

8X8 INC /DE/  
Form 10-Q  
February 01, 2016

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

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FORM 10-Q

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

For the quarterly period ended December 31, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-21783

[8X8, INC.](#)

(Exact name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

77-0142404

(I.R.S. Employer Identification Number)

2125 O'Nel Drive  
San Jose, CA 95131

(Address of Principal Executive Offices)

(408) 727-1885

(Registrant's Telephone Number, including Area Code)

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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

x NO "

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

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

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

The number of shares of the Registrant's Common Stock outstanding as of January 25, 2016 was 88,456,638.

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## Part I -- FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

|   | December 31,<br>2015 | March 31,<br>2015 |
|---|----------------------|-------------------|
| <b>ASSETS</b>                               |                      |                   |
| Current assets:                             |                      |                   |
| Cash and cash equivalents                   | \$ 23,866            | \$ 53,110         |
| Short-term investments                      | 130,719              | 123,984           |
| Accounts receivable, net                    | 9,927                | 6,642             |
| Inventory                                   | 786                  | 704               |
| Deferred cost of goods sold                 | 579                  | 428               |
| Deferred tax asset                          | 3,955                | 4,454             |
| Other current assets                        | 5,068                | 2,274             |
| Total current assets                        | 174,900              | 191,596           |
| Property and equipment, net                 | 11,969               | 10,248            |
| Intangible assets, net                      | 23,050               | 12,260            |
| Goodwill                                    | 48,144               | 36,887            |
| Non-current deferred tax asset              | 43,169               | 43,169            |
| Other assets                                | 2,356                | 1,464             |
| Total assets                                | \$ 303,588           | \$ 295,624        |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                      |                   |
| Current liabilities:                        |                      |                   |
| Accounts payable                            | \$ 9,917             | \$ 7,775          |
| Accrued compensation                        | 9,880                | 6,183             |
| Accrued warranty                            | 322                  | 339               |
| Accrued taxes                               | 4,753                | 2,800             |
| Deferred revenue                            | 1,807                | 1,768             |
| Other accrued liabilities                   | 3,743                | 2,965             |
| Total current liabilities                   | 30,422               | 21,830            |
| Non-current liabilities                     | 3,722                | 1,352             |
| Non-current deferred revenue                | 137                  | 231               |
| Total liabilities                           | 34,281               | 23,413            |
| Commitments and contingencies (Note 6)      |                      |                   |
| Stockholders' equity:                       |                      |                   |
| Common stock                                | 88                   | 88                |
| Additional paid-in capital                  | 381,335              | 378,971           |
| Accumulated other comprehensive loss        | (3,333)              | (2,109)           |
| Accumulated deficit                         | (108,783)            | (104,739)         |
| Total stockholders' equity                  | 269,307              | 272,211           |
| Total liabilities and stockholders' equity  | \$ 303,588           | \$ 295,624        |

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

## 8X8, Inc.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts; unaudited)

|   | Three Months Ended<br>December 31, |           | Nine Months Ended<br>December 31, |            |
|---|------------------------------------|-----------|-----------------------------------|------------|
|   | 2015                               | 2014      | 2015                              | 2014       |
| Service revenue   | \$ 48,948                          | \$ 37,802 | \$ 140,068                        | \$ 108,199 |
| Product revenue   | 4,220                              | 3,570     | 11,935                            | 10,684     |
| Total revenue   | 53,168                             | 41,372    | 152,003                           | 118,883    |
| Operating expenses:                                       |                                    |           |                                   |            |
| Cost of service revenue                                   | 9,713                              | 7,544     | 27,359                            | 22,046     |
| Cost of product revenue                                   | 5,087                              | 3,959     | 14,065                            | 11,690     |
| Research and development                                  | 6,404                              | 3,868     | 17,930                            | 10,770     |
| Sales and marketing                                       | 27,585                             | 20,559    | 78,138                            | 59,159     |
| General and administrative                                | 6,888                              | 4,617     | 18,614                            | 12,388     |
| Gain on patent sale                                       | -                                  | -         | -                                 | (1,000)    |
| Total operating expenses                                  | 55,677                             | 40,547    | 156,106                           | 115,053    |
| Income (loss) from operations                             | (2,509)                            | 825       | (4,103)                           | 3,830      |
| Other income, net   | 272                                | 246       | 710                               | 623        |
| Income (loss) before provision (benefit) for income taxes | (2,237)                            | 1,071     | (3,393)                           | 4,453      |
| Provision (benefit) for income taxes                      | (557)                              | 627       | 651                               | 2,710      |
| Net income (loss)   | \$ (1,680)                         | \$ 444    | \$ (4,044)                        | \$ 1,743   |
| Net income (loss) per share:                              |                                    |           |                                   |            |
| Basic   | \$ (0.02)                          | \$ 0.01   | \$ (0.05)                         | \$ 0.02    |
| Diluted   | \$ (0.02)                          | \$ 0.01   | \$ (0.05)                         | \$ 0.02    |
| Weighted average number of shares:                        |                                    |           |                                   |            |
| Basic   | 88,289                             | 89,594    | 88,812                            | 89,107     |
| Diluted   | 88,289                             | 91,974    | 88,812                            | 91,752     |

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

8X8, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
(In thousands, unaudited)

|  | Three Months Ended<br>December 31, |          | Nine Months Ended<br>December 31, |          |
|--|------------------------------------|----------|-----------------------------------|----------|
|  | 2015                               | 2014     | 2015                              | 2014     |
| Net income (loss)                            | \$ (1,680)                         | \$ 444   | \$ (4,044)                        | \$ 1,743 |
| Other comprehensive loss, net of tax         |                                    |          |                                   |          |
| Unrealized loss on investments in securities | (245)                              | (122)    | (320)                             | (87)     |
| Foreign currency translation adjustment      | (972)                              | (1,005)  | (904)                             | (1,4965) |
| Comprehensive income (loss)                  | \$ (2,897)                         | \$ (683) | \$ (5,268)                        | \$ 160   |

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)

|  | Nine Months Ended<br>December 31, |           |
|--|-----------------------------------|-----------|
|  | 2015                              | 2014      |
| <b>Cash flows from operating activities:</b>   |                                   |           |
| Net income (loss)  | \$ (4,044)                        | \$ 1,743  |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                                   |           |
| Depreciation   | 3,598                             | 2,513     |
| Amortization of intangible assets  | 2,565                             | 1,687     |
| Impairment of long-lived assets  | 640                               | -         |
| Amortization of capitalized software   | 456                               | 255       |
| Net accretion of discount and amortization of premium on marketable securities           | 584                               | 659       |
| Stock-based compensation   | 11,202                            | 6,489     |
| Deferred income tax provision  | 361                               | 2,444     |
| Other  | 467                               | 268       |
| Changes in assets and liabilities:   |                                   |           |
| Accounts receivable, net   | (3,138)                           | (2,062)   |
| Inventory  | (122)                             | 235       |
| Other current and noncurrent assets  | (1,699)                           | (505)     |
| Deferred cost of goods sold  | (156)                             | (179)     |
| Accounts payable   | 674                               | (736)     |
| Accrued compensation   | 3,351                             | 2,044     |
| Accrued warranty   | (17)                              | (237)     |
| Accrued taxes and fees   | 1,837                             | 561       |
| Deferred revenue   | (427)                             | (840)     |
| Other current and noncurrent liabilities   | (748)                             | (564)     |
| Net cash provided by operating activities  | 15,384                            | 13,775    |
| <b>Cash flows from investing activities:</b>   |                                   |           |
| Purchases of property and equipment  | (3,295)                           | (4,523)   |
| Purchase of businesses, net of cash acquired   | (23,434)                          | -         |
| Cost of capitalized software   | (1,275)                           | (456)     |
| Proceeds from maturity of investments  | 38,451                            | 31,400    |
| Sales of investments - available for sale  | 43,934                            | 29,580    |
| Purchases of investments - available for sale  | (90,025)                          | (77,821)  |
| Net cash used in investing activities  | (35,644)                          | (21,820)  |
| <b>Cash flows from financing activities:</b>   |                                   |           |
| Capital lease payments   | (321)                             | (115)     |
| Payment of contingent consideration  | (200)                             | -         |
| Repurchase of common stock   | (11,628)                          | (1,723)   |
| Proceeds from issuance of common stock under employee stock plans                        | 2,848                             | 2,666     |
| Net cash (used in) provided by financing activities                                      | (9,301)                           | 828       |
| Effect of exchange rate changes on cash  | 317                               | 656       |
| Net decrease in cash and cash equivalents  | (29,244)                          | (6,561)   |
| Cash and cash equivalents at the beginning of the period                                 | 53,110                            | 59,159    |
| Cash and cash equivalents at the end of the period                                       | \$ 23,866                         | \$ 52,598 |
| <b>Supplemental cash flow information</b>  |                                   |           |
| Income taxes paid  | \$ 441                            | \$ 181    |
| Interest paid  | 30                                | 25        |

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 BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

8x8, Inc. (8x8 or the Company) is a leading provider of VoIP (Voice over Internet Protocol) technology and SaaS (Software as a service) communication solutions in the cloud for SMBs (Small and Midsize Business) and mid-market and distributed enterprises. The Company delivers a broad suite of SaaS services to in-office and mobile devices spanning cloud telephony, virtual contact center and virtual meeting through its proprietary unified SaaS platform.

BASIS OF PRESENTATION

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 ended March 31 of the calendar year indicated (for example, fiscal 2016 refers to the fiscal year ended March 31, 2016).

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared on substantially the same basis as our annual consolidated financial statements for the fiscal year ended March 31, 2015. In the opinion of the Company's management, these interim condensed consolidated 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 revenue and expenses during the reporting periods. Actual results could differ from these estimates.

The March 31, 2015 year-end condensed consolidated balance sheet data in this document were derived from audited consolidated financial statements and does not include all of the disclosures required by U.S. generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements as of and for the fiscal year ended March 31, 2015 and notes thereto included in the Company's fiscal 2015 Annual Report on Form 10-K.

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

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of 8x8 and its subsidiaries. All material intercompany accounts and transactions have been eliminated.

SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in preparation of these condensed consolidated financial statements are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2015 filed with the SEC on May 29, 2015, and there have been no changes to the Company's significant accounting policies during the three months ended December 31, 2015, except as described in the "Recent Accounting Pronouncements" section below and Note 10, "Segment Reporting".





## RECENT ACCOUNTING PRONOUNCEMENTS

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. This ASU changes the requirements for reporting discontinued operations in FASB ASU 205-20, such that a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. This ASU requires an entity to present, for each comparative period, the assets and liabilities of a disposal group that includes a discontinued operation separately in the asset and liability sections, respectively, of the statement of financial position, as well as additional disclosures about discontinued operations. Additionally, the ASU requires disclosures about a disposal of an individually significant component of an entity that does not qualify for discontinued operations presentation in the financial statements and expands the disclosures about an entity's significant continuing involvement with a discontinued operation. The accounting update is effective for annual periods beginning on or after December 15, 2014. We adopted this pronouncement for our fiscal year beginning April 1, 2015, and there was no effect on our consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, *Simplifying the Measurement of Inventory, (Topic 330)*, which amends the guidelines for the measurement of inventory. Under the amendments, an entity should measure inventory valued using a first-in, first-out or average cost method at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This amendment is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard will become effective for public companies on January 1, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. The Company has not yet selected a transition method. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*. Topic 805 requires an acquirer retrospectively adjust provisional amounts recognized in a business combination during the measurement period. To simplify the accounting for adjustments made to provisional amounts, the amendment requires that the acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined. The acquirer is required to also record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. In addition, an entity is required to present separately on the face of the income statement or disclose in the notes to the financial statements the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date.

The amendments are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the effective date with earlier application permitted for financial statements that have not been issued. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, *Balance Sheet Classification of Deferred Taxes, (Topic 740)*, which amends the current requirement for organizations to present deferred tax assets and liabilities as current and noncurrent in a classified balance sheet. Under the amendment, an entity will be required to classify all deferred tax assets and liabilities as noncurrent.

This amendment is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

## 2. CASH, CASH EQUIVALENTS, INVESTMENTS AND FAIR VALUE MEASUREMENTS

Cash, cash equivalents, available-for-sale investments and fair value measurements were (in thousands):

| As of December 31, 2015             | Amortized<br>Costs | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Estimated<br>Fair Value | Cash and<br>Cash<br>Equivalents | Short-Term<br>Investments |
|-------------------------------------|--------------------|-----------------------------|-----------------------------|-------------------------|---------------------------------|---------------------------|
| <b>Assets:</b>                      |                    |                             |                             |                         |                                 |                           |
| Cash                                | \$ 10,996          | \$ -                        | \$ -                        | \$ 10,996               | \$ 10,996                       | \$ -                      |
| <b>Level 1:</b>                     |                    |                             |                             |                         |                                 |                           |
| Money market funds                  | 12,870             | -                           | -                           | 12,870                  | 12,870                          | -                         |
| Mutual funds                        | 2,000              | -                           | (198)                       | 1,802                   | -                               | 1,802                     |
| <b>Subtotal</b>                     | 25,866             | -                           | (198)                       | 25,668                  | 23,866                          | 1,802                     |
| <b>Level 2:</b>                     |                    |                             |                             |                         |                                 |                           |
| Commercial paper                    | 13,483             | 1                           | (3)                         | 13,481                  | -                               | 13,481                    |
| Corporate debt                      | 77,999             | 14                          | (138)                       | 77,875                  | -                               | 77,875                    |
| Municipal securities                | 5,745              | 1                           | (1)                         | 5,745                   | -                               | 5,745                     |
| Asset backed securities             | 21,782             | -                           | (46)                        | 21,736                  | -                               | 21,736                    |
| Mortgage backed securities          | 2,328              | -                           | (33)                        | 2,295                   | -                               | 2,295                     |
| Agency bond                         | 6,806              | -                           | (22)                        | 6,784                   | -                               | 6,784                     |
| International government securities | 1,000              | 1                           | -                           | 1,001                   | -                               | 1,001                     |
| <b>Subtotal</b>                     | 129,143            | 17                          | (243)                       | 128,917                 | -                               | 128,917                   |
| Total assets                        | \$ 155,009         | \$ 17                       | \$ (441)                    | \$ 154,585              | \$ 23,866                       | \$ 130,719                |
| <b>Level 3:</b>                     |                    |                             |                             |                         |                                 |                           |
| <b>Liabilities:</b>                 |                    |                             |                             |                         |                                 |                           |
| Contingent consideration            | \$ -               | \$ -                        | \$ -                        | \$ 341                  | \$ -                            | \$ -                      |
| Total liabilities                   | \$ -               | \$ -                        | \$ -                        | \$ 341                  | \$ -                            | \$ -                      |

| As of March 31, 2015                | Amortized<br>Costs | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Estimated<br>Fair Value | Cash and<br>Cash<br>Equivalents | Short-Term<br>Investments |
|-------------------------------------|--------------------|-----------------------------|-----------------------------|-------------------------|---------------------------------|---------------------------|
| Cash                                | \$ 24,734          | \$ -                        | \$ -                        | \$ 24,734               | \$ 24,734                       | \$ -                      |
| <b>Level 1:</b>                     |                    |                             |                             |                         |                                 |                           |
| Money market funds                  | 28,376             | -                           | -                           | 28,376                  | 28,376                          | -                         |
| Mutual funds                        | 2,000              | -                           | (107)                       | 1,893                   | -                               | 1,893                     |
| <b>Subtotal</b>                     | 55,110             | -                           | (107)                       | 55,003                  | 53,110                          | 1,893                     |
| <b>Level 2:</b>                     |                    |                             |                             |                         |                                 |                           |
| Commercial paper                    | 9,043              | 1                           | -                           | 9,044                   | -                               | 9,044                     |
| Corporate debt                      | 75,284             | 57                          | (10)                        | 75,331                  | -                               | 75,331                    |
| Municipal securities                | 5,435              | 2                           | (1)                         | 5,436                   | -                               | 5,436                     |
| Asset backed securities             | 21,503             | 4                           | (5)                         | 21,502                  | -                               | 21,502                    |
| Mortgage backed securities          | 5,822              | -                           | (52)                        | 5,770                   | -                               | 5,770                     |
| Agency bond                         | 4,201              | 3                           | -                           | 4,204                   | -                               | 4,204                     |
| International government securities | 800                | 4                           | -                           | 804                     | -                               | 804                       |
| <b>Subtotal</b>                     | 122,088            | 71                          | (68)                        | 122,091                 | -                               | 122,091                   |
| Total                               | \$ 177,198         | \$ 71                       | \$ (175)                    | \$ 177,094              | \$ 53,110                       | \$ 123,984                |

Contractual maturities of investments as of December 31, 2015 are set forth below (in thousands):

|                     | <b>Estimated<br/>Fair Value</b> |
|---------------------|---------------------------------|
| Due within one year | \$ 65,670                       |
| Due after one year  | 65,049                          |
| Total               | \$ 130,719                      |

The Company's contingent consideration liability, included in other accrued liabilities and noncurrent liabilities on the consolidated balance sheets, was associated with the Quality Software Corporation (QSC) acquisition made in the first quarter of fiscal 2016. The liability was measured at fair value using a probability weighted average of the potential payment outcomes that would occur should certain contract milestones be reached. There is no market data available to use in valuing the contingent consideration; therefore, the Company developed its own assumptions related to the achievement of the milestones to evaluate the fair value of the liability. As such, the contingent consideration is classified within Level 3 as described below.

The item classified as Level 3 within the valuation hierarchy, consisting of contingent consideration liability related to the QSC acquisition, was valued based on an estimate of the probability of success of the milestones being achieved. The table below presents a rollforward of the contingent consideration liability valued using a Level 3 input (in thousands):

|   | <b>Three Months Ended<br/>December 31,</b> |             | <b>Nine Months Ended<br/>December 31,</b> |             |
|---|--|-------------|---|-------------|
|   | <b>2015</b>                                | <b>2014</b> | <b>2015</b>                               | <b>2014</b> |
| Balance at beginning of period          | \$ 391                                     | \$ -        | \$ -                                      | \$ -        |
| Purchase price contingent consideration | -  | -           | 541                                       | -           |
| Contingent consideration payments       | (50)                                       | -           | (200)                                     | -           |
| Balance at end of period                | \$ 341                                     | \$ -        | \$ 341                                    | \$ -        |

### 3. BALANCE SHEET DETAIL

|                          | <b>December 31,<br/>2015</b> | <b>March 31,<br/>2015</b> |
|--------------------------|------------------------------|---------------------------|
| Inventory (in thousands) |                              |                           |
| Work-in-process          | \$ 215                       | \$ 169                    |
| Finished goods           | 571                          | 535                       |
| Total                    | \$ 786                       | \$ 704                    |

## 4. INTANGIBLE ASSETS

The carrying value of intangible assets consisted of the following (in thousands):

|   | December 31, 2015     |                          |                     | March 31, 2015        |                          |                     |
|---|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|   | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Technology                                    | \$ 19,353             | \$ (4,797)               | \$ 14,556           | \$ 8,242              | \$ (2,905)               | \$ 5,337            |
| Customer relationships                        | 10,182                | (4,532)                  | 5,650               | 9,686                 | (3,720)                  | 5,966               |
| Trade names/domains                           | 2,439                 | (195)                    | 2,244               | 957                   | -                        | 957                 |
| In-process research and development           | 600                   | -                        | 600                 | -                     | -                        | -                   |
| Total acquired identifiable intangible assets | \$ 32,574             | \$ (9,524)               | \$ 23,050           | \$ 18,885             | \$ (6,625)               | \$ 12,260           |

At December 31, 2015, 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 2016 | \$ 964    |
| 2017           | 3,855     |
| 2018           | 3,587     |
| 2019           | 3,337     |
| 2020           | 3,337     |
| Thereafter     | 5,126     |
| Total          | \$ 20,206 |

## Impairment of Long-Lived Assets

During the three months ended December 31, 2015, the Company decided to end-of-life its hosted virtual desktop service (Zerigo). The Company evaluated long-lived assets related to Zerigo including the technology, customer relationships, and trade name intangible assets for impairment. The Company determined it was appropriate to record an impairment charge equal to the remaining value of the impaired long-lived assets this quarter. The impairment recorded during the three and nine months ended December 31, 2015 was \$0.6 million, of which \$0.4 million and \$0.2 million was recorded in cost of service and sales and marketing, respectively, in the consolidated statements of operations. Revenues and net income (loss) from Zerigo were not material for all periods presented.

## 5. RESEARCH, DEVELOPMENT AND SOFTWARE COSTS

In the first nine months of fiscal 2016, the Company expensed all research and development costs in accordance with ASC 985-20, *Costs of Software to be Sold, Leased or Marketed* (ASC 985-20). At December 31, 2015 and March 31, 2015, total capitalized software development costs in accordance with ASC 985-20 included in other long-term assets were approximately \$0 and \$1.0 million, respectively, and accumulated amortization costs related to capitalized software were approximately \$0 and \$0.5 million, respectively.

The Company accounts for computer software developed or obtained for internal use in accordance with ASC 350-40, *Internal Use Software* (ASC 350-40). In the first nine months of fiscal 2016, the Company capitalized \$1.3 million of software development costs in accordance with ASC 350-40, of which \$1.1 million have been classified as other long-term assets and \$0.2 million have classified as property and equipment. At December 31, 2015, the Company had capitalized \$2.8 million of software development costs in accordance with ASC 350-40, of which \$1.8 million have been classified as other long-term assets, and \$1.0 million have been classified as property and equipment. As of March 31, 2015, the Company capitalized \$1.5 million in accordance with ASC 350-40, of which \$0.8 million has been classified as property and equipment and \$0.7 million has been classified as other long-term assets. In the first nine months of fiscal 2015 and as of December 31, 2014, the Company capitalized \$1.1 million in accordance with ASC 350-40, of which \$0.6 million is classified as property and equipment and \$0.5 million is classified as other long-term assets. At December 31, 2015 and March 31, 2015, accumulated amortization costs related to capitalized software were approximately \$0.1 million and \$0, respectively.

## 6. COMMITMENTS AND CONTINGENCIES

### Guarantees

### Indemnifications

In the normal course of business, the Company may agree to indemnify other parties, including customers, lessors and parties to other transactions with the Company, with respect to certain matters such as breaches of representations or covenants or intellectual property infringement or other claims made by third 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 consolidated statements of operations, were as follows (in thousands):

|                                | Three Months Ended<br>December 31, |        | Nine Months Ended<br>December 31, |        |
|--------------------------------|------------------------------------|--------|-----------------------------------|--------|
|                                | 2015                               | 2014   | 2015                              | 2014   |
| Balance at beginning of period | \$ 325                             | \$ 538 | \$ 339                            | \$ 660 |
| Accruals for warranties        | 88                                 | 54     | 263                               | 123    |
| Settlements                    | (70)                               | (86)   | (223)                             | (277)  |
| Adjustments                    | (21)                               | (83)   | (57)                              | (83)   |
| Balance at end of period       | \$ 322                             | \$ 423 | \$ 322                            | \$ 423 |

### Minimum Third Party Customer Support Commitments

In the third quarter of 2010, the Company amended its 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, which represents a minimum remaining obligation of \$2.2 million under the contract.

### Minimum Third Party Network Service Provider Commitments

The Company has entered into contracts with multiple vendors for third party network service which expire on various dates in fiscal 2016 through 2018. At December 31, 2015, future minimum annual payments under these third party network service contracts were as follows (in thousands):

|                              |          |
|------------------------------|----------|
| <u>Year ending March 31:</u> |          |
| Remaining 2016               | \$ 751   |
| 2017                         | 2,452    |
| 2018                         | 891      |
| Total minimum payments       | \$ 4,094 |

### Legal Proceedings

The Company, from time to time, is involved in various legal claims or litigation, including patent infringement claims that can arise in the normal course of the Company's operations. Pending or future litigation could be costly, could cause the diversion of management's attention and could upon resolution, have a material adverse effect on the Company's business, results of operations, financial condition and cash flows.

On February 22, 2011, the Company was named a defendant in *Bear Creek Technologies, Inc. (BCT) v. 8x8, Inc. et al.*, filed in the U.S. District Court for the District of Delaware (the Court), along with 20 other defendants. In August 2011, the suit was dismissed without prejudice and then was refiled against the Company before the same Court. On November 28, 2012, the USPTO initiated and has since maintained a Reexamination Proceeding in which the claims of the patent (asserted against the Company) were rejected as being invalid based on four separate grounds. In response to the USPTO invalidity rejections, the Company filed an informational pleading (on July 10, 2013) to join a motion to stay the proceeding in the District Court, which this motion was granted on July 17, 2013. On May 5, 2015, the Court administratively closed this case with leave to reopen if needed. The Reexamination Proceeding has been on appeal since September 15, 2014. A Decision on Appeal was issued on December 29, 2015, affirming the rejection of all claims. This Decision remains subject to appeal at this date.

On November 25, 2015, the Company was named a defendant in *2-Way Computing, Inc. (2-Way) v. 8x8, Inc.*, filed in the U.S. District Court for the District of Nevada. 2-Way also simultaneously sued five other defendants for infringing the same patent asserted against 8x8. The Company has not yet answered the complaint and cannot estimate potential liability in this case at this early stage of the litigation.

On April 16, 2015, the Company was named as a defendant in a lawsuit, *Slocumb Law Firm v. 8x8, Inc.*, filed in the United States District Court for the Middle District of Alabama. The Slocumb Law Firm alleges that it purchased certain business services from the Company that did not perform as advertised or expected, and asserts various causes of actions including fraud, breach of contract, violations of the Alabama Deceptive Trade Practices Act and negligence. On June 10, 2015, the United States Magistrate Judge issued a Report and Recommendation that the Court grant the Company's motion to stay the case and compel the Slocumb Law Firm to arbitrate its claims against the Company in Santa Clara County, California pursuant to a clause mandating arbitration of disputes set forth in the terms and conditions to which Slocumb Law Firm agreed in connection with its purchase of business services from the Company. The Company has not yet received a formal arbitration demand from the Slocumb Law Firm, nor has discovery commenced. The Company intends to vigorously defend against Slocumb Law Firm's claims.

### 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 sales, use, telecommunications, excise, and income taxes. Several jurisdictions currently are conducting tax audits of the Company's records. 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.





## 7. STOCK-BASED COMPENSATION

The following table summarizes stock-based compensation expense (in thousands):

|  | Three Months Ended<br>December 31, |          | Nine Months Ended<br>December 31, |          |
|--|------------------------------------|----------|-----------------------------------|----------|
|  | 2015                               | 2014     | 2015                              | 2014     |
| Cost of service revenue  | \$ 346                             | \$ 201   | \$ 828                            | \$ 476   |
| Cost of product revenue  | -                                  | -        | -                                 | -        |
| Research and development   | 850                                | 420      | 2,107                             | 1,049    |
| Sales and marketing  | 1,689                              | 966      | 4,308                             | 2,620    |
| General and administrative   | 1,778                              | 1,047    | 3,959                             | 2,344    |
| Total stock-based compensation expense<br>related to employee stock options and<br>employee stock purchases, pre-tax | 4,663                              | 2,634    | 11,202                            | 6,489    |
| Tax benefit  | -                                  | -        | -                                 | -        |
| Stock-based compensation expense<br>related to employee stock options and<br>employee stock purchases, net of tax    | \$ 4,663                           | \$ 2,634 | \$ 11,202                         | \$ 6,489 |

## Stock Options, Stock Purchase Right and Restricted Stock Unit Activity

Stock Option activity under all the Company's stock option plans for the nine months ended December 31, 2015, is summarized as follows:

|   | Number of<br>Shares | Weighted<br>Average<br>Exercise Price<br>Per Share |
|---|---------------------|--|
| <b>Outstanding at March 31, 2015</b>                    | 5,327,907           | \$ 5.19  |
| Granted   | 686,604             | 8.51   |
| Exercised   | (647,158)           | 2.54   |
| Canceled/Forfeited                                      | (96,241)            | 8.06   |
| <b>Outstanding at December 31, 2015</b>                 | 5,271,112           | \$ 5.90  |
| <b>Vested and expected to vest at December 31, 2015</b> | 5,271,112           | \$ 5.90  |
| <b>Exercisable at December 31, 2015</b>                 | 3,229,890           | \$ 4.38  |

Stock Purchase Right activity for the nine months ended December 31, 2015, is summarized as follows:

|                              | Number of<br>Shares | Weighted<br>Average<br>Grant-Date<br>Fair Market<br>Value | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in Years) |
|------------------------------|---------------------|---|--|
| Balance at March 31, 2015    | 223,835             | \$ 5.92   | 1.50   |
| Granted                      | -                   | -   | -  |
| Vested                       | (107,039)           | 5.36  | -  |
| Forfeited                    | (20,750)            | 7.59  | -  |
| Balance at December 31, 2015 | 96,046              | \$ 6.18   | 0.95   |

Restricted Stock Unit activity for the nine months ended December 31, 2015, is summarized as follows:

|                              | Number of<br>Shares | Weighted<br>Average<br>Grant Date<br>Fair Value | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in Years) |
|------------------------------|---------------------|---|--|
| Balance at March 31, 2015    | 2,698,686           | \$ 7.33   | 1.88   |
| Granted                      | 2,516,522           | 8.67  |  |
| Vested                       | (529,797)           | 7.62  |  |
| Forfeited                    | (175,815)           | 7.98  |  |
| Balance at December 31, 2015 | 4,509,596           | \$ 8.02   | 1.82   |

The following table summarizes stock options outstanding and exercisable at December 31, 2015:

|                         | Options Outstanding |   |   |                                 | Options Exercisable |   |                                 |  |
|-------------------------|---------------------|---|---|---------------------------------|---------------------|---|---------------------------------|--|
|                         | Shares              | Weighted<br>Average<br>Exercise<br>Price<br>Per Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (Years) | Aggregate<br>Intrinsic<br>Value | Shares              | Weighted<br>Average<br>Exercise<br>Price<br>Per Share | Aggregate<br>Intrinsic<br>Value |  |
| \$ 0.55 to \$ 1.26      | 1,079,850           | \$ 1.12   | 1.8   | \$ 11,160,555                   | 1,079,850           | \$ 1.12   | \$ 11,160,555                   |  |
| \$ 1.27 to \$ 5.87      | 1,280,153           | \$ 3.81   | 3.9   | 9,776,033                       | 1,196,313           | \$ 3.68   | 9,300,097                       |  |
| \$ 6.86 to \$ 8.15      | 1,305,587           | \$ 7.38   | 9.0   | 5,313,052                       | 311,797             | \$ 7.17   | 1,333,417                       |  |
| \$ 8.54 to \$ 9.74      | 1,409,422           | \$ 9.37   | 8.0   | 2,927,371                       | 568,493             | \$ 9.64   | 1,031,456                       |  |
| \$ 10.50 to \$<br>11.26 | 196,100             | \$ 10.97  | 8.5   | 94,420                          | 73,437              | \$ 11.10  | 25,937                          |  |
|                         | 5,271,112           |   |   | \$ 29,271,431                   | 3,229,890           |   | \$ 22,851,462                   |  |

As of December 31, 2015, there was \$36.4 million of unamortized stock-based compensation expense related to unvested stock options and awards which is expected to be recognized over a weighted average period of 2.53 years.

#### Assumptions Used to Calculate Stock-Based Compensation Expense

The fair value of each of the Company's option grants has been estimated on the date of grant using the Black-Scholes pricing model with the following assumptions:

|  | Three Months Ended<br>December 31, |            | Nine Months Ended<br>December 31, |            |
|--|------------------------------------|------------|-----------------------------------|------------|
|  | 2015                               | 2014       | 2015                              | 2014       |
| Expected volatility                            | 51%                                | 61%        | 53%                               | 61%        |
| Expected dividend yield                        | -                                  | -          | -                                 | -          |
| Risk-free interest rate                        | 1.75%                              | 1.71%      | 1.60%                             | 1.71%      |
| Weighted average expected option term          | 5.25 years                         | 6.10 years | 5.44 years                        | 6.00 years |
| Weighted average fair value of options granted | \$ 4.92                            | \$ 4.02    | \$ 4.12                           | \$ 4.01    |

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

|  | Three Months Ended<br>December 31, |      | Nine Months Ended<br>December 31, |            |
|--|------------------------------------|------|-----------------------------------|------------|
|  | 2015                               | 2014 | 2015                              | 2014       |
| Expected volatility                                    | -                                  | -    | 45%                               | 46%        |
| Expected dividend yield                                | -                                  | -    | -                                 | -          |
| Risk-free interest rate                                | -                                  | -    | 0.30%                             | 0.90%      |
| Weighted average expected ESPP option term             | -                                  | -    | 0.75 years                        | 0.75 years |
| Weighted average fair value of<br>ESPP options granted | \$ -                               | \$ - | \$ 2.78                           | \$ 2.46    |

As of December 31, 2015, there were approximately \$0.3 million 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.

### Performance Stock Units

During the three months ended September 30, 2015, the Company issued restricted performance stock units (PSUs) to a group of executives with vesting that is contingent on both market performance and continued service. These PSUs vest (1) 50% on September 22, 2017 and (2) 50% on September 27, 2018, in each case subject to performance of the Company's common stock relative to the Russell 2000 Index during the period from grant date through such vesting date. A 2x multiplier will be applied to the total shareholder returns (TSR) for each 1% of positive or negative relative TSR, and the number of shares earned will increase or decrease by 2% of the target numbers. In the event 8x8's common stock performance is below negative 30%, relative to the benchmark, no shares will be issued.

To value these market-based restricted performance stock units under the Equity Compensation Plans, the Company used a Monte Carlo simulation model on the date of grant. Fair value determined using the Monte Carlo simulation model varies based on the assumptions used for the expected stock price volatility, the correlation coefficient between the Company and the NASDAQ Composite Index, risk free interest rates, and future dividend payments.

### Stock Repurchases

In February 2015, the Company's board of directors authorized the Company to purchase up to \$20.0 million of its common stock from time to time until February 29, 2016 (the Repurchase Plan). Share repurchases, if any, will be funded with available cash. Repurchases under the Repurchase Plan may be made through open market purchases at prevailing market prices or in privately negotiated transactions. The timing, volume and nature of share repurchases are subject to market prices and conditions, applicable securities laws and other factors, and are at the discretion of the Company's management. Share repurchases under the Repurchase Plan may be commenced, suspended or discontinued at any time. In October 2015, the Company's board of directors authorized the Company to repurchase an additional \$15.0 million under the Repurchase Plan. The remaining authorized repurchase amount at December 31, 2015 was approximately \$19.6 million.

The stock repurchase activity for the three months ended and as of December 31, 2015, is summarized as follows:

|  | Shares<br>Repurchased | Weighted Average<br>Per Share | Amount<br>Repurchased <sup>(1)</sup> |
|--|-----------------------|-------------------------------|--------------------------------------|
| Balances as of September 30, 2015              | 1,900,761             | \$ 7.82                       | \$ 14,858,923                        |
| Purchase of common stock under Repurchase Plan | 65,841                | 8.27                          | 544,622                              |
| Balances as of December 31, 2015               | 1,966,602             | \$ 7.83                       | \$ 15,403,545                        |

(1) Amount excludes commission fees.

## 8. INCOME TAXES

For the three months ended December 31, 2015, we recorded a benefit from income taxes of \$0.6 million. The tax benefit was primarily attributable to tax expense related to actual year-to-date income of domestic operations less the tax effect of certain discrete items. For the three months ended December 31, 2014, the Company recorded a provision for income taxes of \$0.6 million, which was primarily attributable to income from operations.

We estimate our annual effective rate at the end of each quarterly period, and we record the tax effect of certain discrete items, which are unusual or occur infrequently, in the interim period in which they occur, including changes in judgment about deferred tax valuation allowances. The determination of the effective tax rate reflects tax expense and benefit generated in certain domestic and foreign jurisdictions. However, jurisdictions with a year-to-date loss where no tax benefit can be recognized are excluded from the annual effective tax rate. At December 31, 2015, there were \$2.4 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 nine-month period ended December 31, 2015, 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 1996 to fiscal 2015 may be subject to examination by the Internal Revenue Service, California and various other states. As of January 20, 2016, there were no active federal or state income tax audits. Returns filed in foreign jurisdictions may be subject to examination for the fiscal years 2011 to 2015.

## 9. NET INCOME (LOSS) PER SHARE

The following is a reconciliation of the weighted average number of common shares outstanding used in calculating basic and diluted net income (loss) per share (in thousands, except share and per share data):

|  | Three Months Ended<br>December 31, |         | Nine Months Ended<br>December 31, |          |
|--|------------------------------------|---------|-----------------------------------|----------|
|  | 2015                               | 2014    | 2015                              | 2014     |
| Numerator:   |                                    |         |                                   |          |
| Net income (loss) available to common stockholders | \$ (1,680)                         | \$ 444  | \$ (4,044)                        | \$ 1,743 |
| Denominator:                                       |                                    |         |                                   |          |
| Common shares                                      | 88,289                             | 89,594  | 88,812                            | 89,107   |
| Denominator for basic calculation                  | 88,289                             | 89,594  | 88,812                            | 89,107   |
| Employee stock options                             | -                                  | 1,963   | -                                 | 2,210    |
| Stock purchase rights                              | -                                  | 417     | -                                 | 435      |
| Denominator for diluted calculation                | 88,289                             | 91,974  | 88,812                            | 91,752   |
| Net income (loss) per share                        |                                    |         |                                   |          |
| Basic  | \$ (0.02)                          | \$ 0.01 | \$ (0.05)                         | \$ 0.02  |
| Diluted  | \$ (0.02)                          | \$ 0.01 | \$ (0.05)                         | \$ 0.02  |

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

|   | Three Months Ended<br>December 31, |       | Nine Months Ended<br>December 31, |       |
|---|------------------------------------|-------|-----------------------------------|-------|
|   | 2015                               | 2014  | 2015                              | 2014  |
| Employee stock options                              | 1,232                              | 2,106 | 2,539                             | 1,634 |
| Stock purchase rights                               | -                                  | 370   | 55                                | 59    |
| Total anti-dilutive employee stock-based securities | 1,232                              | 2,476 | 2,594                             | 1,693 |

## 10. 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 manages its operations primarily on a geographic basis. The Chief Executive Officer, the Chief Financial Officer, and the Chief Technology Officer or the Company's Chief Operating Decision Makers (CODMs), evaluate performance of the Company and make decisions regarding allocation of resources based on geographic results. The Company's reportable operating segments are the Americas and Europe. The Americas segment is primarily North America. The Europe segment is primarily the United Kingdom. Each operating segment provides similar products and services.

The Company's CODMs evaluate the performance of its operating segments based on revenues and net income. Revenues are attributed to each segment based on the ordering location of the customer or ship to location. The Company does not allocate research and development, sales and marketing, general and administrative, amortization expense, stock-based compensation expense, and commitment and contingencies for each segment as management does not consider this information in its evaluation of the performance of each operating segment. The Company did not allocate goodwill for each segment as the Company had not completed its analysis of assigning goodwill to its reporting units as of January 28, 2016.

The Company's revenue distribution by geographic region (based upon the destination of shipments and the customer's service address) is as follows:

|                           | Three Months Ended<br>December 31, |      | Nine Months Ended<br>December 31, |      |
|---------------------------|------------------------------------|------|-----------------------------------|------|
|                           | 2015                               | 2014 | 2015                              | 2014 |
| Americas (principally US) | 87%                                | 92%  | 87%                               | 92%  |
| Europe                    | 13%                                | 7%   | 12%                               | 7%   |
| Asia Pacific              | 0%                                 | 1%   | 1%                                | 1%   |
|                           | 100%                               | 100% | 100%                              | 100% |

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

|                           | December 31,<br>2015 | March 31,<br>2015 |
|---------------------------|----------------------|-------------------|
| Americas (principally US) | \$ 8,756             | \$ 8,348          |
| Europe                    | 2,838                | 1,411             |
| Asia-Pacific              | 375                  | 489               |
| Total                     | \$ 11,969            | \$ 10,248         |

The following table provides financial information by operating segment (in thousands):

|                            | Three Months Ended<br>December 31, |            | Nine Months Ended<br>December 31, |            |
|----------------------------|------------------------------------|------------|-----------------------------------|------------|
|                            | 2015                               | 2014       | 2015                              | 2014       |
| Americas (principally US): |                                    |            |                                   |            |
| Net Revenue                | \$ 46,503                          | \$ 38,436  | \$ 134,177                        | \$ 110,334 |
| Net Income                 | \$ 467                             | \$ 1,478   | \$ 733                            | \$ 4,481   |
| Europe:                    |                                    |            |                                   |            |
| Net Revenue                | \$ 6,665                           | \$ 2,936   | \$ 17,826                         | \$ 8,549   |
| Net Loss                   | \$ (2,147)                         | \$ (1,034) | \$ (4,777)                        | \$ (2,738) |

## 11. ACQUISITIONS

## DXI Group Limited

On May 26, 2015, the Company entered into a share purchase agreement with the shareholders of DXI Limited, API Telecom Limited, Easycallnow Limited and RAS Telecom Limited (collectively, DXI) for the purchase of the entire share capital of DXI. The transaction closed effective May 29, 2015 and was not subject to regulatory approvals. The total aggregate purchase price was approximately \$22.5 million, consisting of \$18.7 million in cash paid to the DXI shareholders at closing, and \$3.8 million in cash deposited into escrow to be held for two years as security against indemnity claims made by the Company after the closing date. Approximately 352,000 shares of common stock valued at approximately \$3.0 million were issued only to former management shareholders of DXI as part of the share purchase agreement and are subject to certain restrictions, including a four-year annual vesting requirement based on the continued employment of such shareholders. Under ASC 805-10-55-25, *Business Combinations*, the shares are considered post acquisition compensation vs. consideration transferred. The value of the shares will be amortized over the vesting period of forty-eight months. The shares are further subject to indemnity claims asserted by the Company prior to vesting. Vesting of the shares is subject to acceleration in the event of the shareholder's death or disability, or upon an employment termination without adequate cause, as provided in the share purchase agreement. The cash escrow also applies only to the management shareholders of DXI and is to be released in annual installments over two years. The share purchase agreement contains representations and warranties by the management shareholders that are customary in the UK for transactions of this size and nature. The Company also awarded restricted stock units representing the right to receive approximately 53,000 shares of common stock that were valued at approximately \$482,000 to certain continuing employees of DXI, which will be amortized as stock-based compensation over the requisite service period.

The Company recorded the acquired tangible and identifiable intangible assets and liabilities assumed based on their estimated fair values. The excess of the consideration transferred over the aggregate fair values of the assets acquired and liabilities assumed is recorded as goodwill. The amount of goodwill recognized is primarily attributable to the expected contributions of the entity to the overall corporate strategy in addition to synergies and acquired workforce of the acquired business. The finite-lived intangible assets consist of the following: customer relationships, with an estimated weighted-average useful life of two and five years; and developed technology, with an estimated weighted-average useful life of seven years. The indefinite lived intangible asset consisted of a tradename. The fair value assigned to identifiable intangible assets acquired was based on estimates and assumptions made by management using various income approach methods. Intangible assets are amortized on a straight-line basis. The preliminary fair values of net tangible assets and intangible assets acquired were based upon preliminary valuations and our estimates and assumptions are subject to change within the measurement period (up to one year from the acquisition date). The primary areas that remain preliminary relate to the fair values of intangible assets acquired, certain tangible assets and liabilities acquired, and residual goodwill.

The preliminary fair values of the assets acquired and liabilities assumed are as follows (in thousands):

|   | <b>Estimated<br/>Fair Value</b> |
|---|---------------------------------|
| Assets acquired:                                |                                 |
| Cash  | \$ 1,318                        |
| Current assets                                  | 2,016                           |
| Property and equipment                          | 1,453                           |
| Intangible assets                               | 13,374                          |
| Total assets acquired                           | 18,161                          |
| Liabilities assumed:                            |                                 |
| Current liabilities and non-current liabilities | (5,734)                         |
| Total liabilities assumed                       | (5,734)                         |
| Net identifiable assets acquired                | 12,427                          |
| Goodwill  | 10,125                          |
| Total consideration transferred                 | \$ 22,552                       |

None of the goodwill recognized is expected to be deductible for income tax purposes.





DXI contributed revenue of approximately \$7.4 million and (\$2.0) million net loss for the period from the date of acquisition to December 31, 2015. Total acquisition related costs were approximately \$0.9 million. The Company determined that the acquisition was not deemed to be a material business combination and it is impractical to include such pro forma information given the difficulty in obtaining the historical financial information of DXI. Inclusion of such information would require the Company to make estimates and assumptions regarding DXI's historical financial results that the Company believes may ultimately prove inaccurate.

In the second quarter of fiscal 2016, the Company updated its analysis of the valuation of the assets and liabilities acquired, which resulted in an increase of approximately \$1.1 million to goodwill, a decrease in intangible assets of approximately \$1.3 million, and a decrease to current and non-current liabilities of \$0.2 million, compared with the preliminary estimates recorded for the first quarter of fiscal 2016. The impact of the change in preliminary values on the first quarter of fiscal 2016 statement of operations was not material. Therefore, no measurement period adjustment was required.

#### Quality Software Corporation

On June 18, 2015, the Company entered into an asset purchase agreement with the shareholder of QSC and other parties affiliated with the shareholder and QSC for the purchase of certain assets as per the purchase agreement. The total aggregate fair value of the consideration was approximately \$2.9 million, which \$2.2 million was paid in cash to the QSC shareholder at closing. As part of the aggregate purchase price, there is also \$0.5 million in contingent consideration payable subject to attainment of certain revenue and product release milestones for the acquired business, and \$0.3 million in cash held by the Company in escrow to be retained for two years as security against indemnity claims made by the Company after the closing date. The preliminary fair value of the contingent consideration and escrow amounts was \$0.7 million at the acquisition date.

The Company recorded the acquired identifiable intangible assets and liabilities assumed based on their estimated fair values. The excess of the consideration transferred over the aggregate fair values of the assets acquired and liabilities assumed is recorded as goodwill. The amount of goodwill recognized is primarily attributable to the expected contributions of the entity to the overall corporate strategy in addition to synergies and acquired workforce of the acquired business. The finite-lived intangible assets consist of the following: customer relationships, with an estimated weighted-average useful life of five years; and developed technology, with an estimated weighted-average useful life of seven years. The indefinite lived intangible asset consisted of in-process research and development and a tradename. The fair value assigned to identifiable intangible assets acquired was based on estimates and assumptions made by management using various income approach methods. Intangible assets are amortized on a straight-line basis. The preliminary fair values of intangible assets acquired were based upon preliminary valuations and our estimates and assumptions are subject to change within the measurement period (up to one year from the acquisition date). The areas that remain preliminary relate to the fair values of intangible assets acquired and residual goodwill.

The preliminary fair values of the assets acquired and liabilities assumed are as follows (in thousands):

|                                 | <b>Estimated<br/>Fair Value</b> |
|---------------------------------|---------------------------------|
| Assets acquired:                |                                 |
| Intangible assets               | \$ 1,225                        |
| Goodwill                        | 1,664                           |
| Total consideration transferred | \$ 2,889                        |

The goodwill recognized is expected to be deductible for income tax purposes.

QSC's contributions to revenue and income for the period from the date of acquisition to December 31, 2015 were not material. Total acquisition related costs were approximately \$0.1 million. The Company determined that the acquisition was not deemed to be a material business combination and it is impractical to include such pro forma information given the difficulty in obtaining the historical financial information of QSC. Inclusion of such information

would require the Company to make estimates and assumptions regarding QSC's historical financial results that we believe may ultimately prove inaccurate.

In the second quarter of fiscal 2016, the Company updated its analysis of the valuation of intangible assets with definitive lives, which resulted in \$450,000 being reallocated from intangibles to goodwill compared with the preliminary estimates recorded for the first quarter of fiscal 2016. The impact of the change in preliminary values on the first quarter of fiscal 2016 statement of operations was not material. Therefore, no measurement period adjustment was required.

## 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. 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 or for any reason, except as required by law, even as new information becomes available or other events occur in the future. In addition to the factors discussed elsewhere in this Form 10-Q, see the Risk Factors discussion in Item 1A of our 2015 Form 10-K in connection with reviewing any forward-looking statements and other disclosures contained in this Form 10-Q.

### BUSINESS OVERVIEW

We are a leading provider of VoIP and SaaS communication solutions in the cloud for SMBs and mid-market and distributed enterprises. We deliver a broad suite of SaaS services including hosted cloud telephony, virtual contact center, and virtual meeting to in-office and mobile devices through our proprietary unified SaaS platform. Our integrated, "pure-cloud" services platform is based on internally owned and managed technologies and is uniquely positioned to serve mid-market and enterprise businesses making the shift to cloud based unified communications. We make a full set of unified communications capabilities including cloud telephony, contact center, video and web conferencing available from anywhere in the world. With 8x8 analytics and reporting, our customers have a robust suite of web based tools that provide enterprise-level analytics that can be used to make highly informed business decisions, whether employees are mobile via the mobile client or in-office using a softphone, or a desk phone. Since fiscal 2004, substantially all of our revenue has been generated from the sale, license and provision of communications services. 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 2016 refers to the fiscal year ending March 31, 2016).

## SUMMARY AND OUTLOOK

In the third quarter of fiscal 2016, our bookings of new monthly recurring revenue from our mid-market, enterprise customers and new monthly recurring revenue generated from our channel sales teams increased substantially, reflecting strong demand for our services in our target market segments. Also, average monthly service revenue per business customer increased 21% to a record \$369, compared with \$305 in the same period last year. Our ability to offer a broad range of cloud-based mission critical communications services is bringing us larger deals where we continue to displace incumbent, premises-based systems.

As we continue our focus on building a more profitable and sustaining mid-market customer base, one that contributes significantly greater lifetime value than the average small business customer, we are adding fewer one - two line business customers. We expect this trend to continue based on our continued focus on selling to larger businesses.

## 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 1 - 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 |                   |                  |                   |                  |
|---|-------------------------------|-------------------|------------------|-------------------|------------------|
|   | Dec. 31,<br>2015              | Sept. 30,<br>2015 | June 30,<br>2015 | March 31,<br>2015 | Dec. 31,<br>2014 |
| Business customers average monthly service revenue per customer (1) | \$ 369                        | \$ 360            | \$ 353           | \$ 320            | \$ 305           |
| Monthly business service revenue churn (2)(3)                       | 1.2%                          | 0.7%              | 1.0%             | 0.5%              | 1.0%             |
| Overall service margin  | 80%                           | 80%               | 81%              | 81%               | 80%              |
| Overall product margin  | -21%                          | -15%              | -18%             | -19%              | -11%             |
| Overall gross margin  | 72%                           | 73%               | 73%              | 73%               | 72%              |

- (1) 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.
- (2) Business customer service revenue churn is calculated by dividing the service revenue lost from business customers (after the expiration of 30-day trial) during the period by the simple average of business customer service revenue during the same period and dividing the result by the number of months in the

period.

- (3) Excludes DXI business customer service revenue churn for the periods ended June 30, September 30, and December 31, 2015. DXI churn is excluded because revenue recorded by DXI is tied to usage levels and are not correlated with customer turnover.

## RESULTS OF OPERATIONS

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

| <u>Service revenue</u>      | December 31,                  |            | Dollar Change | Percent Change |
|-----------------------------|-------------------------------|------------|---------------|----------------|
|                             | 2015                          | 2014       |               |                |
|                             | (dollar amounts in thousands) |            |               |                |
| Three months ended          | \$ 48,948                     | \$ 37,802  | \$ 11,146     | 29.5%          |
| Percentage of total revenue | 92.1%                         | 91.4%      |               |                |
| Nine months ended           | \$ 140,068                    | \$ 108,199 | \$ 31,869     | 29.5%          |
| Percentage of total revenue | 92.1%                         | 91.0%      |               |                |

Service revenue consists of revenue attributable to the provision of our 8x8 cloud communication and collaboration services. We expect that 8x8 service revenues will continue to comprise nearly all of our service revenues for the foreseeable future. 8x8 service revenues increased in the third quarter and first nine months of fiscal 2016 primarily due to the increase in our business customer subscriber base (net of customer churn), in particular, to mid-market and enterprise customers, revenue of approximately \$7.4 million from customers acquired as part of the DXI acquisition, and an increase in the average monthly service revenue per customer. Average monthly service revenue per customer increased from \$305 at December 31, 2014 to \$369 at December 31, 2015. We expect the number of business customers and average monthly service revenue per customer to continue to grow in fiscal 2016.

| <u>Product revenue</u>      | December 31,                  |           | Dollar Change | Percent Change |
|-----------------------------|-------------------------------|-----------|---------------|----------------|
|                             | 2015                          | 2014      |               |                |
|                             | (dollar amounts in thousands) |           |               |                |
| Three months ended          | \$ 4,220                      | \$ 3,570  | \$ 650        | 18.2%          |
| Percentage of total revenue | 7.9%                          | 8.6%      |               |                |
| Nine months ended           | \$ 11,935                     | \$ 10,684 | \$ 1,251      | 11.7%          |
| Percentage of total revenue | 7.9%                          | 9.0%      |               |                |

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 and nine months ended December 31, 2015 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 and nine months ended December 31, 2015 or 2014.

| <u>Cost of service revenue</u> | December 31,                  |           | Dollar Change | Percent Change |
|--------------------------------|-------------------------------|-----------|---------------|----------------|
|                                | 2015                          | 2014      |               |                |
|                                | (dollar amounts in thousands) |           |               |                |
| Three months ended             | \$ 9,713                      | \$ 7,544  | \$ 2,169      | 28.8%          |
| Percentage of service revenue  | 19.8%                         | 20.0%     |               |                |
| Nine months ended              | \$ 27,359                     | \$ 22,046 | \$ 5,313      | 24.1%          |
| Percentage of service revenue  | 19.5%                         | 20.4%     |               |                |

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 expenses. Cost of service revenue for the three months ended December 31, 2015 increased over the comparable period in the prior fiscal year primarily due to a \$0.5 million increase in amortization expense, a \$0.4 million increase in third party network services expenses, a \$0.4 million increase in payroll and related expenses, a \$0.4 million increase due to the impairment of long-lived assets, a \$0.2 million increase in repairs and maintenance expense, and a \$0.1 million increase in stock-based compensation cost. Also, for the third quarter of fiscal 2016, the DXI acquisition increased total cost of service revenue by \$1.2 million compared to the prior period in fiscal 2015.

Cost of service revenue for the nine months ended December 31, 2015 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 \$1.0 million increase in payroll and related expenses, a \$0.9 million increase in amortization expense, a \$0.5 million increase in depreciation expense, a \$0.4 million increase due to the impairment of long lived assets, and a \$0.4 million increase in stock-based compensation expenses. Also, for the nine months ended December 31, 2015, the DXI acquisition increased total cost of service revenue by \$3.1 million, compared to the nine months ended December 31, 2014.

| <u>Cost of product revenue</u> | December 31,                  |           | Dollar Change | Percent Change |
|--------------------------------|-------------------------------|-----------|---------------|----------------|
|                                | 2015                          | 2014      |               |                |
|                                | (dollar amounts in thousands) |           |               |                |
| Three months ended             | \$ 5,087                      | \$ 3,959  | \$ 1,128      | 28.5%          |
| Percentage of product revenue  | 120.5%                        | 110.9%    |               |                |
| Nine months ended              | \$ 14,065                     | \$ 11,690 | \$ 2,375      | 20.3%          |
| Percentage of product revenue  | 117.8%                        | 109.4%    |               |                |

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 December 31, 2015 increased over the comparable period in the prior fiscal year primarily due to an increase in equipment shipped to customers. The increase in negative margin was due to increased discounting on customer equipment purchases in the most recent quarter.

The cost of product revenue for the nine months ended December 31, 2015 increased over the comparable period in the prior fiscal year primarily due to an increase in equipment shipped to customers. The increase in negative margin was due to increased discounting on customer equipment purchases.

| <u>Research and development</u> | December 31,                  |           | Dollar Change | Percent Change |
|---------------------------------|-------------------------------|-----------|---------------|----------------|
|                                 | 2015                          | 2014      |               |                |
|                                 | (dollar amounts in thousands) |           |               |                |
| Three months ended              | \$ 6,404                      | \$ 3,868  | \$ 2,536      | 65.6%          |
| Percentage of total revenue     | 12.0%                         | 9.3%      |               |                |
| Nine months ended               | \$ 17,930                     | \$ 10,770 | \$ 7,160      | 66.5%          |
| Percentage of total revenue     | 11.8%                         | 9.1%      |               |                |

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 December 31, 2015, 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 December 31, 2015 increased over the comparable period in the prior fiscal year primarily due to a \$1.3 million increase in payroll and related costs, a \$0.4 million increase in stock-based compensation costs, and a \$0.1 million increase in depreciation expense. Also, for the third quarter of fiscal 2016, the DXI acquisition and our Romanian subsidiary increased total research and development costs by \$1.3 and \$0.3 million, respectively, compared to the prior period in fiscal 2015.

The research and development expenses for the nine months ended December 31, 2015 increased over the comparable period in the prior fiscal year primarily due to a \$5.1 million increase in payroll and related costs, a \$1.0 million increase in stock-based compensation expenses, a \$0.3 million increase in depreciation expense, and a \$0.2 million increase in consulting, temporary personnel, and outside service expenses. Also, for the nine months ended December 31, 2015, the DXI acquisition and our Romanian subsidiary increased total research and development costs by \$3.0 million and \$0.4 million, respectively, compared to the nine months ended December 31, 2014. We expect research and development expenses to increase for the foreseeable future as we continue to invest in our DXI unit and in the formation of our research and development team in Romania.



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| <u>Sales and marketing</u>  | December 31,                  |           | Dollar Change | Percent Change |
|-----------------------------|-------------------------------|-----------|---------------|----------------|
|                             | 2015                          | 2014      |               |                |
|                             | (dollar amounts in thousands) |           |               |                |
| Three months ended          | \$ 27,585                     | \$ 20,559 | \$ 7,026      | 34.2%          |
| Percentage of total revenue | 51.9%                         | 49.7%     |               |                |
| Nine months ended           | \$ 78,138                     | \$ 59,159 | \$ 18,979     | 32.1%          |
| Percentage of total revenue | 51.4%                         | 49.8%     |               |                |

Sales and marketing expenses consist primarily of personnel and related overhead costs for sales, marketing, and customer service which includes deployment engineering. 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 third quarter of fiscal 2016 increased over the same quarter in the prior fiscal year primarily because of a \$3.4 million increase in payroll and related costs, a \$0.8 million increase in indirect channel commission expenses, a \$0.7 million increase in stock-based compensation expenses, a \$0.6 million increase in temporary personnel, consulting and outside service expenses, a \$0.3 million increase in advertising costs, and a \$0.3 million increase in travel costs. Also, for the third quarter of fiscal 2016, the DXI acquisition increased total sales and marketing expense by \$1.0 million compared to the prior period in fiscal 2015.

Sales and marketing expenses for the nine months ended December 31, 2015 increased over the same period in the prior fiscal year primarily because of a \$8.8 million increase in payroll and related costs, a \$2.3 million increase in indirect channel commissions, \$1.6 million increase in stock-based compensation expenses, a \$1.5 million increase in temporary personnel, consulting and outside service expenses, a \$0.9 million increase in travel expenses, a \$0.8 million increase in advertising expenses, and a \$0.5 million increase in trade show costs. Also, for the nine months ended December 31, 2015, the DXI acquisition increased total sales and marketing expense by \$2.4 million, compared to the nine months ended December 31, 2014. We expect sales and marketing expenses to increase for the foreseeable future as we continue to increase our efforts to sell to larger businesses and to deploy our cloud communication and collaboration services globally to enterprise customers.

| <u>General and administrative</u> | December 31,                  |           | Dollar Change | Percent Change |
|-----------------------------------|-------------------------------|-----------|---------------|----------------|
|                                   | 2015                          | 2014      |               |                |
|                                   | (dollar amounts in thousands) |           |               |                |
| Three months ended                | \$ 6,888                      | \$ 4,617  | \$ 2,271      | 49.2%          |
| Percentage of total revenue       | 13.0%                         | 11.2%     |               |                |
| Nine months ended                 | \$ 18,614                     | \$ 12,388 | \$ 6,226      | 50.3%          |
| Percentage of total revenue       | 12.2%                         | 10.4%     |               |                |

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 third quarter of fiscal 2016 increased over the same quarter in the prior fiscal year primarily because of a \$0.7 million increase in stock-based compensation expenses, a \$0.4 million increase in payroll and related costs, a \$0.2 million increase in temporary personnel, consulting and outside service expenses, a \$0.2 million increase in legal fees, a \$0.1 million increase in accounting and tax fees, and a \$0.1 million increase in recruiting expenses. Also, for the third quarter of fiscal 2016, the DXI acquisition increased total general and administrative expenses by \$0.4 million compared to the prior period in fiscal 2015.

General and administrative expenses for the nine months ended December 31, 2015 increased over the same period in the prior fiscal year primarily because of a \$1.6 million increase in stock-based compensation expenses, a \$1.4 million increase in payroll and related expenses, a \$1.0 million increase in legal fees, primarily due to the business acquisitions that occurred in the first quarter of fiscal 2016, a \$0.6 million increase in temporary personnel, consulting and outside service expenses, a \$0.5 million increase in rent expense, a \$0.4 million increase in accounting and tax fees, a \$0.2 million increase in license and fee expenses, and a \$0.1 million increase in depreciation expense. Also, for the nine months ended December 31, 2015, the DXI acquisition increased general and administrative expenses by \$1.1 million, compared to the nine months ended December 31, 2014.

| <u>Gain on patent sale</u>  | December 31,                  |            | Dollar Change | Percent Change |
|-----------------------------|-------------------------------|------------|---------------|----------------|
|                             | 2015                          | 2014       |               |                |
|                             | (dollar amounts in thousands) |            |               |                |
| Three months ended          | \$ -                          | \$ -       | \$ -          | n/a            |
| Percentage of total revenue | 0.0%                          | 0.0%       |               |                |
| Nine months ended           | \$ -                          | \$ (1,000) | \$ 1,000      | -100.0%        |
| Percentage of total revenue | 0.0%                          | -0.8%      |               |                |

In June 2012, we entered into a patent purchase agreement for the sale of a family of United States patents. We recognized a gain of \$1.0 million for the three and nine months ended December 31, 2014 due to the third party purchaser entering into a license agreement with its customer. The gain on patent sale has been recorded as a reduction of operating expenses in the consolidated statements of operations.

| <u>Other income, net</u>    | December 31,                  |        | Dollar Change | Percent Change |
|-----------------------------|-------------------------------|--------|---------------|----------------|
|                             | 2015                          | 2014   |               |                |
|                             | (dollar amounts in thousands) |        |               |                |
| Three months ended          | \$ 272                        | \$ 246 | \$ 26         | 10.6%          |
| Percentage of total revenue | 0.5%                          | 0.6%   |               |                |
| Nine months ended           | \$ 710                        | \$ 623 | \$ 87         | 14.0%          |
| Percentage of total revenue | 0.5%                          | 0.5%   |               |                |

Other income, net, primarily consisted of interest income earned on our cash, cash equivalents and investments and amortization or accretion of investments in fiscal 2016 and 2015.

| <u>Provision (benefit) for income tax</u>                               | December 31,                  |          | Dollar Change | Percent Change |
|---|-------------------------------|----------|---------------|----------------|
|   | 2015                          | 2014     |               |                |
|   | (dollar amounts in thousands) |          |               |                |
| Three months ended  | \$ (557)                      | \$ 627   | \$ (1,184)    | -188.8%        |
| Percentage of income (loss) before provision (benefit) for income taxes | 24.9%                         | 58.5%    |               |                |
| Nine months ended   | \$ 651                        | \$ 2,710 | \$ (2,059)    | -76.0%         |
| Percentage of income (loss) before provision (benefit) for income taxes | -19.2%                        | 60.9%    |               |                |

For the three months ended December 31, 2015, we recorded a benefit from income taxes of \$0.6 million. The tax benefit was primarily attributable to tax expense related to actual year-to-date income of domestic operations less the tax effect of certain discrete items. For the three months ended December 31, 2014, we recorded a provision for income taxes of \$0.6 million, all of which related to domestic income from operations.

For the nine months ended December 31, 2015, we recorded a provision for income taxes of \$0.7 million, which was primarily attributable to domestic loss from operations. For the nine months ended December 31, 2014, we recorded a provision for income taxes of \$2.7 million which was primarily attributable to domestic income from operations.

We estimate our annual effective rate at the end of each quarterly period, and we record the tax effect of certain discrete items, which are unusual or occur infrequently, in the interim period in which they occur, including changes in judgment about deferred tax valuation allowances. The determination of the effective tax rate reflects tax expense and benefit generated in certain domestic and foreign jurisdictions. However, jurisdictions with a year-to-date loss where no tax benefit can be recognized are excluded from the annual effective tax rate.

## Liquidity and Capital Resources

As of December 31, 2015, we had approximately \$154.6 million in cash, cash equivalents and short-term investments.

Net cash provided by operating activities for the nine months ended December 31, 2015 was approximately \$15.4 million, compared with \$13.8 million for the nine months ended December 31, 2014. 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 \$35.6 million during the nine months ended December 31, 2015. We spent approximately \$3.3 million on the purchase of property and equipment, we spent approximately \$23.4 million on acquisitions of two businesses, and we purchased approximately \$7.6 million of short term investments, net of sales and maturities of short term investments. The net cash used in investing activities for the nine months ended December 31, 2014 was \$21.8 million, as we purchased approximately \$16.8 million of short term investments, net of sales and maturities of short term investments, and we spent approximately \$4.5 million on the purchase of property and equipment.

Net cash used in financing activities for the nine months ended December 31, 2015 was approximately \$9.3 million, which was primarily due from cash used to repurchase our common stock as part of our Repurchase Plan in the amount of approximately \$11.2 million and \$0.4 million

due to repurchase of restricted shares, partially offset by cash received from the issuance of common stock under our employee stock purchase plan of approximately \$2.8 million. Net cash provided by financing activities for the nine months ended December 31, 2014 were approximately \$0.8 million, which was primarily due to cash received from the issuance of common stock under our employee stock purchase plan of approximately \$2.7 million, partially offset from cash used to repurchased our common stock as part of our Repurchase Plan in the amount of approximately \$1.7 million.

## 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 entered into a series of noncancelable capital lease agreements for office equipment bearing interest at various rates. Assets under capital lease at December 31, 2015 totaled \$1.7 million with accumulated amortization of \$0.5 million.

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 December 31, 2015, 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 December 31, 2015, future minimum annual payments under these third party network service contracts were \$0.8 million in fiscal year 2016, \$2.5 million for fiscal year 2017, and \$0.9 million for fiscal year 2018.

We lease our UK headquarters in Aylesbury UK under an operating lease agreement that expires in March 2017. The lease was amended in September 2014 for additional space. The lease has a base monthly rent of approximately \$13,000, and requires us to pay property taxes, service charges, utilities and normal maintenance costs. We also lease office space in London UK under an operating lease agreement that expires in April 2019. The lease has a base monthly rent of approximately \$6,900.

We lease additional spaces in London UK for our DXI location under operating leases that expire through October 2016. The lease has a base monthly rent of approximately \$29,700, and requires us to pay service charges and normal maintenance costs.

We lease space in Romania for our Romanian subsidiary under an operating lease that expires in December 2020. The lease has a base monthly rent of approximately \$2,700, and requires us to pay service charges and normal maintenance costs.

### 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 December 31, 2015.

#### 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 third quarter of fiscal 2016, 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 6".

## 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, 2015, which we filed with the Securities and Exchange Commission on May 29, 2015.

## ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

## Issuer Purchases of Equity Securities

The activity under the Repurchase Plan for the three months ended December 31, 2015 is summarized as follows:

|                                | <b>Total Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>Per Share</b> | <b>Total Number<br/>of Shares Purchased<br/>as Part of Publicly<br/>Announced Program</b> | <b>Approximate Dollar<br/>Value of Shares that<br/>May Yet be<br/>Purchased<br/>Under the Program<sup>(1)</sup></b> |
|--------------------------------|---|---|---|---|
| October 1 - October 31, 2015   | 65,841  | \$ 8.27                                     | 65,841  | \$ 19,595,138   |
| November 1 - November 30, 2015 | -   | -   | -   | 19,595,138  |
| December 1 - December 31, 2015 | -   | -   | -   | 19,595,138  |
| Total                          | 65,841  | \$ 8.27                                     | 65,841  |   |

(1) Increase due to Board of Director's authorization of an additional \$15.0 million under the Repurchase Plan in October 2015.

## ITEM 5. Other Information

None.

## ITEM 6. Exhibits

| Exhibit<br>Number | Description  |
|-------------------|--|
| 31.1              | <u>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.</u> |
| 31.2              | <u>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.</u> |
| 32.1              | <u>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.</u>  |
| 32.2              | <u>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.</u>  |
| 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: January 29, 2016

8X8, INC.  
(Registrant)

By: /s/ MARYELLEN GENOVESE

MaryEllen Genovese

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