ENTROPIC COMMUNICATIONS INC
Form 10-Q
August 05, 2008
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SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 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: 001-33844

ENTROPIC COMMUNICATIONS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0947630**
(State or Other Jurisdiction of Incorporation)	**(IRS Employer Identification No.)**

6290 Sequence Drive

San Diego, CA 92121

(Address of Principal Executive Offices and Zip Code)

(858) 768-3600

(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 such 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 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 smaller reporting company in Rule 12b-2 of the Exchange Act.

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

(Do not check if a smaller reporting company)

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

As of the close of business on July 31, 2008, 68,919,930 shares of the registrant s common stock, $0.001 par value per share, were outstanding.

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ENTROPIC COMMUNICATIONS, INC.

FORM 10-Q

For the Quarterly Period Ended June 30, 2008

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PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,027	$ 51,475
Restricted cash		58
Marketable securities	12,009	2,965
Accounts receivable, net	35,588	24,489
Inventory	21,079	15,332
Prepaid expenses, deferred income taxes and other current assets	1,925	2,238
Total current assets	87,628	96,557
Property and equipment, net	12,612	8,952
Intangible assets, net	33,185	34,145
Goodwill	88,082	86,256
Other long-term assets	283	416
Total assets	$ 221,790	$ 226,326
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 22,141	$ 18,909
Accrued payroll and benefits	5,490	4,253
Deferred revenues	187	303
Current portion of line of credit and loans payable		2,860
Current portion of software licenses and capital lease obligations	119	384
Total current liabilities	27,937	26,709
Stock repurchase liability	1,208	1,765
Lines of credit and loans payable, less current portion		5,547
Other long-term liabilities	3,165	1,907
Commitments and contingencies		
Stockholders equity:		
Preferred stock		
Common stock	69	68
Additional paid-in capital	292,010	282,627
Accumulated deficit	(102,599)	(92,297)
Total stockholders equity	189,480	190,398
Total liabilities, preferred stock and stockholders equity	$ 221,790	$ 226,326

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

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ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net revenues	$ 42,836	$ 26,207	$ 84,824	$ 46,233
Cost of net revenues	23,869	17,961	46,706	32,492
Gross profit	18,967	8,246	38,118	13,741
Operating expenses:				
Research and development	15,678	6,699	28,990	10,889
Sales and marketing	4,455	1,859	8,599	3,359
General and administrative	3,541	1,631	7,064	2,398
Write off of in-process research and development	1,300	21,400	1,300	21,400
Amortization of purchased intangibles	713	42	1,309	42
Restructuring charge	(10)		1,069	
Total operating expenses	25,677	31,631	48,331	38,088
Loss from operations	(6,710)	(23,385)	(10,213)	(24,347)
Other income (expense), net	191	(337)	(7)	(487)
Loss before income taxes	(6,519)	(23,722)	(10,220)	(24,834)
(Benefit) provision for income taxes	(72)		82	
Net loss	(6,447)	(23,722)	(10,302)	(24,834)
Accretion of redeemable convertible preferred stock		(31)		(63)
Net loss attributable to common stockholders	$ (6,447)	$ (23,753)	$ (10,302)	$ (24,897)
Net loss per share attributable to common stockholders basic and diluted	$ (0.10)	$ (3.82)	$ (0.15)	$ (4.33)
Weighted average number of shares used to compute loss per share attributable to common stockholders	67,215	6,223	67,023	5,756

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

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ENTROPIC COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30, 2008	2007
Operating activities:		
Net loss	$ (10,302)	$ (24,834)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,514	641
Amortization of purchased intangible assets	4,139	42
Stock-based compensation to consultants	84	58
Stock-based compensation to employees	6,912	813
Interest expense attributable to amortization and early payoff of debt issuance costs	476	57
In-process research and development	1,300	21,400
Revaluation of preferred stock warrant liabilities		612
Impairment of assets related to restructuring charge	259	
Loss on disposal of assets	8	
Changes in operating assets and liabilities:		
Restricted cash	58	
Accounts receivable	(11,097)	(1,073)
Inventory	(5,733)	(7,207)
Prepaid expenses, deferred income taxes and other current assets	313	(387)
Other long-term assets	43	(677)
Accounts payable and accrued expenses	3,050	6,655
Accrued payroll and benefits	1,102	222
Deferred revenues	(116)	3
Other long-term liabilities	1,258	
Net cash used in operating activities	(6,732)	(3,675)
Investing activities:		
Purchases of property and equipment	(5,269)	(551)
Purchases of marketable securities	(17,144)	
Sales/maturities of marketable securities	8,100	7,116
Net cash (used in) provided by acquisitions	(6,113)	4,561
Net cash (used in) provided by investing activities	(20,426)	11,126
Financing activities:		
Principal payments on debt and capital lease obligations	(9,121)	(1,348)
Proceeds from line of credit obligations		2,000
Proceeds from issuance common stock net of repurchases and issuance costs	1,831	1,074
Net cash (used in) provided by financing activities	(7,290)	1,726
Net (decrease) increase in cash and cash equivalents	(34,448)	9,177
Cash and cash equivalents at beginning of period	51,475	5,928
Cash and cash equivalents at end of period	$ 17,027	$ 15,105

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

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ENTROPIC COMMUNICATIONS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008

1. Organization and Summary of Significant Accounting Policies

Business

Entropic Communications, Inc. (the Company) was organized under the laws of the state of Delaware on January 31, 2001. The Company is a fabless semiconductor company that designs, develops and markets systems solutions to enable connected home entertainment.

In October 2007, the Company completed a 1-for-3.25 reverse stock split. The accompanying financial statements and notes to the financial statements give retroactive effect to the reverse stock split for all periods presented.

Basis of Presentation

The accompanying interim unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC). They do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the Company s audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2007 included in the Company s Annual Report on Form 10-K (Annual Report) filed on March 3, 2008 with the SEC.

The interim condensed consolidated financial statements included herein are unaudited; however, they contain all normal recurring accruals and adjustments that, in the opinion of management, are necessary to present fairly the Company s consolidated financial position, results of operations and cash flows as of and for the periods indicated. The interim results are not necessarily indicative of the results to be expected for future quarters or the full year.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Among the significant estimates affecting the condensed consolidated financial statements are those related to business combinations, revenue recognition, allowance for doubtful accounts, inventory reserves, long-lived assets (including goodwill and intangible assets), warranty reserves, accrued bonuses, income taxes, valuation of equity securities and stock-based compensation. On an on-going basis, management reviews its estimates based upon currently available information. Actual results could differ materially from those estimates.

Revenue Recognition

The Company s revenues are generated principally by sales of its semiconductor products. During the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, product revenues represented approximately 99% of its total net revenues. The Company also generates service revenues from development contracts.

The majority of the Company s sales occur through the efforts of its direct sales force. The remainder of the Company s sales occurs through distributors. During the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, more than 99% of the Company s sales occurred through the efforts of its direct sales force.

In accordance with SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, and SAB No. 104, *Revenue Recognition*, the Company recognizes product revenues when the following fundamental criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price to the customer is fixed or determinable and

(iv) collection of the resulting receivable is reasonably assured. These criteria are usually met at the time of product shipment. However, the Company does not recognize revenue until all customer acceptance requirements have been met, when applicable.

A portion of the Company s sales are made through distributors, agents, or customers acting as agents under agreements allowing for pricing credits and/or rights of return. Product revenues on sales made through these distributors are not recognized until the distributors ship the product to their customers. The Company records reductions to revenues for estimated product returns and pricing adjustments, such as competitive pricing programs, in the same period that the related revenue is recorded. To date, product returns and pricing adjustments have not been significant.

The Company also has entered into an inventory hubbing arrangement with a key customer. Pursuant to this arrangement, the Company delivers products to the designated third party warehouse based upon the customer s projected needs, but does not recognize product revenue unless and until the customer removes the Company s products from the third party warehouse to incorporate into its own products.

The Company derives revenues from development contracts that involve new and unproven technologies. Revenues under these contracts are deferred until customer acceptance is obtained, and other contract-specific terms have been completed in accordance with the completed contract method of American Institute of Certified Public Accountants Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Provisions for losses related to development contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable. The costs associated with development contracts are included in cost of service revenue. The Company defers the cost of services provided under its development contracts.

The Company acquired a development agreement in connection with its acquisition of RF Magic, Inc. (RF Magic) in June 2007 that provides the Company with royalties in exchange for an exclusive right to manufacture and sell certain products. The Company has determined that it is not able to reliably estimate the royalties earned in the period the sales occur. Thus, the Company records revenues based on cash receipts. The royalty revenues recorded during the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008 and 2007, were $797,000, $0, $1,763,000 and $0, respectively.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash and cash equivalents, marketable securities, accounts receivable, leases payable, lines of credit and loans payable. The Company s policy is to place its cash and cash equivalents with high quality financial institutions in order to limit its credit exposure. Credit is extended based on an evaluation of the customer s financial condition and a cash deposit is generally not required. The Company estimates potential losses on trade receivables on an ongoing basis.

The Company invests cash in deposits and money market funds with major financial institutions, U.S. government obligations and debt securities of corporations with strong credit ratings in a variety of industries. It is the Company s policy to invest in instruments that have a final maturity of no longer than two years, with a portfolio weighted average maturity of no longer than 12 months.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Lower of cost or market adjustments reduce the carrying value of the related inventory and take into consideration reductions in sales prices, excess inventory levels and obsolete inventory. These adjustments are done on a part-by-part basis. Once established, these adjustments are considered permanent and are not reversed until the related inventory is sold or disposed.

Guarantees and Indemnifications

In the ordinary course of business, the Company has entered into agreements with customers that include indemnity provisions. To date, there have been no known events or circumstances that have resulted in any significant costs related to these indemnification provisions, and as a result, no liabilities have been recorded in the accompanying interim unaudited financial statements.

Rebates

The Company accounts for rebates in accordance with Emerging Issues Task Force (EITF) Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*, and, accordingly, at the time of the sale accrues 100% of the potential rebate as a reduction to revenue and does not apply a breakage factor. The amount of these reductions is based upon the terms included in various rebate agreements. The Company reverses the accrual for unclaimed rebate amounts as specific rebate programs contractually end or when management believes unclaimed rebates are no longer subject to payment and will not be paid.

Warranty Accrual

The Company s products are subject to warranty periods of one year or more. The Company provides for the estimated future costs of replacement upon shipment of the product as cost of net revenues. The Company has not incurred significant warranty claims to date. The warranty accrual is based on management s best estimate of expected costs associated with product failure and historical product failures.

6 - 24,589 Corporate debt 69,163 69 (8) 69,224 Municipal securities 5,434 4 (3) 5,435 Asset backed securities 20,067 11 (3) 20,075 Mortgage backed securities 4,882 - (3) 4,879 International government securities 800 5 - 805 Total available-for-sale investments $ 151,858 $ 116 $ (17) $ 151,957 Reported as (in thousands): Cash and cash equivalents $ 25,020 Short-term investments 126,937 Total $ 151,957

Contractual maturities of mutual funds, commercial paper, corporate debt, municipal securities, asset backed securities, mortgage backed securities, international government securities and money market funds as of June 30, 2014 are set forth below (in thousands):

Due within one year	$	75,972
Due after one year		75,985
Total	$	151,957

As of March 31, 2014		**Amortized Costs**		**Gross Unrealized Gain**		**Gross Unrealized Loss**		**Estimated Fair Value**
Money market funds	$	32,611	$	-	$	-	$	32,611
Fixed income								
Mutual funds		1,964		-		(55)		1,909
Commercial paper		30,374		5		-		30,379
Corporate debt		63,621		35		(39)		63,617
Municipal securities		5,435		5		(1)		5,439
Asset backed securities		17,049		6		(1)		17,054
International government securities		800		4		-		804
Total available-for-sale investments	$	151,854	$	55	$	(96)	$	151,813

Reported as (in thousands):		
Cash and cash equivalents	$	32,611
Short-term investments		47,181
Long-term investments		72,021
Total	$	151,813

Contractual maturities of mutual funds, commercial paper, corporate debt, municipal securities, asset backed securities, international government securities and money market funds as of March 31, 2014 are set forth below (in thousands):

Due within one year	$	79,792
Due after one year		72,021
Total	$	151,813

Intangible Assets

Amortization expense for the customer relationship intangible asset is included in sales and marketing expenses. Amortization expense for technology is included in cost of service revenue. The carrying values of intangible assets were as follows (in thousands):

	June 30, 2014			March 31, 2014		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Carrying Amount**
Technology	$ 8,242	$ (2,286)	$ 5,956	$ 8,242	$ (2,080)	$ 6,162
Customer relationships	9,686	(1,929)	7,757	9,686	(1,710)	7,976
Trade names/domains	957	-	957	957	-	957
Total acquired identifiable intangible assets	$ 18,885	$ (4,215)	$ 14,670	$ 18,885	$ (3,790)	$ 15,095

At June 30, 2014, annual amortization of intangible assets, based upon our existing intangible assets and current useful lives, is estimated to be the following (in thousands):

	Amount
Remaining 2015	$ 1,712
2016	2,282
2017	2,275
2018	2,027
2019	1,781
Thereafter	3,636
Total	$ 13,713

Research, Development and Software Costs

The Company accounts for software to be sold or otherwise marketed in accordance with ASC 985-20 - *Costs of Software to be Sold, Leased or Marketed,* which requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. The Company defines establishment of technological feasibility as the completion of a working model. Software development costs for software to be sold or otherwise marketed incurred prior to the establishment of technological feasibility are included in research and development and are expensed as incurred. Software development costs incurred subsequent to the establishment of technological feasibility through the period of general market availability of the product are capitalized, if material.

In the first three months of fiscal 2015, the Company expensed all research and development costs in accordance with ASC 985-20. At June 30, 2014, total capitalized software development costs included in other long-term assets was approximately $945,000 and accumulated amortization costs related to capitalized software was approximately $233,000.

Foreign Currency Translation

The Company has determined that the functional currency of its UK foreign subsidiary is the subsidiary's local currency, the British Pound Sterling ("GBP"), which the Company believes most appropriately reflects the current economic facts and circumstances of the UK subsidiary's operations. The assets and liabilities of the subsidiary are translated at the applicable exchange rate as of the end of the balance sheet period and revenue and expenses are translated at an average rate over the period presented. Resulting currency translation adjustments are recorded as a component of accumulated other comprehensive income or loss within the stockholder's equity in the consolidated balance sheets.

Stock Purchase Right/Restricted Stock Unit and Option Activity

Stock purchase right activity for the three months ended June 30, 2014 is summarized as follows:

	Number of Shares	Weighted Average Grant-Date Fair Market Value	Weighted Average Remaining Contractual Term (in Years)
Balance at March 31, 2014	489,627	$ 4.83	1.93
Granted	31,432	7.88	
Vested	(56,057)	2.80	
Forfeited	(24,625)	5.50	
Balance at June 30, 2014	440,377	$ 5.27	1.91

Restricted stock unit and performance stock unit activity for the three months ended June 30, 2014 is summarized as follows:

	Number of Shares	Weighted Average Purchase Price	Weighted Average Remaining Contractual Term (in Years)
Balance at March 31, 2014	1,134,856	$ -	2.00
Granted	77,750	-	
Vested	(7,875)	-	
Forfeited	(74,204)	-	
Balance at June 30, 2014	1,130,527	$ -	1.80

Option activity for the three months ended June 30, 2014 is summarized as follows:

	Shares Available for Grant	Shares Subject to Options Outstanding	Weighted Average Exercise Price Per Share
Balance at March 31, 2014	1,613,943	6,002,382	$ 4.14
Granted - options	(10,000)	10,000	7.88
Stock purchase rights/restricted stock unit (1)	(109,182)	-	-
Exercised	-	(137,940)	1.55
Canceled/forfeited - options	269,056	(269,056)	5.10
Canceled/forfeited - restricted stock unit	74,393	-	-
Balance at June 30, 2014	1,838,210	5,605,386	$ 4.16

(1) The reduction to shares available for grant includes awards granted of 109,182 shares.

The following table summarizes the stock options outstanding and exercisable at June 30, 2014:

	Options Outstanding					Options Exercisable		
Range of Exercise Price	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value	Shares		Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value
$0.55 - $1.26	1,628,745	$ 1.04	3.6	$ 11,472,489	1,628,745		$ 1.04	$ 11,472,489
$1.27 - $1.79	1,238,578	$ 1.53	1.7	8,110,169	1,238,578		$ 1.53	8,110,169
$1.80 - $5.87	1,345,025	$ 4.67	6.7	4,593,163	834,255		$ 4.24	3,201,363
$5.88 - $9.74	1,243,038	$ 9.49	9.2	95,930	93,135		$ 8.92	40,317
$10.97 - $11.26	150,000	$ 11.11	9.5	-	-		$ -	-
	5,605,386			$ 24,271,751	3,794,713			$ 22,824,338

Stock-based Compensation Expense

The Company accounts for its employee stock options, stock purchase rights, restricted stock units including restricted performance stock units granted under the 1996 Stock Plan, 1996 Director Option Plan, the 2006 Stock Plan, the 2003 Contactual Plan, the 2012 Equity Incentive Plan, the 2013 New Employee Inducement Incentive Plan and stock purchase rights under the 1996 Employee Stock Purchase Plan (collectively "Equity Compensation Plans") under the provisions of ASC 718 - *Stock Compensation*. Under the provisions of ASC 718, stock-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.

To value option grants, stock purchase rights and restricted stock units under the Equity Compensation Plans for stock-based compensation, the Company used the Black-Scholes option valuation model. Fair value determined using the Black-Scholes option valuation model varies based on assumptions used for the expected stock prices volatility, expected life, risk-free interest rates and future dividend payments. For the three months ended June 30, 2014 and 2013, the Company used the historical volatility of its stock over a period equal to the expected life of the options. The expected life assumptions represent the weighted-average period stock-based awards are expecting to remain outstanding. These expected life assumptions were 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 payout. Compensation expense for stock-based payment awards is recognized using the straight-line single-option method and includes the impact of estimated forfeitures.

As of June 30, 2014, there was $15.6 million of unamortized stock-based compensation expense related to unvested stock awards which is expected to be recognized over a weighted average period of 2.83 years.

The following table summarizes the assumptions used to compute reported stock-based compensation to employees and directors for the three months ended June 30, 2014 and 2013:

	Three Months Ended June 30,	
	2014	2013
Expected volatility	59%	66%
Expected dividend yield	-	-
Risk-free interest rate	1.53%	0.73%
Weighted average expected option term	5.00 years	4.50 years
Weighted average fair value of options granted	$ 4.01	$ 3.96

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In accordance with ASC 718 - *Stock Compensation*, the Company recorded $1,671,000 and $718,000 in compensation expense relative to stock-based awards for the three months ended June 30, 2014 and 2013, respectively.

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan, or ESPP, 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 the applicable nine month purchase period within that offering period, whichever is lower. The contribution amount may not exceed 10% of an employee's base compensation, including commissions but not including bonuses and overtime. The Company accounts for the ESPP as a compensatory plan and recorded compensation expense of $176,000 and $189,000 for the three months ended June 30, 2014 and 2013, respectively, in accordance with ASC 718.

As of June 30, 2014, there was $179,000 of total unrecognized compensation cost related to employee stock purchases. This cost is expected to be recognized over a weighted average period of 0.5 years.

ASC 718 requires the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow. The future realization of tax benefits related to stock-based 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-based compensation charges incurred during the three months ended June 30, 2014 and 2013.

The following table summarizes the classification of stock-based compensation expense related to employee stock options and employee stock purchases under ASC 718 among the Company's operating functions for the three months ended June 30, 2014 and 2013 which was recorded as follows (in thousands):

	Three Months Ended June 30,	
	2014	**2013**
Cost of service revenue	$ 115	$ 68
Cost of product revenue	-	-
Research and development	314	154
Sales and marketing	744	347
General and administrative	674	338
Total stock-based compensation expense related to employee stock options and employee stock purchases, pre-tax	1,847	907
Tax benefit	-	-
Stock-based compensation expense related to employee stock options and employee stock purchases, net of tax	$ 1,847	$ 907

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* and the IASB has issued IFRS 15, *Revenue from Contracts with Customers*. The issuance of these documents completes the joint effort by the FASB and the IASB to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and IFRS. The new guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. This ASU will supersede the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance. For public entities, the amendments are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

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In June 2014, the FASB issued Accounting Standards Update No. 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*. This ASU requires that a performance target that affects vesting and could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, *Compensation-Stock Compensation*, as it relates to such awards. ASU 2014-12 is effective for us in our first quarter of fiscal 2017 with early adoption permitted using either of two methods: (i) prospective to all awards granted or modified after the effective date; or (ii) retrospective to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter, with the cumulative effect of applying ASU 2014-12 as an adjustment to the opening retained earnings balance as of the beginning of the earliest annual period presented in the financial statements. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

3. FAIR VALUE MEASUREMENT

The following tables present the Company's fair value hierarchy for assets and liabilities measured at fair value on a recurring basis at June 30, 2014 and March 31, 2014 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	**Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance at June 30, 2014**
Cash equivalents:				
Money market funds	$ 25,020	$ -	$ -	$ 25,020
Short-term investments:				
Mutual funds	1,930	-	-	1,930
Commercial paper	-	24,589	-	24,589
Corporate debt	-	69,224	-	69,224
Municipal securities	-	5,435	-	5,435
Asset backed securities	-	20,075	-	20,075
Mortgage backed securities	-	4,879	-	4,879
International government securities	-	805	-	805
Total	$ 26,950	$ 125,007	$ -	$ 151,957

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at March 31, 2014
Cash equivalents:				
Money market funds	$ 32,611	$ -	$ -	$ 32,611
Short-term investments:				
Mutual funds	1,909	-	-	1,909
Commercial paper	-	30,379	-	30,379
Corporate debt	-	14,893	-	14,893
Long-term investments:				
Corporate debt	-	48,724	-	48,724
Municipal securities	-	5,439	-	5,439
Asset backed securities	-	17,054	-	17,054
International government securities	-	804	-	804
Total	$ 34,520	$ 117,293	$ -	$ 151,813

4. BALANCE SHEET DETAIL

	June 30, 2014	March 31, 2014
Inventory (in thousands):		
Work-in-process	$ 9	$ 23
Finished goods	744	788
	$ 753	$ 811

5. NET INCOME PER SHARE

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

	Three Months Ended June 30,	
	2014	**2013**
	(in thousands, except per share amounts)	
Numerator:		
Income from continuing operations	$ 8	$ 1,992
Income from discontinued operations, net of income tax provision	-	147
Net income available to common stockholders	8	2,139
Denominator:		
Common shares	88,592	72,510
Denominator for basic calculation	88,592	72,510
Employee stock options	2,480	2,911
Stock purchase rights	373	335
Denominator for diluted calculation	91,445	75,756
Income per share - continuing operations:		
Basic	$ 0.00	$ 0.03
Diluted	$ 0.00	$ 0.03
Income per share - discontinued operations:		
Basic	$ 0.00	$ 0.00
Diluted	$ 0.00	$ 0.00
Net income per share:		
Basic	$ 0.00	$ 0.03
Diluted	$ 0.00	$ 0.03

The following shares attributable to outstanding stock options and stock purchase rights 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,	
	2014	**2013**
Employee stock options	1,370	935
Stock purchase rights	79	2
Total anti-dilutive employee stock-based securities	1,449	937

6. INCOME TAXES

For the three months ended June 30, 2014, the Company recorded a provision for income taxes of $0.7 million, which was primarily attributable to net income from continuing operations. For the three months ended June 30, 2013, the Company recorded a provision for income taxes of $1.1 million, which was primarily attributable to net income from continuing operations ($1.0 million) and from discontinued operations ($0.1 million).

The effective tax rate is calculated by dividing the income tax provision by net income before income tax expense.

At March 31, 2014, there were $2.2 million of unrecognized tax benefits that, if recognized, would have affected the effective tax rate. The Company does not believe that there has been any significant change in the unrecognized tax benefits in the three-month period ended June 30, 2014, and does not expect the remaining unrecognized tax benefit to change materially in the next 12 months. To the extent that the remaining unrecognized tax benefits are ultimately recognized, they will have an impact on the effective tax rate in future periods.

The Company is subject to taxation in the U.S., California and various other states and foreign jurisdictions in which it has or had a subsidiary or branch operations or it is collecting sales tax. All tax returns from fiscal 1995 to fiscal 2014 may be subject to examination by the Internal Revenue Service, California and various other states. As of July 23, 2014, there were no active federal or state income tax audits. Returns filed in foreign jurisdictions may be subject to examination for the fiscal years 2010 to 2014.

7. SEGMENT REPORTING

ASC 280, "Segment Reporting" 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 ASC 280, 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 Company's chief operating decision makers, the Chief Executive Officer, Chief Financial Officer and Chief Technology Officer, evaluate performance of the Company and make decisions regarding allocation of resources based on total Company results.

No customer represented greater than 10% of the Company's total revenues for the three months ended June 30, 2014 or 2013. The Company's revenue distribution by geographic region (based upon the destination of shipments and the customer's service address) was as follows:

	Three Months Ended June 30,	
	2014	**2013**
Americas (principally US)	91%	99%
Europe	8%	0%
Asia Pacific	1%	1%
	100%	100%

Geographic area data is based upon the location of the property and equipment and is as follows (in thousands):

	June 30, 2014	March 31, 2014
United States	$ 6,483	$ 6,305
Europe	1,567	1,087
Asia	289	319
Total	$ 8,339	$ 7,711

8. COMMITMENTS AND CONTINGENCIES

Guarantees

Indemnifications

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

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

Product Warranties

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

	Three Months Ended June 30,	
	2014	2013
Balance at beginning of period	$ 660	$ 452
Accruals for warranties	54	177
Payments	(95)	(155)
Balance at end of period	$ 619	$ 474

Minimum Third Party Customer Support Commitments

In the third quarter of fiscal 2010, the Company amended a contract with one of its third party customer support vendors containing a minimum monthly commitment of approximately $0.4 million. The agreement requires a 150-day notice to terminate. The total remaining obligation under the amended contract is $2.2 million.

Minimum Third Party Network Service Provider Commitments

The Company entered into contracts with multiple vendors for third party network services that expire on various dates in fiscal 2015 through 2016. At June 30, 2014, future minimum annual payments under these third party network service contracts were as follows (in thousands):

Year ending March 31:		
Remaining 2015	$	1,355
2016		214
Total minimum payments	$	1,569

Legal Proceedings

From time to time, the Company may become 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 is not currently aware of any such matters that it believes would have a material adverse effect on its financial position, results of operations or cash flows.

On February 22, 2011, we were named a defendant in a lawsuit, Bear Creek Technologies, Inc. v. 8x8, Inc. *et al.*, along with 20 other defendants. On August 17, 2011, we were dismissed without prejudice from this lawsuit under Rule 21 of the Federal Rules of Civil Procedure. On August 17, 2011, we were sued again by Bear Creek Technologies, Inc. in the United States District Court for the District of Delaware. We believe we have factual and legal defenses to these claims and are presenting a vigorous defense. Further, on November 28, 2012, the U.S. Patent & Trademark Office initiated a Reexamination proceeding with a Reexamination Declaration explaining that there is a substantial new question of patentability, based on four separate grounds and affecting each claim of the patent which is the basis for the complaint filed against us. On March 26, 2013, the USPTO issued a first Office Action in the Reexamination, with all claims of the '722 patent being rejected on each of the four separate grounds raised in the Request for Reexamination. On July 10, 2013, we filed an informational pleading in support of and joining a motion to stay the proceeding in the District Court; the District Court granted the motion on July 17, 2013, based on the possibility that at least one of the USPTO rejections will be upheld and considering the USPTO's conclusion that Bear Creek's patent suffers from a defective claim for priority. On March 24, 2014, the USPTO issued another Office Action in which the rejections of the claims were maintained. We cannot estimate potential liability in this case at this early stage of litigation.

On October 25, 2011, we were named a defendant in a lawsuit, Klausner Technologies, Inc. v. Oracle Corporation *et al.*, along with 30 other defendants filed in the U.S. District Court for the District of Delaware. Based on a transfer of ownership of the patent in suit, the lawsuit against 8x8 became IPVX Patent Holdings, Inc., v. 8x8, Inc. The lawsuit alleges infringement of a patent that is believed to have expired. On November 1, 2011, IPVX dismissed the complaint voluntarily and filed new complaints separating the defendants, including a new complaint against 8x8. On March 21, 2013, the District Court granted 8x8's Motion to Change Venue, and ordered the transfer of the case to the U.S. District Court for the Northern District of California. The Company filed its answer to the complaint on April 25, 2014. On July 7, 2014, the parties agreed to participate in a Court-facilitated mediation session, and subsequently agreed to settle all claims in the suit under confidential terms which await finalization; subject to such the written agreement being finalized, this lawsuit is dismissed. The impact of the settlement on the Company will be immaterial.

On March 31, 2014, we were named a defendant in a lawsuit, CallWave Communications LLC v. 8x8, Inc. CallWave Communications also sued Fonality Inc. on March 31, 2014, and previously sued other companies including Verizon, Google, T-Mobile, and AT&T. We are currently assessing factual and legal defenses to these claims and expect to present a vigorous defense. We have answered the complaint and filed counterclaims in response thereto. We cannot estimate potential liability in this case at this early stage of the litigation.

State and Municipal Taxes

From time to time, the Company has received inquiries from a number of state and municipal taxing agencies with respect to the remittance of taxes. The Company collects or has accrued for taxes that it believes are required to be remitted. The amounts that have been remitted have historically been within the accruals established by the Company.

9. DISCONTINUED OPERATIONS

On September 30, 2013, the Company completed the sale of its dedicated server hosting business to IRC Company, Inc. ("IRC") and, as a result, no longer provides dedicated server hosting services. In the transaction, IRC purchased 100% of the stock of Central Host, Inc., which had been wholly owned by the Company and all of the assets specific to the dedicated server hosting business.

The Company sold its dedicated server hosting business for total consideration of $3.0 million in cash, which was received on October 1, 2013.

The dedicated server hosting business has been reported as discontinued operations. The results of operations position of these discontinued operations is as follows:

Results of operations:

	Three Months Ended June 30,			
	2014		2013	
Revenue	$	-	$	753
Operating expense		-		502
Income before income taxes		-		251
Provision for income taxes		-		104
Income from discontinued operations		-		147

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

FORWARD-LOOKING STATEMENTS

This Management 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 cloud communications and collaboration services, the quality and reliability of our services, the prices for our services, customer renewal rates, customer acquisition costs, our ability to compete effectively in the hosted telecommunications and cloud-based computing services business, actions by our competitors, including price reductions for their competitive services, our ability to provide cost-effective and timely service and support to larger distributed enterprises, potential federal and state regulatory actions, compliance costs, potential warranty claims and product defects, our need for and the availability of adequate working capital, our ability to innovate technologically, the timely supply of products by our contract manufacturers, our management's ability to execute its plans, strategies and objectives for future operations, including the execution of integration plans, and to realize the expected benefits of our acquisitions, and potential future intellectual property infringement claims and other litigation that could adversely affect our business and operating 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 the factors discussed elsewhere in this Form 10-Q, see the Risk Factors discussion in Item 1A of our 2013 Form 10-K. The forward-looking statements included in this Form 10-Q are made only as of the date of this report, and we undertake no obligation to update the forward-looking statements to reflect subsequent events or circumstances.

BUSINESS OVERVIEW

We develop and market a comprehensive portfolio of cloud-based communication and collaboration solutions that include hosted cloud telephony, unified communications, contact center, video conferencing and virtual desktop software and services. These communication and collaboration services are offered from the Internet cloud via a software-as-a-service subscription. We also provide cloud-based computing services. As of June 30, 2014, we had 39,340 business customers. Since fiscal 2004, substantially all of our revenue has been generated from the sale, license and provision of these cloud products, services and technology. Prior to fiscal 2003, our focus was on our Voice over Internet Protocol semiconductor business.

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 2015 refers to the fiscal year ending March 31, 2015).

RECLASSIFICATION

Certain amounts previously reported within our consolidated statements of income have been reclassified to conform to the current period presentation. The reclassification included certain prior-period amounts that are related to our discontinued operations.

The reclassification had no impact on our previously reported net income or basic and diluted net income per share amounts. The operating results discussed under "Results of Operations" exclude the impact of our discontinued operations for all periods presented.

SUMMARY AND OUTLOOK

In the first quarter of fiscal 2015, we displayed continued momentum with revenue increasing 30% year over year to a record $37.9 million; our channel and mid-market sales increasing 94% year over year, representing 44% of new monthly recurring revenue sold in the quarter; and average monthly service revenue per business customer of $293, up 11% compared with $263 in the same period last year.

CRITICAL ACCOUNTING POLICIES & ESTIMATES

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

RECENT ACCOUNTING PRONOUNCEMENTS

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

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 (1)				
	June 30, 2014	**March 31, 2014**	**Dec 31, 2013**	**Sept. 30, 2013**	**June 30, 2013**
Total business customers (2)	39,340	37,933	36,753	34,674	33,374
Business customers average monthly service revenue per customer (3)	$ 293	$ 287	$ 274	$ 268	$ 263
Monthly business service revenue churn	0.4%	1.2%	1.5%	1.2%	1.2%
Overall service margin	80%	79%	81%	81%	82%
Overall product margin	-9%	-23%	-34%	-27%	-22%
Overall gross margin	71%	70%	71%	71%	72%

(1) Selected operating statistics table include continuing operations and excludes dedicated server hosting business sold September 30, 2013.

(2) Business customers are defined as customers paying for service. Customers that are currently in the 30-day trial period are considered to be customers that are paying for service. Customers subscribing to Virtual Office Solo, DNS or Cloud VPS services are not included as business customers.

(3) Business customer average monthly service revenue per customer is service revenue from business customers in the period divided by the number of months in the period divided by the simple average number of business customers during the period.

RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our condensed consolidated financial statements and the notes thereto.

Service revenue	June 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 34,276	$ 26,499	$ 7,777	29.3%
Percentage of total revenue	90.4%	90.6%		

Service revenue consists primarily of revenue attributable to the provision of our 8x8 cloud communication and collaboration services, and royalties earned from cloud technology licenses. We expect that cloud communication and collaboration service revenues will continue to comprise nearly all of our service revenues for the foreseeable future. 8x8 service revenues increased in the first quarter of fiscal 2015 primarily due to the increase in our business customer subscriber base and an increase in the average monthly service revenue per customer. Our business service subscriber base grew from 33,374 business customers on June 30, 2013, to 39,340 on June 30, 2014.

Product revenue	June 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 3,637	$ 2,752	$ 885	32.2%
Percentage of total revenue	9.6%	9.4%		

Product revenue consists primarily of revenue from sales of IP telephones in conjunction with our 8x8 cloud telephony service. Product revenue increased for the three months ended June 30, 2014 primarily due to an increase in equipment sales to business customers.

No customer represented greater than 10% of the Company's total revenues for the three months ended June 30, 2014 or 2013.

Cost of service revenue	June 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 6,997	$ 4,786	$ 2,211	46.2%
Percentage of service revenue	20.4%	18.1%		

The cost of service revenue primarily consists of costs associated with network operations and related personnel, telephony origination and termination services provided by third party carriers and technology license and royalty expenses. Cost of service revenue for the three months ended June 30, 2014 increased over the comparable period in the prior fiscal year primarily due to a $1.1 million increase in third party network services expenses, a $0.5 million increase in payroll and related expenses, a $0.2 million increase in depreciation expense, and a $0.1 million increase in consulting, temporary personnel, and outside service expenses.

Cost of product revenue	June 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 3,969	$ 3,347	$ 622	18.6%
Percentage of product revenue	109.1%	121.6%		

The cost of product revenue consists primarily of IP Telephones, estimated warranty obligations and direct and indirect costs associated with product purchasing, scheduling, shipping and handling. The amount of revenue allocated to product revenue based on the relative selling price is less than the cost of the IP phone equipment. The cost of product revenue for the three months ended June 30, 2014 increased over the comparable period in the prior fiscal year primarily due to an increase in equipment shipped to customers. The decrease in negative margin is due to less discounting of equipment in the current period.

Research and development	June 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 3,406	$ 2,336	$ 1,070	45.8%
Percentage of total revenue	9.0%	8.0%		

Historically, our research and development expenses have consisted primarily of personnel, system prototype design, and equipment costs necessary for us to conduct our development and engineering efforts. During the three months ended June 30, 2014, we expensed all research and development costs as they were incurred in accordance with ASC 985-20. The research and development expenses for the three months ended June 30, 2014 increased over the comparable period in the prior fiscal year primarily due to a $0.3 million increase in consulting, temporary personnel, and outside service expenses, a $0.3 million decrease in amounts capitalized as software developments costs, a $0.2 million increase in stock-based compensation expenses, and a $0.1 million increase in payroll and related costs.

Sales and marketing	June 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 19,160	$ 13,072	$ 6,088	46.6%
Percentage of total revenue	50.5%	44.7%		

Sales and marketing expenses consist primarily of personnel and related overhead costs for sales, marketing, and customer service. Such costs also include outsourced customer service call center operations, sales commissions, as well as trade show, advertising and other marketing and promotional expenses. Sales and marketing expenses for the first quarter of fiscal 2015 increased over the same quarter in the prior fiscal year primarily because of a $3.5 million increase in payroll and related costs, a $0.5 million increase in temporary personnel, consulting and outside service expenses, a $0.5 million increase in indirect channel commission expenses, and a $0.4 increase in stock-based compensation expenses.

General and administrative	June 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 3,878	$ 2,772	$ 1,106	39.9%
Percentage of total revenue	10.2%	9.5%		

General and administrative expenses consist primarily of personnel and related overhead costs for finance, human resources and general management. General and administrative expenses for the first quarter of fiscal 2015 increased over the same quarter in the prior fiscal year primarily because of a $0.3 million increase in payroll and related costs, a $0.3 million increase in stock-based compensation expenses, a $0.2 million increase in legal fees, and a $0.2 million increase in recruiting, temporary personnel, consulting and outside service expenses.

Other income, net	**June 30, 2014**	**2013**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 177	$ 15	$ 162	1080.0%
Percentage of total revenue	0.5%	0.1%		

In the three months ended June 30, 2014, other income, net primarily consisted of interest income earned on our cash, cash equivalents and investments.

Provision for income tax	**June 30, 2014**	**2013**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 672	$ 961	$ (289)	-30.1%
Percentage of income before provision for income taxes	98.8%	32.5%		

For the three months ended June 30, 2014, we recorded a provision for income taxes of $0.7 million which was primarily attributable to income from continuing operations. For the three months ended June 30, 2013, we recorded a provision for income taxes of $1.1 million which was primarily attributable to net income from continuing operations ($1.0 million) and discontinued operations ($0.1 million).

The effective tax rate set forth in the previous table is calculated by dividing the income tax provision by net income before income tax expense. We estimate our annual effective tax rate at the end of each quarter. In estimating the annual effective tax rate, we, in consultation with our tax advisors, consider, among other things, annual pre-tax income, permanent tax differences, the geographic mix of pre-tax income and the application and interpretations of existing tax laws.

Income from discontinued operations, net of income tax provision	**June 30, 2014**	**2013**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ -	$ 147	$ (147)	-100.0%
Percentage of total revenue	0.0%	0.5%		

On September 30, 2013, we sold our dedicated server hosting business. The current historical results of our dedicated server hosting business have been reclassified to income from discontinued operations, net of income tax provision.

Liquidity and Capital Resources

As of June 30, 2014, we had approximately $182.0 million in cash, cash equivalents and short-term investments.

Net cash provided by operating activities for the three months ended June 30, 2014 was approximately $4.7 million, compared with $5.2 million for the three months ended June 30, 2013. Cash provided by operating activities has historically been affected by the amount of net income, sales of subscriptions, changes in working capital accounts particularly in deferred revenue due to timing of annual plan renewals, add-backs of non-cash expense items such as the use of deferred tax assets, depreciation and amortization and the expense associated with stock-based awards.

Net cash used in investing activities was approximately $8.9 million during the three months ended June 30, 2014. We spent approximately $1.0 million on the purchase of property and equipment, and we purchased $7.9 million of short-term investments, net of sales and proceeds from maturities of short-term investments. The net cash used in investing activities for the three months ended June 30, 2013 was $0.8 million during which period we spent approximately $0.5 million on the purchase of additional furniture and fixtures and leasehold and capitalized $0.3 million of software costs.

Our financing activities for the three months ended June 30, 2014 were not material. For the three-month period ended June 30, 2013, our financing activities consisted primarily of cash proceeds of $1.3 million related to the exercise of employee stock options and the purchase of shares under the employee stock purchase plan and $0.1 million of cash used to repurchase shares of our common stock.

Contractual Obligations

We lease our headquarters facility in San Jose, California under an operating lease agreement that expires in October 2019. The lease is an industrial net lease with monthly base rent of $130,821 for the first 15 months with a 3% increase each year thereafter, and requires us to pay property taxes, utilities and normal maintenance costs.

We lease our UK headquarters in Aylesbury UK under an operating lease agreement that expires in March 2017, with a break clause in March 2015 exercisable with six months' notice. The lease has a base monthly rent of $9,201 until March 2015, rising to $9,909 thereafter, and requires us to pay property taxes, service charges, utilities and normal maintenance costs.

We entered into a series of noncancelable capital lease agreements for office equipment bearing interest at various rates. Assets under capital lease at June 30, 2014 totaled $502,000 with accumulated amortization of $325,000.

In the third quarter of 2010, we amended the contract with one of our third party customer support vendors containing a minimum monthly commitment of approximately $0.4 million. The agreement requires a 150-day notice to terminate. At June 30, 2014, the total remaining obligation under the contract was $2.2 million.

We have entered into contracts with multiple vendors for third party network services. At June 30, 2014, future minimum annual payments under these third party network service contracts were $1.4 million in fiscal 2015 and $0.2 million for fiscal 2016.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency

Our financial market risk consists primarily of risks associated with international operations and related foreign currencies. We derive a portion of our revenue from customers in Europe and Asia. In order to reduce the risk from fluctuation in foreign exchange rates, the vast majority of our sales are denominated in U.S. dollars. In addition, almost all of our arrangements with our contract manufacturers are denominated in U.S. dollars. We have not entered into any currency hedging activities. To date, our exposure to exchange rate volatility has not been significant; however, there can be no assurance that there will not be a material impact in the future.

Investments

The primary objective of our investment activities is to preserve principal while maximizing income without significantly increasing risk. Some of the securities in which we invest may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. To minimize this risk, we may maintain our portfolio of cash equivalents and investments in a variety of securities, including commercial paper, money market funds, debt securities and certificates of deposit. The risk associated with fluctuating interest rates is limited to our investment portfolio and we do not believe that a 10% change in interest rates would have a significant impact on our interest income.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 ("Disclosure Controls") that are designed to ensure that information we are required to disclose in reports filed or submitted under the Securities and Exchange Act of 1934 is accumulated and communicated to management, including our principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure, and that such information is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

As of the end of the period covered by this Quarterly Report on Form 10-Q, under the supervision of our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of our Disclosure Controls. Based on this evaluation our Chief Executive Officer and our Chief Financial Officer have concluded that our Disclosure Controls were effective as of June 30, 2014.

Limitations on the Effectiveness of Controls

Our management, including the Chief Executive Officer and Chief Financial Officer, do not expect that our Disclosure Controls or internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

Changes in Internal Control over Financial Reporting

During the first quarter of fiscal 2015, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II -- OTHER INFORMATION

ITEM 1. Legal Proceedings

Descriptions of our legal proceedings are contained in Part I, Item 1, Financial Statements - Notes to Condensed Consolidated Financial Statements - "Note 8".

ITEM 1A. Risk Factors

We face many significant risks in our business, some of which are unknown to us and not presently foreseen. These risks could have a material adverse impact on our business, financial condition and results of operations in the future. We have disclosed a number of material risks under Part I, Item 1A of our annual report on Form 10-K for the fiscal year ended March 31, 2014, which we filed with the Securities and Exchange Commission on May 27, 2014.

ITEM 6. EXHIBITS

Exhibit Number	Description
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

SIGNATURE

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

Date: July 25, 2014

8X8, INC.
(Registrant)

By: /s/ DANIEL WEIRICH
Daniel Weirich

Chief Financial Officer
(Principal Financial and Chief Accounting Officer and Duly Authorized Officer)