes all changes in equity (net assets) during a period from non-owner sources. The difference between the Company's net income and comprehensive income is due primarily to unrealized losses on investments classified as available-for-sale. Comprehensive income for the three and nine months ended December 31, 2009 and 2008 was as follows (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008

Edgar Filing: 8X8 INC /DE/ - Form 10-Q

Net income, as reported	\$ 1,014	\$ 180	\$ 2,764	\$ 1,412
Unrealized loss on investments in securities	-	-	-	(5)
Comprehensive income	\$ 1,014	\$ 180	\$ 2,764	\$ 1,407

- 12 -

---



## 6. SEGMENT REPORTING

ASC 280 - Segment Reporting (formerly SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information"), establishes annual and interim reporting standards for an enterprise's business segments and related disclosures about its products, services, geographic areas and major customers. The method for determining what information to report is based upon the way management organizes the operating segments within the Company for making operating decisions and assessing financial performance. The Company has determined that it has only one reportable segment. Revenue for this segment is presented by groupings of similar products and services (in thousands) in the following table:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
8x8 service, equipment and other	\$ 15,928	\$ 16,186	\$ 47,471	\$ 48,637
Technology licensing and related software	16	17	58	272
Total revenues	\$ 15,944	\$ 16,203	\$ 47,529	\$ 48,909

No customer represented greater than 10% of the Company's total revenue for the three and nine months ended December 31, 2009 or 2008. Revenue from customers outside the United States was not material for the three and nine months ended December 31, 2009 or 2008.

## 7. INCOME TAXES

Income taxes are accounted for using the asset and liability approach. Under the asset and liability approach, a current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the current year. A deferred tax liability or asset is recognized for the estimated future tax effects attributed to temporary differences and carryforwards. If necessary, the deferred tax assets are reduced by the amount of benefits that the Company determines, based on available evidence, is more likely than not to be realized. Other than the state gross receipt and franchise taxes and the foreign subsidiary taxes, the Company made no provision for income taxes in any periods presented in the accompanying condensed consolidated financial statements because of net losses incurred, or it expects to utilize net operating loss carryforwards for which there is a valuation allowance.

The Company accounts for the uncertainty in income taxes under the provisions of ASC 740 - *Income Taxes* (formerly FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes: an Interpretation of FASB Statement No. 109"), which clarifies the accounting and disclosure for uncertainty in income taxes recognized in an enterprise's financial statements. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not to be sustained on audit, based on the technical merits of the position. The Company believes that any income tax filing positions and deductions not sustained on audit will not result in a material change to its financial position or results of operations.

At March 31, 2009, the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was \$2.2 million, but any affect would have been fully offset by the application of the valuation allowance. The Company does not believe that there has been any change in the unrecognized tax benefits in the nine-month period ended December 31, 2009 and does not believe it is reasonably possible that the unrecognized tax benefit will materially change in the next 12 months. To the extent that the unrecognized tax benefits are ultimately recognized they may have an impact on the effective tax rate in future periods; however, such impact on the effective tax rate would only occur if the recognition of such unrecognized tax benefits occurs in a future period when the Company has already determined it is more likely than not that its deferred tax assets are realizable.

The Company is subject to taxation in the U.S., California and various other states and foreign jurisdictions in which we have or had a subsidiary or branch operations or we are collecting sales tax. All tax returns from fiscal 1995 to fiscal 2009 may be subject to examination by the Internal Revenue Service, California and various other states. The Company extended the filing date of the 2009 federal tax return and all state income tax returns. As of February 5, 2010, the federal return and all state returns that the Company believes it is required to file, with the exception of two state returns, had been filed. In addition, as of December 31, 2009, there were no active federal, state or local income tax audits. Returns filed in foreign jurisdictions may be subject to examination for the fiscal years 2005 to 2009.

The Company's policy for recording interest and penalties associated with audits is to record such items as a component of operating expense income before taxes. During the nine months ended December 31, 2009 and 2008, the Company did not recognize any interest or penalties related to unrecognized tax benefits.

## 8. COMMITMENTS AND CONTINGENCIES

### Guarantees

### Indemnifications

In the normal course of business, the Company indemnifies other parties, including customers, lessors and parties to other transactions with the Company, with respect to certain matters. Under these arrangements, the Company typically agrees to hold the other party harmless against losses arising from a breach of representations or covenants, intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, the Company has entered into indemnification agreements with its officers and directors.

It is not possible to determine the maximum potential amount of the Company's exposure under these indemnification agreements due to the limited history of indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material impact on the Company's operating results, financial position or cash flows. Under some of these agreements, however, the Company's potential indemnification liability might not have a contractual limit.

### Product Warranties

The Company accrues for the estimated costs that may be incurred under its product warranties upon revenue recognition. Changes in the Company's product warranty liability, which is included in cost of product revenue in the condensed consolidated statements of operations, during the three and nine months ended December 31, 2009 and 2008 were as follows (in thousands):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2009	2008	2009	2008
Balance at beginning of period	\$ 370	\$ 298	\$ 328	\$ 314
Accruals for warranties	66	120	304	259
Settlements	(80)	(91)	(276)	(246)
Balance at end of period	<u>\$ 356</u>	<u>\$ 327</u>	<u>\$ 356</u>	<u>\$ 327</u>

## Leases

In May 2009, the Company entered into a three-year lease for a new primary facility in Sunnyvale, California that expires in fiscal 2013. The Company has the option to accelerate the termination date of the lease to the 12<sup>th</sup>, 18<sup>th</sup>, 24<sup>th</sup>, or 30<sup>th</sup> full calendar month of the lease term, by providing six months advance notice. In the event the Company exercises this early termination option, the Company would be required to pay a fee to the landlord equal to the unamortized portion of any leasing commission and the unamortized portion of the initial alteration expenses incurred by the landlord as summarized in a current report on Form 8-K filed by the Company with the SEC on May 7, 2009. At December 31, 2009, future minimum annual lease payments under current and new operating leases were as follows (in thousands):

Year ending March 31:		
Remaining 2010	\$	139
2011		594
2012		657
2013		284
		<hr/>
Total minimum payments	\$	1,674
		<hr/>

In each of March 2007 and August 2009, the Company entered into a series of noncancelable capital lease agreements for office equipment bearing interest at various rates. At December 31, 2009, future minimum annual lease payments under noncancelable capital leases were as follows (in thousands):

Year ending March 31:		
Remaining 2010	\$	10
2011		41
2012		40
2013		7
		<hr/>
Total minimum payments		98
Less: Amount representing interest		(7)
		<hr/>
		91
Less: Short-term portion of capital lease obligations		(39)
		<hr/>
Long-term portion of capital lease obligations	\$	52
		<hr/>

Capital leases included in office equipment were \$212,000 at December 31, 2009. Total accumulated depreciation was \$121,000 at December 31, 2009. Amortization expense for assets recorded under capital leases is included in depreciation expense.

## Minimum Third Party Customer Support Commitments

In the third quarter of fiscal 2010, the Company amended a contract with one of its third party customer support vendors containing a minimum monthly commitment of approximately \$430,000. The agreement requires a rolling 150-day notice to terminate. The total remaining obligation under the amended contract is \$2.2 million.

## Legal Proceedings

From time to time, the Company may be involved in various legal claims and litigation that arise in the normal course of its operations. While the results of such claims and litigation cannot be predicted with certainty, the Company currently believes that it is not a party to any litigation the final outcome of which is likely to have a material adverse effect on the Company's financial position, results of operations or cash flows. However, should the Company not prevail in any such litigation it could have a material adverse impact on the Company's operating results, cash flows or

financial position. Even if the Company prevails in such litigation, it may divert the attention of management and require the expenditure of significant financial resources to resolve.

- 15 -

---

## State and Municipal Taxes

For a period of time, the Company did not collect or remit state or municipal taxes (such as sales, excise, and *ad valorem* taxes), fees or surcharges ("Taxes") on the charges to the Company's customers for its services, although the Company has historically complied with the California sales tax and financial contributions to the 9-1-1 system and universal service fund. The Company has received inquiries or demands from a number of state and municipal taxing agencies seeking payment of Taxes that are applied to or collected from customers of providers of traditional public switched telephone network services. Although the Company has consistently maintained that these Taxes do not apply to its service for a variety of reasons depending on the statute or rule that establishes such obligations, a number of states have changed their statutes as part of the streamlined sales tax initiatives and the Company has begun collecting and remitting Taxes in those states. Some of these Taxes could apply to the Company retroactively. Three states and one city currently are conducting sales tax audits of the Company's records. In October 2009, we received notices of proposed assessment as a result of two of the sales tax audits amounting to approximately \$1.9 million, which the Company considers to be unsubstantiated. The Company has accrued a tax liability of \$0.2 million as of December 31, 2009 to account for its estimated liability for past sales tax obligations related to these proposed assessments.

## Regulatory Matters

The effect of any future laws, regulations and orders on the Company's operations, including, but not limited to, the 8x8 service, cannot be determined. But as a general matter, increased regulation and the imposition of additional funding obligations increases the Company's costs of providing service that may or may not be recoverable from the Company's customers. This could result in making the Company's services less competitive with traditional telecommunications services if the Company increases its retail prices or decreases the Company's profit margins if it attempts to absorb such costs.

On March 17, 2010, the Federal Communications Commission (FCC) will present its national broadband plan to Congress. The purpose of the plan is to stimulate demand for broadband Internet access with the hopes of creating a virtuous cycle of increased consumer use of broadband applications and devices which will, in turn, spur the deployment of more broadband facilities creating a positive feedback loop. While the details of the plan are unknown at this time, it is expected that many elements of the current telecommunications regulatory structure will be impacted including, among many other things, universal service, intercarrier compensation, and principles concerning open Internet access rules. It is possible that the FCC could propose the adoption of new rules or legislation that could negatively impact our service in a number of ways that are not possible for us to foresee at this time.

In 2005, the Federal Communications Commission (FCC) adopted four general Internet policy principles that it would use in evaluating broadband Internet access providers conduct. The enforceability of these principles remains an open question and is the subject of ongoing litigation. On October 22, 2009, the FCC released a Notice of Proposed Rulemaking seeking comment on whether it should adopt these policy principles, in addition to other obligations, as enforceable rules in order to preserve the open Internet and, if so, what rules should be adopted. In particular, the agency is considering adopting enforceable rules that would, subject to reasonable network management, prohibit a provider of broadband Internet access service from: (1) preventing any of its users from sending or receiving the lawful content of the user's choice over the Internet; (2) preventing any of its users from running the lawful applications or using the lawful services of the user's choice; (3) preventing any of its users from connecting to and using on its network the user's choice of lawful devices that do not harm the network; and (4) depriving any of its users of the user's entitlement to competition among network providers, application providers, service providers and content providers. Additionally, the FCC is considering rules that would require broadband Internet access service providers, subject to reasonable network management, to treat lawful content, applications, and services in a nondiscriminatory manner, as well as to disclose information concerning network management and other practices as is reasonably required for users and content, application, and service providers to enjoy the protections ensured by any rules adopted as a result of this proceeding. If the FCC were to adopt enforceable rules concerning the open Internet,

the Company would have greater protection for its service offerings than it does today. The Company is wholly reliant on providers of broadband Internet access service providers to access its customers and to provide its services. While the Company has not encountered any material difficulties with regard to the issues being considered by the FCC in this proceeding, increased network congestion in the future may result in broadband Internet access providers engaging in actions that would either reduce the quality of the services provided by us today, or impede our ability to rollout new services that use more bandwidth. The Company cannot predict whether the FCC will adopt the proposed rules or any rules that are the subject of this proceeding nor can it predict what impact such rules will have on the business at this time.

On July 10, 2009, AT&T filed a "Petition for Immediate Commission Action" to reform the Federal Communications Commission's universal service fund contribution methodology. The AT&T petition requests that the Commission reform its contribution mechanism and adopt a telephone-numbers based contribution methodology where parties would make federal universal service fund contributions on the basis of "assessable telephone numbers." Under the current federal universal service fund contribution mechanism, nomadic interconnected VoIP providers, like the Company, are required to contribute to the federal universal service fund which the Company does. The Company's current contribution methodology is based on a traffic study that it completed where it determined the percentage of its customers' calls that are interstate in nature. The Company cannot predict whether the FCC will adopt AT&T's proposal nor can it predict what the impact on its business will be at this time.

Certain states continue to attempt to subject the Company's service to state universal service fund contribution obligations. At this time, at least three states, including Nebraska, contend that providers of interconnected VoIP services, like the Company, should contribute to its universal service fund. On March 3, 2008, the U.S. District Court for Nebraska issued a preliminary injunction and found that Nebraska Public Service Commission (NPSC) does not have jurisdiction to require universal service fund contributions from nomadic interconnected VoIP providers, like the Company. On May 1, 2009, a panel of the U.S. Circuit Court of Appeals for the Eighth Circuit affirmed the U.S. District court ruling. But on May 14, 2009, the NPSC requested a rehearing or a rehearing en banc of the decision handed down by the three-judge panel. On June 5, 2009, the Eighth Circuit denied the request for rehearing of the NPSC. Following this denial, another state, outside of the Eighth Circuit, attempted to require the Company to continue to contribute its state's Universal Service Fund. The Company continues to maintain that under current laws, and in light of the decisions in the Eighth Circuit, its interpretation that it is not currently subject to any state's universal service fund contribution obligations for its nomadic interconnected VoIP service offering is correct. Should this stance change, the Company plans to pass any increased cost of state universal service fund contributions through to its customers that would increase its retail prices making the Company's services less competitive with traditional telecommunications services.

On July 16, 2009, the NPSC and the Kansas Corporation Commission (KCC) filed a joint petition with the FCC seeking a declaratory ruling that the FCC has not preempted states from assessing universal service charges on the intrastate revenue of nomadic interconnected VoIP service providers, like the Company. Additionally, the petitioners ask the FCC to rule that states have discretion to adopt any mechanism to assess state universal service fund contributions so long as the methodology does not assess interstate revenue and contains procedures designed to ensure that no provider pays assessments to more than one state on the same intrastate revenue. The joint petitioners also seek a retroactive ruling that states have the authority to impose state universal service fund contribution obligations on providers of nomadic interconnected VoIP services. It is unclear from the petition how far back the period of retroactivity would extend. On August 10, 2009, the FCC requested comments on the petition filed by the NPSC and the KCC. The Company cannot predict the outcome of this FCC proceeding, nor its potential impact on the Company, at this time.

## 9. STOCK REPURCHASES

In July 2009, the Company's board of directors authorized the Company to purchase up to \$2.0 million of its common stock from time to time until July 28, 2010 (the "Repurchase Plan"). Share repurchases, if any, will be funded with available cash. Repurchases under the Repurchase Plan may be made through open market purchases at prevailing market prices or in privately negotiated transactions. The timing, volume and nature of share repurchases are subject to market prices and conditions, applicable securities laws and other factors, and are at the discretion of the Company's management. Share repurchases under the Repurchase Plan may be commenced, suspended or discontinued at any time. The remaining authorized repurchase amount at December 31, 2009 is approximately \$1.8 million. The activity under the Repurchase Plan for the nine months ended December 31, 2009 is summarized as follows:

Weighted



Edgar Filing: 8X8 INC /DE/ - Form 10-Q

	<u>Shares Repurchased</u>	<u>Average Price Per Share</u>	<u>Amount Repurchased</u>
Repurchase of common stock	282,376	\$ 0.75	\$ 211,741
Balance at December 31, 2009	<u>282,376</u>	\$ 0.75	<u>\$ 211,741</u>

- 17 -

---

The total purchase prices of the common stock repurchased and retired were reflected as a reduction to stockholders' equity during the period of repurchase.

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

### FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as "may," "will," "should," "estimates," "predicts," "potential," "continue," "strategy," "believes," "anticipates," "plans," "expects," "intends," and similar expressions are intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements. Actual results and trends may differ materially from historical results or those projected in any such forward-looking statements depending on a variety of factors. These factors include, but are not limited to, customer acceptance and demand for our VoIP products and services, the reliability of our services, the prices for our services, customer renewal rates, customer acquisition costs, actions by our competitors, including price reductions for their telephone services, potential federal and state regulatory actions, compliance costs, potential warranty claims and product defects, our needs for and the availability of adequate working capital, our ability to innovate technologically, the timely supply of products by our contract manufacturers, potential future intellectual property infringement claims that could adversely affect our business and operating results, and our ability to retain our listing on the NASDAQ Capital Market. The forward-looking statements may also be impacted by the additional risks faced by us as described in this Report, including those set forth in the Risk Factors discussion in Part II, Item 1A of this Form 10-Q. In addition to those factors discussed elsewhere in this Form 10-Q, see the Risk Factors discussion in Part I, Item 1A of our 2009 Form 10-K. The forward-looking statements included in this Form 10-Q are made only as of the date of this report, and we undertake no obligation to update the forward-looking statements to reflect subsequent events or circumstances.

### BUSINESS OVERVIEW

We develop and market telecommunication technology for Internet protocol, or IP, telephony and video applications. We offer the 8x8 broadband and video communications service and launched the 8x8 residential service offering in November 2002 and the 8x8 business service offering in March 2004. Substantially all of our revenue is generated from the sale, license and provisioning of VoIP products, services and technologies.

Our fiscal year ends March 31 of each calendar year. Each reference to a fiscal year in this report refers to the fiscal year ending March 31 of the calendar year indicated (for example, fiscal 2010 refers to the fiscal year ending March 31, 2010).

### CRITICAL ACCOUNTING POLICIES & ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of assets and liabilities. On an on-going basis, we evaluate our critical accounting policies and estimates. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies and estimates are discussed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009. As of December 31, 2009, there had been no material changes to our critical accounting

policies and estimates.

RECENT ACCOUNTING PRONOUNCEMENTS

See Item 1 of Part I, "Financial Statements - Note 2 - Basis of Presentation - Recent Accounting Pronouncements."

- 18 -

---

## SELECTED OPERATING STATISTICS

We periodically review certain key business metrics, within the context of our articulated performance goals, in order to evaluate the effectiveness of our operational strategies, allocate resources and maximize the financial performance of our business. The selected operating statistics include the following:

## Selected Operating Statistics

	Dec. 31, 2009	Sept. 30, 2009	June 30, 2009	March 31, 2009	Dec. 31, 2008	Sept. 30, 2008	June 30, 2008	March 31, 2008
Gross business customer additions (1)	2,785	2,609	2,907	2,792	2,437	3,324	2,398	2,162
Gross business customer cancellations (less cancellations within 30 days of sign-up)	1,331	1,416	1,371	1,245	1,224	1,187	1,098	1,138
Business customer churn (less cancellations within 30 days of sign-up) (2)	2.4%	2.7%	2.7%	2.7%	2.9%	3.1%	3.2%	3.6%
Total business customers (3)	19,407	18,199	17,266	16,013	14,706	13,744	11,898	10,845
Business customer average monthly service per customer (4)	\$ 204	\$ 201	\$ 196	\$ 202	\$ 208	\$ 220	\$ 237	\$ 229
Revenue from business customers (in '000s)	\$ 12,650	\$ 11,842	\$ 10,722	\$ 10,728	\$ 10,614	\$ 9,826	\$ 9,077	\$ 8,111
Revenue from residential and video customers (in '000s)	\$ 3,278	\$ 4,168	\$ 4,811	\$ 5,236	\$ 5,572	\$ 6,356	\$ 7,192	\$ 7,685
Revenue from technology licensing (in '000s)	\$ 16	\$ 17	\$ 25	\$ (199)	\$ 17	\$ 243	\$ 12	\$ 536
<b>Total Revenue</b>	<b>\$ 15,944</b>	<b>\$ 16,027</b>	<b>\$ 15,558</b>	<b>\$ 15,765</b>	<b>\$ 16,203</b>	<b>\$ 16,425</b>	<b>\$ 16,281</b>	<b>\$ 16,332</b>
Percentage of revenue from business customers	79.3%	73.9%	68.9%	68.1%	65.5%	59.8%	55.8%	49.7%
Percentage of revenue from residential and								