

Crexendo, Inc.  
Form 10-K  
March 06, 2018

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

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FORM 10-K  

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2017:

Or

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

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Crexendo, Inc.  
(Exact name of registrant as specified in its charter)  

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Nevada                                      001-32277    87-0591719  
(State or Other Jurisdiction          (Commission (I.R.S. Employer  
of Incorporation or Organization) File Number) Identification No.)

1615 South 52nd Street, Tempe, AZ 85281  
(Address of Principal Executive Office) (Zip Code)

(602) 714-8500  
(Registrant's telephone number, including area code)  
(Former name, former address and former fiscal year, if changed since last report)  

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

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	OTCQX Marketplace

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of December 31, 2017 was approximately \$7,716,764.

The number of shares of the registrant's common stock outstanding as of February 19, 2018 was 14,287,556.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Registrant's 2018 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K.



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## PART I

Throughout this Annual Report, we refer to Crexendo, Inc., together with its subsidiaries, as “we,” “us,” “our Company,” “Crexendo®” or “the Company.” As used in this Annual Report, “Ride The Cloud™” is a registered trademark of our Company in the United States and other countries. All other product names are or may be trademarks of, and are used to identify the products and services of, their respective owners.

THIS ANNUAL REPORT ON FORM 10-K CONTAINS FORWARD-LOOKING STATEMENTS. THESE STATEMENTS RELATE TO FUTURE EVENTS OR OUR FUTURE FINANCIAL PERFORMANCE. IN SOME CASES, YOU CAN IDENTIFY FORWARD-LOOKING STATEMENTS BY TERMINOLOGY SUCH AS “MAY,” “WILL,” “SHOULD,” “EXPECT,” “PLAN,” “INTEND,” “ANTICIPATE,” “BELIEVE,” “ESTIMATE,” “PROJECT,” “PREPARE,” “POTENTIAL” OR “CONTINUE” (INCLUDING THE NEGATIVE OF SUCH TERMS), OR OTHER SIMILAR TERMINOLOGY. THESE STATEMENTS ARE ONLY ESTIMATIONS, AND ARE BASED UPON VARIOUS ASSUMPTIONS THAT MAY NOT BE REALIZED. ACTUAL EVENTS OR RESULTS MAY DIFFER MATERIALLY. IN EVALUATING THESE STATEMENTS, YOU SHOULD SPECIFICALLY CONSIDER VARIOUS FACTORS, INCLUDING, BUT NOT LIMITED TO, THE RISKS OUTLINED BELOW UNDER ITEM 1A. THESE FACTORS MAY CAUSE OUR ACTUAL RESULTS TO DIFFER MATERIALLY FROM ANY FORWARD-LOOKING STATEMENT.

ALTHOUGH WE BELIEVE THAT THE ESTIMATIONS REFLECTED IN THE FORWARD-LOOKING STATEMENTS ARE REASONABLE, WE CANNOT GUARANTEE FUTURE RESULTS, LEVELS OF ACTIVITY, PERFORMANCE OR ACHIEVEMENTS. MOREOVER, NEITHER WE NOR ANY OTHER PERSON ASSUMES RESPONSIBILITY FOR THE ACCURACY AND COMPLETENESS OF THE FORWARD-LOOKING STATEMENTS. WE DO NOT INTEND TO UPDATE ANY OF THE FORWARD-LOOKING STATEMENTS AFTER THE DATE OF THIS ANNUAL REPORT TO CONFORM SUCH STATEMENTS TO ACTUAL RESULTS OR TO CHANGES IN OUR EXPECTATIONS, UNLESS REQUIRED BY LAW.

### ITEM 1. BUSINESS

#### OVERVIEW

Crexendo, Inc. is a next-generation CLEC and an award-winning leader and provider of unified communications cloud telecom services, broadband internet services, and other cloud business services that are designed to provide enterprise-class cloud services to any size businesses at affordable monthly rates.

Cloud Telecommunications segment - Our cloud telecommunications services transmit calls using IP or cloud technology, which converts voice signals into digital data packets for transmission over the Internet or cloud. Each of our calling plans provides a number of basic features typically offered by traditional telephone service providers, plus a wide range of enhanced features that we believe offer an attractive value proposition to our customers. This platform enables a user, via a single “identity” or telephone number, to access and utilize services and features regardless of how the user is connected to the Internet or cloud, whether it’s from a desktop device or a mobile device.

We generate recurring revenue from our cloud telecommunications and broadband Internet services. Our cloud telecommunications contracts typically have a thirty-six to sixty month term. We generate product revenue and equipment financing revenue from the sale and lease of our cloud telecommunications equipment. Revenues from the sale of equipment, including those from sales-type leases, are recognized at the time of sale or at the inception of the lease, as appropriate.

Web Services segment - We generate recurring revenue from website hosting and other professional services.

## OUR SERVICES AND PRODUCTS

Our goal is to provide a broad range of cloud-based products and services that nearly eliminate the cost of a businesses' technology infrastructure and enable businesses of any size to more efficiently run their business. By providing a variety of comprehensive and scalable solutions, we are able to cater to businesses of all sizes on a monthly subscription basis without the need for expensive capital investments, regardless of where their business is in its lifecycle. Our products and services can be categorized in the following offerings:





Cloud Telecommunications Services - Our cloud telecommunications service offering includes hardware, software, and unified communication solutions for businesses using IP or cloud technology over any high-speed internet connection. These services are rendered through a variety of devices and user interfaces such as a Crexendo branded desktop phones and/or mobile and desktop applications. Some examples of mobile devices are Android cell phones, iPhones, iPads or Android tablets. These services enable our customers to seamlessly communicate with others through phone calls that originate/terminate on our network or PSTN networks. Our cloud telecommunications services are powered by our proprietary implementation of standards based Web and VoIP cloud technologies. Our services use our highly scalable complex infrastructure that we build and manage based on industry standard best practices to achieve greater efficiencies, better quality of service (QoS) and customer satisfaction. Our infrastructure comprises of compute, storage, network technologies, 3rd party products and vendor relationships. We also develop end user portals for account management, license management, billing and customer support and adopt other cloud technologies through our partnerships.

Crexendo's cloud telecommunication service offers a wide variety of essential and advanced features for businesses of all sizes. Many of these features included in the service offering are:

Business Productivity Features such as dial-by extension and name, transfer, conference, call recording, Unlimited calling to anywhere in the US and Canada, International calling, Toll free (Inbound and Outbound)

Individual Productivity Features such as Caller ID, Call Waiting, Last Call Return, Call Recording, Music/Message-On-Hold, Voicemail, Unified Messaging, Hot-Desking

Group Productivity Features such as Call Park, Call Pickup, Interactive Voice Response (IVR), Individual and Universal Paging, Corporate Directory, Multi-Party Conferencing, Group Mailboxes, Web and mobile devices based collaboration applications

Call Center Features such as Automated Call Distribution (ACD), Call Monitor, Whisper and Barge, Automatic Call Recording, One way call recording, Analytics

Advanced Unified Communication Features such as Find-Me-Follow-Me, Sequential Ring and Simultaneous Ring, Voicemail transcription

Mobile Features such as extension dialing, transfer and conference and seamless hand-off from WiFi to/from 3G and 4G, LTE, as well as other data services. These features are also available on CrexMo, an intelligent mobile application for iPhones and Android smartphones, as well as iPads and Android tablets

Traditional PBX Features such as Busy Lamp Fields, System Hold. 16-48 Port density Analog Devices

Expanded Desktop Device Selection such as Entry Level Phone, Executive Desktop, DECT Phone for roaming users

Advanced Faxing solution such as Cloud Fax (cFax) allowing customers to send and receive Faxes from their Email Clients, Mobile Phones and Desktops without having to use a Fax Machine simply by attaching a file

Web based online portal to administer, manage and provision the system.

Asynchronous communication tools like SMS/MMS, chat and document sharing to keep in pace with emerging communication trends.

Many of these services are included in our basic offering to our customers for a monthly recurring fee and do not require a capital expense. Some of the advanced features such as Automatic Call Recording and Call Center Features require additional monthly fees. Crexendo continues to invest and develop its technology and CPaaS offerings to make them more competitive and profitable.

Website Services - Our website services segment allows businesses to host their websites in our data center for a recurring monthly fee.

#### SEGMENT INFORMATION

The Company has two operating segments, which consist of Cloud Telecommunications and Web Services. Segment revenue and income (loss) before income tax provision was as follows (in thousands):



Year Ended  
December 31,

2017      2016

Revenue:

Cloud Telecommunications	\$9,320	\$7,757
Web Services	1,057	1,362
Consolidated revenue	\$10,377	\$9,119

Year Ended  
December 31,

2017      2016

Income/(loss) before income tax provision:

Cloud Telecommunications	\$(1,514)	\$(3,210)
Web Services	501	430
Loss before income tax	\$(1,013)	\$(2,780)

TECHNOLOGY

We believe our proprietary implementation of standard Web, IP, Cloud, Mobile and Internet technologies represent a key component of our business model. We believe these technologies and how we deliver them to our customers distinguish our services and products from the services and products offered by our competitors. Our technology infrastructure and virtual network operation center, all of which is built and managed on industry standard computers, storage, network, data and platforms offers us greater efficiencies while maintaining scalability and redundancy. The synergies between Web and Telecommunication protocols such as TCP/IP, HTTP, XML, SIP and innovations in computing, load balancing, redundancy and high availability of Web and Telecommunications technologies offers us a unique advantage in delivering these services to our customers seamlessly from our data center.

Our Cloud Telecommunications technology is continuously being enhanced with additional features and software functionality. Our current functionality includes:

High-end desktop telephony devices such as Gigabit, PoE, 6 Line Color Phone with 10 programmable buttons and lower end Monochrome 2 Line wall mountable device;

Basic Business Telephony Features such as those offered in a traditional private branch exchange (“PBX”) systems like extension dialing, Direct Inward Dialing (DID), Hold/Resume, Music-On-Hold, Call Transfer (Attended and Unattended), Conferencing, Local, Long Distance, Toll-Free and International Dialing, Voicemail, Auto-Attendant

and traditional faxing;

Advanced telephony features such as Call Park, Call Pickup, Paging (through the phones), Overhead paging, Call Recording;

Call Center Functionality such as Agent Log In/Log Out, Whisper, Barge and Call center reporting;

Unified Communications features like Simultaneous Ring, Sequential Ring, Status based Routing (Find-Me-Follow-Me), 10-party instant conference, and Mobile application (CrexMo);

Crexendo Mobile Application (CrexMo), which allows users to place and receive extension calls using Crexendo's network, transfer and conference other users right from their mobile device as if they were in the office. It also provided users instant access to visual voicemail and call logs;

End User Portal and Unified Messaging with Voicemail, Call Recording and eFax inbox.

Collaboration products like group chat, SMS/MMS, document sharing, video and web conferencing

Our website software platform is continuously being enhanced and is an innovative website-building environment. We continue to invest and develop on our Web platform to make it more easy-to-use, enable larger mobile and 3rd party integration features thus enabling our web customers to drive more traffic to their web-sites.



## RESEARCH AND DEVELOPMENT

We invested \$750,000 and \$826,000 for the years ended December 31, 2017 and 2016, respectively, in the research and development of our technologies and data center. The majority of these expenditures were for enhancements to our cloud telecommunications products and services and website development software.

## COMPETITION

The market for cloud business communications services is large and increasingly competitive. We expect competition to continue to increase in the future. Some of these competitors include:

traditional on-premise, hardware business communications providers such as Alcatel-Lucent Enterprise, Avaya Inc., Cisco Systems, Inc., and Siemens Enterprise Networks, LLC, any of which may now or in the future also host their solutions through the cloud;

software providers such as Microsoft Corporation (Microsoft Teams (formerly Skype for Business)) and BroadSoft, Inc. (which recently announced an agreement to be acquired by Cisco Systems, Inc.) that generally license their software and may now or in the future also host their solutions through the cloud, and their resellers including major carriers and cable companies;

established communications providers that resell on-premise hardware, software, and hosted solutions, such as AT&T, Verizon Communications Inc., and Comcast Corporation in the United States, TELUS and others in Canada, and BT, Vodafone, and others in the U.K., all of whom have significantly greater resources than us and do now or may in the future also develop and/or host their own or other solutions through the cloud;

other cloud companies such as 8x8, Inc., RingCentral, Inc., Amazon.com, Inc., DialPad, Inc., Fuze (formerly Thinking Phone Networks), StarBlue (merger of Star2Star and BlueFace), Intermedia.net, Inc., J2 Global, Inc., Jive Communications, Inc. (which recently announced an agreement to be acquired by LogMeIn, Inc.), Microsoft Corporation (Microsoft Teams (formerly Skype for Business)), Nextiva, Inc., Slack Technologies, Inc., Vonage Holdings Corp., and West Corporation;

other large internet companies such as Alphabet Inc., Facebook, Inc., Oracle Corporation, and Salesforce.com, Inc., any of which might launch its own cloud-based business communication services or acquire other cloud-based business communications companies in the future; and

established contact center providers such as Amazon.com, Inc., Aspect Software, Inc., Avaya Inc., Five9, Inc., Genesys Telecommunications Laboratories, Inc.), and NewVoiceMedia.

Additionally, should we determine to pursue acquisition opportunities, we may compete with other companies with similar growth strategies. Some of these competitors may be larger and have greater financial resources than we do. Competition for these acquisition targets could also result in increased prices of acquisition targets and a diminished pool of companies available for acquisition.

There are relatively low barriers to entry into our business. Our proprietary technology does not preclude or inhibit competitors from entering our markets. In particular, we anticipate new entrants will attempt to develop competing products and services or new forums for conducting e-commerce and telecommunications services which could be deemed competition. Additionally, if telecommunications service providers with more resources and name recognition were to enter our markets, they may redefine our industry and make it difficult for us to compete.

Expected technology advances associated with the Cloud, increasing use of the Cloud, and new software products are welcome advancements that we believe will broaden the Cloud's viability. We anticipate that we can compete successfully by relying on our infrastructure, marketing strategies and techniques, systems and procedures, and by adding additional products and services in the future. We believe we can continue the operation of our business by periodic review and revision to our product offerings and marketing approach.





## INTELLECTUAL PROPERTY

Our success depends in part on using and protecting our proprietary technology and other intellectual property. Furthermore, we must conduct our operations without infringing on the proprietary rights of third parties. We also rely upon trade secrets and the know-how and expertise of our key employees. To protect our proprietary technology and other intellectual property, we rely on a combination of the protections provided by applicable copyright, trademark and trade secret laws, as well as confidentiality procedures and licensing arrangements. Although we believe we have taken appropriate steps to protect our intellectual property rights, including requiring employees and third parties who are granted access to our intellectual property to enter into confidentiality agreements, these measures may not be sufficient to protect our rights against third parties. Others may independently develop or otherwise acquire unpatented technologies or products similar or superior to ours.

We license from third parties certain software and Internet tools which we include in our services and products. If any of these licenses were terminated, we could be required to seek licenses for similar software and Internet tools from other third parties or develop these tools internally. We may not be able to obtain such licenses or develop such tools in a timely fashion, on acceptable terms, or at all.

Companies participating in the software, Internet technology, and telecommunication industries are frequently involved in disputes relating to intellectual property. We may be required to defend our intellectual property rights against infringement, duplication, discovery and misappropriation by third parties or to defend against third-party claims of infringement. Likewise, disputes may arise in the future with respect to ownership of technology developed by employees who were previously employed by other companies. Any such litigation or disputes could be costly and divert our attention from our business. An adverse determination could subject us to significant liabilities to third parties, require us to seek licenses from, or pay royalties to, third parties, or require us to develop appropriate alternative technology. Some or all of these licenses may not be available to us on acceptable terms, or at all. In addition, we may be unable to develop alternate technology at an acceptable price, or at all. Any of these events could have a material adverse effect on our business prospects, financial position, or results of operations.

## EMPLOYEES

As of December 31, 2017, we had 54 employees; 51 full-time and 3 part-time, including 3 executives, 15 sales representatives and sales management, 10 engineers and IT support, 18 in operations and customer support, 8 in finance, legal, and other general administration.

## CORPORATE INFORMATION

Crexendo, Inc. was incorporated as a Nevada corporation under the name "Netgateway, Inc." on April 13, 1995. In November 1999, we were reincorporated under the laws of Delaware. In July 2002, we changed our corporate name to "iMergent, Inc." In May 2011, our stockholders approved an amendment to our Certificate of Incorporation to change our name from "iMergent, Inc." to "Crexendo, Inc." The name change was effective May 18, 2011. Our ticker symbol "IIG" on the New York Stock Exchange was changed to "EXE" on May 18, 2011. We changed the name to better reflect the scope and direction of our business activities of assisting and providing web-based technology solutions to any size businesses who are seeking to take advantage of the benefits of conducting business on the cloud. On January 13, 2015, the Company moved to the OTCQX Marketplace and our ticker symbol was changed to "CXDO". In November 2016, we were reincorporated as a Nevada corporation.

We are headquartered at 1615 South 52nd Street, Tempe, AZ, 85281, and our telephone number is (602) 714-8500. Our website is [www.crexendo.com](http://www.crexendo.com). Our website and the information contained therein or connected thereto shall not be deemed to be incorporated into this Annual Report.

We make available free of charge on or through our Internet website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities Exchange and Commission (“SEC”).

You may read and copy this Annual Report at the SEC’s public reference room at 450 Fifth Street, NW, Washington D.C. 20549. Information on the operation of the public reference room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding our filings at [www.sec.gov](http://www.sec.gov).



## GOVERNMENTAL REGULATION

As a provider of Internet communications services, we are subject to regulation in the U.S. by the FCC. Some of these regulatory obligations include contributing to the Federal Universal Service Fund, Telecommunications Relay Service Fund and federal programs related to number administration; providing access to E-911 services; protecting customer information; and porting phone numbers upon a valid customer request. We are also required to pay state and local 911 fees and contribute to state universal service funds in those states that assess Internet voice communications services. We are a competitive local exchange carrier (CLEC) in forty-seven states. We are subject to the same FCC regulations applicable to telecommunications companies, as well as regulation by the public utility commission in these states. Specific regulations vary on a state-by-state basis, but generally include the requirement to register or seek certification to provide its services, to file and update tariffs setting forth the terms, conditions and prices for our intrastate services and to comply with various reporting, record-keeping, surcharge collection, and consumer protection requirements.

We are subject to regulations generally applicable to all businesses. We are also subject to an increasing number of laws and regulations directly applicable to telecommunication, internet access and commerce. The adoption of any such additional laws or regulations may decrease the rate of growth of the Internet, which could in turn decrease the demand for our products and services. Such laws may also increase our costs of doing business or otherwise have an adverse effect on our business prospects, financial position or results of operations. Moreover, the applicability to the Internet of existing laws governing issues such as property ownership, libel, and personal privacy is uncertain. Future federal or state legislation or regulation could have a material adverse effect on our business prospects, financial condition and results of operations.

### ITEM 1A. RISK FACTORS.

Our quarterly and annual results of operations have fluctuated in the past and may continue to do so in the future. As a result, we may fail to meet or to exceed the expectations of research analysts or investors, which could cause our stock price to fluctuate.

Our quarterly and annual results of operations have varied historically from period to period, and we expect that they will continue to fluctuate due to a variety of factors, many of which are outside of our control, including:

our ability to retain existing customers and resellers, expand our existing customers' user base, and attract new customers;

our ability to introduce new solutions;

the actions of our competitors, including pricing changes or the introduction of new solutions;

our ability to effectively manage our growth;

our ability to successfully penetrate the market for larger businesses;

the mix of annual and multi-year subscriptions at any given time;

the timing, cost, and effectiveness of our advertising and marketing efforts;

the timing, operating cost, and capital expenditures related to the operation, maintenance and expansion of our business;

service outages or information security breaches and any related impact on our reputation;

our ability to accurately forecast revenues and appropriately plan our expenses;

our ability to realize our deferred tax assets;

costs associated with defending and resolving intellectual property infringement and other claims;

changes in tax laws, regulations, or accounting rules;

the timing and cost of developing or acquiring technologies, services or businesses, and our ability to successfully manage any such acquisitions;

adverse weather conditions; and.

the impact of worldwide economic, political, industry, and market conditions.

Any one of the factors above, or the cumulative effect of some or all of the factors referred to above, may result in significant fluctuations in our quarterly and annual results of operations. This variability and unpredictability could result in our failure to meet the expectations of securities analysts or investors for any period, which could cause our stock price to decline. In addition, a significant percentage of our operating expenses is fixed in nature and is based on forecasted revenues trends. Accordingly, in the event of revenue shortfalls, we may not be able to mitigate the negative impact on net income (loss) and margins in the short term. If we fail to meet or exceed the expectations of research analysts or investors, the market price of our shares could fall substantially, and we could face costly lawsuits, including securities class-action suits.



We have incurred operating losses in current and prior periods.

We sustained operating losses in the current and prior years. Our ability to obtain positive cash flows from operating activities will depend on many factors including, but not limited to, our ability to (i) improve sales and marketing efficiencies, (ii) reduce costs, (iii) reach more highly qualified prospects, and (iv) achieve operational improvements. We have incurred operating losses in each of the three prior years and may incur operating losses in the foreseeable future

Fluctuations in our operating results may affect our stock price and ability to raise capital.

Our operating results for any given quarter or fiscal year should not be relied upon as an indication of future performance. Our future results will fluctuate, and those results may fall below the expectations of investors and may cause the trading price of our common stock to fall. This may impair our ability to raise capital, should we seek to do so. Our quarterly results may fluctuate based on, including but not limited to our sales results, marketing, management, our ability to compete, pricing, and other risk factors contained in this section.

Our Chief Executive Officer owns a significant amount of our common stock and could exercise substantial corporate control. There may be limited ability to sell the company absent the consent of the CEO.

Steven G. Mihaylo, Chief Executive Officer (“CEO”) of Crexendo, Inc., owns 74% of the outstanding shares of our common stock based on the number of shares outstanding as of December 31, 2017. As a result, Mr. Mihaylo would have the ability to determine the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, amalgamation, consolidation or sale of all or substantially all of our assets. Mr. Mihaylo may have the ability to control the management and affairs of our Company. As a “control company” it may not be required that the company maintains an independent board. As a director and officer, Mr. Mihaylo owes a fiduciary duty to our stockholders. As a stockholder, Mr. Mihaylo is entitled to vote his shares, in his own interests, which may not always be in the interests of our stockholders generally. Accordingly, even though certain transactions may be in the best interests of other stockholders, this concentration of ownership may harm the market price of our common stock by, among other things, delaying, deferring or preventing a change in control of our Company, impeding a merger, amalgamation, consolidation, takeover or other business combination involving our Company, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our Company.

In addition, sales or other dispositions of our shares by Mr. Mihaylo may depress our stock price. Sales of a significant number of shares of our common stock in the public market could harm the market price of our common stock. As additional shares of our common stock become available for resale in the public market, the supply of our common stock will increase, which could result in a decrease in the market price of our common stock.

Some of the provisions of our certificate of incorporation and bylaws could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders by providing them with the opportunity to sell their shares at a premium to the then market price. Our bylaws contain provisions regulating the introduction of business at annual stockholders’ meetings by anyone other than the board of directors. These provisions may have the effect of making it more difficult, delaying, discouraging, preventing or rendering costlier an acquisition or a change in control of our Company.

Our securities have been thinly traded. An active trading market in our equity securities may cease to exist, which would adversely affect the market price and liquidity of our common stock, in addition our stock price has been subject to fluctuating prices.



Our common stock is traded exclusively in the over-the-counter market. We cannot predict the actions of market makers, investors or other market participants, and can offer no assurances that the market for our securities will be stable. If there is no active trading market in our equity securities, the market price and liquidity of the securities will be adversely affected. The market price of our common stock could decline as a result of sales of a large number of shares of our common stock in the market or the perception that these sales could occur. These sales also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. As of February 19, 2018, we had outstanding 14,287,556 shares of common stock.

Additional dilution will result if outstanding options to acquire shares of our common stock are exercised. In addition, in the event future financings are required they could be convertible into or exchangeable for our equity securities, investors may experience additional dilution.

Lack of sufficient stockholder equity or continued losses from operations could subject us to fail to comply with the listing requirements of the OTCQX, if that occurred, the price of our common stock and our ability to access the capital markets could be negatively impacted, and our business will be harmed. We currently do not meet the minimum listing requirement for the NYSE or NASDAQ.



Our common stock is currently listed on OTCQX. We have had annual losses from continuing operations for the last five years with the possibility of continued losses. While at current such losses would not impact our listing with OTCQX requirement may change from time to time and it is possible we may not remain in compliance with the minimum condition of OTCQX listing standards. Delisting from the OTCQX could negatively affect the trading price of our stock and could also have other negative results, including the potential loss of confidence by suppliers and employees, the failure to attract the interest of institutional investors, and fewer business development opportunities. At present we do not meet the minimum listing requirements for the New York Stock Exchange (NYSE) or the NASDAQ Stock Exchange (NASDAQ) which may make raising capital, issuing additional securities or using the securities of the Company to effect acquisitions or merger more difficult or expensive.

We may undertake acquisitions, mergers or change to our capital structure to expand our business, which may pose risks to our business and dilute the ownership of our existing stockholders.

As part of a potential growth strategy, we may attempt to acquire or merge with certain businesses. Whether we realize benefits from any such transactions will depend in part upon the integration of the acquired businesses; the performance of the acquired products, services and capacities of the technologies acquired, as well as the personnel hired in connection therewith. Accordingly, our results of operations could be adversely affected from transaction-related charges, amortization of intangible assets, and charges for impairment of long-term assets. While we believe that we have established appropriate and adequate procedures and processes to mitigate these risks, there can be no assurance that any potential transaction will be successful.

In addition, the financing of any acquisition may require us to raise additional funds through public or private sources. Additional funds may not be available on terms that are favorable to us and, in the case of equity financings, may result in dilution to our stockholders. Future acquisitions by us could also result in large and immediate write-offs or assumptions of debt and contingent liabilities, any of which may have a material adverse effect on our consolidated financial position, results of operations, and cash flows.

Our ability to use our net operating loss carry-forwards may be reduced in the event of an ownership change, and could adversely affect our financial results.

As of December 31, 2017, we had net operating loss (“NOL”) carry-forwards of approximately \$24,401,000, of which \$5,761,000 is subject to Section 382 limitations. Section 382 of the Internal Revenue Code, as amended (the “Code”) imposes limitations on a corporation’s ability to utilize its NOL carry-forwards. In general terms, an ownership change results from transactions increasing the ownership of certain stockholders in the stock of a corporation by more than 50% over a three-year period. Since our formation, we have issued a significant number of shares, and purchasers of those shares have sold some of them, resulting in two ownership changes, as defined by Code Section 382. As a result of the last ownership change, utilization of our NOL is subject to an annual limitation determined by multiplying the value of our stock at the time of the ownership change by the applicable federal long-term tax-exempt rate. The annual limitation is approximately \$461,000. Any limited amounts may be carried over into later years, and the amount of the limitation may, under certain circumstances, be increased by the “recognized built-in gains” that occur during the five-year period after the ownership change (the recognition period). Future changes in ownership of more than 50% may also limit the use of these remaining NOL carry-forwards. Our earnings, if any, and cash resources would be materially and adversely affected if we cannot receive the full benefit of the remaining NOL carry-forwards. An ownership change could occur as a result of circumstances that are not within our control.

The telecommunications industry is highly competitive. We face intense competition from traditional telephone companies, wireless companies, cable companies and alternative voice communication providers and other VoIP companies.

Our Cloud telecommunications services compete with other voice over internet protocol (VoIP) providers. In addition, we also compete with traditional telephone service providers which provide telephone service based on the public switched telephone network (PSTN). Our VoIP offering is not fully compatible with such customers. Some of these traditional providers have also added VoIP services. There is also competition from cable providers, which have added VoIP service offerings in bundled packages to their existing cable customers. The telecommunications industry is highly competitive. We face intense competition from traditional telephone companies, wireless companies, cable companies, and alternative voice communication providers.

Most traditional wire line and wireless telephone service providers, cable companies, and some VoIP providers are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. Because most of our target customers are already purchasing communications services from one or more of these providers, our success is dependent upon our ability to attract target customers away from their existing providers. Our competitors' financial resources may allow them to offer services at prices below cost or even for free in order to maintain and gain market share or otherwise improve their competitive positions.



The markets for our products and services are continuing to evolve and are increasingly competitive. Demand and market acceptance for recently introduced and proposed new products and services and sales of such products and services are subject to a high level of uncertainty and risk. Our business may suffer if the market develops in an unexpected manner, develops more slowly than in the past or becomes saturated with competitors, if any new products and services do not sustain market acceptance. A number of very large, well-capitalized, high profile companies serve the e-commerce, VoIP and Cloud technology markets. If any of these companies entered our markets in a focused and concentrated fashion, we could lose customers, particularly more sophisticated and financially stable customers.

Our VoIP or cloud telecommunications service competes against established well financed alternative voice communication providers, (such as 8x8 and Ring Central) who may provide comparable services at comparable or lower pricing.

Pricing in the telecommunications industry is very fluid and competitive. Price is often a substantial motivation factor in a customer's decision to switch to our telephony products and services. Our competitors may reduce their rates which may require us to reduce our rates, which would affect our margins and revenues, or otherwise make our pricing non-competitive. We may be at a disadvantage compared with those competitors who have substantially greater resources than us or may otherwise be better positioned to withstand an extended period of downward pricing pressure.

Many of our current and potential competitors have longer operating histories, significantly greater resources and brand awareness, and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers. Our competitors may also offer bundled service arrangements that present a more differentiated or better integrated product to customers. Announcements, or expectations, as to the introduction of new products and technologies by our competitors or us could cause customers to defer purchases of our existing products, which also could have a material adverse effect on our business, financial condition or operating results.

Changes to rates by our suppliers, competitors and increasing regulatory charges may require us to raise prices which could impact results.

Pricing in the telecommunications industry is very fluid and competitive. Price is often a substantial motivating factor in a customer's decision to switch to our cloud telecommunications products and services. Our competitors may reduce their rates which may require us to reduce our rates, which would affect our margins and revenues, or otherwise make our pricing non-competitive. Our upstream carriers, suppliers and vendors may increase their rates thus directly impacting our cost of sales, which would affect our margins. Interconnected VoIP traffic may be subject to increased charges. Should this occur, the rates paid to our underlying carriers may increase which could reduce our profitability. Changes in our underlying costs of sales may increase rates we charge our customers which could make us less competitive and impact our sales and retention of existing customers.

We have targeted sales to mid-market and larger enterprise customers. Not properly managing these customers could negatively affect our business, margins, cash flow and operations.

Selling to larger enterprise customers contains inherent risks and uncertainties. Our sales cycle has become more time-consuming and expensive. The delays associated with closing and installing larger customers may impact results on a quarter to quarter basis. There may be additional pricing pressure in this market which may affect margins and profitability. Revenue recognition may be delayed for some complex transactions, all of which could harm our business and operating results. The loss of a large customer may have a material negative impact on quarterly or annual results.

Multi-location users require additional and expensive customer service which may require additional expense and impact margins on enterprise sales. Enterprise customers may demand more features, integration services and customization which require additional engineering and operational time which could impact margins on an enterprise sale. Multi-location enterprise customer sales may have different requirements in different locations which may be difficult to fulfill or satisfy various interests which could result in cancellations.

Enterprise customers might demand we provide service locations internationally where we may encounter technical, logistical, infrastructure and regulatory limitations on our ability to implement or deliver our services. Our inability to provide service in certain international locations may result in a cancellation of the entire contract. Further with larger enterprise customer sales, the risk of customers transporting desktop devices internationally without our knowledge may increase.

We must acquire new customers on an ongoing basis to maintain and increase our customers and revenues.

We will have to acquire new customers in order to increase revenues. We incur significant costs to acquire new customers, and those costs are an important factor in determining our profitability. Therefore, if we are unsuccessful in retaining customers or are required to spend significant amounts to acquire new customers beyond those budgeted, our revenue could decrease, which could prevent us from reaching profitability and have our net loss increase. Marketing expenditures are an ongoing requirement and will become a larger ongoing requirement of our business.





If we do not successfully expand our sales including our partner channel program and direct sales, we may be unable to substantially increase our sales.

We sell our products primarily through direct sales and our partner channel, and we must substantially expand the number of partners and producing direct sales personnel to increase organic revenue substantially. If we are unable to expand our partner channel network and hire and retain qualified sales personnel, our ability to increase our organic revenue and grow our business could be compromised. The challenge of attracting, training, and retaining qualified candidates, may make it difficult to grow revenue.

We face risks in our sales to certain market segments including, but not limited to, sales subject to HIPAA Regulations.

We have sold and will continue to attempt to sell to certain customer segments which may have requirements for additional privacy or security. In addition sales may be made to customers that are subject to additional security requirements and or HIPAA requirements. Selling into segments with additional requirements increases potential liability which in some instances may be unlimited. While the Company believes it meets or exceeds all requirements for sales into such segments, there is no assurance that the Company systems fully comply with all requirements. Our customers can use our services to store contact and other personal or identifying information, and to process, transmit, receive, store and retrieve a variety of communications and messages, including information about their own customers and other contacts. In addition, customers may use our services to store protected health information, or PHI, that is protected under the Health Insurance Portability and Accountability Act, or HIPAA, Noncompliance with laws and regulations relating to privacy and HIPAA may lead to significant fines, penalties or civil liability.

We face risks in our strategy of designing and developing our own desktop telephones ("desktop devices").

We continue to primarily sell Crexendo ® branded desktop devices, although, the Company also supports third party devices manufactured by Yealink, Cisco, and Polycom. Our desktop devices are being manufactured by third party vendors in China. The Crexendo branded desktop devices include firmware specifically designed for our cloud telecommunications services. If the phones are successfully manufactured there is no assurance of the acceptance of the desktop devices. Successful roll out is not guaranteed and is contingent on various factors including but not limited to; meeting certain industry standards, the availability of our vendors to meet agreed terms, supply from vendors being sufficient to meet demand, industry acceptance of the desktop devices, desktop devices meeting the needs of our customers, competitive pricing of the desktop devices, feature set of the desktop devices being up to competitive standards, regulatory approval as required of the desktop devices and competitor claims relating to the desktop devices. Our failure to be able to fully implement the sale of the Crexendo desktop devices or the inability to have desktop devices manufactured to meet our supply needs may cause us damage as well as require us to have to purchase desktop devices from other suppliers at a higher price which could affect sales and margins. Our desktop devices come preloaded with our firmware and are not currently intended to work with other competitors' or vendors' services.

Our churn rate may increase in future periods due to customer cancellations or other factors, which may adversely impact our revenue or require us to spend more money to grow our customer base.

Our customers generally have initial service periods of between three and five year and may discontinue their subscriptions for our services after the expiration of their initial subscription period. In addition, our customers may renew for lower subscription amounts or for shorter contract lengths. We may not accurately predict cancellation rates for our customers. Our cancellation rates may increase or fluctuate because of a number of factors, including customer usage, pricing changes, number of applications used by our customers, customer satisfaction with our service, the acquisition of our customers by other companies and deteriorating general economic conditions. If our customers do

not renew their subscriptions for our service or decrease the amount they spend with us, our revenue will decline, and our business will suffer.

Our rate of customer cancellations may increase in future periods due to many factors, some of which are beyond our control, such as the financial condition of our customers or the state of credit markets. In addition, a single, protracted service outage or a series of service disruptions, whether due to our services or those of our bandwidth carriers, may result in a sharp increase in customer cancellations.

If we do not successfully expand our physical infrastructure and build diverse geo redundant locations, which require large investments, we may be unable to substantially increase our sales and retain customers

Our ability to provide cloud telecommunications services is dependent upon on Data Center, facilities and equipment in our single Data Center. While most of our equipment required for providing these services are redundant in nature and offer high availability, certain types of failures or malfunctioning of critical hardware/software equipment, including but not limited to fire, water or other physical damage may impact our ability to deliver continuous service to our customers, which may impact our revenue, profitability and retaining of customer and acquiring new customers.



Our ability to provide telecommunication services due to loss of physical facilities in our only data center from act of God or terrorism or vandalism or gross negligence of person(s) currently or formerly associated with the company may result in loss of revenue and future business.

Our ability to recover from disasters, if and when they occur is paramount to offer continued service to our existing customers. While we have adequate equipment and procedures to handle disaster recovery including but not limited to offsite data storage; recovery from such scenarios may cause excessive delays in restoration of service and may result in some data loss. This may lead to loss of customers and may severely impact our revenue.

We may not be able to scale our business efficiently or quickly enough to meet our customers' growing needs, in which case our operating results could be harmed.

As usage of our cloud telecommunications services by mid-market and larger distributed enterprises expands and as customers continue to integrate our services across their enterprises, we are required to devote additional resources to improving our application architecture, integrating our products and applications across our technology platform as well as expanding integration and performance. We will need to appropriately scale our internal business systems and our services organization, including customer support and services and regulatory compliance, to serve a growing customer base. Any failure of or delay in these efforts could cause to prevent acquisition of customers, impaired system performance and reduced customer satisfaction. These issues could result in decreased sales to new customers, lower renewal rates by existing customers, which could hurt our revenue growth and our reputation. We cannot be sure that the expansion and improvements to our infrastructure and systems will be fully or effectively implemented on a timely basis, if at all. These efforts may reduce revenue and our margins and adversely impact our financial results.

Our success depends in part upon the capacity, reliability, and performance of our network infrastructure, including the capacity provided by our Internet bandwidth suppliers.

We depend on these companies to provide uninterrupted and error-free service. Some of these providers are also our competitors. We do not have control over these providers. We may be subject to interruptions or delays in network service. If we fail to maintain reliable bandwidth or performance that could significantly reduce customer demand for our services and damage our business.

Our success depends in part upon the capacity, reliability, and performance of our telecom carriers, and their network infrastructure, including the capacity provided by our Tier 1 and non-Tier 1 Telecom suppliers for Telecom Origination and Termination Services

We depend on these companies to provide uninterrupted and error-free service telecom services, sourcing of DIDs, porting of numbers and delivering telephone calls from and to endpoints and devices on our network. Some of these providers are also our competitors. We do not have control over these providers. We may be subject to interruptions or delays in their service. If we fail to maintain reliable connectivity or performance with our upstream carriers it could then significantly reduce customer demand for our services and damage our business.

Our ability to provide telecommunications services is dependent upon third-party facilities and equipment, the failure of which could cause delays or interruptions of our service and impact our revenue and profitability.

Our ability to provide quality and reliable cloud telecommunications service is in part dependent upon the proper functioning of facilities and equipment owned and operated by third parties and is, therefore, beyond our control. Our cloud telecommunications service (and to a lesser extent our e-commerce services) requires our customers to have an operative broadband Internet connection and an electrical power supply, which are provided by the customer's Internet

service provider and electric utility company and not by us. The quality of some broadband Internet connections may be too poor for customers to use our services properly. In addition, if there is any interruption to a customer's broadband Internet service or electrical power supply, that customer will be unable to make or receive calls, including emergency calls (our E-911 service), using our service. We outsource several of our network functions to third-party providers. If our third-party service providers fail to maintain these facilities properly, or fail to respond quickly to problems, our customers may experience service interruptions. The failure of any of these third party service providers to properly maintain services may be subject to factors including but not limited to the following: (i) cause a loss of customers, (ii) adversely affect our reputation, (iii) cause negative publicity, (iv) negatively impact our ability to acquire customers, (v) negatively impact our revenue and profitability, (vi) potential law suits for not reaching E-911 services, and (vii) potential law suits for loss of business and loss of reputation.



We rely on third parties to provide a portion of our customer service responses, initiate local number portability for our customers, deliver calls to and from PSTN and other public telephone VoIP/Wireless service providers and provide aspects of our E-911 service.

We offer our cloud telecommunications customers support 24 hours a day, seven days a week. We may rely on third parties (sometimes outside of the U.S) to respond to customer inquiries. These third-party providers generally represent us without identifying themselves as independent parties. The ability of third-party providers to provide these representatives may be disrupted due to issues outside our control.

We also maintain an agreement with an E-911 provider to assist us in routing emergency calls directly to an emergency service dispatcher at the PSAP in the area of the customer's registered location and terminating E-911 calls. We also contract with a provider for the national call center that operates 24 hours a day, seven days a week to receive certain emergency calls and with several companies that maintain PSAP databases for the purpose of deploying and operating E-911 services. The dispatcher will have automatic access to the customer's telephone number and registered location information. If a customer moves their Crexendo service to a new location, the customer's registered location information must be updated and verified by the customer. Until that takes place, the customer will have to verbally advise the emergency dispatcher of his or her actual location at the time of an emergency 9-1-1 call. This can lead to delays in the delivery of emergency services

Interruptions in service from these vendors could also cause failures in our customers' access to E-911 services and expose us to liability.

We also have agreements with companies that initiate our local number portability, which allow new customers to retain their existing telephone numbers when subscribing to our services. We will need to work with these companies to properly port numbers. The failure to port numbers may subject us to loss of customers or regulatory review.

If any of these third parties do not provide reliable, high-quality service, our reputation and our business will be harmed. In addition, industry consolidation among providers of services to us may impact our ability to obtain these services or increase our expense for these services.

Our dependence on outside contractors and third-party agents for fulfillment of certain items and critical manufacturing services could result in product or delivery delays and/or damage our customer relations.

We outsource the manufacturing of certain products we sell and products we provide. We submit purchase orders to agents or the companies that manufacture the products. We describe, among other things, the type and quantities of products or components to be supplied or manufactured and the delivery date and other terms applicable to the products or components. Our suppliers or manufacturers potentially may not accept any purchase order that we submit. Our reliance on outside parties involves a number of potential risks, including: (i) the absence of adequate capacity, (ii) the unavailability of, or interruptions in access to, production or manufacturing processes, (iii) reduced control over delivery schedules, (iv) errors in the product, and (v) claims of third party intellectual infringement or defective merchandise. If delays, problems or defects were to occur, it could adversely affect our business, cause claims for damages to be filed against us, and negatively impact our consolidated operations and cash flows.

Errors in our technology or technological issues outside our control could cause delays or interruptions to our customers.

Our services (including cloud telecommunications and e-commerce) may be disrupted by problems with our technology and systems such as malfunctions in our software or facilities. In addition there may be service interruptions for reasons outside our control. Our customers and potential customers subscribing to our services have

experienced interruptions in the past and may experience interruptions in the future as a result of these types of problems. Interruptions could cause us to lose customers and offer customer credits, which could adversely affect our revenue and profitability. Network and Telecommunication interruptions may also impair our ability to sign-up new customers. In addition since our systems and our customers' ability to use our services are Internet-dependent, our services may be subject to "cyber-attacks" from the Internet, which could have a significant impact on our systems and services. Our customers' ability to use our services is dependent on third-party internet providers which may suffer service disruptions. If service interruptions adversely affect the perceived reliability of our service, we may have difficulty attracting and retaining customers and our growth may suffer.

Our operations could be hurt by a natural disaster, network security breach, or other catastrophic event.

We maintain a fully redundant network infrastructure in our data center in Tempe, Arizona. Currently, we do not have multiple site capacity if any catastrophic event occurs, although we expect to attain multiple site redundancy sometime in the future. This system does not guarantee continued reliability if a catastrophic event occurs. Despite implementation of network security measures, our servers may be vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering with our computer systems including, but not limited to, denial of service attacks. In addition, if there is a breach or alleged breach of security or privacy involving our services including but not limited to data loss, or if any third party undertakes illegal or harmful actions using our communications or e-commerce services, our business and reputation could suffer substantial adverse publicity and impairment. We have experienced interruptions in service in the past. While we do not believe that we have lost customers as a consequence, the harm to our reputation is difficult to assess. We have taken and continue to take steps to improve our infrastructure to prevent service interruptions.





Failure in our data center or services could lead to significant costs and disruptions.

All data centers, including ours, are subject to various points of failure. Problems with cooling equipment, generators, uninterruptible power supply, routers, switches, or other equipment, whether or not within our control, could result in service interruptions for our customers as well as equipment damage. Any failure or downtime could affect a significant percentage of our customers. The total destruction or severe impairment of our data center facilities could result in significant downtime of our services and the loss of customer data.

Internet security issues and growing Cyber threats pose risks to the development of e-commerce and our business.

Security and privacy concerns may inhibit the growth of the Internet and other online services generally, especially as a means of conducting commercial transactions.

We could experience security breaches in the transmission and analysis of confidential and proprietary information of the consumer, the merchant, or both, as well as our own confidential and proprietary information.

Anyone able to circumvent security measures could misappropriate proprietary information or cause interruptions in our operations, as well as the operations of the merchant. We may be required to expend significant capital and other resources to protect against security breaches or to minimize problems caused by security breaches. To the extent that we experience breaches in the security of proprietary information which we store and transmit, our reputation could be damaged and we could be exposed to a risk of loss or litigation.

We collect personal and credit card information from our customers and employees could misuse this information.

We maintain credit card and other personal information in our systems. Due to the sensitive nature of retaining such information we have implemented policies and procedures to preserve and protect our data and our customers' data against loss, misuse, corruption, misappropriation caused by systems failures, unauthorized access, or misuse. Notwithstanding these policies, we could be subject to liability claims by individuals and customers whose data resides in our databases for the misuse of that information. While the Company believes its systems meet or exceed industry standards the Company does not believe it is required to meet PCI level 1 compliance and has not certified under that level. Failure to meet PCI compliance levels could negatively impact the Company's ability to collect and store credit card information which could cause substantial disruption to our business.

We depend upon industry standard protocols, best practices, solutions, third-party software, technology, tools including but not limited to Open Source software.

We rely on non-proprietary third party licensing and software some of which may be Open Source and protected under various licensing agreements. We may be subject to additional royalties, license or trademark infringement costs or other unknown costs when one or more of these third-party technologies are affected or need to be replaced due to end-of-support or end-of-sale of such third parties.

We may incur substantial expenses in defending against third-party patent and trademark infringement claims regardless of their merit.

From time to time, parties may assert patent infringement claims against us in the form of letters, lawsuits, and other forms of communication. Third parties may also assert claims against us alleging infringement of copyrights, trademark rights, trade secret rights or other proprietary rights or alleging unfair competition. If there is a determination that we have infringed third-party proprietary rights, we could incur substantial monetary liability and be prevented from using the rights in the future.

We depend on our senior management and other key personnel, and a loss of these individuals could adversely impact our ability to execute our business plan and grow our business.

We depend on the continued services of our key personnel, including our Officers and certain engineers. Each of these individuals has acquired specialized knowledge and skills with respect to our operations. The loss of one or more of these key personnel could negatively impact our performance. In addition, we expect to hire additional personnel as we continue to execute our strategic plan, particularly if we are successful in expanding our operations. Competition for the limited number of qualified personnel in our industry is intense. At times, we have experienced difficulties in hiring personnel with the necessary training or experience.



Our public filings are subject to review by the Securities and Exchange Commission (SEC)

Our SEC filings are reviewed by the SEC from time to time and any significant changes required as a result of any such review may result in material liability to us and have a material adverse impact on the trading price of our common stock.

Examinations by relevant tax authorities may result in material changes in related tax reserves for tax positions taken in previously filed tax returns or may impact the valuation of certain deferred income tax assets, such as net operating loss carry-forwards.

Based on the outcome of examinations by relevant tax authorities, or as a result of the expiration of statutes of limitations for specific jurisdictions, it is reasonably possible that the related tax reserves for tax positions taken regarding previously filed tax returns will materially change from those recorded in our financial statements. In addition, the outcome of examinations may impact the valuation of certain deferred income tax assets (such as net operating loss carry-forwards) in future periods. It is not possible to estimate the impact of the amount of such changes, if any, to previously recorded uncertain tax positions.

Changes in our business model and sales strategies may adversely impact revenue.

When the Company shifted away from a seminar sales model, our web services revenue was adversely impacted. Our website hosting revenue has continued to decline since we no longer sell our website development software through a seminar sales model. The Company is not actively marketing its website development software or website hosting services. Our web services segment revenue may continue to decline over time as more competitors enter the website building and hosting industry.

From time to time we had been the subject of governmental inquiries and investigations related to our discontinued seminar sales model and business practices that could require us to pay refunds, damages or fines, which could negatively impact our financial results or ability to conduct business. We have received customer complaints and civil actions.

From time to time, we received inquiries from federal, national, state, city and local government officials in the various jurisdictions in which we operated. These inquiries had historically been related to our discontinued seminar sales practices. There is still the potential of review of past sales and sales of our current web and telecom services. We respond to these inquiries and have generally been successful in addressing the concerns of these persons and entities, without a formal complaint or charge being made, although there is often no formal closing of the inquiry or investigation. The ultimate resolution of these or other inquiries or investigations may have a material adverse effect on our business or operations, or a formal complaint could be initiated. During the ordinary course of business, we also receive a number of complaints and inquiries from customers, governmental and private entities. In some cases, these complaints and inquiries from agencies and customers have ended up in civil court. We may continue to receive customer and agency claims and actions.

Changes in laws and regulations and the interpretation and enforcement of such laws and regulations could adversely impact our financial results or ability to conduct business.

We are subject to a variety of federal and state laws and regulations as well as oversight from a variety of governmental agencies and public service commissions. The laws governing our business may change in ways that harm our business. Federal or state governmental agencies administering and enforcing such laws may also choose to interpret and apply them in ways that harm our business. These interpretations are also subject to change. Regulatory action could materially impair or force us to change our business model and may adversely affect our revenue,

increase our compliance costs, and reduce our profitability. In addition, governmental agencies such as the Securities and Exchange Commission (SEC), Internal Revenue Service (IRS), Federal Trade Commission (FTC), Federal Communication Commission (FCC) and state taxing authorities may conclude that we have violated federal laws, state laws or other rules and regulations, and we could be subject to fines, penalties or other actions that could adversely impact our financial results or our ability to conduct business.

The FCC net neutrality rules have changed. We cannot predict the effect of this, nor the impact of this change on our business.

We could face interference with our services, lower speed of bandwidth for our services and/or higher costs. While we believe interference with access to our products and services remains unlikely, broadband Internet access provider interference has occurred, and could increase in frequency due to the termination of the network neutrality rules. This could cause us to lose existing customers, impair our ability to attract new customers, and harm our revenue and growth. These problems could also arise in international markets.



Our Telecommunications services are required to comply with industry standards, FCC regulations, privacy laws as well as certain State and local jurisdiction specific regulations failure to comply with those may subject us to penalties and may also require us to modify existing products and/or service.

The acceptance of telecommunications services is dependent upon our meeting certain industry standards. We are required to comply with certain rules and regulations of the FCC regarding safety standards. Standards are continuously being modified and replaced. As standards evolve, we may be required to modify our existing products or develop and support new versions of our products. We must comply with certain federal, state, and local requirements regarding how we interact with our customers, including marketing practices, consumer protection, privacy, and billing issues, the provision of 9-1-1 emergency service and the quality of service we provide to our customers. The failure of our products and services to comply, or delays in compliance, with various existing and evolving standards could delay future offerings and impact our sales, margins, and profitability. Changes to the Universal Service Funds by the FCC or various States may require us to increase our costs which could negatively affect revenue and margins.

We are subject to Federal laws and FCC regulations that require us to protect customer information. While we have protections in place to protect customer information there is no assurance that our systems will not be subject to failure or intentional fraudulent attack. The failure to protect required information could subject us to penalties and diminish the confidence our customers have in our systems which could negatively affect results. While we try to comply with all applicable data protection laws, regulations, standards, and codes of conduct, as well as our own posted privacy policies and contractual commitments to the extent possible, any failure by us to protect our users' privacy and data, including as a result of our systems being compromised by hacking or other malicious or surreptitious activity, could result in a loss of user confidence in our services and ultimately in a loss of users, which could materially and adversely affect our business as well as subject us to law suits, civil fines and criminal penalties.

Governmental entities, class action lawyers and consumer advocates are reviewing the data collection and use by companies that must maintain such data. Our own requirements as well as regulatory codes of conduct, enforcement actions by regulatory agencies, and lawsuits by other parties could impose additional compliance costs on us as well as subject us to unknown potential liabilities. These evolving laws, rules and practices may also curtail our current business activities which may delay or affect our ability to become profitable as well as affect customers and other business opportunities.

We are also subject to the privacy and data protection-related obligations in our contracts with our customers and other third parties. Any failure, or perceived failure, to comply with federal, state, or international laws, or to comply with our contractual obligations related to privacy, could result in proceedings or actions against us which could result in significant liability to us as well as harm to our reputation. Additionally, third parties with whom we contract may violate or appear to violate laws or regulations which could subject us to the same risks.

There is considerable uncertainty with respect to the state of law governing data transfers between the European Union ("EU"), and other countries with similar data protection laws, and it remains unclear what the final resolution will be for cross-border data transfers of personal information. There may be risks associated with data transfer and customers who use International Locations.

States are adding regulation for VoIP providers which could increase our costs and change certain aspects of our service.

Certain states take the position that offerings by VoIP providers are intrastate and therefore subject to state regulation. We have registered as a CLEC in most states, however our rates are not regulated in the same manner as traditional telephone service providers. Some states are also requiring that we register as a seller of VoIP services even though



we have registered as a CLEC. Some states argue that if the beginning and desktop devices of communications are known, and if some of these communications occur entirely within the boundaries of a state, the state can regulate that offering and may therefore add additional taxes or surcharges or regulate rates in a similar matter to traditional telephone service providers. We believe that the FCC has pre-empted states from regulating VoIP providers in the same manner as providers of traditional telecommunications services. We cannot predict how this issue will be resolved or its impact on our business at this time.

Our ability to offer services outside the U.S. is subject to different regulations which may be unknown and uncertain.

Regulatory treatment of VoIP providers outside the United States varies from country to country, and local jurisdictions. Many times, the laws are vague, unclear and regulations are not enforced uniformly. We are licensed as a VoIP seller in Canada, and are considering expanding to other countries. We also cannot control if our customers take their devices out of the United States and use them abroad. Our resellers may sell to customers who maintain facilities outside the United States. The failure by us or our customers and resellers to comply with laws and regulations could reduce our revenue and profitability. As we expand to additional Countries there may be additional regulations that we are required to comply with, the failure to comply or properly assess regulations may subject us to penalties, fines and other actions which could materially affect our business.<sup>1</sup>



ITEM 2.  
PROPERTIES

Our corporate office consists of approximately 22,000 square feet of office space in Tempe, Arizona owned by our CEO. Our corporate office is located at 1615 South 52nd Street, Tempe, Arizona 85281. We maintain property insurance on the corporate office building as required by the lease and tenant fire and casualty insurance on our assets located in these buildings in an amount that we deem adequate.

ITEM 3.  
LEGAL PROCEEDINGS

From time to time we receive inquiries from federal, state, city and local government officials as well as the FCC and taxing authorities in the various jurisdictions in which we operate. These inquiries and investigations related primarily to our discontinued seminar operations and concern compliance with various city, county, state, and/or federal regulations involving sales, representations made, customer service, refund policies, services and marketing practices. We respond to these inquiries and have generally been successful in addressing the concerns of these persons and entities, without a formal complaint or charge being made, although there is often no formal closing of the inquiry or investigation. There can be no assurance that the ultimate resolution of these or other inquiries and investigations will not have a material adverse effect on our business or operations, or that a formal complaint will not be initiated. We also receive complaints and inquiries in the ordinary course of our business from both customers and governmental and non-governmental bodies on behalf of customers, and in some cases these customer complaints have risen to the level of litigation. There can be no assurance that the ultimate resolution of these matters will not have a material adverse effect on our business or results of operations.

ITEM 4.  
MINE SAFETY DISCLOSURES

The disclosure required by this item is not applicable

PART II

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

MARKET INFORMATION

Our common stock began trading on the NYSE - MKT on August 16, 2004 under the symbol "IIG." In May 2011, our stockholders approved an amendment to our Certificate of Incorporation to change our name from "iMergent, Inc." to "Crexendo, Inc." The name change was effective May 18, 2011. Our ticker symbol "IIG" on the New York Stock Exchange was changed to "EXE" on May 18, 2011. On January 13, 2015, the Company moved to the OTCQX Marketplace and our ticker symbol was changed to "CXDO". The following table sets forth the range of high and low sales prices as reported on the OTCQX Marketplace for the periods indicated.



High Low

Year Ended December 31, 2017

October to December 2017	\$2.71	\$1.46
July to September 2017	1.95	1.45
April to June 2017	1.84	1.45
January to March 2017	1.60	1.45

Year Ended December 31, 2016

October to December 2016	\$1.55	\$1.36
July to September 2016	1.50	1.30
April to June 2016	1.55	1.21
January to March 2016	1.41	0.61

SECURITY HOLDERS

There were approximately 1,191 holders of record of our shares of common stock as of December 31, 2017. The number of holders does not include individual participants in security positions listings.

DIVIDENDS

There were no dividends declared for the years ended December 31, 2017 and 2016.

ISSUER PURCHASES OF EQUITY SECURITIES

None

RECENT SALES OF UNREGISTERED SECURITIES

None

ITEM 6.

SELECTED FINANCIAL DATA

Not required.

ITEM 7.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SAFE HARBOR

In addition to historical information, this Annual Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, risks and uncertainties, including the risk factors set forth in Item 1A. above and the risk factors set forth in this Annual Report. Generally, the words "anticipate", "expect", "intend", "believe" and similar expressions identify forward-looking

statements. The forward-looking statements made in this Annual Report are made as of the filing date of this Annual Report with the SEC, and future events or circumstances could cause results that differ significantly from the forward-looking statements included here. Accordingly, we caution readers not to place undue reliance on these statements. We expressly disclaim any obligation to update or alter our forward-looking statements, whether, as a result of new information, future events or otherwise after the date of this document.



## OVERVIEW

Crexendo, Inc. is a next-generation CLEC and an award-winning leader and provider of unified communications cloud telecom services, broadband internet services, and other cloud business services that are designed to provide enterprise-class cloud services to any size businesses at affordable monthly rates. The Company has two operating segments, which consist of Cloud Telecommunications and Web Services.

**Cloud Telecommunications** - Our cloud telecommunications services transmit calls using IP or cloud technology, which converts voice signals into digital data packets for transmission over the Internet or cloud. Each of our calling plans provides a number of basic features typically offered by traditional telephone service providers, plus a wide range of enhanced features that we believe offer an attractive value proposition to our customers. This platform enables a user, via a single “identity” or telephone number, to access and utilize services and features regardless of how the user is connected to the Internet or cloud, whether it’s from a desktop device or an application on a mobile device.

We generate recurring revenue from our cloud telecommunications and broadband Internet services. Our cloud telecommunications contracts typically have a thirty-six to sixty month term. We generate product revenue and equipment financing revenue from the sale and lease of our cloud telecommunications equipment. Revenues from the sale of equipment, including those from sales-type leases, are recognized at the time of sale or at the inception of the lease, as appropriate.

Our Cloud Telecommunications service revenue increased 27% or \$1,691,000 to \$7,973,000 for the year ended December 31, 2017 as compared to \$6,282,000 for the year ended December 31, 2016. Our Cloud Telecommunications product revenue decreased 9% or \$128,000 to \$1,347,000 for the year ended December 31, 2017 as compared to \$1,475,000 for the year ended December 31, 2016. As of December 31, 2017 and 2016, our backlog was \$19,871,000 and \$15,921,000, respectively.

**Web Services** – We generate recurring revenue from website hosting and other professional services.

Our Web Services revenue decreased 22% or \$305,000 to \$1,057,000 for the year ended December 31, 2017 as compared to \$1,362,000 for the year ended December 31, 2016.

### Results of Consolidated Operations

The following discussion of financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto and other financial information included herein this Annual Report.

Results of Consolidated Operations (in thousands, except for per share amounts)

	Year Ended December 31,	
Consolidated	2017	2016
Service revenue	\$9,030	\$7,644
Product revenue	\$1,347	\$1,475
Total revenue	\$10,377	\$9,119



Loss before income taxes	(1,013)	(2,780)
Income tax provision	(7)	(12)
Net loss	(1,020)	(2,792)
Basic/diluted net loss per share	\$(0.07)	\$(0.21)

## Year Ended December 31, 2017 Compared to Year Ended December 31, 2016

## Service Revenue

Service revenue consists primarily of fees collected for cloud telecommunications services, professional services, interest from sales-type leases, broadband Internet services, website hosting, and web management services. Service revenue increased 18% or \$1,386,000, to \$9,030,000 for the year ended December 31, 2017 as compared to \$7,644,000 for the year ended December 31, 2016. Cloud Telecommunications service revenue increased 27% or \$1,691,000, to \$7,973,000 for the year ended December 31, 2017 as compared to \$6,282,000 for the year ended December 31, 2016. Web service revenue decreased 22% or \$305,000, to \$1,057,000 for the year ended December 31, 2017 as compared to \$1,362,000 for the year ended December 31, 2016.



## Product Revenue

Product revenue consists primarily of fees collected for the sale of desktop phone devices and third party equipment. Product revenue decreased by 9% or \$128,000, to \$1,347,000 for the year ended December 31, 2017 as compared to \$1,475,000 for the year ended December 31, 2016. Product revenue fluctuates from one period to the next based on timing of installations. Our typical customer installation is complete within 30 days. However, larger enterprise customers can take multiple months, depending on size and the number of locations. Product revenue is recognized when products have been installed and services commence. We believe growth will initially be seen through increase in our backlog.

## Loss Before Income Taxes

Loss before income tax decreased 64% or \$1,767,000 to \$1,013,000 for the year ended December 31, 2017 as compared to \$2,780,000 for the year ended December 31, 2016. The decrease in loss before income tax is primarily due to an increase in revenue of \$1,258,000 and a decrease in total operating expenses of \$680,000, offset by an increase in other expense of \$171,000 related to interest expense from the related party note payable and decrease in sublease income of \$97,000 from fulfillment of our lease obligations.

## Income Tax Provision

We had an income tax provision of \$7,000 for the year ended December 31, 2017 compared to an income tax provision of \$12,000 for the year ended December 31, 2016. We had a pre-tax loss for the years ended December 31, 2017 and 2016 of \$1,013,000 and \$2,780,000, respectively, and a full valuation allowance on all of our deferred tax assets for the years ended December 31, 2017 and 2016.

## Use of Non-GAAP Financial Measures

To evaluate our business, we consider and use non-generally accepted accounting principles (Non-GAAP) net income (loss) and Adjusted EBITDA as a supplemental measure of operating performance. These measures include the same adjustments that management takes into account when it reviews and assesses operating performance on a period-to-period basis. We consider Non-GAAP net income (loss) to be an important indicator of overall business performance because it allows us to evaluate results without the effects of share-based compensation, rent expense paid with common stock, and amortization of intangibles. We define EBITDA as U.S. GAAP net income (loss) before interest income, interest expense, other income and expense, provision for income taxes, and depreciation and amortization. We believe EBITDA provides a useful metric to investors to compare us with other companies within our industry and across industries. We define Adjusted EBITDA as EBITDA adjusted for share-based compensation, and rent expense paid with stock. We use Adjusted EBITDA as a supplemental measure to review and assess operating performance. We also believe use of Adjusted EBITDA facilitates investors' use of operating performance comparisons from period to period, as well as across companies.

In our March 6, 2018 earnings press release, as furnished on Form 8-K, we included Non-GAAP net loss, EBITDA and Adjusted EBITDA. The terms Non-GAAP net loss, EBITDA, and Adjusted EBITDA are not defined under U.S. GAAP, and are not measures of operating income, operating performance or liquidity presented in analytical tools, and when assessing our operating performance, Non-GAAP net loss, EBITDA, and Adjusted EBITDA should not be considered in isolation, or as a substitute for net loss or other consolidated income statement data prepared in accordance with U.S. GAAP. Some of these limitations include, but are not limited to:

EBITDA and Adjusted EBITDA do not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;

they do not reflect changes in, or cash requirements for, our working capital needs;

they do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt that we may incur;

they do not reflect income taxes or the cash requirements for any tax payments;

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will be replaced sometime in the future, and EBITDA and Adjusted EBITDA do not reflect any cash requirements for such replacements;

while share-based compensation is a component of operating expense, the impact on our financial statements compared to other companies can vary significantly due to such factors as the assumed life of the options and the assumed volatility of our common stock; and

other companies may calculate EBITDA and Adjusted EBITDA differently than we do, limiting their usefulness as comparative measures.



We compensate for these limitations by relying primarily on our U.S. GAAP results and using Non-GAAP net income (loss), EBITDA, and Adjusted EBITDA only as supplemental support for management's analysis of business performance. Non-GAAP net income (loss), EBITDA and Adjusted EBITDA are calculated as follows for the periods presented.

Reconciliation of Non-GAAP Financial Measures

In accordance with the requirements of Regulation G issued by the SEC, we are presenting the most directly comparable U.S. GAAP financial measures and reconciling the unaudited Non-GAAP financial metrics to the comparable U.S. GAAP measures.

Reconciliation of U.S. GAAP Net Loss to Non-GAAP Net Income/(Loss)  
(Unaudited)

	Three Months Ended December 31,		Year Ended December 31,	
	2017	2016	2017	2016
	(In thousands)		(In thousands)	
U.S. GAAP net loss	\$(7)	\$(525)	\$(1,020)	\$(2,792)
Share-based compensation	92	149	573	653
Amortization of rent expense paid in stock, net of deferred gain	-	57	38	229
Amortization of intangible assets	23	33	96	131
Non-cash interest expense	3	30	201	124
Non-GAAP net income/(loss)	\$111	\$(256)	\$(112)	\$(1,655)
Non-GAAP net income/(loss) per common share:				
Basic	\$0.01	\$(0.02)	\$(0.01)	\$(0.12)
Diluted	\$0.01	\$(0.02)	\$(0.01)	\$(0.12)
Weighted-average common shares outstanding:				
Basic	14,276,729	13,483,502	13,938,342	13,358,311
Diluted	14,732,765	13,483,502	13,938,342	13,358,311

Reconciliation of U.S. GAAP Net Loss to EBITDA to Adjusted EBITDA  
(Unaudited)

	Three Months Ended December 31,	Year Ended December 31,
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2017 2016 2017 2016

(In thousands) (In thousands)

U.S. GAAP net loss	\$(7)	\$(525)	\$(1,020)	\$(2,792)
Depreciation and amortization	25	36	106	146
Interest expense	3	33	209	138
Interest and other income	(4)	(18)	(21)	(121)
Income tax provision/(benefit)	(9)	1	7	12
EBITDA	8	(473)	(719)	(2,617)
Share-based compensation	92	149	573	653
Amortization of rent expense paid in stock, net of deferred gain	-	57	38	229
Adjusted EBITDA	\$100	\$(267)	\$(108)	\$(1,735)

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The following accounting policies are the most critical in understanding our consolidated financial position, results of operations or cash flows, and that may require management to make subjective or complex judgments about matters that are inherently uncertain.





Goodwill – Goodwill is tested for impairment using a fair-value-based approach on an annual basis (December 31) and between annual tests if indicators of potential impairment exist.

Intangible Assets - Our intangible assets consist primarily of customer relationships and developed technology. The intangible assets are amortized following the patterns in which the economic benefits are consumed. We periodically review the estimated useful lives of our intangible assets and review these assets for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The determination of impairment is based on estimates of future undiscounted cash flows. If an intangible asset is considered to be impaired, the amount of the impairment will be equal to the excess of the carrying value over the fair value of the asset.

Contingent liabilities - Contingent liabilities require significant judgment in estimating potential payouts. Contingent considerations arising from business combinations require management to estimate future payouts based on forecasted results, which are highly sensitive to the estimates of discount rates and future revenues. These estimates can change significantly from period to period and reviewed each reporting period to establish the fair value of the contingent liability.

For additional information on use of estimates, see summary of Significant Accounting Policies in the notes to the Consolidated Financial Statements.

#### Segment Operating Results

The Company has two operating segments, which consist of Cloud Telecommunications and Web Services. The information below is organized in accordance with our two reportable segments. Segment operating income (loss) is equal to segment net revenue less segment cost of service revenue, cost of product revenue, sales and marketing, research and development, and general and administrative expenses.

Operating Results of our Cloud Telecommunications Segment (in thousands)

	Year Ended December 31,	
	2017	2016
Cloud Telecommunications		
Service revenue	\$7,973	\$6,282
Product revenue	1,347	1,475
Total revenue	9,320	7,757
Operating expenses:		
Cost of service revenue	2,791	2,790
Cost of product revenue	549	632
Research and development	726	793
Selling and marketing	2,924	2,531
General and administrative		