

J2 GLOBAL COMMUNICATIONS INC
Form 10-K
February 25, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from _____ to _____

Commission File Number: 0-25965

j2 GLOBAL COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or
organization)

51-0371142
(I.R.S. Employer Identification No.)

6922 Hollywood Boulevard, Suite 500, Los Angeles, California 90028, (323) 860-9200
(Address and telephone number of principal executive offices)

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

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, \$0.01 par value
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes

No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of the last business day of the registrant's most recently completed second fiscal quarter, the approximate aggregate market value of the common stock held by non-affiliates, based upon the closing price of the common stock as quoted by the NASDAQ Global Select Market was \$672,955,896. Shares of common stock held by executive officers, directors and holders of more than 5% of the outstanding common stock have been excluded. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 16, 2009, the registrant had 43,945,979 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held May 7, 2009 are incorporated by reference into Part III of this Form 10-K.

This Annual Report on Form 10-K includes 74 pages with the Index to Exhibits located on page 65.

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PART I

Item 1. Business

Company Overview

j2 Global Communications, Inc. (“j2 Global”, “our”, “us” or “we”) is a Delaware corporation founded in 1995. By leveraging the power of the Internet, we provide outsourced, value-added messaging and communications services to individuals and businesses throughout the world. We offer fax, voicemail, email and call handling services and bundled suites of certain of these services. We market our services principally under the brand names eFax®, eFax Corporate®, Onebox®, eVoice® and Electric Mail®.

We deliver many of our services through our global telephony/Internet Protocol (“IP”) network, which spans more than 3,000 cities in 46 countries across six continents. We have created this network, and continuously seek to expand it, through negotiation with U.S. and foreign telecommunications and co-location providers for telephone numbers (also referred to as Direct Inward Dial numbers or “DIDs”), Internet bandwidth and co-location space for our equipment. We maintain and seek to grow an inventory of telephone numbers to be assigned to new customers. Most of these numbers are “local” (as opposed to toll-free), which enables us to provide our paying subscribers telephone numbers with a geographic identity. In addition to growing our business internally, we have used acquisitions to grow our customer base, enhance our technology and acquire skilled personnel.

Our core services include fax, voicemail, email and call handling, as well as bundled suites of certain of these services. These are business services that make our customers more efficient, more mobile, more cost-effective and more secure than traditional alternatives. We generate substantially all of our revenue from subscribers that pay activation, subscription and usage fees. Activation and subscription fees are referred to as “fixed” revenues, while usage fees are referred to as “variable” revenues. We also generate revenues from patent licensing fees, advertising and revenue share from our customers’ use of premium rate telephone numbers. Of the 11.6 million telephone numbers deployed as of December 31, 2008, approximately 1.2 million were serving paying subscribers, with the balance deployed to free subscribers, including those with premium rate telephone numbers. We operate in one reportable segment: value-added messaging and communications services, which provides for the delivery of fax, voice and email messages and communications via the telephone and/or Internet networks.

During the past three years, we have derived a substantial portion of our revenues from our DID-based services, including eFax, Onebox, and eVoice. As a result, we believe that paying DIDs and the revenues associated therewith are an important metric for understanding our business. It has been and continues to be our objective to increase the number of paying DIDs through a variety of distribution channels and marketing arrangements and by enhancing our brand awareness. In addition, we seek to increase revenues through a combination of stimulating use by our customers of usage-based services, introducing new services and instituting appropriate price increases to our fixed monthly subscription and other fees.

We market our services to a broad spectrum of prospective customers including individuals, small to medium-sized businesses and large enterprises and government organizations. Our marketing efforts include enhancing brand awareness; utilizing online advertising through Internet portals, Internet service providers (“ISPs”), search engines and affiliate programs; and selling through both a telesales and direct sales force. Currently, we have seven primary methods by which we acquire paying subscribers: (i) selling direct through our Websites, targeting primarily individuals; (ii) attracting direct paying individual subscribers through various Internet portals, ISPs, search engines and affiliate programs; (iii) promoting our solutions to small to mid-sized businesses through our Websites targeting corporate, enterprise and governmental customers; (iv) converting a portion of our free base of customers to a paid solution; (v) selling our solutions to large enterprises and governmental organizations through our direct sales force and tradeshows; (vi) attracting international individual and business customers through our international Websites and direct sales force; and (vii) offering additional services to our existing customers. We continuously seek to extend the

number of distribution channels through which we acquire paying customers and improve the cost and volume of customers obtained through our current channels.

In addition to growing our business organically, we have used acquisitions to grow our customer base, enhance our technology and acquire skilled personnel. During 2008, we completed four acquisitions: (a) fax assets of Mediaburst Limited, a UK-based provider of messaging services, (b) all of the outstanding shares of Phone People Holdings Corporation, a U.S.-based provider of voice messaging services, (c) assets of Mailwise, LLP, a U.S.-based provider of email services, and (d) assets of Mijanda, Inc., a U.S.-based provider of fax and voice services. During 2007, we completed two acquisitions: (a) assets of YAC Limited, a provider of messaging services primarily in the United Kingdom, and (b) the RapidFAX digital fax business of Easylink Services International Corporation. During 2006, we purchased assets of Send2Fax, LLC, a South Carolina provider of Internet fax services.

Through a combination of internal technology development and acquisitions, we have built a patent portfolio consisting of 57 issued U.S. and foreign patents and numerous pending U.S. and foreign patent applications. We generate licensing revenues from some of these patents. We intend to continue to invest in patents, to aggressively protect our patent assets from unauthorized use and to continue to generate patent licensing revenues from authorized users. For more information on our patents and other intellectual

property, please refer to the section entitled “Patents and Proprietary Rights” contained in Item 1 of this Annual Report on Form 10-K.

Our Solutions

We believe businesses and individuals are increasingly outsourcing their communication and messaging needs. Their goal is to reduce or eliminate costs while also enhancing the security of transmissions and user efficiency. Our core eFax solution enables users to receive faxes into their email inboxes. Our core eVoice and Onebox solutions provide customers a virtual receptionist with various available enhancements. These services represent more efficient and less expensive solutions than many existing alternatives, and provide for increased security, privacy and message handling flexibility (e.g., the ability to store messages electronically and forward them by simply forwarding an email).

We currently offer integrated solutions designed to replace or augment individual and corporate messaging and communication services. We tailor our solutions to satisfy the differing needs of our customers. Our paid services allow a subscriber to select a local telephone number from among more than 3,000 cities around the world. Toll-free U.S. and Canadian telephone numbers are also available, as are premium rate numbers in various countries in Western Europe. In addition, our services enhance the ability of businesses to provide messaging services to their remote workforces, increase their level of information security and control and allocate costs more effectively.

We offer the following services and solutions:

Fax

eFax offers desktop faxing services. Various tiers of service provide increasing levels of features and functionality. Our eFax Free® service is our limited use, advertising-supported “introductory offering,” which assigns the subscriber a unique randomly selected telephone number that enables the user to receive a limited number of faxes into his or her personal email inbox and to access these messages via a Web-based email interface. In exchange, the subscriber agrees to receive and open email advertising, which we distribute on a consistent basis. In various countries in Western Europe, we also offer premium rate telephone numbers at no charge to our subscribers. Our eFax Plus® and eFax Pro™ services allow a subscriber to choose either a toll-free telephone number that covers both the U.S. and Canada or a local telephone number from among more than 3,000 cities worldwide. This service level enables subscribers to receive inbound fax messages in their email inboxes, access these messages via a full-featured Web-based email interface and send digital documents to any fax number in the world directly from their desktops. This service offering is also localized in many international currencies and the following languages, including Chinese (Cantonese), Dutch, French, German, Italian, Polish, Portuguese and Spanish, among others.

eFax Corporate offers capabilities similar to those offered by eFax Plus and eFax Pro, but with added features and tools geared towards enterprises and their users. For example, we provide our corporate customers a Web browser-based account administration interface, which enables them to provision telephone numbers to employees, as needed, without contacting our account representatives. eFax Corporate also offers the option of enhanced security features, which are particularly attractive to law firms and companies in regulated industries such as banking, brokerage and healthcare.

eFax Developer™ offers high-volume, production fax solutions. Designed for quick and simple integration with application environments, eFax Developer provides inbound and outbound fax services through a secure XML interface. Enhanced features such as bar-code recognition, dynamic retries and high speed transmission are included and accessible 24/7/365. Robust fax capabilities can easily be implemented through simple software development kits or through a universal web post solution. eFAX Developer provides the scaling power of an outside fax service with the flexibility of an internal server without requiring additional equipment, supplies or expertise.

eFax Broadcast™ and jBlast® offer cost-effective solutions for high-volume outbound faxing. These services enable users to send important documents simultaneously to hundreds or thousands of recipients anywhere in the world. Customers do not need special computer equipment, expensive fax boards or multiple phone lines. These services also enable customers to accurately monitor the status of their faxes and update their database of “Do Not Fax” names and undeliverable fax numbers.

We have alternative desktop faxing solutions that are offered under a variety of brands and pricing plans geared primarily toward the individual or small business user.

Voice

eVoice Receptionist™ and Onebox Receptionist™ are virtual PBX solutions that provide small and medium-sized businesses on-demand voice communications services, featuring a toll-free or local company telephone number, a professionally-produced auto-attendant and menu tree. With these services, a subscriber can assign departmental and individual extensions that can connect to

multiple U.S. or Canadian telephone numbers, including traditional land-line telephones as well as mobile and IP networks, and can enhance reachability through “find me/follow me” capabilities. These services also include advanced integrated voicemail for each extension, effectively unifying mobile, office and other separate voicemail services, as well as efficiency-enhancing delivery of voicemails in both native format and as transcribed text.

Onebox® is a full-featured suite of unified communications services, including email, voicemail, fax and “find me/follow me” capabilities. Onebox Unified Messaging provides the subscriber a unique toll-free or local number and enables him or her to receive voicemail messages or faxes via email or access them by telephone; to send, receive or reply to faxes or voicemail messages online or by telephone; and to store faxes and email messages online.

Email

Electric Mail® is an outsourced hosted email service that we offer to businesses. Electric Mail develops and delivers email and related solutions that are hosted offsite and seamlessly integrate into a customer’s existing email system. The services include Electric WebMail™, E-mmunity™ virus scanning, SpamSMART™ SPAM filtering, and VaultSMART™ /PolicySMART™ archiving which delivers a secure, scalable email archive and customizable compliance tools to correspond to a company’s retention policy.

Global Network and Operations

We have multiple physical Points of Presence (“POPs”) worldwide, a central data center in Los Angeles and a remote disaster recovery facility. We connect our POPs to our central data centers via redundant, and often times diverse, Virtual Private Networks (“VPNs”) using the Internet. Our network is designed to deliver value-added user applications, customer support, billing and a local presence for our customers from among more than 3,000 cities in 46 countries on six continents. Our network covers all major metropolitan areas in the U.S., U.K., and Canada and such other major cities as Berlin, Hong Kong, Madrid, Manila, Mexico City, Milan, Paris, Rome, Singapore, Sydney, Taipei, Tokyo and Zurich. For financial information about geographic areas, see Note 14 of the Notes to Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K.

We obtain telephone numbers from various local carriers throughout the U.S. and internationally. Our ability to continue to acquire additional quantities of telephone numbers in desired locations in the future will depend on our relationships with our local carriers, our ability to pay market prices for such telephone numbers, a continuing growth in alternate providers and the regulatory environment. Please refer to the sections entitled “Government Regulation” and “Risk Factors” contained in Item 1 and 1A, respectively, of this Annual Report on Form 10-K.

Customer Support Services

Our Customer Service organization provides support to our customers through a combination of online self-help, email messages, interactive chat sessions and telephone calls. Our Internet-based online self-help tools enable customers to resolve simple issues on their own, eliminating the need to speak or write to our customer service representatives. We use internal personnel and contracted third parties (on a dedicated personnel basis) to answer our customer emails and telephone calls and to participate in interactive chat sessions.

We provide email support seven days per week, 24 hours per day to all subscribers. Paying subscribers have access to live-operator telephone support seven days per week, 24 hours per day. Dedicated telephone support is provided for Corporate customers 24 hours per day, seven days per week.

Competition

Competition in the outsourced, value-added messaging and communications space is fierce and continues to intensify. We face competition from, among others, fax-to-email providers, broadcast fax companies, traditional fax machine or

multi-function printer companies, unified messaging/communications providers, telephone companies, voicemail providers, companies offering PBX systems and outsourced PBX solutions and email providers. We believe that the primary competitive factors determining success in the market for value-added messaging and communications services include financial strengths and stability, pricing, reputation for reliability and security of service, intellectual property ownership, effectiveness of customer support, service and software ease-of-use, service scalability, customer messaging and branding, geographic coverage, scope of services and local language sales, messaging and support.

Our most popular solutions relate to faxing, including the ability to deliver faxes to our customers via email and our outbound desktop faxing capabilities. These solutions compete primarily against traditional fax machine manufacturers, which are generally large and well established companies, providers of fax servers and related software, such as Open Text Corporation and its recently acquired subsidiary Captaris, Inc., as well as publicly traded and privately-held application service providers, such as Premiere Global

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Services, Inc. (formerly PTEK Holdings Inc.) and Easylink Services International Corporation (formerly Easylink Services Corporation). Some of these companies may have greater financial and other resources than we do. For more information regarding the competition that we face, please refer to the section entitled “Risk Factors” contained in Item 1A of this Annual Report on Form 10-K.

Patents and Proprietary Rights

We regard the protection of our intellectual property rights as important to our success. We aggressively protect these rights by relying on a combination of patents, trademarks, copyrights, trade dress and trade secret laws and by using the domain name dispute resolution system. We also enter into confidentiality and invention assignment agreements with employees and contractors, and nondisclosure agreements with parties with whom we conduct business in order to limit access to and disclosure of our proprietary information.

We have a portfolio of 57 issued U.S. and foreign patents and have numerous pending U.S. and foreign patent applications, all covering components of our technology and in some cases technologies beyond those that we currently offer. We seek patents for inventions that contribute to our business and technology strategy. We have obtained patent licenses for certain technologies where such licenses are necessary or advantageous. Unless and until patents are issued on the pending applications, no patent rights on those applications can be enforced.

Over the past three years we have generated royalties from licensing certain of our patents and have enforced these patents against companies using our patented technology without our permission. We have pending patent infringement lawsuits against several companies. In each case, we are seeking at least a reasonable royalty for the infringement of the patent(s) in suit, a permanent injunction against continued infringement and attorneys’ fees, interest and costs. Some of these cases have been stayed due to pending re-examination proceedings on certain of our U.S. patents with the U.S. Patent and Trademark Office, and others continue to proceed forward.

We own and use a number of trademarks in connection with our products and services, including eFax and the eFax logo, eFax Corporate and the eFax Corporate logo, eVoice and the eVoice logo, Onebox and the Onebox logo and Electric Mail and the Electric Mail logo, among others. Many of these trademarks are registered in the U.S. and other countries, and numerous trademark applications are pending in the U.S. and several non-U.S. jurisdictions. We hold numerous Internet domain names, including “efax.com”, “jconnect.com”, “fax.com”, “j2.com”, “j2global.com”, “onebox.com”, “electricmail.com”, “efaxcorporate.com” and “evoice.com”, among others. We have in place an active program to continue securing “eFax” and other domain names in non-U.S. jurisdictions. We have filed to protect our rights to the “eFax” and other names in certain alternative top-level domains such as “.org”, “.net”, “.biz”, “.info” and “.us”, among others.

Like other technology-based businesses, we face the risk that we will be unable to protect our intellectual property and other proprietary rights, and the risk that we will be found to have infringed the proprietary rights of others. For more information regarding these risks, please refer to the section entitled “Risk Factors” contained in Item 1A of this Annual Report on Form 10-K.

Government Regulation

We are subject to a number of foreign and domestic laws and regulations that affect companies conducting business related to the Internet and telecommunications, addressing issues such as privacy, data protection, freedom of expression, indecency, obscenity, defamation, libel, pricing, online products and services, taxation, content, advertising, copyrights and other intellectual property, information security and technological convergence. We face risks from proposed legislation or new interpretations of existing legislation that could occur in the future.

We provide our services through data transmissions over public telephone lines and other facilities provided by telecommunications companies (“carriers”). These transmissions and carriers are subject to regulation by the U.S. Federal Communications Commission (“FCC”), state public utility commissions and foreign governmental authorities.

However, as an Internet messaging services provider, we generally are not subject to direct regulation by any governmental agency in the U.S., other than regulations applicable to businesses generally. This is not the case in some international locations. Nevertheless, as Internet services and telecommunications services converge or the services we offer expand, we may face increased domestic or foreign regulation of our business in areas such as delivery of broadband services, inter-carrier compensation and continued regulation of competition.

Continued regulation arising from telephone number administration may also make it more difficult for us to obtain necessary numbering resources. For example, in the U.S., the FCC allows states to petition for authority to adopt technology-specific area codes. We have sought reconsideration from the FCC of this decision, and the outcome of this proceeding could affect our ability to offer services in competition with incumbents. So far, California and Connecticut have requested authority to adopt special area codes for

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unified messaging. The FCC conditionally granted Connecticut's petition in 2003, but the state has not yet adopted a specialized code. The FCC granted California's petition with fewer conditions. We opposed California's request for this authority and are now participating in the reconsideration stage of the FCC proceeding. Although there has been diminished activity of this sort since 2003, if other states apply for and implement specialized area codes, our ability to compete in those states could be adversely affected. Similar regulation has occurred internationally (e.g., Germany prohibits issuing a local telephone number to anyone without a physical presence in the area) and may continue to be enacted in additional locations in the future.

In addition, Congress and the FCC are reviewing legislation and regulations related to the Universal Service Fund ("USF"), which subsidizes the U.S. telecommunications system. Congress and the FCC are considering altering the formula by which entities contribute to the USF. If adopted, one proposal to implement a flat-fee per phone number methodology could alter or eliminate the provision of our non-paid (free advertising-supported) services and could cause us to raise the price of our paid services. Other changes to the USF may also increase our costs and impact our operations. For example, in 2008 the FCC determined that conference calling services are directly assessable for USF purposes. As a result, we now pay directly into the USF for those services. The FCC could reclassify other communications services and determine that they are directly assessable, which may further increase our cost of doing business.

The FCC is authorized to take enforcement action against companies that send so-called "junk faxes" and has held numerous fax broadcasters liable for violating the Telephone Consumer Protection Act of 1991 ("TCPA"), the Junk Fax Prevention Act of 2005 ("Junk Fax Act") and related FCC rules. Individuals may also, under certain circumstances, have a private cause of action for violations and recover monetary damages. Entities that merely transmit facsimile messages on behalf of others may be found liable if they have a high degree of involvement in transmitting junk faxes or have actual notice of illegal junk fax transmissions and failed to take steps to prevent such transmissions. We take significant steps to ensure that our services are not used to transmit unsolicited faxes on a large scale and we do not believe that we have a high degree of involvement or notice of the use of our service to broadcast junk faxes. However, because fax transmitters do not enjoy an absolute exemption from liability under the rules, we could face FCC inquiry and enforcement, civil litigation or private causes of action, which could result in financial penalties that could cause material adverse effects to our operations. We are currently involved in litigation involving alleged violations of the TCPA with Protus IP Solutions, Inc. For more information about this lawsuit, see Item 3 of this Annual Report on Form 10-K entitled "Legal Proceedings."

In the area of data protection, many U.S. states and foreign jurisdictions have passed laws requiring notification to users when there is a security breach for personal data. We are also subject to federal, state and foreign laws regarding privacy and protection of user data. The costs of compliance with these laws may increase in the future as a result of changes in interpretation. Furthermore, any failure on our part to comply with these laws may subject us to significant liabilities. There is a risk that these laws may be interpreted and applied in conflicting ways from country to country and in a manner that is not consistent with our current data protection practices. Complying with these varying international requirements could cause us to incur additional costs and change our business practices. Further, any failure by us to protect our users' privacy and data could adversely affect our business.

Future developments in laws that govern online activities might inhibit the growth of the Internet, impose taxes, mandate costly technical requirements, create uncertainty in the market or otherwise have an adverse effect on the Internet. There is also substantial uncertainty as to the applicability to the Internet of laws governing issues such as property ownership, fraud, tort, copyrights and other intellectual property issues, taxation, defamation, obscenity and privacy, none of which contemplated the existence of the Internet. These developments could, in turn, have a material adverse effect on our business, prospects, financial condition and results of operations. Also uncertain is the impact of foreign legal developments regarding jurisdiction and choice of law for cases involving Internet-based activities.

Seasonality and Backlog

Our subscriber revenues are impacted by the number of effective business days in a given period. We experience no material backlog in sales orders or the provisioning of customer orders. We traditionally experience lower than average usage and customer sign-ups in the fourth quarter.

Research and Development

The markets for our services are evolving rapidly, requiring ongoing expenditures for research and development and timely introduction of new services and service enhancements. Our future success will depend, in part, on our ability to enhance our current services, to respond effectively to technological changes, to sell additional services to our existing customer base and to introduce new services and technologies that address the increasingly sophisticated needs of our customers.

We devote significant resources to develop new services and service enhancements. Our research, development and engineering expenditures were \$12.0 million, \$11.8 million and \$8.8 million for the fiscal years ended December 31, 2008, 2007

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and 2006, respectively. For more information regarding the technological risks that we face, please refer to the section entitled "Risk Factors" contained in Item 1A of this Annual Report on Form 10-K.

Employees

As of December 31, 2008, we had approximately 400 employees, the majority of whom are in the U.S.

Our future success will depend, in part, on our ability to continue to attract, retain and motivate highly qualified technical, marketing and management personnel. Our employees are not represented by any collective bargaining unit or agreement. We have never experienced a work stoppage. We believe our relationship with our employees is good.

Web Availability of Reports

Our corporate information Website is www.j2global.com. The information on our Website is not part of this Annual Report on Form 10-K. However, on the Investor Relations portion of this Website the public can access free of charge our annual, quarterly and current reports, changes in the stock ownership of our directors and executive officers and other documents filed with the Securities and Exchange Commission ("SEC") as soon as reasonably practicable after the filing dates. Further, the SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov.

Item 1A. Risk Factors

Before deciding to invest in j2 Global or to maintain or increase your investment, you should carefully consider the risks described below in addition to the other cautionary statements and risks described elsewhere in this Annual Report on Form 10-K and our other filings with the SEC, including our subsequent reports on Forms 10-Q and 8-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may affect our business. If any of these known or unknown risks or uncertainties actually occurs, our business, prospects, financial condition, operating results and cash flows could be materially adversely affected. In that event, the market price of our common stock will likely decline and you may lose part or all of your investment.

Risks Related To Our Business

In order to sustain our growth, we must continue to attract new paid subscribers at a greater rate and with at least an equal amount of revenues per subscriber than we lose existing paid subscribers.

We may not be able to continue to grow or even sustain our current base of paid customers on a quarterly or annual basis. Our future success depends heavily on the continued growth of our paid user base. In order to sustain our growth we must continuously obtain an increasing number of paid users to replace the users who cancel their service. In addition, these new users must provide revenue levels per subscriber that are greater than or equal to the levels of our current customers or the customers they are replacing. We must also retain our existing customers while continuing to attract new ones at desirable costs. We cannot be certain that our continuous efforts to offer high quality services at attractive prices will be sufficient to retain our customer base or attract new customers at rates sufficient to offset customers who cancel their service. In addition, we believe that competition from companies providing similar or alternative services has caused, and may continue to cause, some of our customers or prospective customers to sign up with or to switch to our competitors' services. Moreover, we have experienced, and may continue to experience, an overall reduction in our average revenue per subscriber as the percentage of our subscriber revenues from lower priced alternative fax brands and voice services has increased. These factors may adversely affect our customer retention rates, the number of our new customer acquisitions, our average revenue per subscriber and/or subscriber usage levels. Any combination of a decline in our rate of new customer sign-ups, decline in usage rates of our customers, decline in average revenue per subscriber, decline in customer retention rates or decline in the size of our overall customer base

may result in a decrease in our revenues, which could have a material adverse effect on our business, prospects, financial condition, operating results and cash flows.

Weakness in the financial markets and in the economy as a whole has adversely affected and may continue to adversely affect segments of our customers, which has resulted and may continue to result in decreased usage levels, customer acquisitions and customer retention rates and, in turn, could lead to a decrease in our revenues or rate of revenue growth.

Certain segments of our customers - those whose business activity is tied to the health of the credit markets and the broader economy, such as banks, brokerage firms and those in the real estate industry - have been and may continue to be adversely affected by the current turmoil in the credit markets and weakness in the broader mortgage market and the general economy. To the extent our customers' businesses have been adversely affected by these economic factors and their usage levels of our services decline, we have and may continue to experience a decrease in our average usage per subscriber and, therefore, a decrease in our average variable revenue per subscriber. In addition, continued weakness in the economy has adversely affected and may continue to adversely affect

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our customer retention rates and the number of our new customer acquisitions. These factors have adversely impacted, and may continue to adversely impact, our revenues and profitability.

Increased numbers of credit and debit card declines as a result of decreased availability of credit and/or a weakening economy could lead to a decrease in our revenues or rate of revenue growth.

A significant number of our paid subscribers pay for their services through credit and debit cards. Weakness in the credit markets and in the U.S. and global economy has resulted in and may continue to result in increased numbers of rejected credit and debit card payments. We believe this has resulted in and may continue to result in increased customer cancellations and decreased customer signups. This also has required and may continue to require us to increase our reserves for doubtful accounts and write-offs of accounts receivables. The foregoing may adversely impact our revenues and profitability.

Our financial results may be adversely impacted by higher-than-expected tax rates or exposure to additional tax liabilities.

We are a U.S.-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. Our provision for income taxes is based on jurisdictional mix of earnings, statutory rates and enacted tax rules, including transfer pricing. Significant judgment is required in determining our provision for income taxes and in evaluating our tax positions on a worldwide basis. It is possible that these positions may be challenged or we may find tax-beneficial intercompany transactions to be uneconomical, either of which may have a significant impact on our effective tax rate.

A number of factors affect our income tax rate and the combined effect of these factors could result in an increase in our effective income tax rate. An increase in future effective income tax rates would adversely affect net income in future periods. We operate in different countries that have different income tax rates. Effective tax rates could be adversely affected by earnings being lower than anticipated in countries having lower statutory rates and higher than anticipated in countries having higher statutory rates, by changes in the valuation of deferred tax assets or liabilities or by changes in tax laws or interpretations thereof.

Effective January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109 (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes by creating a framework for how companies should recognize, measure, present and disclose in their financial statements uncertain tax positions that they have taken or expect to take in a tax return. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments and which may not accurately anticipate actual outcomes (see Note 8 of the Notes to Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K).

A substantial portion of our cash and investments are invested outside of the U.S. We may be subject to incremental taxes upon repatriation of such funds to the U.S.

We may be subject to examination of our tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. We are currently under audit by the Internal Revenue Service for tax years 2004 through 2006. In addition, we have been notified by the California Franchise Tax Board that we are being audited for tax years 2005 through 2007. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our income and other tax-related reserves and expense. If our reserves are not sufficient to cover these contingencies, such inadequacy could materially adversely affect our business, prospects, financial condition, operating results and cash flows.

A system failure or security breach could delay or interrupt service to our customers, harm our reputation or subject us to significant liability.

Our operations are dependent on our ability to protect our network from interruption by damage from fire, earthquake, power loss, telecommunications failure, unauthorized entry, computer viruses or other events beyond our control. There can be no assurance that our existing and planned precautions of backup systems, regular data backups, security protocols and other procedures will be adequate to prevent significant damage, system failure or data loss. Also, despite the implementation of security measures, our infrastructure may be vulnerable to computer viruses, hackers or similar disruptive problems caused by our subscribers, employees or other Internet users who attempt to invade public and private data networks. Currently, a significant number of our users authorize us to bill their credit or debit card accounts directly for all