8X8 INC /DE/
Form 10-Q
July 31, 2009

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

FORM 10-Q

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from ________to _________

Commission file number 000-21783

8X8, INC.

(Exact name of Registrant as Specified in its Charter)

Delaware	**77-0142404**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

3151 Jay Street
Santa Clara, CA 95054

(Address of Principal Executive Offices including Zip Code)

(408) 727-1885

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES

¨ NO ¨

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

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

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

The number of shares of the Registrant's Common Stock outstanding as of July 29, 2009 was 62,694,039.

FORM 10-Q PDF

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Part I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

		June 30, 2009		March 31, 2009
ASSETS				
Current assets:				
Cash and cash equivalents	$	15,485	$	16,376
Accounts receivable, net		415		414
Inventory		2,589		2,297
Deferred cost of goods sold		110		193
Other current assets		661		648
Total current assets		19,260		19,928
Property and equipment, net		1,533		1,485
Other assets		430		443
Total assets	$	21,223	$	21,856
LIABILITIES AND STOCKHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	$	5,404	$	4,810
Accrued compensation		1,331		1,264
Accrued warranty		373		328
Accrued taxes		1,629		1,777
Deferred revenue		1,490		2,254
Other accrued liabilities		1,291		2,081
Total current liabilities		11,518		12,514
Other liabilities		187		291
Fair value of warrant liability		27		21
Total liabilities		11,732		12,826
Commitments and contingencies (Note 8)				
Stockholders' equity:				
Common stock		63		63
Additional paid-in capital		211,733		211,686
Accumulated deficit		(202,305)		(202,719)
Total stockholders' equity		9,491		9,030
Total liabilities and stockholders' equity	$	21,223	$	21,856

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

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

	Three Months Ended June 30,	
	2009	2008
Service revenues	$ 14,520	$ 15,019
Product revenues	1,038	1,262
Total revenues	15,558	16,281
Operating expenses:		
Cost of service revenues	3,501	3,814
Cost of product revenues	1,821	1,432
Research and development	1,237	1,192
Selling, general and administrative	8,573	8,751
Total operating expenses	15,132	15,189
Income from operations	426	1,092
Other income, net	12	85
Income (loss) on change in fair value of warrant liability	(7)	69
Income before provision for income taxes	431	1,246
Provision for income taxes	17	58
Net income	$ 414	$ 1,188
Net income per share:		
Basic	$ 0.01	$ 0.02
Diluted	$ 0.01	$ 0.02
Weighted average number of shares:		
Basic	62,688	62,096
Diluted	62,766	62,192

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

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

	Three Months Ended June 30,	
	2009	**2008**
Cash flows from operating activities:		
Net income	$ 414	$ 1,188
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	287	339
Stock compensation	43	328
Change in fair value of warrant liability	6	(69)
Other	(91)	23
Changes in assets and liabilities		
Accounts receivable, net	(40)	232
Inventory	(163)	(192)
Other current and noncurrent assets	(1)	85
Deferred cost of goods sold	83	(95)
Accounts payable	480	751
Accrued compensation	67	331
Accrued warranty	45	2
Accrued taxes & fees	(148)	(1,412)
Deferred revenue	(764)	(658)
Other current and noncurrent liabilities	(885)	(487)
Net cash provided by (used in) operating activities	(667)	366
Cash flows from investing activities:		
Purchases of property and equipment	(219)	(168)
Maturities of short-term investments	-	1,585
Net cash provided by (used in) investing activities	(219)	1,417
Cash flows from financing activities:		
Capital lease payments	(9)	(9)
Proceeds from issuance of common stock under employee stock plans	4	75
Net cash provided by (used in) financing activities	(5)	66
Net increase (decrease) in cash and cash equivalents	(891)	1,849
Cash and cash equivalents at the beginning of the period	16,376	11,185
Cash and cash equivalents at the end of the period	$ 15,485	$ 13,034

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

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

1. DESCRIPTION OF THE BUSINESS

THE COMPANY

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

The Company offers the 8x8 voice and video communications service. In November 2002, the Company launched the 8x8 residential service offering and in March 2004, the Company launched the 8x8 business service offering. The 8x8 voice and video communications service enables broadband Internet users to add digital voice and video communications services to their high-speed Internet connection. Customers can choose a direct-dial phone number from any of the rate centers offered by the service, and then use an 8x8-supplied terminal adapter to connect any telephone to a broadband Internet connection to make or receive calls from a regular telephone number. All 8x8 telephone accounts come with voice mail, caller ID, call waiting, call waiting caller ID, call forwarding, hold, line-alternate, 3-way conferencing, web access to account controls, and online billing. 8x8 has developed a suite of business services called 8x8 Virtual Office that offer feature-rich communications services to small and medium-sized business, eliminating the need for traditional telecommunications services and business phone systems. 8x8's primary product focus is on replacing private branch exchange, or PBX, telephone systems in the small business marketplace with a hosted business solution. The Company also sells pre-programmed IP and analog telephones with speakerphones and a display screen, in conjunction with its Virtual Office service plans, which enable its business customers to access additional features of Virtual Office through on-screen phone menus. Between November 2002 and April 2009, the Company marketed its services under the Packet8 brand. In May 2009, the Company began marketing its services under the 8x8 brand.

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

LIQUIDITY

Although the Company incurred negative cash flows from operations in the quarter ended June 30, 2009, the Company generated positive cash flows for the fiscal years ended March 31, 2009 and 2008. Historical net losses and negative cash flows prior to fiscal 2008 had been funded primarily through the issuance of equity securities and borrowings. Management believes that current cash and cash equivalents will be sufficient to finance the Company's operations for at least the next twelve months. However, the Company continually evaluates its cash needs and may pursue additional equity or debt financing in order to achieve the Company's overall business objectives. There can be no assurance that such financing will be available, or, if available, at a price that is acceptable to the Company. Failure to generate sufficient revenues, raise additional capital or reduce certain discretionary spending could have an adverse impact on the Company's ability to achieve its longer term business objectives.

2. BASIS OF PRESENTATION

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared on substantially the same basis as our annual financial statements for the fiscal year ended March 31, 2009. In the opinion of management, these financial statements reflect all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of our financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

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

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

Investments

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

8x8 Service Revenue

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

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

Deferred Cost of Goods Sold

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

Warrant Liability

The Company accounts for its warrants in accordance with Emerging Issues Task Force Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock" ("EITF 00-19") which requires warrants to be classified as permanent equity, temporary equity or as assets or liabilities. In general, warrants that either require net-cash settlement or are presumed to require net-cash settlement are recorded as assets and liabilities at fair value and warrants that require settlement in shares are recorded as equity instruments. Certain of the Company's warrants require settlement in shares and are accounted for as permanent equity. The Company has two investor warrants that are classified as liabilities because they include a provision that specifies that the Company must deliver freely tradable shares upon exercise by the warrant holder. Because there are circumstances, irrespective of likelihood, that may not be within the control of the Company that could prevent delivery of registered shares, EITF 00-19 requires the warrants be recorded as a liability at fair value, with subsequent changes in fair value recorded as income (loss) in change in fair value of warrant liability. The fair value of the warrant is determined using a Black-Scholes option pricing model, and is affected by changes in inputs to that model including our stock price, expected stock price volatility and contractual term.

Accounting for Stock-Based Compensation

The Company accounts for stock-based compensation under Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("SFAS 123(R)"), which establishes standards for the accounting for equity instruments exchanged for employee services. SFAS 123(R) revised SFAS 123 "Accounting for Stock-Based Compensation" ("SFAS 123") and superseded Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees," and related interpretations. Under the provisions of SFAS 123(R), share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant), net of estimated forfeitures. The Company elected to adopt the modified prospective transition method as provided by SFAS 123(R).

Stock-based compensation expense recognized in the Company's Condensed Consolidated Statements of Income for the first quarter of fiscal 2010 included the unvested portion of stock-based awards granted subsequent to January 29, 2009. Stock-based awards granted in periods subsequent to April 1, 2006 were measured based on SFAS 123(R) criteria and the compensation expense for all share-based payment awards granted is recognized using the straight-line single-option method. Stock-based compensation expense includes the impact of estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Stock-based Compensation Plans

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

As of June 30, 2009, the 1992 Stock Plan, 1996 Stock Plan and 1996 Director Option Plan had expired and the 1999 Nonstatutory Stock Option Plan was cancelled by the Board, but there are still options outstanding under these plans. Options generally vest over four years, are granted at fair market value on the date of the grant and expire ten years from that date.

The Company's 2006 Stock Plan (the "2006 Plan") has 7,000,000 shares of common stock reserved for issuance. The 2006 Plan provides for granting incentive stock-based awards to employees and nonstatutory stock options to employees, directors or consultants. The stock option price of incentive stock options granted may not be less than the fair market value on the effective date of the grant. Other types of options and awards under the 2006 Plan may be granted at any price approved by the administrator, which generally will be the compensation committee of the board of directors. Options generally vest over four years and expire ten years after grant. The 2006 Plan expires in May 2016.

Option Activity

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

	Shares Available for Grant	**Shares Subject to Options Outstanding**		**Weighted Average Exercise Price Per Share**
Balance at March 31, 2009	2,415,875	10,736,279	$	1.85
Granted	-	-		-
Exercised	-	(8,000)		0.55
Canceled/forfeited	807,661	(807,661)		1.70
Termination of plans	(389,876)	-		-
Balance at June 30, 2009	2,833,660	9,920,618	$	1.86

The following table summarizes the stock options outstanding and exercisable at June 30, 2009:

Options Outstanding				**Options Exercisable**		
	Weighted Average Exercise Price	**Weighted Average Remaining Contractual**	**Aggregate Intrinsic**		**Weighted Average Exercise Price**	**Aggregate Intrinsic**

	Shares		Per Share	Life (Years)		Value	Shares		Per Share		Value
$0.01 - $1.18	2,316,477	$	0.90	7.77	$	12,320	2,316,477	$	0.90	$	12,320
$1.19 - $1.27	2,062,000	$	1.26	7.92		-	2,062,000	$	1.26		-
$1.28 - $1.72	2,201,710	$	1.55	5.87		-	2,201,710	$	1.55		-
$1.73 - $2.31	2,019,431	$	1.89	3.50		-	2,016,305	$	1.89		-
$2.32 - $14.94	1,321,000	$	4.98	2.67		-	1,321,000	$	4.98		-
	9,920,618				$	12,320	9,917,492			$	12,320

Stock-based Compensation Expense

As of June 30, 2009, there was $0.1 million of unamortized stock-based compensation expense related to unvested stock awards which is expected to be recognized over a weighted average period of 3.75 years.

To value option grants and other awards for actual and pro forma stock-based compensation, the Company has used the Black-Scholes option valuation model. When the measurement date is certain, the fair value of each option grant is estimated on the date of grant. Fair value determined using Black-Scholes varies based on assumptions used for the expected stock price volatility, expected life, risk-free interest rates and future dividend payments. During the three month periods ended June 30, 2009 and 2008, the Company used historical volatility of the common stock over a period equal to the expected life of the options to estimate their fair value. The expected life assumption represents the weighted-average period stock-based awards are expected to remain outstanding. These expected life assumptions are established through the review of historical exercise behavior of stock-based award grants with similar vesting periods. The risk-free interest rate is based on the closing market bid yields on actively traded U.S. treasury securities in the over-the-counter market for the expected term equal to the expected term of the option. The dividend yield assumption is based on the Company's history and expectation of future dividend payouts.

The following table summarizes the assumptions used to compute reported and pro forma stock-based compensation to employees and directors for the three months ended June 30, 2008:

		Three Months Ended June 30, 2008
Expected volatility		75%
Expected dividend yield		-
Risk-free interest rate		2.91%
Weighted average expected option term		4.00 years
Weighted average fair value of options granted	$	0.66

In accordance with SFAS 123(R), the Company recorded $4,000 and $295,000 in compensation expense relative to stock-based awards for the three months ended June 30, 2009 and 2008, respectively.

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan, eligible employees can participate and purchase common stock semi-annually through payroll deductions at a price equal to 85% of the fair market value of the common stock at the beginning of each one year offering period or the end of a six month purchase period, whichever is lower. The contribution amount may not exceed ten percent of an employee's base compensation, including commissions but not including bonuses and overtime. The Company accounts for the Employee Stock Purchase Plan as a compensatory plan and recorded compensation expense of $39,000 and $33,000 for the three months ended June 30, 2009 and 2008, respectively in accordance with SFAS 123(R).

The adoption of SFAS 123(R) did not impact the Company's methodology to estimate the fair value of share-based payment awards under the Company's Employee Stock Purchase Plan. The estimated fair value of stock purchase rights granted under the Employee Stock Purchase Plan were estimated at the date of grant using the Black-Scholes pricing model with the following weighted-average assumptions:

	Three Months Ended June 30,	
	2009	2008
Expected volatility	68%	54%
Expected dividend yield	-	-

Risk-free interest rate		0.87%		3.83%
Weighted average expected option term		0.81 years		0.75 years
Weighted average fair value of options granted	$	0.28	$	0.44

As of June 30, 2009, there was $46,000 of total unrecognized compensation cost related to employee stock purchases. These costs are expected to be recognized over a weighted average period of 0.5 years.

SFAS 123(R) requires the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow. The future realizability of tax benefits related to stock compensation is dependent upon the timing of employee exercises and future taxable income, among other factors. The Company did not realize any tax benefit from the stock compensation charge incurred during the three months ended June 30, 2009 and 2008 as the Company believes that it is more likely than not that it will not realize the benefit from tax deductions related to equity compensation.

As prescribed in SFAS 123(R), the following table summarizes the distribution of stock-based compensation expense related to employee stock options and employee stock purchases under SFAS 123(R) among the Company's operating functions for the three months ended June 30, 2009 and 2008 which was recorded as follows (in thousands):

	Three Months Ended June 30,	
	2009	**2008**
Cost of service revenues	$ 5	$ 4
Cost of product revenues	-	4
Research and development	14	69
Selling, general and administrative	24	251
Total stock-based compensation expense related to employee stock options and employee stock purchases, pre-tax	43	328
Tax benefit	-	-
Stock based compensation expense related to employeee stock options and employee stock purchases, net of tax	$ 43	$ 328

Recent Accounting Pronouncements

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

3. BALANCE SHEET DETAIL

	June 30, 2009	March 31, 2009
Inventory (in thousands):		
Work-in-process	$ 2,063	$ 1,695
Finished goods	526	602
	$ 2,589	$ 2,297

4. NET INCOME PER SHARE

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

	Three Months Ended June 30,	
	2009	2008
Numerator:		
Net income available to common stockholders	$ 414	$ 1,188
Denominator:		
Common shares	62,688	62,096
Denominator for basic calculation	62,688	62,096
Employee stock options	78	96
Employee stock purchase plan	-	-
Warrants	-	-
Denominator for diluted calculation	62,766	62,192
Net income per share		
Basic	$ 0.01	$ 0.02
Diluted	$ 0.01	$ 0.02

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

	Three Months Ended June 30,	
	2009	2008
Common stock options	9,872	10,126
Warrants	3,374	7,838
	13,246	17,964

5. COMPREHENSIVE INCOME

Comprehensive income, as defined, includes all changes in equity (net assets) during a period from non-owner sources. The difference between the Company's net income and comprehensive income is due primarily to unrealized losses on investments classified as available-for-sale. Comprehensive income for the three months ended June 30, 2009 and 2008 was as follows (in thousands):

	Three Months Ended June 30,	
	2009	2008
Net income, as reported	$ 414	$ 1,188
Unrealized loss on investments in securities	-	(5)
Comprehensive income	$ 414	$ 1,183

6. SEGMENT REPORTING

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

	Three Months Ended June 30,	
	2009	2008
8x8 service, equipment and other	$ 15,533	$ 16,269
Technology licensing and related software	25	12
Total revenues	$ 15,558	$ 16,281

No customer represented greater than 10% of the Company's total revenues for the three months ended June 30, 2009 or 2008. Revenues from customers outside the United States were not material for the three months ended June 30, 2009 or 2008.

7. INCOME TAXES

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

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

At March 31, 2009, the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate was $2.2 million, but any affect would have been fully offset by the application of the valuation allowance. The Company does not believe that there has been any change in the unrecognized tax benefits in the period ended June 30, 2009 and does not believe it is reasonably possible that the unrecognized tax benefit will materially change in the next 12 months. To the extent that the unrecognized tax benefits are ultimately recognized they may have an impact on the effective tax rate in future periods; however, such impact on the effective tax rate would only occur if the recognition of such unrecognized tax benefits occurs in a future period when the Company has already determined it is more likely than not that its deferred tax assets are realizable.

The Company is subject to taxation in the U.S., California and various states and foreign jurisdictions in which we have or had a subsidiary or branch operations or we are collecting sales tax. All tax returns from fiscal 1995 to fiscal 2009 may be subject to examination by the Internal Revenue Service, California and various states. The Company extended the filing date of the 2009 federal tax return and all state income tax returns. As of June 30, 2009, these returns had not yet been filed. In addition, as of June 30, 2009, there were no active federal, state or local income tax audits. The foreign tax jurisdictions may be subject to examination for the fiscal years 2005 to 2009.

The Company's policy for recording interest and penalties associated with audits is to record such items as a component of operating expense income before taxes. During the three months ended June 30, 2009 and 2008, the Company did not recognize any interest or penalties related to unrecognized tax benefits.

8. COMMITMENTS AND CONTINGENCIES

Guarantees

Indemnifications

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

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

Product Warranties

The Company accrues for the estimated costs that may be incurred under its product warranties upon revenue recognition. Changes in the Company's product warranty liability, which is included in cost of product revenues in the condensed consolidated statements of income, during the three months ended June 30, 2009 were as follows (in thousands):

	Three Months Ended June 30,	
	2009	**2008**

Balance at beginning of period	$	328	$	314
Accruals for warranties		149		65
Settlements		(104)		(63)
Balance at end of period	$	373	$	316

Standby letters of credit

The Company has a standby letter of credit totaling $100,000, which was issued to guarantee certain contractual obligations and is collateralized by cash deposits at the Company's primary bank. The collateral related to this letter of credit is recorded in the other assets line items in the condensed consolidated balance sheets.

Leases

In May 2009, the Company entered into a new lease agreement. The term of the lease is three years and the Company has the right to accelerate the termination date. The Company has the option to accelerate the termination date of the lease to the 12th, 18th, 24th, or 30th full calendar month of the lease term, by providing six months advance notice. In the event, the Company exercises this early termination option, the Company would be required to pay a fee to the landlord equal to the unamortized portion of any leasing commission, the Initial Alterations and any portions of the Allowance and HVAC Allowance disbursed to the Company as outlined in a Form 8-K filed on May 7, 2009. At June 30, 2009, future minimum annual lease payments under current and new operating leases were as follows (in thousands):

Year ending March 31:		
Remaining 2010	$	408
2011		594
2012		657
2013		284
Total minimum payments	$	1,943

In April 2005, June 2006 and March 2007, the Company entered into a series of noncancelable capital lease agreements, respectively, for office equipment bearing interest at various rates. At June 30, 2009, future minimum annual lease payments were as follows (in thousands):

Year ending March 31:		
Remaining 2010	$	32
2011		26
2012		22
Total minimum payments		80
Less: Amount representing interest		(4)
		76
Less: Short-term portion of capital lease obligations		(37)
Long-term portion of capital lease obligations	$	39

Capital leases included in office equipment were $182,000 at June 30, 2009. Total accumulated depreciation was $111,000 at June 30, 2009.

Amortization expense for assets recorded under capital leases is included in depreciation expense.

Minimum Third Party Customer Support Commitments

In March 2009, the Company entered into a contract with one of its third party customer support vendors containing a minimum monthly commitment of approximately $491,000 effective April 1, 2009. The agreement requires 150 day notice to terminate. The total remaining obligation under the contract is $2.5 million.

Legal Proceedings

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

State and Municipal Taxes

For a period of time, the Company did not collect or remit state or municipal taxes (such as sales, excise, and ad valorem taxes), fees or surcharges ("Taxes") on the charges to the Company's customers for its services, although the Company has historically complied with the California sales tax and financial contributions to the 9-1-1 system and universal service fund. The Company has received inquiries or demands from a number of state and municipal taxing agencies seeking payment of Taxes that are applied to or collected from customers of providers of traditional public switched telephone network services. Although the Company has consistently maintained that these Taxes do not apply to its service for a variety of reasons depending on the statute or rule that establishes such obligations, a number of states have changed their statutes as part of the streamlined sales tax initiatives and the Company has begun collecting and remitting Taxes in those states. Some of these Taxes could apply to the Company retroactively, and two states currently are conducting sales tax audits of the Company's records. As such, the Company has accrued a tax liability of $0.2 million at June 30, 2009 as its best estimate of the potential tax exposure for any retroactive assessment by numerous states and municipalities.

Regulatory Matters

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

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

Certain states continue to attempt to subject the Company's service to state universal service fund contribution obligations. At this time, at least three states, including Nebraska, contend that providers of interconnected VoIP services, like the Company, should contribute to its universal service fund. On March 3, 2008, the U.S. District Court for Nebraska issued a preliminary injunction and found that Nebraska's state Public Service Commission does not have jurisdiction to require universal service fund contributions from nomadic interconnected VoIP providers, like the Company. On May 1, 2009, a panel of the U.S. Circuit Court of Appeals for the Eighth Circuit affirmed the U.S. District court ruling. But on May 14, 2009, the Nebraska Public Service Commission requested a rehearing or a rehearing en banc of the decision handed down by the three-judge panel. On June 5, 2009, the Eighth Circuit denied the request for rehearing of the Nebraska Public Service Commission. Following this denial, another state, outside of the Eighth Circuit, attempted to require the Company to continue to contribute its state's Universal Service Fund. The Company continues to maintain that the current state of the law, especially in light of the now concluded litigation in the Eighth Circuit, supports its interpretation of the law that it is not currently subject to any state's universal service fund contribution obligations for its nomadic interconnected VoIP service offering.

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

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

FORWARD-LOOKING STATEMENTS

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

BUSINESS OVERVIEW

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

Our fiscal year ends on March 31 of each calendar year. Each reference to a fiscal year in this report refers to the fiscal year ending March 31 of the calendar year indicated (for example, fiscal 2009 refers to the fiscal year ending March 31, 2009).

CRITICAL ACCOUNTING POLICIES & ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of assets and liabilities. On an on-going basis, we evaluate our critical accounting policies and estimates. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies and estimates are discussed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2009.

RECENT ACCOUNTING PRONOUNCEMENTS

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

SELECTED OPERATING STATISTICS

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

	Selected Operating Statistics							
	June 30, 2009	**March 31, 2009**	**Dec. 31, 2008**	**Sept. 30, 2008**	**June 30, 2008**	**March 31, 2008**	**Dec. 31, 2007**	**Sept. 30, 2007**
Gross business customer additions (1)	2,907	2,792	2,437	3,324	2,398	2,162	1,924	1,872
Gross business customer cancellations (less cancellations within 30 days of sign-up)	1,371	1,245	1,224	1,187	1,098	1,138	949	849
Business customer churn (less cancellations								