UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from ________ to ________.

Commission file number 001-32277

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

Delaware (State or other jurisdiction of incorporation or organization)	87-0591719 (I.R.S. Employer Identification No.)
1615 South 52nd Street, Tempe, AZ (Address of Principal Executive Offices)	85281 (Zip Code)

(602) 714-8500
(Registrant’s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the

Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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 þ No ¨

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

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

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

The number of shares outstanding of the registrant’s common stock as of August 1, 2013 was 10,709,904.

INDEX

PART I – FINANCIAL INFORMATION

Back to Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(In thousands, except par value and share data)
(unaudited)

	June 30, 2013	December 31, 2012
Assets		
Current Assets:		
Cash and cash equivalents	$4,930	$7,440
Restricted cash	1,444	1,444
Trade receivables, net of allowance of doubtful accounts of $641		
as of June 30, 2013 and $1,326 as of December 31, 2012	1,341	3,043
Inventories	131	171
Equipment financing receivables	51	28
Income taxes receivable	63	434
Prepaid expenses and other	510	333
Total Current Assets	8,470	12,893
Certificate of deposit	250	500
Long-term trade receivables, net of allowance of doubtful accounts of $106		
as of June 30, 2013 and $196 as of December 31, 2012	152	395
Long-term equipment financing receivables	196	96
Property and equipment, net	2,658	3,172
Deferred income tax assets, net	105	103
Intangible assets	671	6
Goodwill	340	265
Other long-term assets	95	97
Total Assets	$12,937	$17,527
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$307	$418
Accrued expenses and other	1,307	3,010
Deferred income tax liability	105	103
Deferred revenue, current portion	1,348	3,052
Contingent consideration	87	-
Total Current Liabilities	3,154	6,583
Deferred revenue, net of current portion	143	399
Other long-term liabilities	-	253
Total Liabilities	3,297	7,235

Stockholders' Equity:		
Preferred stock, par value $0.001 per share - authorized 5,000,000 shares; none issued	-	-
Common stock, par value $0.001 per share - authorized 100,000,000 shares; 10,709,904 shares outstanding as of June 30, 2013 and 10,669,201 shares outstanding as of December 31, 2012	11	11
Additional paid-in capital	50,364	49,824
Contingent consideration	276	-
Accumulated deficit	(41,011)	(39,543)
Total Stockholders' Equity	9,640	10,292
Total Liabilities and Stockholders' Equity	$12,937	$17,527

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

Back to Table of Contents

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(In thousands, except per share and share data)
(unaudited)

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Revenue	$2,737	$4,914	$5,759	$10,169
Operating expenses:				
Cost of revenue	970	1,298	2,012	2,719
Selling and marketing	717	984	1,625	1,917
General and administrative	1,852	2,741	3,290	5,774
Research and development	414	505	895	1,099
Total operating expenses	3,953	5,528	7,822	11,509
Loss from operations	(1,216)	(614)	(2,063)	(1,340)
Other income (expense):				
Interest income	146	524	365	1,266
Other income (expense), net	(26)	(14)	(33)	14
Total other income, net	120	510	332	1,280
Loss before income tax provision	(1,096)	(104)	(1,731)	(60)
Income tax benefit (provision)	26	(13)	263	140
Net income (loss)	$(1,070)	$(117)	$(1,468)	$80
Net income (loss) per common share:				
Basic	$(0.10)	$(0.01)	$(0.14)	$0.01
Diluted	$(0.10)	$(0.01)	$(0.14)	$0.01
Dividends per common share:	$-	$-	$-	$0.02
Weighted average common shares outstanding:				
Basic	10,682,393	10,634,104	10,675,990	10,582,372
Diluted	10,682,393	10,634,104	10,675,990	10,614,888

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

Back to Table of Contents

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statement of Stockholders' Equity
For the Six Months Ended June 30, 2013
(In thousands, except share data)
(unaudited)

	Common Stock Shares	Amount	Additional Paid-in Capital	Contingent Consideration	Accumulated Deficit	Total Stockholders' Equity
Balance, January 1, 2013	10,669,201	$ 11	$ 49,824	$ -	$ (39,543)	$ 10,292
Expense for stock options granted to employees	-	-	430	-	-	430
Proceeds from the exercise of stock options	2,187	-	3	-	-	3
Contingent consideration	-	-	-	276	-	276
Issuance of common stock for business acquisition	38,516	-	107	-	-	107
Net loss	-	-	-	-	(1,468)	(1,468)
Balance, June 30, 2013	10,709,904	$ 11	$ 50,364	$ 276	$ (41,011)	$ 9,640

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

Back to Table of Contents

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$(1,468)	$80
Adjustments to reconcile net (loss) income to net		
cash provided by (used for) operating activities:		
Lease abandonment	(606)	-
Depreciation and amortization	598	759
Expense for stock options issued to employees	430	455
Change in uncertain tax positions	(253)	(167)
Changes in assets and liabilities:		
Trade receivables	1,945	6,157
Equipment financing receivables	(123)	(25)
Inventories	40	28
Income taxes receivable	371	38
Prepaid expenses and other	(177)	(37)
Other long-term assets	2	20
Accounts payable, accrued expenses and other	(1,202)	(573)
Deferred revenue	(1,960)	(6,000)
Other long-term liabilities	-	4
Net cash (used for) provided by operating activities	(2,403)	739
CASH FLOWS FROM INVESTING ACTIVITIES		
Redemption of certificate of deposit	250	-
Acquisition of property and equipment	(60)	(1,024)
Acquisition of PBX Central	(300)	-
Net cash used for investing activities	(110)	(1,024)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options	3	498
Payments made on contingent consideration	-	(6)
Dividend payments	-	(422)
Net cash provided by financing activities	3	70
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,510)	(215)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	7,440	8,658
CASH AND CASH EQUIVALENTS, END OF PERIOD	$4,930	$8,443
Supplemental disclosure of cash flow information:		
Cash received during the period:		
Income taxes	$(382)	$(11)
Supplemental disclosure of non-cash investing and financing information:		
Purchases of property and equipment included in accounts payable	$-	$16
Business acquisition with stock (Note 9)	$107	$-

Contingent consideration related to acquisition (Note 9)	$363	$-

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

Back to Table of Contents

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CREXENDO, INC. AND SUBSIDIARIES
Notes to the Condensed Consolidated Financial Statements (unaudited)

(1) Significant Accounting Policies

Description of Business - Crexendo, Inc. is incorporated in the state of Delaware. As used hereafter in the notes to consolidated financial statements, we refer to Crexendo, Inc. and its wholly owned subsidiaries, as “we,” “us,” or “our Company”. In May 2011, our stockholders approved an amendment to our Certificate of Incorporation to change our name from "iMergent, Inc." to "Crexendo, Inc." The name change was effective May 18, 2011. Our ticker symbol "IIG" on the New York Stock Exchange was changed to “EXE” on May 18, 2011. We are a hosted services company that provides web hosting, hosted telecommunications services, search engine optimization management, link building, e-commerce software, website development, and broadband internet services for businesses and entrepreneurs. Our services are designed to make enterprise-class hosting services available to small and medium-sized businesses at affordable monthly rates. The Company has three operating segments, which consist of Crexendo Network Services, Crexendo Web Services and StoresOnline.

In July 2011, we announced the suspension of our direct mail seminar sales channel in our StoresOnline segment. Accordingly, we have shifted our focus toward growing our Crexendo Network Services and Crexendo Web Services segments. As a result, the Company has transformed into a start-up company with the inherent risks and uncertainties of funding operations until profitability is achieved. Due to changes in our business model and the rapidly evolving nature of our business and the markets we serve, we believe period-to-period comparisons of our operating results, including operating expenses as a percentage of revenue and cash flows, are not necessarily meaningful and should not be relied upon as an indication of future performance. We currently plan to fund our growth during the next twelve months using our cash and cash equivalents of $4,930,000, the collection of remaining accounts receivable from our former StoresOnline business, and restricted cash expected to be released from restriction. In addition, in March 2013, the Company received a letter from the CEO, and majority shareholder, that if there is a shortfall in cash, that the CEO would provide additional financial support if necessary up to $2.0 million. The Company believes that it has sufficient funds to sustain its operations during the next 12 months. Beyond the next twelve months, the Company’s forecast indicates that given current trends and growth projections, the Company may need to raise additional capital. There can be no assurances that such additional capital, if needed, would be available on acceptable terms or at all, which would adversely affect our Company’s ability to achieve our business objectives. In addition, if our future operating performance during the next twelve months is below our expectations, our liquidity and ability to operate our business could be adversely affected unless the Company is able to raise additional capital during that period to offset the shortfall in performance.

Basis of Presentation – These unaudited condensed consolidated financial statements include the accounts and operations of Crexendo, Inc. and its wholly owned subsidiaries, which include Avail 24/7 Inc., Crexendo Business Solutions, Inc., Galaxy Mall, Inc., StoresOnline Inc., StoresOnline International Canada ULC, StoresOnline International, Inc., StoresOnline International Ltd., StoresOnline International Canada, Ltd., Internet Training Group, Inc., Crexendo International, Inc., Crexendo Telecom, Inc., Crexendo India Limited, and Crexendo Property Management, LLC. All intercompany account balances and transactions have been eliminated in consolidation. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles, consistent in all material respects with those applied in our financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. Because these financial statements address interim periods, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Such interim financial information is unaudited but reflects all adjustments that in the opinion of management are necessary for the fair presentation of the interim periods presented. The results of operations presented in this Quarterly Report on Form 10-Q are not necessarily indicative of the results that may be expected for the year ending December 31, 2013 or for any future periods. This Quarterly Report on Form 10-Q should be read in conjunction with the Company’s audited financial statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Back to Table of Contents

Cash and Cash Equivalents - We consider all highly liquid, short-term investments with maturities of three months or less at the time of purchase to be cash equivalents.

Restricted Cash – We classified $1,444,000 as restricted cash as of June 30, 2013 and December 31, 2012, respectively. Cash is restricted for state licensing letters of credit, compensating balance requirement of our merchant accounts, and purchasing card agreements. The Company expects the restrictions to be removed during the next year and therefore classified restricted cash as current. As of June 30, 2013, we had restricted cash in financial institutions in excess of federally insured limits in the amount of $1,444,000.

Trade Receivables – We have historically offered to our StoresOnline customers the option to finance, typically through 24 and 36-month extended payment term arrangements (“EPTAs”), purchases made at our Internet Training Workshops through our StoresOnline segment. EPTAs are reflected as short-term and long-term trade receivables, as applicable, as we have the intent and ability to hold the receivables for the foreseeable future, until maturity or payoff. EPTAs are recorded on a nonaccrual status beginning on the contract date.

Allowance for Doubtful Accounts – For sales made through EPTA contracts, we record an allowance for doubtful accounts each reporting period based on the Company’s ongoing assessment of collectability. The allowance represents estimated losses resulting from customers’ failure to make required payments. The allowance for doubtful accounts for EPTAs is netted against the current and long-term trade receivables balances. The allowance estimate is based on historical collection experience, specific identification of probable bad debts based on collection efforts, aging of trade receivables, customer payment history, and other known factors, including current economic conditions. We believe that the allowance for doubtful accounts is adequate based on our assessment to date, however, actual collection results may differ materially from our expectations. Because revenue generated from customers financing through EPTAs is deferred and not recognized prior to the collection of cash, adjustments to the allowance for doubtful accounts related to our EPTA contracts increase or decrease deferred revenue. Trade receivables are written off against the allowance when the related customers are no longer making required payments and the trade receivables are determined to be uncollectible, typically 90 days past their original due date. For sales made in our Crexendo Web Services and Crexendo Network Services segments, the allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Interest Income - Interest income is primarily earned from EPTA contracts. EPTA contract terms generally contain an 18% simple interest rate. Interest income is recognized on these accounts only to the extent cash is received as the receivables are generally 24 and 36-months in length and collection of the full amount of the receivable is not probable. We recognized $146,000 and $524,000 for the three months ended June 30, 2013 and 2012, respectively. We recognized $365,000 and $1,266,000 for the six months ended June 30, 2013 and 2012, respectively.

Inventory - Inventories consist of telecommunication equipment and is stated at the lower of cost (first-in, first-out method) or market. In accordance with applicable accounting guidance we regularly evaluate whether inventory is stated at the lower of cost or market.

Certificate of Deposit - We hold a $250,000 certificate of deposit as collateral for merchant accounts, which automatically renews every 12 months. The certificate of deposit is classified as long-term in the condensed consolidated balance sheets.

Property and Equipment - Depreciation and amortization expense is computed using the straight-line method in amounts sufficient to allocate the cost of depreciable assets over their estimated useful lives ranging from two to five years. The cost of leasehold improvements is amortized using the straight-line method over the shorter of the estimated useful life of the asset or the term of the related lease. Depreciation and amortization expense is included in general and administrative expenses and totaled $317,000 and $391,000 for the three months ended June 30, 2013 and 2012, respectively and $574,000 and $502,000 for the six months ended June 30, 2013 and 2012, respectively. Depreciable lives by asset group are as follows:

Back to Table of Contents

Computer and office equipment	2 to 5 years
Computer software	3 years
Furniture and fixtures	4 years
Leasehold improvements	2 to 5 years
Building	20 years

Maintenance and repairs are expensed as incurred. The cost and accumulated depreciation of property and equipment sold or otherwise retired are removed from the accounts and any related gain or loss on disposition is reflected in net income or loss for the year.

Goodwill – Goodwill of $265,000 was recorded in connection with the acquisition of CastleWave in 2010. Goodwill of $75,000 was recorded in connection with the acquisition of PBX Central on June 4, 2013. Goodwill is tested for impairment using a fair-value-based approach on an annual basis (December 31) and between annual tests if indicators of potential impairment exist.

Intangible Assets - Our intangible assets consist primarily of assets acquired in the acquisition of CastleWave and PBX Central, which include customer relationships, developed technology, technical know-how, and a non-compete agreement. The fair value of identifiable intangible assets is based upon the lower of discounted future cash flow projections or the amount paid in an arm's length transaction. The intangible assets are amortized following the patterns in which the economic benefits are consumed. Amortization expense from these acquired assets is included in general and administrative expenses and totaled $17,000 and $18,000 for the three months ended June 30, 2013 and 2012, respectively and $24,000 and $36,000 for the six months ended June 30, 2013 and 2012, respectively.

Use of Estimates - In preparing the consolidated financial statements, management makes assumptions, estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of net sales and expenses during the reported periods. Specific estimates and judgments include inventory valuation and obsolescence, intangible assets, allowances for doubtful accounts, sales returns and allowances, uncertainties related to certain income tax benefits, valuation of deferred income tax assets, valuations of share-based payments and recoverability of long-lived assets. Management's estimates are based on historical experience and on our expectations that are believed to be reasonable. The combination of these factors forms 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 our current estimates and those differences may be material.

Revenue Recognition - In general, we recognize revenue when all of the following conditions are satisfied: (1) there is persuasive evidence of an arrangement; (2) the product or service has been provided to the customer; (3) the amount of fees to be paid by the customer is fixed or determinable; and (4) the collection of our fees is probable. We recognize revenue from our Web Services and Network Services segments on an accrual basis and revenue from our StoresOnline segment on a cash basis. Specifics to revenue category are as follows:

Software licenses and DVD training courses sold under EPTAs are recognized as revenue upon receipt of cash from customers and not at the time of sale. Accounting standards require revenue to be deferred until customer payments are received if collection of the original principal balance is not probable.

We enter into agreements where revenue is derived from multiple deliverables including any mix of products and/or services. For these arrangements, we determine whether the delivered item(s) has value to the customer on a stand-alone basis, and in the event the arrangement includes a general right of return relative to the delivered item(s), whether the delivery or performance of the undelivered item(s) is considered probable and substantially in our control. If these criteria are met, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative selling price. If these criteria are not met, the arrangement is accounted for as a single unit of accounting which would result in revenue being recognized ratably over the contract term or deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. The amount of product and services revenue recognized for arrangements with multiple deliverables is impacted by the allocation of arrangement consideration to the deliverables in the arrangement based on the relative selling prices. In determining our selling prices, we apply the selling price hierarchy using vendor specific objective evidence (VSOE) when available, third-party evidence of selling price ("TPE") if VSOE does not exist, and best estimated selling price ("BESP") if neither VSOE nor TPE is available.

Back to Table of Contents

VSOE of fair value for elements of an arrangement is based upon the normal pricing and discounting practices for a deliverable when sold separately. In determining VSOE, we require that a substantial majority of the selling prices fall within a reasonably narrow pricing range, generally evidenced by a substantial majority of such historical stand-alone transactions falling within a reasonably narrow range of the median rate. In addition, we consider major service groups, geographies, customer classifications, and other variables in determining VSOE.

We are typically not able to determine TPE for our products or services. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our offerings contain a significant level of differentiation such that the comparable pricing of products with similar functionality is difficult to obtain. Furthermore, we are unable to reliably determine what similar competitor products' selling prices are on a stand-alone basis.

When we are unable to establish the selling price using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. We determine BESP for a product or service by considering multiple factors including, but not limited to, cost of products, gross margin objectives, pricing practices, geographies, customer classes and distribution channels.

We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the timing of revenue recognized but does not change the total revenue recognized on any agreement.

Professional Services Revenue - Fees collected for professional services, including website design and development, search engine optimization services, link-building, paid search management services, and telecom installation services are recognized as revenue, net of expected customer refunds, over the period during which the services are performed, based upon the value for such services.

Web and Telecommunications Services Hosting Revenue - Fees collected for hosting revenue are recognized ratably as services are provided. Customers are billed for these services on a monthly or annual basis at the customer's option. We recognize revenue ratably over the applicable service period. When we provide a free trial period, we do not begin to recognize subscription revenue until the trial period has ended and the customer has been billed for the services.

Back to Table of Contents

Equipment Sales and Financing Revenue - Fees generated from the sale of telecommunications equipment are recognized when the devices are installed and hosted telecommunications services begin.

Fees generated from renting our hosted telecommunication equipment (IP or cloud telephone devices) through leasing contracts are recognized as revenue based on whether the lease qualifies as an operating lease or sales-type lease. The two primary accounting provisions which we use to classify transactions as sales-type or operating leases are: 1) lease term to determine if it is equal to or greater than 75% of the economic life of the equipment and 2) the present value of the minimum lease payments to determine if they are equal to or greater than 90% of the fair market value of the equipment at the inception of the lease. The economic life of most of our products is estimated to be three years, since this represents the most frequent contractual lease term for our products, and there is no residual value for used equipment. Residual values, if any, are established at the lease inception using estimates of fair value at the end of the lease term. The vast majority of our leases that qualify as sales-type leases are non-cancelable and include cancellation penalties approximately equal to the full value of the lease receivables. Leases that do not meet the criteria for sales-type lease accounting are accounted for as operating leases. Revenue from sales-type leases is recognized upon installation and the interest portion is deferred and recognized as earned. Revenue from operating leases in recognized ratably over the applicable service period.

Commission Revenue - We have contracts with third-party entities with respect to telemarketing product sales to our customers following the sale of the initial software licenses. These products and services are intended to assist the customers with their Internet businesses. These products are sold and delivered completely by third parties. We receive commissions from these third parties, and recognize the revenue as the commissions are received, net of expected customer refunds.

Cost of Revenue – Cost of revenue consists primarily of salaries for fulfillment services, and the cost of telecommunications equipment, services, and other products sold.

Prepaid Sales Commissions - For arrangements where we recognize revenue over the relevant contract period, we defer related commission payments to our direct sales force and amortize these amounts over the same period that the related revenues are recognized. This is done to match commissions with the related revenues. Commission payments are nonrefundable unless amounts due from a customer are determined to be uncollectible or if the customer subsequently changes or terminates the level of service, in which case commissions which were paid are recoverable by us. We deferred $53,000 and $0 of commissions and amortized to sales and marketing expense $5,000 and $0 as of June 30, 2013 and December 31, 2012, respectively.

Research and Development - Research and development costs are expensed as incurred. Costs related to internally developed software are expensed as research and development expense until technological feasibility has been achieved, after which the costs are capitalized.

Fair Value Measurements - The fair value of our financial assets and liabilities was determined based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 — Unadjusted quoted prices that are available in active markets for the identical assets or liabilities at the measurement date.

Level 2 — Other observable inputs available at the measurement date, other than quoted prices included in Level 1, either directly or indirectly, including:

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets in non-active markets;
Inputs other than quoted prices that are observable for the asset or liability; and
Inputs that are derived principally from or corroborated by other observable market data.

Level 3 — Unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

Back to Table of Contents

Financial Instruments - The carrying values of cash and cash equivalents, restricted cash, certificates of deposit, and merchant account deposits approximate their fair values due to either the short maturity of the instruments or the recent date of the initial transaction.

Income Taxes - We recognize a liability or asset for the deferred tax consequences of all temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements that will result in taxable or deductible amounts in future years when the reported amounts of the assets and liabilities are recovered or settled. Accruals for uncertain tax positions are provided for in accordance with accounting guidance. Accordingly, we may recognize the tax benefits from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting guidance is also provided on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in the financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our financial position, results of operations, and cash flows. In assessing the need for a valuation allowance, we evaluate all significant available positive and negative evidence, including historical operating results, estimates of future taxable income and the existence of prudent and feasible tax planning strategies. We have placed a full valuation allowance on deferred tax assets, see Note 5.

Interest and penalties associated with income taxes are classified as income tax expense in the consolidated statements of operations.

We do not intend to permanently reinvest the undistributed earnings of our United Kingdom subsidiary, therefore, we have provided for U.S. deferred income taxes on such undistributed foreign earnings. All other foreign subsidiaries are considered disregarded foreign entities for US tax purposes.

Stock-Based Compensation - For equity-classified awards, compensation expense is recognized over the requisite service period based on the computed fair value on the grant date of the award. Equity classified awards include the issuance of stock options and restricted stock. The restricted stock includes all dividend rights and is a participating security; however, the restricted stock does not change earnings per share under the two-class method.

Comprehensive Income (Loss) – There were no other components of comprehensive income (loss) other than net income (loss) for the three and six months ended June 30, 2013 and 2012.

Operating Segments - Accounting guidance establishes standards for the way public business enterprises are to report information about operating segments in annual financial statements and requires enterprises to report selected information about operating segments in financial reports issued to stockholders. The Company has three operating segments, which consist of StoresOnline, Crexendo Web Services and Crexendo Network Services. Effective October 1, 2012, the Company changed its reporting segments to reflect the allocation of previously unallocated corporate expenses to each of the three operating segments. The Company revised its segment reporting to reflect changes in how the Chief Operating Decision Maker (CODM) internally measures performance and allocates resources. Segment operating results for the three and six months ended June 30, 2012 have been recast to conform to current quarter segment operating results presentation. Accounting guidance also establishes standards for related disclosure about products and services, geographic areas and major customers. We generate over 90% of our total revenue from customers within North America (United States and Canada) and less than 10% of our total revenues from customers in other parts of the world.

12

Back to Table of Contents

Significant Customers – No customer accounted for 10% or more of our total revenue or total accounts receivable for the three and six months ended June 30, 2013 and 2012.

(2) Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing the net income (loss) for the period by the weighted-average number of common shares outstanding during the period. Diluted net income per common share is computed giving effect to all dilutive common stock equivalents, consisting of common stock options and restricted shares held in escrow. Diluted net loss per common share for the three months ended June 30, 2013 and 2012 was the same as basic net loss per common share, as the common share equivalents were anti-dilutive. Diluted net loss per common share for the six months ended June 30, 2013 was the same as basic net loss per common share, as the common share equivalents were anti-dilutive. Diluted net income per common share for the six months ended June 30, 2012 included 7,000 restricted shares held in escrow. The following table sets forth the computation of basic and diluted net income (loss) per common share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net (loss) income (in thousands)	$(1,070)	$(117)	$(1,468)	$80
Weighted-average share reconciliation:				
Weighted-average shares outstanding	10,682,393	10,641,104	10,675,990	10,589,372
Weighted-average restricted shares held in escrow	-	(7,000)	-	(7,000)
Weighted-average basic shares outstanding	10,682,393	10,634,104	10,675,990	10,582,372
Dilutive employee stock options	-	-	-	25,516
Dilutive restricted shares held in escrow	-	-	-	7,000
Diluted shares outstanding	10,682,393	10,634,104	10,675,990	10,614,888
Net (loss) income per common share:				
Basic	$(0.10)	$(0.01)	$(0.14)	$0.01
Diluted	$(0.10)	$(0.01)	$(0.14)	$0.01

The following table includes the number of common stock equivalent shares that are not included in the computation of diluted income (loss) per share because including them would have been anti-dilutive.

	Three Months ended June 30,		Six Months ended June 30,	
	2013	2012	2013	2012
Outstanding stock options	2,292,784	1,284,442	2,056,455	1,436,479
Restricted shares held in escrow	-	7,000	-	-
Total	2,292,784	1,291,442	2,056,455	1,436,479

(3) Trade Receivables, net

Our trade receivables balance primarily consists of the residual Extended Payment Term Agreements (EPTAs) sold through our workshop seminars that we discontinued in July 2011. Below is an analysis of the days outstanding of our trade receivables as shown on our balance sheet (in thousands):

13

Back to Table of Contents

	June 30, 2013	December 31, 2012
Non-EPTA trade receivables	$ 520	$ 432
Conforming EPTAs	1,392	3,945
Non-Conforming EPTAs:		
1 - 30 days	142	341
31 - 60 days	100	163
61 - 90 days	86	79
Gross trade receivables	2,240	4,960
Less allowance for doubtful accounts	(747)	(1,522)
Trade receivables, net	$ 1,493	$ 3,438
Current trade receivables, net	$ 1,341	$ 3,043
Long-term trade receivables, net	152	395
Trade receivables, net	$ 1,493	$ 3,438

All current and long-term EPTAs in the table above had original contract terms of greater than one year. The Company wrote off $729,000 of EPTAs during the six months ended June 30, 2013 and $3,939,000 during the year ended December 31, 2012, of which, all had original contract terms of greater than one year.

(4) Equipment Financing Receivables

On April 1, 2012, we began renting our hosted telecommunication equipment (IP or cloud telephone devices) through leasing contracts that we classify as either operating leases or sale-type leases. The vast majority of our leases that qualify as sales-type leases are non-cancelable and include cancellation penalties approximately equal to the full value of the lease receivables. Leases that do not meet the criteria for sales-type lease accounting are accounted for as operating leases.

Equipment finance receivables arising from the rental of our hosted telecommunication equipment through sales-type leases, were as follows (in thousands):

	June 30, 2013	December 31, 2012
Gross financing receivables	$616	$ 283
Less unearned income	(369)	(159)
Financing receivables, net	247	124
Less: Current portion of finance receivables, net	51	28
Finance receivables due after one year	$196	$ 96

Equipment finance receivables are expected to be collected within the next thirty-six to sixty months.

(5) Income Taxes

Our effective tax rate for the three and six months ended June 30, 2013 was 2.4% and 15.5%, respectively, which resulted in a benefit for income taxes of $26,000 and $263,000 respectively, The benefit for the six months ended June 30, 2013 was primarily due to the statute of limitations expiring on some uncertain tax positions.

Our effective tax rate for the three months ended June 30, 2012 was 13% which resulted in an income tax provision of $13,000. Our effective tax rate for the six months ended June 30, 2012 was 233%, which resulted in a benefit for income taxes of $140,000.

Back to Table of Contents

Significant management judgment is required in determining our provision for income taxes and in determining whether deferred tax assets will be realized in full or in part. In assessing the recovery of the deferred tax assets, we considered whether it is more likely than not that some portion or all of our deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in the periods in which those temporary differences become deductible. We considered the scheduled reversals of future deferred tax assets, projected future taxable income, the suspension of the sale of product and services through the seminar sales channel for our StoresOnline segment, the restructuring of the StoresOnline segment, and tax planning strategies in making this assessment. As a result, we determined it was more likely than not that the deferred tax assets would not be realized; accordingly, we recorded a full valuation allowance. Subsequent to placing a full valuation allowance on our net deferred tax assets, adjustments impacting our tax rate have been and are expected to continue to be insignificant.

(6) Fair Value Measurements

We have financial instruments as of June 30, 2013 and December 31, 2012 for which the fair value is summarized below (in thousands):

	June 30, 2013		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets:				
Trade receivables, net	$1,493	$1,468	$3,438	$3,383
Certificate of deposit	250	250	500	500
Liabilities:				
Acquisition related contingent consideration	$87	$87	-	-

Assets for which fair value is disclosed but not required to be recognized in the balance sheet on a recurring basis are summarized below as of June 30, 2013 and December 31, 2012 (in thousands):

		Fair value measurement at reporting date		
Description	As of June 30, 2013	Level 1	Level 2	Level 3
Assets:				
Trade receivables, net	$1,468	$-	$-	$1,468
Certificate of deposit	250	-	250	-

Description	As of December 31, 2012	Level 1	Level 2	Level 3
Assets:				
Trade receivables, net	$3,383	$-	$-	$3,383
Certificate of deposit	500	-	500	-

The carrying amount of certificates of deposit approximates fair value, as determined by certificates of deposit with similar terms and conditions. The trade receivables consist primarily of extended payment term agreements and the fair value is computed using a discounted cash flow model with an estimated market rate.

Liabilities measured at fair value on a recurring basis are summarized below as of June 30, 2013 (in thousands). There were no liabilities measured at fair value on a recurring basis at December 31, 2012.

		Fair value measurement at reporting date		
Description	As of June 30, 2013	Level 1	Level 2	Level 3
Liabilities:				
Acquisition related contingent consideration	$87	$-	$-	$87

Level 3 instruments are valued based on unobservable inputs that are supported by little or no market activity and reflect the Company's own assumptions in measuring fair value. Future changes in fair value of the contingent financial milestone consideration, as a result of changes in significant inputs such as the discount rate and estimated probabilities of financial milestone achievements, could have a material effect on the statement of operations and balance sheet in the period of the change.

Back to Table of Contents

The progression of the Company's Level 3 instruments fair valued on a recurring basis for the six months ended June 30, 2013 are shown in the table below (in thousands):

	Acquisition Related Contingent Consideration
Balance at December 31, 2012	$ -
Additions	87
Balance at June 30, 2013	87

(7) Commitments and Contingencies

Legal Proceedings

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

We have recorded liabilities of approximately $202,000 as of June 30, 2013 and December 31, 2012, respectively, for estimated losses resulting from various legal proceedings in which we are engaged. Attorney's fees associated with the various legal proceedings are expensed as incurred. We are also subject to various claims and legal proceedings covering matters that arise in the ordinary course of business. We believe that the resolution of these other cases will not have a material adverse effect on our business, financial position, or results of operations.

(8) Segment Information

Management has chosen to organize the Company around differences based on its products and services. Crexendo Web Services segment generates revenue from managing e-commerce or lead generation offerings, websites, search engine optimization/management and online promotional needs for small, medium, and large businesses. Crexendo Network Services segment generates revenue from selling hosted telecommunication and broadband data services. We believe that the StoresOnline segment will continue to generate revenue by offering businesses a continuum of services and technology providing tools and training to establish a successful website on the Internet for entrepreneurs and small office/home office (SOHO) customers

The Company has three operating segments, which consist of StoresOnline, Crexendo Web Services, and Crexendo Network Services. Effective October 1, 2012, the Company changed its reporting segments to reflect the allocation of previously unallocated corporate expenses to each of the three operating segments. The Company revised its segment reporting to reflect changes in how the Chief Operating Decision Maker (CODM) internally measures performance and allocates resources. Segment operating results for the prior year have been revised to conform to current year segment operating results presentation.

Segment revenue and income (loss) before income tax provision was as follows (in thousands):

Back to Table of Contents

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenue:				
StoresOnline	$1,677	$4,054	$3,781	$8,464
Crexendo Web Services	569	692	1,102	1,462
Crexendo Network Services	491	168	876	243
Consolidated revenue	2,737	4,914	5,759	10,169
Loss from Operations:				
StoresOnline	629	1,682	1,645	3,344
Crexendo Web Services	(594)	(1,099)	(1,223)	(2,539)
Crexendo Network Services	(1,251)	(1,197)	(2,485)	(2,145)
Total operating loss	(1,216)	(614)	(2,063)	(1,340)
Other Income, net:				
StoresOnline	120	504	326	1,266
Crexendo Web Services	-	3	3	7
Crexendo Network Services	-	3	3	7
Total other income	120	510	332	1,280
Loss before income tax provision				
StoresOnline	749	2,186	1,971	4,610
Crexendo Web Services	(594)	(1,096)	(1,220)	(2,532)
Crexendo Network Services	(1,251)	(1,194)	(2,482)	(2,138)
Loss before income tax provision	$(1,096)	$(104)	$(1,731)	$(60)

(9) Business Acquisition

PBX Holdings, LLC. Acquisition

On June 4, 2013 we acquired certain assets from PBX Holdings, LLC., dba PBX Central, a privately-held provider of IP Telecom and Cloud communications located in Austin, Texas. The aggregate purchase price of approximately $769,000 consisted of $300,000 of cash paid at closing and 38,516 shares of our common stock with an estimated fair value of approximately $107,000. The fair value of the issuance of common stock issued as consideration for PBX Central was determined on the basis of the closing market price of the Company's common stock on the acquisition date. In addition, the Company recorded as part of the purchase price approximately $363,000 of contingent consideration it estimates will be earned relating to an additional payment provision. The estimated additional payment obligation is comprised of approximately $87,000 of cash consideration and 115,385 shares of the Company's common stock with an estimated value of approximately $276,000 at the time of the acquisition. The Company's consolidated financial statements include the results of operations of PBX Central from the date of acquisition. The historical results of operations of PBX Central were not significant to the Company's consolidated results of operations for the periods presented. The total purchase consideration was allocated to the assets acquired and liabilities assumed at their estimated fair values as of the date of acquisition, as determined by management. The excess of the purchase price over the amounts allocated to assets acquired and liabilities assumed has been recorded as goodwill. In accordance with current accounting standards, goodwill associated with the PBX Central acquisition will not be amortized and will be tested for impairment at least annually.

Back to Table of Contents

The preliminary purchase price allocation is subject to completion of final fair value allocations. The actual amounts that will be recorded based upon final assessment of the fair values may differ substantially from the information in the unaudited condensed consolidated financial statements. The primary area of the purchase price allocation that is not yet finalized relate to the valuation of the intangible assets acquired.We anticipate finalizing our purchase price allocation during the third quarter of 2013. The following table presents the preliminary allocation of the purchase price for PBX Central (in thousands):

Consideration (including estimated unpaid contingent consideration):	
Cash	$387
Common Stock	383
Total Consideration	$770
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Property and Equipment	$7
Identifiable intangible assets	688
Total identifiable net assets	695
Goodwill	75
	$770

The following were the identified intangible assets acquired and the respective estimated periods over which such assets will be amortized (in thousands):

	Amount	Weighted Average useful life (In years)
Technology	$180	2
Customer relationships	508	10
Total	$688	

In determining the preliminary purchase price allocation, the Company considered, among other factors, its intention to use the acquired assets and the historical and estimated future demand for PBX Central services. The estimated fair value of customer relationships was based upon the income approach. The income approach relies on an estimation of the present value of the future monetary benefits expected to flow to the owner of an asset during its remaining economic life. This approach requires a projection of the cash flow that the asset is expected to generate in the future. The projected cash flow is discounted to its present value using a rate of return, or discount rate that accounts for the time value of money and the degree of risk inherent in the asset. The income approach may take the form of a “relief from royalty” methodology, a cost savings methodology, a “with and without” methodology, or excess earnings methodology, depending on the specific asset under consideration.

The cost approach was used to determine the fair value of the technology acquired from PBX Central. The cost approach estimates the value of the intangible asset by quantifying the aggregate expenditures that would be required to replace the intangible asset. Such expenditures include the developers’ time and materials. The underlying assumption is that the cost to purchase or develop an asset are commensurate with the economic benefits the asset is expected to generate over its remaining economic life. Management has estimated the cost to develop a similar product with current technology. The key assumptions used in valuing the technology acquired are developers’ time.

The customer relationships were valued using a form of the income approach known as the multi-period excess earnings method. Inherent in the multi-period excess earnings method is the recognition that, in most cases, all of the assets of the business, both tangible and intangible, contribute to the generation of the cash flow of the business and the net cash flows attributable to the subject asset must recognize the support of the other assets which contribute to the realization of the cash flows. This future cash flow was then discounted using an estimated required rate of return for the asset to determine the present value of the future cash flows attributable to the asset. The key assumptions used in valuing the customer relationships acquired are as follows: discount rate of 18%, tax rate of 38.1%, contributory asset charges for technology license and tangible assets used to deliver services, and estimated economic life of 10 years.

The total weighted average amortization period for the identified intangible assets acquired from PBX Central is 6 years. The goodwill resulting from the PBX Central acquisition is not currently deductible for income tax purposes.

Back to Table of Contents

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

This section and other parts of this Form 10-Q contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and our Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A, "Risk Factors," which are incorporated herein by reference. The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2012 (the "2012 Form 10-K") filed with the SEC and the Condensed Consolidated Financial Statements and notes thereto included in the 2012 Form 10-K and elsewhere in this Form 10-Q. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

OVERVIEW

We are a hosted services company that provides web hosting, hosted telecommunications services, search engine optimization management, link building, e-commerce software, website development, and broadband internet services for businesses and entrepreneurs. Our services are designed to make enterprise-class hosting services available to small and medium-sized businesses at affordable monthly rates. The Company has three operating segments, which consist of StoresOnline, Crexendo Web Services, and Crexendo Network Services.

StoresOnline segment – Our StoresOnline segment serves the small office/ home office (SOHO) business owner and entrepreneur seeking the tools and training to establish a successful website on the Internet. Specifically, StoresOnline services a market segment looking for a "do-it-yourself" option as an alternative to the high cost of contracting an e-commerce or lead generation web developer and, most importantly, an ad agency for website promotion. Both are difficult barriers to many entrepreneurs looking to establish a presence on the Internet.

We have historically sold our StoresOnline products and services through a direct mail seminar format utilizing direct response marketing campaigns. In July 2011, we suspended the sale of our products and services through the direct mail seminar format. Following the suspension the direct mail seminar format, our primary marketing channel for our StoresOnline segment has been through in-house telemarketing, online marketing channels, and direct prospecting.

We generate revenue from the cash collections from our extended payment term agreements (EPTAs), web hosting, and Avail 24/7 services.

Crexendo Web Services segment –We generate professional services revenue primarily from search engine optimization services, link building, paid search management services, conversion rate optimization services, and website design and development. These services are typically billed on a fixed price basis or on a monthly recurring basis with an initial term of six to twelve months.

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

Back to Table of Contents

We generate subscription fees from our hosted telecommunications and broadband Internet services. Our hosted telecommunications contracts typically have a 36-60 month term. We generate product revenue and equipment financing revenue from the sale and lease of our hosted telecommunications equipment. Revenues from the sale of equipment, including those from sales-type leases, are recognized at the time of sale or at the inception of the lease, as appropriate.

On June 4, 2013 we acquired certain assets from PBX Holdings, LLC., dba PBX Central, a privately-held provider of IP Telecom and Cloud communications located in Austin, Texas. The purchase price of approximately $769,000 consisted of $387,000 of cash and 153,846 shares of our common stock with an estimated fair value of approximately $363,000 at the time of the acquisition. Our consolidated financial statements include the results of operations of PBX Central from the date of acquisition. The historical results of operations of PBX Central were not significant to our consolidated results of operations for the periods presented.

OUR SERVICES AND PRODUCTS

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

Web Hosting - Our web hosting services allows businesses and entrepreneurs to host their web-sites in our data center for a monthly fee.

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

Crexendo's hosted telecommunication service offers a wide variety of essential and advanced features for small and medium-size businesses. Many of these features included in the service offering are:

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

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

Group Productivity Features such as Call Park, Call Pickup, Interactive Voice Response (IVR), Individual and Universal Paging, Corporate Directory, Multi-Party Conferencing

Call Center Features such as Automated Call Distribution (ACD), Call Monitor, Whisper and Barge, Automatic Call Recording

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

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

Back to Table of Contents

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

Search Engine Optimization (SEO) - There are two general aspects to Search Engine Optimization ("SEO"). First, the tactical level, that includes conditioning a website and/or its pages to be relevant and search-engine friendly. Second, we help businesses strategically select keywords and keyword phrases. The popularity of a site plays a role in what keyword phrases a business can compete on versus what keyword phrases might be "out of their league". We focus on the strategic selection of keywords and prioritize keywords that have healthy search volumes and high 'win' capability. Our experience coupled with our software allow us to strategically select the best choices for keyword phrases to target which provide the highest probability of getting high search engine positions and draws maximum traffic to the website. Our SEO packages include a keyword interview, strategic keyword research, baseline ranking report, search engine optimization plan, and comparison ranking report.

Link Building - Link building is a critical component of off-page SEO. To be effective, a link building campaign must be done manually. Search engines can detect links obtained via automated submission. Also, links need to come from many different types of sites, not just one or two. Link building is closely related to search engine optimization, as such; we carefully synchronize all our link building efforts and anchor text with our search engine optimization efforts.

An effective link building effort is labor intensive, with no real shortcuts. We use a broad based approach for link building that follows search engine webmaster guidelines. We use strategies that include, but aren't limited to: Web 2.0 sites, social media and social bookmarking sites, vertical portals, local directories, live directories, and others.

Paid Search Management - We offer paid search management services, such as management of Google® AdWords™, Yahoo and Microsoft Advertising adCenter™ accounts for our customers.

Modern paid search networks are incredibly sophisticated and require a tremendous amount of experience and expertise to avoid the many potential pitfalls of paid search. We assist customers by taking a conservative approach to paid search management. By using a combination of proprietary automation tools, split test dedicated landing pages, as well as the practiced eye of an expert monitoring our customer accounts on a daily basis, we are able to consistently raise conversion rates and lower the cost of pay-per-click (PPC) acquisition.

Website Design and Development - Using our proprietary software and processes we design and develop websites with "conversion" in mind. The term conversion means different things to different websites. To a lead-generation website, it means getting prospects to submit their contact information so the sales team can contact them. For an e-commerce website, conversion means getting an online customer to complete an order.

Our website design packages range from a semi-custom template based design package to a completely custom design package. We incorporate analytics into every website we build. Proper analytics allow identification of weak spots in the conversion process. Once weak spots are identified, the site can be adjusted to smooth out the process and help turn more prospects into customers.

Once the site is complete, we provide tutorials and tools to allow customers to make changes to their sites as often as necessary without having to pay additional programming fees. Alternatively, customers can elect to have us manage the changes to their websites for an additional fee.

ECONOMIC FACTORS

The tight credit markets in place over the past several years have adversely affected our StoresOnline business as consumers and businesses continued to be limited in their ability to obtain alternate sources of financing. The tight credit markets contributed to our decision to suspend the sale of our products and services through the seminar sales channel. The high unemployment rate has also had a negative impact on our StoresOnline customer base and has historically resulted in high default rates on our accounts receivable. While we have seen our collection rates stabilize and improve over the past several quarters, our default rate on StoresOnline receivables remain high. Since we recognize revenue when the cash is collected on our StoresOnline segment, an improvement in our StoresOnline accounts receivables collection rates will result in additional future revenue, while deterioration in our StoresOnline accounts receivables collection rate will decrease future revenue.

Back to Table of Contents

TECHNOLOGY

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

Our web software platform is continuously being enhanced and is an innovative website-building environment. Features and functions of our software include:

during website development, our customers can experience the look and feel of their websites as if they were their own customers. They can shop, navigate, order products, track orders, and more. If they want to change or add more elements, they can edit, rearrange, add, and delete the elements all within a dynamic, point-and-click environment;

designs that are customized based on the customers' choices and arrangements. Customers can modify the look and feel of the design to complement their services or products. In addition, design modification and arrangement are executed within a streamlined, point-and-click environment;

blogs, online journals, message boards, and forums that are easily integrated into the content of the website. As administrators, the customers have full control in terms of filtering content, allowing images, and other blog, message board, and forum permissions;

customizable forms that address customer-specific needs. By using customized forms, our customers can set up secure, encrypted forms with improved ease to collect sensitive information from their customers. This is especially useful for service-based businesses, as these forms can be used for job, loan, applications, questionnaires, bids, quotes, lead generation, etc.;

advanced out of the box eCommerce features include: shopping cart, ordering rules setup for shipping, sales tax, discount codes, UPS integration, inventory control system, gift certificate and gift card purchasing and redemption, integration with Amazon® Checkout and/or Google® Checkout, Google® Base integration, eBay® auctions integration, shopping cart supporting multiple currencies and price sets, automatic sitemap generation used by search engines, and advanced website product search using filters to quickly narrow down the product offering based on product attributes.

We continue to invest and develop on our Web platform to make it more easy-to-use, enable larger mobile and 3rd party integration features thus enabling our web customers to drive more traffic to their web-sites.

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

Back to Table of Contents

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

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

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

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

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

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

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our financial statements, we make estimates, assumptions and judgments that can have a significant impact on our revenue, operating income or loss and net income or loss, as well as on the value of certain assets and liabilities on our balance sheet. We believe that the estimates, assumptions and judgments involved in our accounting policies described in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2012 have the greatest potential impact on our financial statements, so we consider them to be our critical accounting policies and estimates. Our senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-Q with the Audit Committee of our Board of Directors.

RESULTS OF OPERATIONS

The following discussion of financial condition and results of operations should be read in conjunction with our consolidated financial statements and notes thereto and other financial information included elsewhere in this Form 10-Q.

Results of Consolidated Operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenue	$ 2,737	$ 4,914	$ 5,759	$ 10,169
Loss before income taxes	(1,096)	(104)	(1,731)	(60)
Income tax benefit (provision)	26	(13)	263	140
Net (loss) income	(1,070)	(117)	(1,468)	80
Basic net (loss) income per share	$ (0.10)	$ (0.01)	$ (0.14)	$ 0.01
Diluted net (loss) income per share	$ (0.10)	$ (0.01)	$ (0.14)	$ 0.01

Back to Table of Contents

Three months ended June 30, 2013 compared to three months ended June 30, 2012

Revenue

Total revenue decreased 44% or $2,177,000, to $2,737,000 for the three months ended June 30, 2013 as compared to $4,914,000 for the three months ended June 30, 2012. StoresOnline segment revenue decreased 59% or $2,377,000, to $1,677,000 for the three months ended June 30, 2013, as compared to $4,054,000 for the three months ended June 30, 2012. Crexendo Web Services segment revenue decreased 18% or $123,000, to $569,000 for the three months ended June 30, 2013 as compared to $692,000 for the three months ended June 30, 2012. The decreases were offset by an increase in revenue from Crexendo Network Services. Crexendo Network Services segment revenue increased 192% or $323,000, to $491,000 for the three months ended June 30, 2013 as compared to $168,000 for the three months ended June 30, 2012.

Loss Before Income Taxes

Loss before income tax increased $992,000, to $1,096,000 for the three months ended June 30, 2013 as compared to loss before income tax of $104,000 for the three months ended June 30, 2012. Revenue decreased 44% or $2,177,000, to $2,737,000 for the three months ended June 30, 2013 as compared to $4,914,000 for the three months ending June 30, 2012. Total operating expenses decreased 29% or $1,575,000, to $3,953,000 for the three months ended June 30, 2013 as compared to $5,528,000 for the three months ended June 30, 2012.

Income Tax Provision

Our effective tax rate for the three months ended June 30, 2013 was 2.4%, which resulted in a benefit for income taxes of $26,000. Our effective tax rate for the three months ended June 30, 2012 was 13%, which resulted in a provision for income taxes of $13,000.

Six months ended June 30, 2013 compared to six months ended June 30, 2012

Revenue

Total revenue decreased 43% or $4,410,000, to $5,759,000 for the six months ended June 30, 2013 as compared to $10,169,000 for the six months ended June 30, 2012. StoresOnline segment revenue decreased 55% or $4,683,000, to $3,781,000 for the six months ended June 30, 2013, as compared to $8,464,000 for the six months ended June 30, 2012. Crexendo Web Services segment revenue decreased 25% or $360,000, to $1,102,000 for the six months ended June 30, 2013 as compared to $1,462,000 for the six months ended June 30, 2012. The decrease was offset by an increase in revenue from Crexendo Network Services. Crexendo Network Services segment revenue increased 261% or $633,000, to $876,000 for the six months ended June 30, 2013 as compared to $243,000 for the six months ended June 30, 2012.

Loss Before Income Taxes

Loss before income tax increased $1,671,000, to $1,731,000 for the six months ended June 30, 2013 as compared to loss before income tax of $60,000 for the six months ended June 30, 2012. Revenue decreased 43% or $4,410,000, to $5,759,000 for the six months ended June 30, 2013 as compared to $10,169,000 for the six months ending June 30, 2012. Total operating expenses decreased 32% or $3,687,000, to $7,822,000 for the six months ended June 30, 2013 as compared to $11,509,000 for the six months ended June 30, 2012.

24

Back to Table of Contents

Income Tax Provision

Our effective tax rate for the six months ended June 30, 2013 and 2012 was 16% and 233%, respectively, which resulted in a benefit for income taxes of $263,000 and $140,000, respectively.

Segment Operating Results

The Company has three operating segments, which consist of StoresOnline, Crexendo Web Services, and Crexendo Network Services. Effective October 1, 2012, the Company changed its reporting segments to reflect the allocation of previously unallocated corporate expenses to each of the three operating segments. The Company revised its segment reporting to reflect changes in how the Chief Operating Decision Maker (CODM) internally measures performance and allocates resources. Segment operating results for the three and six months ended June 30, 2012 have been modified to conform to current segment operating results presentations. The information below is organized in accordance with our three reportable segments. Segment operating income (loss) is equal to segment net revenue less segment cost of revenue, sales and marketing, and general and administrative expenses.

Operating Results of StoresOnline (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
StoresOnline				
Revenue	$ 1,677	$ 4,054	$ 3,781	$ 8,464
Operating expenses:				
Cost of revenue	109	479	314	1,132
Research and development	166	113	356	257
Selling and marketing	7	90	19	191
General and administrative	766	1,690	1,447	3,540
Operating income	629	1,682	1,645	3,344
Other income	120	504	326	1,266
Income before taxes	$ 749	$ 2,186	$ 1,971	$ 4,610

Three months ended June 30, 2013 compared to three months ended June 30, 2012

Revenue

StoresOnline segment revenue decreased 59% or $2,377,000, to $1,677,000 for the three months ended June 30, 2013 as compared to $4,054,000 for the three months ended June 30, 2012.

Following our decision to suspend our direct mail seminar sales in July 2011, revenue from our StoresOnline segment has been generated primarily through principal amounts collected on historical sales of StoresOnline products and services sold through EPTAs. Fees for our StoresOnline products and services sold under EPTAs are recognized as revenue as cash payments are received from the customer and not at the time of sale.

Revenue related to cash collected under EPTA agreements decreased 69% or $1,803,000, to $826,000 for the three months ended June 30, 2013 as compared to $2,629,000 for the three months ended June 30, 2012. Our typical EPTA agreement has a term of two to three years. As such, while we no longer plan to offer EPTAs to our customers as a result of the suspension of our direct mail seminar sales, we will continue to recognize revenue from those EPTA contracts executed prior to July 2011 as cash is collected from those contracts. EPTAs were originally recognized in our balance sheet, net of an allowance for doubtful accounts, through our deferred revenue balance. The remaining deferred revenue balance is expected to be recognized as revenue, however, at a decreasing rate over the next year to eighteen months. The following table summarizes the activity within deferred revenue for the three months ended June 30, 2013 and 2012 (in thousands):

Back to Table of Contents

StoresOnline deferred revenue as of March 31, 2013	$1,780
Cash collected on principal of EPTA contracts	(826)
Adjustments of EPTA deferred revenue	61
StoresOnline deferred revenue as of June 30, 2013	$1,015
StoresOnline deferred revenue as of March 31, 2012	$12,038
Cash collected on principal of EPTA contracts	(2,629)
Less writeoffs	(181)
StoresOnline deferred revenue as of June 30, 2012	$9,228

Revenue related to cash collected on previously written off bad debt decreased 27% or $45,000, to $122,000 for the three months ended June 30, 2013 as compared to $167,000 for the three months ended June 30, 2012.

Due to the suspension of our direct mail seminar sales channel in July 2011, we had no cash sales of StoresOnline Software licenses ("SOS licenses") or other products at events during the three months ended June 30, 2013 and June 30, 2012. Hosting revenue decreased 30% or $239,000, to $555,000 for the three months ended June 30, 2013 as compared to $794,000 for the three months ended June 30, 2012. The decrease in hosting revenue was primarily due to attrition in the StoresOnline customer base since July 2011, primarily as a result of the suspension of the direct mail seminar sales channel.

Commissions from third parties and other revenue decreased 83% or $441,000, to $92,000 for the three months ended June 30, 2013 as compared to $533,000 for the three months ended June 30, 2012. The decrease in commissions was primarily due to the suspension our direct mail seminar sales channel. As a result of this decision, we no longer send leads to third parties, and we do not expect this revenue source to be significant in the future.

Cost of Revenue

Cost of revenue consists primarily of credit card fees, the cost of products sold, as well as customer support costs. Cost of revenue decreased 72% or $818,000, to $314,000 for the six months ended June 30, 2013 as compared to $1,132,000 for the six months ended June 30, 2012. The decrease in cost of revenue was primarily due to suspension of our direct mail seminar sales channel in July 2011, as such, we are no longer generating revenue from products and services sold to new internet training workshop customers. This resulted in a decrease in costs of fulfillment of $250,000 and a decrease in customer service costs of $556,000. The cost of revenue for the six months ended June 30, 2013 is primarily related to customer services costs and credit card fees.

Research and Development

Research and development expenses consist primarily of salaries and benefits which are attributable to the development of our StoresOnline products. Research and development expenses increased 47% or $53,000, to $166,000 for the three months ended June 30, 2013 as compared to $113,000 for the three months ended June 30, 2012. The increase was primarily due to salaries and expenses related to the continued development of our Web Builder.

Selling and Marketing

Selling and marketing expenses consist of salaries and related expenses for sales and marketing activities associated with our inside sales group. Selling and marketing expenses decreased 92% or $83,000, to $7,000 for the three months ended June 30, 2013 as compared to $90,000 for the three months ended June 30, 2012. The decrease was primarily related to salaries and benefits for inside sales representatives that were terminated as part of our reduction in force in

March 2013.

Back to Table of Contents

General and Administrative

General and administrative expenses consist of salaries and related expenses for executives, administrative personnel, legal, rent, accounting and other professionals, finance company service fees, and other general corporate expenses. General and administrative expenses decreased 55% or $924,000, to $766,000 for the three months ended June 30, 2013 as compared to $1,690,000 for the three months ended June 30, 2012. The decrease was primarily due to a reduction in salaries and related expenses of $237,000, rent allocation of $169,000, servicing fees for our EPTA contracts of $103,000, and allocated corporate expenses of $415,000.

Other Income

Other income primarily relates to interest earned on EPTAs, which generally carry an 18% simple interest rate. Other income decreased 76% or $384,000, to $120,000 for the three months ended June 30, 2013 as compared to $504,000 for the three months ended June 30, 2012. The decrease primarily relates to the decrease in the outstanding EPTA balance to $1,015,000 as of June 30, 2013 compared to $9,026,000 at June 30, 2012.

Six months ended June 30, 2013 compared to six months ended June 30, 2012

Revenue

StoresOnline segment revenue decreased 55% or $4,683,000, to $3,781,000 for the six months ended June 30, 2013 as compared to $8,464,000 for the six months ended June 30, 2012.

Following our decision to suspend our direct mail seminar sales in July 2011, revenue from our StoresOnline segment has been generated primarily through principal amounts collected on historical sales of StoresOnline products and services sold through EPTAs. Fees for our StoresOnline products and services sold under EPTAs are recognized as revenue as cash payments are received from the customer and not at the time of sale.

Revenue related to cash collected under EPTA agreements decreased 64% or $3,676,000, to $2,073,000 for the six months ended June 30, 2013 as compared to $5,749,000 for the six months ended June 30, 2012. Our typical EPTA agreement has a term of two to three years. As such, while we no longer plan to offer EPTAs to our customers as a result of the suspension of our direct mail seminar sales, we will continue to recognize revenue from those EPTA contracts executed prior to July 2011 as cash is collected from those contracts. EPTAs were originally recognized in our balance sheet, net of an allowance for doubtful accounts, through our deferred revenue balance. The remaining deferred revenue balance is expected to be recognized as revenue, however, at a decreasing rate over the next year to eighteen months. The following table summarizes the activity within deferred revenue for the six months ended June 30, 2013 and 2012 (in thousands):

StoresOnline deferred revenue as of January 1, 2013	$3,173
Cash collected on principal of EPTA contracts	(2,073)
Adjustments of EPTA deferred revenue	(85)
StoresOnline deferred revenue as of June 30, 2013	$1,015
StoresOnline deferred revenue as of January 1, 2012	$15,196
Cash collected on principal of EPTA contracts	(5,749)
Less writeoffs	(219)
StoresOnline deferred revenue as of June 30, 2012	$9,228

Revenue related to cash collected on previously written off bad debt decreased 29% or $107,000, to $262,000 for the six months ended June 30, 2013 as compared to $369,000 for the six months ended June 30, 2012.

Back to Table of Contents

Due to the suspension of our direct mail seminar sales channel in July 2011, we had no cash sales of StoresOnline Software licenses ("SOS licenses") or other products at events during the six months ended June 30, 2013 and June 30, 2012. Hosting revenue decreased 28% or $458,000, to $1,195,000 for the six months ended June 30, 2013 as compared to $1,653,000 for the six months ended June 30, 2012. The decrease in hosting revenue was primarily due to attrition in the StoresOnline customer base since July 2011, primarily as a result of the suspension of the direct mail seminar sales channel.

Commissions from third parties and other revenue decreased 81% or $694,000, to $162,000 for the six months ended June 30, 2013 as compared to $856,000 for the six months ended June 30, 2012. The decrease in commissions was primarily due to the suspension our direct mail seminar sales channel. As a result of this decision, we no longer send leads to third parties, and as such, we do not expect this revenue source to be significant in the future.

Cost of Revenue

Cost of revenue consists primarily of credit card fees, the cost of products sold, as well as customer support costs. Cost of revenue decreased 72% or $818,000, to $314,000 for the six months ended June 30, 2013 as compared to $1,132,000 for the six months ended June 30, 2012. The decrease in cost of revenue was primarily due to suspension of our direct mail seminar sales channel in July 2011, as such, we are no longer generating revenue from products and services sold to new internet training workshop customers. The decrease was primarily due to a decrease in costs of fulfillment of $250,000 and a decrease in customer service costs of $556,000. The cost of revenue for the six months ended June 30, 2013 is primarily related to customer services costs and credit card fees.

Research and Development

Research and development expenses consist primarily of salaries and benefits which are attributable to the development of our StoresOnline products. Research and development expenses increased 39% or $99,000, to $356,000 for the six months ended June 30, 2013 as compared to $257,000 for the six months ended June 30, 2012. The increase was primarily due to salaries and expenses related to the continued development of our Web Builder.

Selling and Marketing

Selling and marketing expenses consist of salaries and related expenses for sales and marketing activities associated with our inside sales group. Selling and marketing expenses decreased 90% or $172,000, to $19,000 for the six months ended June 30, 2013 as compared to $191,000 for the six months ended June 30, 2012. The decrease was primarily related to the suspension of our direct mail sales seminars in July 2011, as such, we no longer incur the selling expenses associated with StoresOnline products.

General and Administrative

General and administrative expenses consist of salaries and related expenses for executives, administrative personnel, legal, rent, accounting and other professionals, finance company service fees, and other general corporate expenses. General and administrative expenses decreased 59% or $2,093,000, to $1,447,000 for the six months ended June 30, 2013 as compared to $3,540,000 for the six months ended June 30, 2012. The decrease was primarily due to a reduction in salaries and related expenses of $401,000, accounting fees of $140,000, servicing fees for our EPTA contracts of $236,000, and allocated corporate expenses of $101,000. In addition, the decrease in general and administrative expenses is attributable to a decrease in the office space rent due to the abandonment of an operating lease in Orem, UT during the fourth quarter of 2012, and the release of a lease abandonment accrual.

Other Income

Other income primarily relates to interest earned on EPTAs, which generally carry an 18% simple interest rate. Other income decreased 74% or $940,000, to $326,000 for the six months ended June 30, 2013 as compared to $1,266,000 for the six months ended June 30, 2012. The decrease primarily relates to the decrease in the outstanding EPTA balance to $1,015,000 as of June 30, 2013 compared to $9,026,000 at June 30, 2012.

Back to Table of Contents

Operating Results of Crexendo Web Services segment (in thousands):

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Crexendo Web Services				
Revenue	$ 569	$ 692	$ 1,102	$ 1,462
Operating Expenses:				
Cost of revenue	363	488	752	1,005
Research and development	0	111	0	257
Selling and marketing	220	400	594	941
General and administrative	580	792	979	1,798
Operating loss	(594)	(1,099)	(1,223)	(2,539)
Other income	0	3	3	7
Loss before taxes	$ (594)	$ (1,096)	$ (1,220)	$ (2,532)

Three months ended June 30, 2013 compared to three months ended June 30, 2012

Revenue

Crexendo Web Services segment revenue decreased 18% or $123,000, to $569,000 for the three months ended June 30, 2013 as compared to $692,000 for the three months ended June 30, 2012. The decrease in revenue is primarily related to a reduction in sales effort during the second and third quarters of 2012 as the direct sales representatives were actively training on and selling the new Network Services offerings which the Company began selling in January 2012. During 2012, our backlog dropped to its lowest level to $904,000 as of September 30, 2012. As of June 30, 2013, the Company has increased the backlog to $1,162,000 from new contracts. Revenue from Crexendo Web Services segment is generated primarily through on-page and off-page Search Engine Optimization ("SEO") services, search engine management services, conversion rate optimization services, and website design and development services. A substantial portion of Crexendo Web Services segment's revenue is generated through three to twelve-month service contracts.

Below is a table which displays the Crexendo Web Services segment revenue backlog as of March 31, 2012 and 2013, and June 30, 2012 and 2013, which is expected to be recognized as revenue within the next twelve months (in thousands):

Crexendo Web Services backlog as of March 31, 2013	$ 1,329
Crexendo Web Services backlog as of June 30, 2013	$ 1,162
Crexendo Web Services backlog as of March 31, 2012	$ 1,212
Crexendo Web Services backlog as of June 30, 2012	$ 1,007

Cost of Revenue

Cost of revenue consists primarily of salaries and related expenses related to fulfillment of our web services. Cost of revenue decreased 26% or $125,000, to $363,000 for the three months ended June 30, 2013 as compared to $488,000 for the three months ended June 30, 2012. The decrease is primarily related to the reduction in employee salaries and benefits associated with the fulfillment of service for the Crexendo Web Services segment.

Back to Table of Contents

Research and Development

Research and development expenses decreased 100% or $111,000, to $0 for the three months ended June 30, 2013 as compared to $111,000 for the three months ended June 30, 2012. The decrease was due to no product development during the quarter. We do not anticipate incurring additional research and development expenses for our Web Services segment going forward.

Selling and Marketing

Selling and marketing expenses consist primarily of salaries and benefits, as well as advertising expenses. Selling and marketing expense decreased 45% or $180,000, to $220,000 for the three months ended June 30, 2013 as compared to $400,000 for the three months ended June 30, 2012. This decrease was primarily attributable to the decrease in our direct sales representatives, from 23 representatives at June 30, 2012 to 16 representatives as of June 30, 2013, and a decrease in our marketing expenses.

General and Administrative

General and administrative expenses consist of salaries and related expenses for executives, administrative personnel, legal, rent, accounting and other professional services, and other general corporate expenses. General and administrative expenses decreased 27% or $212,000, to $580,000 for the three months ended June 30, 2013 as compared to $792,000 for the three months ended June 30, 2012. The decrease in general and administrative expenses is primarily due to a decrease in the office space rent due to the abandonment of an operating lease in Orem, UT during the fourth quarter of 2012. In addition, less of an allocation of corporate general and administrative expenses due to the 18% reduction in revenue for the three months ended June 30, 2013 compared to the three months ended June 30, 2012, and a company-wide reduction in general and administrative expenses as we continue to cut unnecessary expenses.

Six months ended June 30, 2013 compared to six months ended June 30, 2012

Revenue

Crexendo Web Services segment revenue decreased 25% or $360,000, to $1,102,000 for the six months ended June 30, 2013 as compared to $1,462,000 for the six months ended June 30, 2012. The decrease in revenue is primarily related to a reduction in sales effort during the second and third quarters of 2012 as the direct sales representatives were actively training on and selling the new Network Services offerings which the Company began selling in January 2012. During 2012, our backlog dropped to its lowest level to $904,000 as of September 30, 2012. As of June 30, 2013, the Company has increased the backlog to $1,162,000 from new contracts. Revenue from Crexendo Web Services segment is generated primarily through on-page and off-page Search Engine Optimization ("SEO") services, search engine management services, conversion rate optimization services, and website design and development services. A substantial portion of Crexendo Web Services segment's revenue is generated through three to twelve-month service contracts.

Below is a table which displays the Crexendo Web Services segment revenue backlog as of January 1, 2012 and 2013, and June 30, 2012 and 2013, which is expected to be recognized as revenue within the next twelve months (in thousands):

Crexendo Web Services backlog as of January 1, 2013	$1,135
Crexendo Web Services backlog as of June 30, 2013	$1,162

Crexendo Web Services backlog as of January 1, 2012	$ 1,142
Crexendo Web Services backlog as of June 30, 2012	$ 1,007

Cost of Revenue

Cost of revenue consists primarily of salaries and related expenses related to fulfillment of our web services. Cost of revenue decreased 25% or $253,000, to $752,000 for the six months ended June 30, 2013 as compared to $1,005,000 for the six months ended June 30, 2012. The decrease is primarily related to the reduction in employee salaries and benefits associated with the fulfillment of service for the Crexendo Web Services segment.

Back to Table of Contents

Research and Development

Research and development expenses decreased 100% or $257,000, to $0 for the six months ended June 30, 2013 as compared to $257,000 for the six months ended June 30, 2012. The decrease was due to no product development during the six months ended June 30, 2013. We do not anticipate incurring additional research and development expenses for our Web Services segment going forward.

Selling and Marketing

Selling and marketing expenses consist primarily of salaries and benefits, as well as advertising expenses. Selling and marketing expense decreased 37% or $347,000, to $594,000 for the six months ended June 30, 2013 as compared to $941,000 for the six months ended June 30, 2012. This decrease was primarily attributable to the decrease in our direct sales representatives, from 23 representatives at June 30, 2012 to 16 representatives as of June 30, 2013, and a decrease in our marketing expenses.

General and Administrative

General and administrative expenses consist of salaries and related expenses for executives, administrative personnel, legal, rent, accounting and other professional services, and other general corporate expenses. General and administrative expenses decreased 46% or $819,000, to $979,000 for the six months ended June 30, 2013 as compared to $1,798,000 for the six months ended June 30, 2012. The decrease in general and administrative expenses is primarily due to a decrease in the office space rent due to the abandonment of an operating lease in Orem, UT during the fourth quarter of 2012, and the release of a lease abandonment accrual. In addition, less of an allocation of corporate general and administrative expenses due to the 25% reduction in revenue for the six months ended June 30, 2013 compared to the six months ended June 30, 2012, and a company-wide reduction in general and administrative expenses as we continue to cut unnecessary expenses.

Operating Results of our Crexendo Network Services segment (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Crexendo Network Services				
Revenue	$ 491	$ 168	$ 876	$ 243
Operating expenses:				
Cost of revenue	498	331	946	582
Research and development	248	281	539	585
Selling and marketing	490	494	1,012	785
General and administrative	506	259	864	436
Operating loss	(1,251)	(1,197)	(2,485)	(2,145)
Other Income	-	3	3	7
Loss before taxes	$ (1,251)	$ (1,194)	$ (2,482)	$ (2,138)

Back to Table of Contents

Three months ended June 30, 2013 compared to three months ended June 30, 2012

Revenue

Crexendo Network Services segment revenue increased 192% or $323,000, to $491,000 for the three months ended June 30, 2013 as compared to $168,000 for the three months ended June 30, 2012. We began selling our network services products through a limited launch during the first half of 2011 with no dedicated sales representatives. A substantial portion of Crexendo Network Services segment revenue is generated through thirty-six to sixty month service contracts. As such, we believe growth in Crexendo Network Services segment will initially be seen through increases in our backlog. Backlog represents contracts signed with no service or payment provided at June 30, 2013 and 2012.

Below is a table which displays the Crexendo Network Services segment revenue backlog as of March 31, 2012 and 2013, and June 30, 2012 and 2013, which we expect to recognize as revenue within the next thirty-six to sixty months (in thousands):

Crexendo Network Services backlog as of March 31, 2013	$3,451
Crexendo Network Services backlog as of June 30, 2013	$4,253
Crexendo Network Services backlog as of March 31, 2012	$965
Crexendo Network Services backlog as of June 30, 2012	$1,292

Cost of Revenue

Cost of revenue consists primarily of product cost and customer support department salaries of our hosted telecommunication services and bandwidth. Cost of revenue increased 51% or $167,000, to $498,000 for the three months ended June 30, 2013 as compared to $331,000 for the three months ended June 30, 2012. The increase in cost of revenue was primarily due to an increase in product cost of $67,000 and customer support costs of $42,000, as we continue to increase personnel to fulfill our increasing hosted telecommunications services orders, and an increase in bandwidth costs of $19,000 and other cost of revenue of $40,000.

Research and Development

Research and development expenses consist primarily of salaries and benefits which are attributable to the development of our new hosted telecommunications products. Research and development expenses decreased 12% or $33,000, to $248,000 for the three months ended June 30, 2013 as compared to $281,000 for the three months ended June 30, 2012.

Selling and Marketing

Selling and marketing expenses consist primarily of salaries and benefits, as well as advertising expenses. Selling and marketing expenses decreased 1% or $4,000, to $490,000 for the three months ended June 30, 2013 as compared to $494,000 for the three months ended June 30, 2012.

General and Administrative

General and administrative expenses consist primarily of payroll and related expenses for executives, administrative personnel, legal, rent, accounting and other professional services, and other general corporate expenses. General and administrative expenses increased 95% or $247,000, to $506,000 for the three months ended June 30, 2013 as compared to $259,000 for the three months ended June 30, 2012. The increase in general and administrative expenses for the three months ended June 30, 2013 primarily consisted of additional salaries and benefits of $95,000, additional allocation of stock option expense of $32,000, corporate accounting service of $18,000, corporate professional services of $22,000 and software and maintenance expenses of $22,000, offset by a decrease of $16,000 in legal fees and permits.

Back to Table of Contents

Six months ended June 30, 2013 compared to six months ended June 30, 2012

Revenue

Crexendo Network Services segment revenue increased 261% or $633,000, to $876,000 for the six months ended June 30, 2013 as compared to $243,000 for the six months ended June 30, 2012. We began selling our network services products through a limited launch during the first half of 2011 with no dedicated sales representatives. A substantial portion of Crexendo Network Services segment revenue is generated through thirty-six to sixty month service contracts. As such, we believe growth in Crexendo Network Services segment will initially be seen through increases in our backlog. Backlog represents contracts signed with no service or payment provided at June 30, 2013 and 2012.

Below is a table which displays the Crexendo Network Services segment revenue backlog as of January 1, 2012 and 2013, and June 30, 2012 and 2013, which we expect to recognize as revenue within the next thirty-six to sixty months (in thousands):

Crexendo Network Services backlog as of January 1, 2013	$2,374
Crexendo Network Services backlog as of June 30, 2013	$4,253
Crexendo Network Services backlog as of January 1, 2012	$155
Crexendo Network Services backlog as of June 30, 2012	$1,292

Cost of Revenue

Cost of revenue consists primarily of product cost and customer support department salaries of our hosted telecommunication services and bandwidth. Cost of revenue increased 63% or $364,000, to $946,000 for the six months ended June 30, 2013 as compared to $582,000 for the six months ended June 30, 2012. The increase in cost of revenue was primarily due to an increase in product cost of $127,000 and customer support costs of $98,000, as we continue to increase personnel to fulfill our increasing hosted telecommunications services orders, and an increase in bandwidth costs of $37,000 and other cost of revenue of $110,000.

Research and Development

Research and development expenses consist primarily of salaries and benefits which are attributable to the development of our new hosted telecommunications products. Research and development expenses decreased 8% or $46,000, to $539,000 for the six months ended June 30, 2013 as compared to $585,000 for the six months ended June 30, 2012.

Selling and Marketing

Selling and marketing expenses consist primarily of salaries and benefits, as well as advertising expenses. Selling and marketing expenses increased 29% or $227,000, to $1,012,000 for the six months ended June 30, 2013 as compared to $785,000 for the six months ended June 30, 2012. The increase in selling and marketing expenses was primarily due to the increase in the allocation of direct sales representative salaries and benefits expense as a result of increased revenue, and commissions related to Network services segment sales.

General and Administrative

General and administrative expenses consist primarily of payroll and related expenses for executives, administrative personnel, legal, rent, accounting and other professional services, and other general corporate expenses. General and administrative expenses increased 98% or $428,000, to $864,000 for the six months ended June 30, 2013 as compared to $436,000 for the six months ended June 30, 2012. The increase in general and administrative expenses for the six months ended June 30, 2013 primarily consisted of additional salaries and benefits of $207,000, additional allocation of stock option expense of $64,000, corporate accounting service of $37,000, and software and maintenance expenses of $48,000, offset by a decrease of $161,000 in allocation of rent expense.

Back to Table of Contents

Liquidity and Capital Resources

In July 2011, we announced the suspension of our direct mail seminar sales channel in our StoresOnline segment. Accordingly, we have shifted our focus toward growing our Crexendo Web Services and Network Services segments.   As a result, the Company has transformed into a start-up company with the inherent risks and uncertainties of funding operations until profitability is achieved. Due to changes in our business model and the rapidly evolving nature of our business and the markets we serve, we believe period-to-period comparisons of our operating results, including operating expenses as a percentage of revenue and cash flows, are not necessarily meaningful and should not be relied upon as an indication of future performance. We currently plan to fund our growth during the next twelve months using our cash and cash equivalents of $4,930,000, the collection of remaining accounts receivable from our former StoresOnline business, and restricted cash expected to be released from restriction. In addition, in March 2013, the Company received a letter from the CEO, and majority shareholder, that if there is a shortfall in cash, that the CEO would provide additional financial support if necessary up to $2.0 million. The Company believes that it has sufficient funds to sustain its operations during the next 12 months. Beyond the next twelve months, the Company's forecast indicates that given current trends and growth projections, the Company may need to raise additional capital. There can be no assurances that such additional capital, if needed, would be available on acceptable terms or at all, which would adversely affect our Company's ability to achieve our business objectives. In addition, if our future operating performance during the next twelve months is below our expectations, our liquidity and ability to operate our business could be adversely affected unless the Company was able to raise additional capital during that period to offset the shortfall in performance.

Working Capital

Working capital decreased 16% or $994,000, to $5,316,000 for the six months ended June 30, 2013 as compared to $6,310,000 for the year ended December 31, 2012. Working capital, excluding deferred revenue, decreased 29% or $2,698,000, to $6,664,000 as of June 30, 2013 as compared to $9,362,000 as of December 31, 2012. Deferred revenue balances represent historical contract sales for which we cannot immediately recognize revenue. We currently anticipate that the costs and expenses we will incur as these deferred revenue amounts are recognized as revenue will be insignificant. Consequently, we do not consider deferred revenue to be a factor that impacts our future cash requirements. The decrease in working capital excluding deferred revenue is primarily attributable to the decrease in revenue from our StoresOnline segment EPTA accounts receivable collections, resulting in the use of our cash and cash equivalents to fund operating activities.

Cash and Cash Equivalents

Cash and cash equivalents decreased 34% or $2,510,000, to $4,930,000 at June 30, 2013 as compared to $7,440,000 as of December 31, 2012. During the six months ended June 30, 2013, we used $2,403,000 in cash for operating activities, we used $110,000 for investing activities, and provided $3,000 for financing activities.

Trade Receivables

Current and long-term trade receivables, net of allowance for doubtful accounts, decreased 57% or $1,945,000, to $1,493,000 at June 30, 2013 as compared to $3,438,000 at December 31, 2012. Long-term trade receivables, net of allowance for doubtful accounts, decreased 62% or $243,000, to $152,000 at June 30, 2013 as compared to $395,000 at December 31, 2012. We offer our customers a contract with payment terms between 24 and 36 months, as one of several payment options. The payments that become due more than 12 months after the end of the fiscal period are classified as long-term trade receivables. The decrease in our accounts receivable balance at June 30, 2013 is primarily related to cash collections of EPTA agreements of $2,073,000 for the six month period ended June 30, 2013.

Accounts Payable

Accounts payable decreased 27% or $111,000, to $307,000 at June 30, 2013 as compared to $418,000 at December 31, 2012. Our accounts payable as of June 30, 2013 were generally within our vendors’ terms of payment.

Back to Table of Contents

Capital

Total stockholders' equity decreased 6% or $652,000, to $9,640,000 at June 30, 2013 as compared to $10,292,000 at December 31, 2012. The significant changes in stockholders' equity during the six months ended June 30, 2013 included an increase of additional paid-in capital of $430,000 for options granted, $3,000 in proceeds from stock option exercises, and $107,000 for issuance of common stock related to the acquisition of PBX Central (Note 9). Also related to the PBX Central acquisition is $276,000 of contingent consideration for stock not yet issued. In addition, we had a net loss of $1,468,000 for the six month period ending June 30, 2013. On October 24, 2012, we announced the suspension of the quarterly dividend program.

Off Balance Sheet Arrangements

As of June 30, 2013, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Impact of Recent Accounting Pronouncements

Not Applicable

Forward-Looking Statements and Factors That May Affect Future Results and Financial Condition

With the exception of historical facts, the statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, which reflect our current expectations and beliefs regarding our future results of operations, performance and achievements. These statements are subject to risks and uncertainties and are based upon assumptions and beliefs that may or may not materialize. These forward-looking statements include, but are not limited to, statements concerning:

our belief that our target market will increasingly look to Internet solutions providers who leverage industry and customer practices, increase predictability of success of their Internet initiatives and decrease implementation risks by providing low-cost, scalable solutions with minimal lead time;

our belief that we can compete successfully by relying on our infrastructure and marketing strategies as well as techniques, systems and procedures, and by adding additional products and services in the future;

our belief that we can continue our success by periodic review and revision of our methods of doing business and by continuing our expansion into domestic and international markets;

our belief that a key component of our success comes from a number of new, recently developed proprietary technologies and that these technologies and advances distinguish our services and products from our competitors and further help to substantially reduce our operating costs and expenses;

our contention that we do not offer our customers a "business opportunity" or a "franchise" as those terms are defined in applicable statutes of the states in which we operate;

our belief that there is a large, fragmented and under-served population of small businesses and entrepreneurs searching for professional services firms that offer business-to-consumer e-commerce solutions coupled with support and continuing education;

- our expectation that our offering of products and services will evolve as some products are replaced by new and enhanced products intended to help our customers achieve success with their Internet-related businesses; and

- our expectation that the costs and expenses we incur will be insignificant as deferred revenue amounts are recognized as product and other revenues when cash is collected.

We caution readers that our operating results are subject to various risks and uncertainties that could cause our actual results and outcomes to differ materially from those discussed or anticipated, including changes in economic conditions and internet technologies, interest rate fluctuations, and the factors set forth in the section entitled, “Risk Factors,” under Part I, Item 1A of the 2011 Form 10-K. We also advise readers not to place any undue reliance on the forward-looking statements contained in this Form 10-Q, which reflect our beliefs and expectations only as of the date of this Report. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances or any changes in our beliefs or expectations, other than as required by law.

Back to Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not required

ITEM 4. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this Report, have concluded that, based on the evaluation of these controls and procedures, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the six months ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Back to Table of Contents

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

ITEM 1A. RISK FACTORS

There are many risk factors that may affect our business and the results of our operations, many of which are beyond our control. Information on certain risks that we believe are material to our business is set forth in "Part I – Item 1A. Risk Factors" of the 2012 Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

We have a share purchase program that authorizes us to purchase outstanding shares of our common stock. The aggregate dollar amount originally authorized in September 2006 for purchase was $20,000,000 through September 2009. In September 2007, our Board of Directors authorized the purchase of an additional $50,000,000 of our common stock through September 2012. We had no share purchases during the six months ended June 30, 2013 and the share purchase program was not renewed.

ITEM 6. EXHIBITS

Exhibits

10.1	2013 Long-Term Incentive Plan
31.1	Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as amended
31.2	Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as amended
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350
101.INS*	XBRL INSTANCE DOCUMENT
101.SCH*	XBRL TAXONOMY EXTENSION SCHEMA DOCUMENT
101.CAL*	XBRL TAXONOMY EXTENSION CALCULATION LINKBASE DOCUMENT
101.DEF*	XBRL TAXONOMY EXTENSION DEFINITION LINKBASE DOCUMENT
101.LAB*	XBRL TAXONOMY EXTENSION LABEL LINKBASE DOCUMENT
101.PRE*	XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE DOCUMENT

* In accordance with Rule 406T of Regulation S-T, these XBRL (eXtensible Business Reporting Language) documents are furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under these sections.

Back to Table of Contents

SIGNATURES

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.

August 14, 2013	Crexendo, Inc.	
	By:	/s/ Steven G. Mihaylo Steven G. Mihaylo Chief Executive Officer
August 14, 2013	By:	/s/ Ronald Vincent Ronald Vincent Chief Financial Officer