

8X8 INC /DE/  
Form 10-Q  
July 29, 2016

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

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FORM 10-Q

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

For the quarterly period ended June 30, 2016

OR

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

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

Commission file number 000-21783

[8X8, INC.](#)

(Exact name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

77-0142404

(I.R.S. Employer Identification Number)

2125 O'Nel Drive  
San Jose, CA 95131

(Address of Principal Executive Offices)

(408) 727-1885

(Registrant's Telephone Number, including Area Code)

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

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

x NO "

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

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

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

The number of shares of the Registrant's Common Stock outstanding as of July 25, 2016 was 89,680,865.

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## Part I -- FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

|   | <b>June 30,<br/>2016</b> | <b>March 31,<br/>2016</b> |
|---|--------------------------|---------------------------|
| <b>ASSETS</b>                               |                          |                           |
| Current assets:                             |                          |                           |
| Cash and cash equivalents                   | \$ 27,466                | \$ 33,576                 |
| Short-term investments                      | 139,607                  | 129,274                   |
| Accounts receivable, net                    | 11,538                   | 11,070                    |
| Inventory                                   | 463                      | 520                       |
| Deferred cost of goods sold                 | 717                      | 634                       |
| Deferred income taxes                       | -                        | 5,382                     |
| Other current assets                        | 5,096                    | 5,444                     |
| Total current assets                        | 184,887                  | 185,900                   |
| Property and equipment, net                 | 13,015                   | 12,375                    |
| Intangible assets, net                      | 19,531                   | 21,464                    |
| Goodwill                                    | 45,931                   | 47,420                    |
| Non-current deferred income taxes           | 48,532                   | 43,189                    |
| Other assets                                | 3,751                    | 3,104                     |
| Total assets                                | \$ 315,647               | \$ 313,452                |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                          |                           |
| Current liabilities:                        |                          |                           |
| Accounts payable                            | \$ 12,649                | \$ 10,954                 |
| Accrued compensation                        | 9,631                    | 10,063                    |
| Accrued warranty                            | 340                      | 326                       |
| Accrued taxes                               | 5,390                    | 5,200                     |
| Accrued outside commissions                 | 2,070                    | 2,186                     |
| Deferred revenue                            | 2,120                    | 1,925                     |
| Other accrued liabilities                   | 3,226                    | 4,080                     |
| Total current liabilities                   | 35,426                   | 34,734                    |
| Non-current liabilities                     | 3,107                    | 3,258                     |
| Non-current deferred revenue                | 134                      | 154                       |
| Total liabilities                           | 38,667                   | 38,146                    |
| Commitments and contingencies (Note 6)      |                          |                           |
| Stockholders' equity:                       |                          |                           |
| Common stock                                | 89                       | 89                        |
| Additional paid-in capital                  | 394,100                  | 389,260                   |
| Accumulated other comprehensive loss        | (6,822)                  | (4,184)                   |
| Accumulated deficit                         | (110,387)                | (109,859)                 |
| Total stockholders' equity                  | 276,980                  | 275,306                   |
| Total liabilities and stockholders' equity  | \$ 315,647               | \$ 313,452                |

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

8X8, Inc.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts; unaudited)

|   | Three Months Ended |           |
|---|--------------------|-----------|
|   | June 30,           |           |
|   | 2016               | 2015      |
| Service revenue                                 | \$ 55,296          | \$ 44,168 |
| Product revenue                                 | 4,745              | 3,724     |
| Total revenue                                   | 60,041             | 47,892    |
| Operating expenses:                             |                    |           |
| Cost of service revenue                         | 10,235             | 8,459     |
| Cost of product revenue                         | 5,505              | 4,382     |
| Research and development                        | 6,710              | 5,080     |
| Sales and marketing                             | 31,691             | 23,824    |
| General and administrative                      | 6,801              | 6,068     |
| Total operating expenses                        | 60,942             | 47,813    |
| Income (loss) from operations                   | (901)              | 79        |
| Other income, net                               | 410                | 234       |
| Income (loss) before provision for income taxes | (491)              | 313       |
| Provision for income taxes                      | 37                 | 785       |
| Net loss  | \$ (528)           | \$ (472)  |
| Net loss per share:                             |                    |           |
| Basic   | \$ (0.01)          | \$ (0.01) |
| Diluted   | \$ (0.01)          | \$ (0.01) |
| Weighted average number of shares:              |                    |           |
| Basic   | 89,434             | 88,233    |
| Diluted   | 89,434             | 88,233    |

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

8X8, Inc.

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

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>June 30,</b>           |             |
|   | <b>2016</b>               | <b>2015</b> |
| Net loss  | \$ (528)                  | \$ (472)    |
| Other comprehensive income (loss), net of tax       |                           |             |
| Unrealized gain (loss) on investments in securities | 146                       | (48)        |
| Foreign currency translation adjustment             | (2,784)                   | 1,478       |
| Comprehensive income (loss)                         | \$ (3,166)                | \$ 958      |

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

8X8, Inc.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands, unaudited)

|   | Three Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|
|   | 2016                           | 2015      |
| <b>Cash flows from operating activities:</b>                                    |                                |           |
| Net loss  | \$ (528)                       | \$ (472)  |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                |           |
| Depreciation  | 1,471                          | 993       |
| Amortization of intangible assets   | 960                            | 546       |
| Amortization of capitalized software  | 146                            | 456       |
| Net accretion of discount and amortization of premium on marketable securities  | 100                            | 236       |
| Stock-based compensation expense  | 5,051                          | 3,022     |
| Deferred income tax (benefit) provision   | (44)                           | 476       |
| Other   | 190                            | 74        |
| Changes in assets and liabilities:  |                                |           |
| Accounts receivable, net  | (1,043)                        | (612)     |
| Inventory   | 53                             | 88        |
| Other current and noncurrent assets   | (508)                          | (470)     |
| Deferred cost of goods sold   | (120)                          | (53)      |
| Accounts payable  | 1,137                          | 933       |
| Accrued compensation  | (354)                          | 725       |
| Accrued warranty  | 14                             | 3         |
| Accrued taxes   | 240                            | 492       |
| Deferred revenue  | 211                            | (704)     |
| Accrued outside commissions   | (116)                          | 199       |
| Other current and noncurrent liabilities  | (324)                          | (1,272)   |
| Net cash provided by operating activities                                       | 6,536                          | 4,660     |
| <b>Cash flows from investing activities:</b>                                    |                                |           |
| Purchases of property and equipment   | (1,604)                        | (1,073)   |
| Cost of capitalized software  | (707)                          | (471)     |
| Purchase of businesses, net of cash acquired                                    | -                              | (23,434)  |
| Proceeds from maturity of investments   | 17,025                         | 7,820     |
| Sales of investments - available for sale                                       | 15,324                         | 22,620    |
| Purchase of investments - available for sale                                    | (42,625)                       | (34,409)  |
| Net cash used in investing activities   | (12,587)                       | (28,947)  |
| <b>Cash flows from financing activities:</b>                                    |                                |           |
| Capital lease payments  | (182)                          | (54)      |
| Payment of contingent consideration and escrow                                  | (200)                          | -         |
| Repurchase of common stock  | (629)                          | (25)      |
| Proceeds from issuance of common stock under employee stock plans               | 1,039                          | 336       |
| Net cash provided by financing activities                                       | 28                             | 257       |
| Effect of exchange rate changes on cash   | (87)                           | 218       |
| Net decrease in cash and cash equivalents                                       | (6,110)                        | (23,812)  |
| Cash and cash equivalents, beginning of the period                              | 33,576                         | 53,110    |
| Cash and cash equivalents, end of the period                                    | \$ 27,466                      | \$ 29,298 |
| <b>Supplemental cash flow information</b>                                       |                                |           |
| Income taxes paid   | \$ 87                          | \$ 52     |
| Interest paid   | 7                              | 6         |

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

8X8, Inc.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

8x8, Inc. (8x8 or the Company) is a provider of cloud-based, enterprise-class software solutions that transform the way businesses communicate and collaborate globally. The Company's integrated, "pure-cloud" offering combines global voice, conferencing, messaging and video with integrated workflows and big data analytics on a single platform to enable increased team productivity, better customer engagement and real-time insights into business performance.

BASIS OF PRESENTATION

The Company's fiscal year ends on March 31 of each calendar year. Each reference to a fiscal year in these notes to the consolidated financial statements refers to the fiscal year ended March 31 of the calendar year indicated (for example, fiscal 2017 refers to the fiscal year ended March 31, 2017).

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared on substantially the same basis as our annual consolidated financial statements for the fiscal year ended March 31, 2016. In the opinion of the Company's management, these interim condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of our financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from these estimates.

The March 31, 2016 year-end condensed consolidated balance sheet data in this document were derived from audited consolidated financial statements and does not include all of the disclosures required by U.S. generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements as of and for the fiscal year ended March 31, 2016 and notes thereto included in the Company's fiscal 2016 Annual Report on Form 10-K.

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

PRINCIPLES OF CONSOLIDATION

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

SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in preparation of these condensed consolidated financial statements are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2016 filed with the SEC on May 31, 2016, and there have been no changes to the Company's significant accounting policies during the three months ended June 30, 2016, except as described in the "Recently Adopted Accounting Pronouncements" section below.





## RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-5, *"Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement."* This update provides guidance in evaluating whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the software license element of the arrangement should be accounted for as an acquisition of a software license. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance does not change generally accepted accounting principles for a customer's accounting for service contracts. This update is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Therefore, the Company has prospectively adopted this new standard on April 1, 2016. The adoption of this standard did not have a material impact on our consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, *Income Taxes - Balance Sheet Classification of Deferred Taxes (Topic 740)*. This ASU requires all deferred tax liabilities and assets to be presented in the balance sheet as noncurrent. As permitted, the Company early adopted this standard prospectively during the quarter ended June 30, 2016. The adoption of this standard resulted in reclassifying current deferred income tax assets to noncurrent deferred income tax assets and current deferred income tax liabilities to noncurrent deferred income tax liabilities. No prior periods were retrospectively adjusted.

## RECENT ACCOUNTING PRONOUNCEMENTS

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

In April 2016, the FASB issued ASU No. 2016-10, *Revenue from Contracts with Customers (Topic 606) - Identifying Performance Obligations and Licensing*. The ASU amends the guidance in ASU 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property.

In May 2016, the FASB issued ASU No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*. The amendment provides clarifying guidance in certain narrow areas and adds some practical expedients.

The Company is currently assessing the impact of this pronouncement and its amendments to its consolidated financial statements.

## 2. FAIR VALUE MEASUREMENTS

Cash, cash equivalents, and available-for-sale investments, and contingent consideration were (in thousands):

|                                     | Amortized<br>Costs | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Estimated<br>Fair Value | Cash and<br>Cash<br>Equivalents | Short-Term<br>Investments |
|-------------------------------------|--------------------|-----------------------------|-----------------------------|-------------------------|---------------------------------|---------------------------|
| <b>As of June 30, 2016</b>          |                    |                             |                             |                         |                                 |                           |
| Cash                                | \$ 22,440          | \$ -                        | \$ -                        | \$ 22,440               | \$ 22,440                       | \$ -                      |
| <b>Level 1:</b>                     |                    |                             |                             |                         |                                 |                           |
| Money market funds                  | 5,026              | -                           | -                           | 5,026                   | 5,026                           | -                         |
| Mutual funds                        | 2,000              | -                           | (175)                       | 1,825                   | -                               | 1,825                     |
| <b>Subtotal</b>                     | 29,466             | -                           | (175)                       | 29,291                  | 27,466                          | 1,825                     |
| <b>Level 2:</b>                     |                    |                             |                             |                         |                                 |                           |
| Commercial paper                    | 15,660             | 8                           | -                           | 15,668                  | -                               | 15,668                    |
| Corporate debt                      | 88,620             | 143                         | (10)                        | 88,753                  | -                               | 88,753                    |
| Municipal securities                | 1,001              | -                           | (1)                         | 1,000                   | -                               | 1,000                     |
| Asset backed securities             | 27,349             | 32                          | (1)                         | 27,380                  | -                               | 27,380                    |
| Mortgage backed securities          | 1,989              | -                           | (14)                        | 1,975                   | -                               | 1,975                     |
| Agency bond                         | 2,000              | 5                           | -                           | 2,005                   | -                               | 2,005                     |
| International government securities | 1,000              | 1                           | -                           | 1,001                   | -                               | 1,001                     |
| <b>Subtotal</b>                     | 137,619            | 189                         | (26)                        | 137,782                 | -                               | 137,782                   |
| Total assets                        | \$ 167,085         | \$ 189                      | \$ (201)                    | \$ 167,073              | \$ 27,466                       | \$ 139,607                |
| <b>Level 3:</b>                     |                    |                             |                             |                         |                                 |                           |
| Contingent consideration            | \$ -               | \$ -                        | \$ -                        | \$ 216                  | \$ -                            | \$ -                      |
| Total liabilities                   | \$ -               | \$ -                        | \$ -                        | \$ 216                  | \$ -                            | \$ -                      |
|                                     |                    |                             | 8                           |                         |                                 |                           |
| <b>As of March 31, 2016</b>         |                    |                             |                             |                         |                                 |                           |
| Cash                                | \$ 18,596          | \$ -                        | \$ -                        | \$ 18,596               | \$ 18,596                       | \$ -                      |
| <b>Level 1:</b>                     |                    |                             |                             |                         |                                 |                           |
| Money market funds                  | 14,980             | -                           | -                           | 14,980                  | 14,980                          | -                         |
| Mutual funds                        | 2,000              | -                           | (187)                       | 1,813                   | -                               | 1,813                     |
| <b>Subtotal</b>                     | 35,576             | -                           | (187)                       | 35,389                  | 33,576                          | 1,813                     |
| <b>Level 2:</b>                     |                    |                             |                             |                         |                                 |                           |
| Commercial paper                    | 6,794              | 2                           | -                           | 6,796                   | -                               | 6,796                     |
| Corporate debt                      | 85,164             | 78                          | (28)                        | 85,214                  | -                               | 85,214                    |
| Municipal securities                | 1,007              | -                           | (1)                         | 1,006                   | -                               | 1,006                     |
| Asset backed securities             | 24,614             | 7                           | (11)                        | 24,610                  | -                               | 24,610                    |
| Mortgage backed securities          | 2,045              | -                           | (17)                        | 2,028                   | -                               | 2,028                     |
| Agency bond                         | 6,805              | 1                           | -                           | 6,806                   | -                               | 6,806                     |
| International government securities | 1,000              | 1                           | -                           | 1,001                   | -                               | 1,001                     |
| <b>Subtotal</b>                     | 127,429            | 89                          | (57)                        | 127,461                 | -                               | 127,461                   |
| Total assets                        | \$ 163,005         | \$ 89                       | \$ (244)                    | \$ 162,850              | \$ 33,576                       | \$ 129,274                |
| <b>Level 3:</b>                     |                    |                             |                             |                         |                                 |                           |
| Contingent consideration            | \$ -               | \$ -                        | \$ -                        | \$ 341                  | \$ -                            | \$ -                      |
| Total liabilities                   | \$ -               | \$ -                        | \$ -                        | \$ 341                  | \$ -                            | \$ -                      |

Contractual maturities of investments as of June 30, 2016 are set forth below (in thousands):

|                     | <b>Estimated<br/>Fair Value</b> |
|---------------------|---------------------------------|
| Due within one year | \$ 79,772                       |
| Due after one year  | 59,835                          |
| Total               | \$ 139,607                      |

### Contingent Consideration and Escrow Liability

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

The items are classified as Level 3 within the valuation hierarchy, consisting of contingent consideration and escrow liability related to the QSC acquisition, were valued based on an estimate of the probability of success of the milestones being achieved and present value computations, respectively. The table below presents a roll-forward of the contingent consideration and escrow liability valued using a Level 3 input (in thousands):

|   | <b>Three Months<br/>Ended<br/>June 30, 2016</b> | <b>Year Ended<br/>March 31,<br/>2016</b> |
|---|---|--|
| Balance at beginning of period          | \$ 341  | \$ -                                     |
| Purchase price contingent consideration | -   | 541                                      |
| Contingent consideration payments       | (125)   | (200)                                    |
| Balance at end of period                | \$ 216  | \$ 341                                   |

### 3. INVENTORIES

|                          | <b>June 30,<br/>2016</b> | <b>March 31,<br/>2016</b> |
|--------------------------|--------------------------|---------------------------|
| Inventory (in thousands) |                          |                           |
| Work-in-process          | \$ 3                     | \$ 76                     |
| Finished goods           | 460                      | 444                       |
| Total                    | \$ 463                   | \$ 520                    |

## 4. INTANGIBLE ASSETS AND GOODWILL

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

|   | June 30, 2016         |                          |                     | March 31, 2016        |                          |                     |
|---|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|   | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Technology                                    | \$ 18,033             | \$ (5,215)               | \$ 12,818           | \$ 18,640             | \$ (4,622)               | \$ 14,018           |
| Customer relationships                        | 9,716                 | (5,215)                  | 4,501               | 9,993                 | (4,847)                  | 5,146               |
| Trade names/domains                           | 2,117                 | -                        | 2,117               | 2,205                 | -                        | 2,205               |
| In-process research and development           | 95                    | -                        | 95                  | 95                    | -                        | 95                  |
| Total acquired identifiable intangible assets | \$ 29,961             | \$ (10,430)              | \$ 19,531           | \$ 30,933             | \$ (9,469)               | \$ 21,464           |

At June 30, 2016, annual amortization of intangible assets, based upon our existing intangible assets and current useful lives, is estimated to be the following (in thousands):

|                | Amount    |
|----------------|-----------|
| Remaining 2017 | \$ 2,758  |
| 2018           | 3,411     |
| 2019           | 3,162     |
| 2020           | 3,162     |
| 2021           | 2,796     |
| Thereafter     | 2,030     |
| Total          | \$ 17,319 |

The following table provides a summary of the changes in the carrying amounts of goodwill by reporting segment (in thousands):

|                              | Americas  | Europe    | Total     |
|------------------------------|-----------|-----------|-----------|
| Balance as of March 31, 2016 | \$ 25,729 | \$ 21,691 | \$ 47,420 |
| Foreign currency translation | -         | (1,489)   | (1,489)   |
| Balance as of June 30, 2016  | \$ 25,729 | \$ 20,202 | \$ 45,931 |

## 5. RESEARCH, DEVELOPMENT AND SOFTWARE COSTS

In the first three months of fiscal 2017 and 2016, the Company expensed all research and development costs in accordance with ASC 985-20, *Costs of Software to be Sold, Leased or Marketed* (ASC 985-20).

The Company accounts for computer software developed or obtained for internal use in accordance with ASC 350-40, *Internal Use Software* (ASC 350-40). Capitalized costs are classified as either long-term assets or property and equipment on the consolidated balance sheets.

## Other Long-Term Assets

In the first three months of fiscal 2017, the Company capitalized \$0.7 million as other long-term assets. In the first three months of fiscal 2016, the Company capitalized \$0.5 million as other long-term assets. At June 30, 2016 and March 31, 2016, total completed capitalized software development costs included in other long-term assets was approximately \$1.7 million and \$0, respectively. At June 30, 2016 and March 31, 2016, accumulated amortization costs related to capitalized software in other long term assets was approximately \$0.1 million and \$0, respectively.

## Property and Equipment

In the first three months of fiscal 2017, the Company capitalized \$0.3 million as property and equipment. The Company did not capitalize any costs in property and equipment in accordance with ASC 350-40 in the first three months of fiscal 2016. At June 30, 2016 and March 31, 2016, total completed capitalized software costs included in property and equipment was approximately \$1.2 million. At June 30, 2016 and March 31, 2016, accumulated amortization costs related to capitalized software in property and equipment was approximately \$0.3 million and \$0.2 million, respectively.



## 6. COMMITMENTS AND CONTINGENCIES

## Leases

The Company leases its headquarters facility in San Jose, California under an operating lease agreement that expires in October 2019. The lease is an industrial net lease with monthly base rent of \$130,821 for the first 15 months with a 3% increase each year thereafter, and requires us to pay property taxes, utilities and normal maintenance costs. The Company also leases facilities for office space under non-cancelable operating leases for its various domestic and international locations.

The Company has entered into a series of noncancelable capital lease agreements for office equipment bearing interest at various rates. Assets under capital lease at June 30, 2016 totaled \$1.6 million with accumulated amortization of \$0.6 million.

## Guarantees

## Indemnifications

In the normal course of business, the Company may agree to indemnify other parties, including customers, lessors and parties to other transactions with the Company, with respect to certain matters such as breaches of representations or covenants or intellectual property infringement or other claims made by third parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, the Company has entered into indemnification agreements with its officers and directors.

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

## Product Warranties

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

|                                | Three Months Ended<br>June 30, |        |
|--------------------------------|--------------------------------|--------|
|                                | 2016                           | 2015   |
| Balance at beginning of period | \$ 326                         | \$ 339 |
| Accruals for warranties        | 114                            | 98     |
| Settlements                    | (87)                           | (83)   |
| Adjustments                    | (13)                           | (12)   |
| Balance at end of period       | \$ 340                         | \$ 342 |

## Minimum Third Party Customer Support Commitments

In the third quarter of 2010, the Company amended its contract with one of its third party customer support vendors containing a minimum monthly commitment of approximately \$0.4 million effective April 1, 2010. The agreement requires a 150-day notice to terminate. At June 30, 2016, the total remaining obligation upon a termination of the contract was \$2.2 million.

### Minimum Third Party Network Service Provider Commitments

The Company has entered into contracts with multiple vendors for third party network service which expire on various dates in fiscal 2017 through 2020. At June 30, 2016, future minimum annual payments under these third party network service contracts were as follows (in thousands):

|                              |          |
|------------------------------|----------|
| <u>Year ending March 31:</u> |          |
| Remaining 2017               | \$ 1,961 |
| 2018                         | 981      |
| 2019                         | 32       |
| 2020                         | 8        |
| Total minimum payments       | \$ 2,982 |

### Legal Proceedings

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

On February 22, 2011, the Company was named a defendant in *Bear Creek Technologies, Inc. v. 8x8, Inc. et al.*, along with 20 other defendants. On August 17, 2011, the suit was dismissed without prejudice as to the Company under Rule 21 of the Federal Rules of Civil Procedure. On August 17, 2011, Bear Creek Technologies, Inc. refiled its suit against the Company in the United States District Court for the District of Delaware. Further, on November 28, 2012, the U.S. Patent & Trademark Office initiated a Reexamination proceeding with a Reexamination Declaration explaining that there is a substantial new question of patentability, based on four separate grounds and affecting each claim of the patent which is the basis for the complaint filed against us. On March 26, 2013, the USPTO issued a first Office Action in the Reexamination, with all claims of the '722 patent being rejected on each of the four separate grounds raised in the Request for Reexamination. On July 10, 2013, the Company filed an informational pleading in support of and joining a motion to stay the proceeding in the District Court; the District Court granted the motion on July 17, 2013, based on the possibility that at least one of the USPTO rejections will be upheld and considering the USPTO's conclusion that Bear Creek's patent suffers from a defective claim for priority. On March 24, 2014, the USPTO issued another Office Action in which the rejections of the claims were maintained. On August 15, 2014, the USPTO issued a Right of Appeal Notice, as the USPTO maintained all rejections of the patent claims.

On September 15, 2014, Bear Creek Technologies, Inc. filed a Notice of Appeal of this decision with the Patent Trial and Appeal Board. The case is currently on appeal. The Company believes that it has meritorious defenses to these claims and is presenting a vigorous defense, but the Company cannot estimate potential liability in this case at this early stage of litigation.

On April 16, 2015, the Company was named as a defendant in *Slocumb Law Firm v. 8x8, Inc.* The Slocumb Law Firm has alleged that it purchased certain business services from the Company that did not perform as advertised or expected, and has asserted causes of actions for fraud, breach of contract, violations of the Alabama Deceptive Trade Practices Act and negligence. On May 7, 2015, the Company filed a motion with the U.S. District Court for the Middle District of Alabama, seeking an order compelling the Slocumb Law Firm to arbitrate its claims against the Company in Santa Clara County, California pursuant to a clause mandating arbitration of disputes set forth in the terms and conditions to which Slocumb Law Firm agreed in connection with its purchase of business services from the Company. No briefing schedule or hearing date for the motion has been set as of this time. Discovery has not yet commenced in the case. The Company intends to vigorously defend against Slocumb Law Firm's claims.

### State and Municipal Taxes

From time to time, the Company has received inquiries from a number of state and municipal taxing agencies with



respect to the remittance of sales, use, telecommunications, excise, and income taxes. Several jurisdictions currently are conducting tax audits of the Company's records. The Company collects or has accrued for taxes that it believes are required to be remitted. The amounts that have been remitted have historically been within the accruals established by the Company.

## 7. STOCK-BASED COMPENSATION

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

|   | Three Months Ended<br>June 30, |          |
|---|--------------------------------|----------|
|   | 2016                           | 2015     |
| Cost of service revenue   | \$ 360                         | \$ 219   |
| Cost of product revenue   | -                              | -        |
| Research and development  | 887                            | 531      |
| Sales and marketing   | 1,915                          | 1,197    |
| General and administrative  | 1,889                          | 1,075    |
| Total stock-based compensation expense related to employee<br>stock options and employee stock purchases, pre-tax | 5,051                          | 3,022    |
| Tax benefit   | -                              | -        |
| Stock-based compensation expense related to employee<br>stock options and employee stock purchases, net of tax    | \$ 5,051                       | \$ 3,022 |

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

Stock Option activity under all the Company's stock option plans for the three months ended June 30, 2016, is summarized as follows:

|   | Number of<br>Shares | Weighted<br>Average<br>Exercise Price<br>Per Share |
|---|---------------------|--|
| <b>Outstanding at March 31, 2016</b>                | 4,793,266           | \$ 6.29  |
| Granted   | 53,976              | 11.31  |
| Exercised   | (191,855)           | 2.18   |
| Canceled/Forfeited                                  | (1)                 | 2.58   |
| <b>Outstanding at June 30, 2016</b>                 | 4,655,386           | \$ 6.52  |
| <b>Vested and expected to vest at June 30, 2016</b> | 4,655,386           | \$ 6.52  |
| <b>Exercisable at June 30, 2016</b>                 | 3,014,307           | \$ 5.45  |

Stock Purchase Right activity for the three months ended June 30, 2016 is summarized as follows:

|                           | Number of<br>Shares | Weighted<br>Average<br>Grant-Date<br>Fair Market<br>Value | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in Years) |
|---------------------------|---------------------|---|--|
| Balance at March 31, 2016 | 82,171              | \$ 6.30   | 0.76   |
| Granted                   | -                   | -   | -  |
| Vested                    | (9,475)             | 6.23  | -  |
| Forfeited                 | -                   | -   | -  |
| Balance at June 30, 2016  | 72,696              | \$ 6.31   | 0.45   |

Restricted Stock Unit activity for the three months ended June 30, 2016 is summarized as follows:

|                           | Number of<br>Shares | Weighted<br>Average<br>Grant Date<br>Fair Value | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in Years) |
|---------------------------|---------------------|---|--|
| Balance at March 31, 2016 | 4,544,799           | \$ 8.08   | 1.67   |
| Granted                   | 300,942             | 11.40   |  |
| Vested                    | (311,949)           | 8.02  |  |
| Forfeited                 | (101,193)           | 8.48  |  |
| Balance at June 30, 2016  | 4,432,599           | \$ 8.32   | 1.53   |

The following table summarizes stock options outstanding and exercisable at June 30, 2016:

|                       | Options Outstanding |   |   |                                 | Options Exercisable |   |                                 |
|-----------------------|---------------------|---|---|---------------------------------|---------------------|---|---------------------------------|
|                       | Shares              | Weighted<br>Average<br>Exercise<br>Price<br>Per Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (Years) | Aggregate<br>Intrinsic<br>Value | Shares              | Weighted<br>Average<br>Exercise<br>Price<br>Per Share | Aggregate<br>Intrinsic<br>Value |
| \$0.55 to \$1.27      | 933,625             | \$ 1.12   | 1.5   | \$ 12,596,169                   | 933,625             | \$ 1.12   | \$ 12,596,169                   |
| \$1.39 to \$6.86      | 1,477,028           | \$ 5.83   | 6.8   | 12,968,088                      | 1,050,590           | \$ 5.43   | 9,643,718                       |
| \$7.52 to \$8.93      | 973,650             | \$ 8.28   | 8.8   | 6,165,143                       | 271,615             | \$ 8.22   | 1,735,944                       |
| \$9.21 to \$9.74      | 983,835             | \$ 9.62   | 7.2   | 4,905,183                       | 666,290             | \$ 9.63   | 3,319,570                       |
| \$10.50 to<br>\$11.31 | 287,248             | \$ 11.02  | 8.5   | 1,031,611                       | 92,187              | \$ 11.10  | 323,576                         |
|                       | 4,655,386           |   |   | \$ 37,666,194                   | 3,014,307           |   | \$ 27,618,977                   |

As of June 30, 2016, there was \$32.9 million of unamortized stock-based compensation expense related to unvested stock options and awards which is expected to be recognized over a weighted average period of 2.22 years.

Unamortized stock-based compensation expense related to shares issued as part of an acquisition was approximately \$1.8 million, which will be recognized over a weighted average period of 2.92 years.

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

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

|  | Three Months Ended<br>June 30, |            |
|--|--------------------------------|------------|
|  | 2016                           | 2015       |
| Expected volatility                            | 51%                            | 53%        |
| Expected dividend yield                        | -                              | -          |
| Risk-free interest rate                        | 1.40%                          | 1.59%      |
| Weighted average expected option term          | 5.75 years                     | 5.25 years |
| Weighted average fair value of options granted | \$ 5.45                        | \$ 4.17    |

## Stock Repurchases

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

In October 2015, the Company's board of directors authorized the Company to purchase an additional \$15.0 million of its common stock from time to time until October 20, 2016 under the 2015 Repurchase Plan. There were no stock repurchases for the period ended June 30, 2016. The remaining authorized repurchase amount at June 30, 2016 was \$15.0 million.

## 8. INCOME TAXES

For the three months ended June 30, 2016, the Company recorded a provision for income taxes of \$37,000, which was primarily attributable to income from operations. For the three months ended June 30, 2015, the Company recorded a provision for income taxes of \$0.8 million which was primarily attributable to income from operations.

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

At March 31, 2016, the Company had a liability for unrecognized tax benefits of \$2.9 million, all of which, if recognized, would decrease the company's effective tax rate. The Company does not believe that there has been any significant change in the unrecognized tax benefits in the three-month period ended June 30, 2016, and does not expect the remaining unrecognized tax benefit to change materially in the next 12 months. To the extent that the remaining unrecognized tax benefits are ultimately recognized, they will have an impact on the effective tax rate in future periods.

The Company is subject to taxation in the U.S., California and various other states and foreign jurisdictions in which it has or had a subsidiary or branch operations or it is collecting sales tax. All tax returns from fiscal 2013 to fiscal 2016 may be subject to examination by the Internal Revenue Service, California and various other states. As of July 22, 2016, there were no active federal or state income tax audits. Returns filed in foreign jurisdictions may be subject to examination for the fiscal years 2011 to 2016.

## 9. NET INCOME (LOSS) PER SHARE

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

|   | Three Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|
|   | 2016                           | 2015      |
| Numerator:                                |                                |           |
| Net loss available to common stockholders | \$ (528)                       | \$ (472)  |
| Denominator:                              |                                |           |
| Common shares                             | 89,434                         | 88,233    |
| Denominator for basic calculation         | 89,434                         | 88,233    |
| Employee stock options                    | -                              | -         |
| Stock purchase rights                     | -                              | -         |
| Denominator for diluted calculation       | 89,434                         | 88,233    |
| Net loss per share                        |                                |           |
| Basic                                     | \$ (0.01)                      | \$ (0.01) |
| Diluted                                   | \$ (0.01)                      | \$ (0.01) |

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

|   | Three Months Ended<br>June 30, |       |
|---|--------------------------------|-------|
|   | 2016                           | 2015  |
| Employee stock options                              | 1,528                          | 2,447 |
| Stock purchase rights                               | 1,602                          | 70    |
| Total anti-dilutive employee stock-based securities | 3,130                          | 2,517 |

## 10. SEGMENT REPORTING

ASC 280, *Segment Reporting*, establishes annual and interim reporting standards for an enterprise's business segments and related disclosures about its products, services, geographic areas and major customers. Under ASC 280, the method for determining what information to report is based upon the way management organizes the operating segments within the Company for making operating decisions and assessing financial performance.

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

The Company's CODMs evaluate the performance of its operating segments based on revenues and net income. Revenues are attributed to each segment based on the ordering location of the customer or ship to location. The Company allocates corporate overhead costs such as research and development, sales and marketing, general and administrative, amortization expense, stock-based compensation expense, and commitment and contingencies to the Americas segment.

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

|                           | <b>Three Months Ended<br/>June 30,</b> |             |
|---------------------------|--|-------------|
|                           | <b>2016</b>                            | <b>2015</b> |
| Americas (principally US) | 88%                                    | 88%         |
| Europe                    | 11%                                    | 9%          |
| Asia Pacific              | 1%                                     | 3%          |
|                           | 100%                                   | 100%        |

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

|                           | <b>June 30,<br/>2016</b> | <b>March 31,<br/>2016</b> |
|---------------------------|--------------------------|---------------------------|
| Americas (principally US) | \$ 9,643                 | \$ 9,165                  |
| Europe                    | 3,126                    | 2,642                     |
| Asia-Pacific              | 246                      | 568                       |
| Total                     | \$ 13,015                | \$ 12,375                 |

The following table provides financial information by segment for the three month period ending June 30, 2016 and 2015 (in thousands):

|                            | <b>Three Months Ended<br/>June 30,</b> |             |
|----------------------------|--|-------------|
|                            | <b>2016</b>                            | <b>2015</b> |
| Americas (principally US): |  |             |
| Net revenue                | \$ 53,398                              | \$ 43,588   |
| Net income                 | \$ 1,466                               | \$ 251      |
| Europe:                    |  |             |
| Net revenue                | \$ 6,643                               | \$ 4,304    |
| Net loss                   | \$ (1,994)                             | \$ (723)    |

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

### FORWARD-LOOKING STATEMENTS

This Management Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as "may," "will," "should," "estimates," "predicts," "potential," "continue," "strategy," "believes," "anticipates," "plans," "expects," "intends," and similar expressions are intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements. Actual results and trends may differ materially from historical results or those projected in any such forward-looking statements depending on a variety of factors. These factors include, but are not limited to, customer acceptance and demand for our cloud communications and collaboration services, the quality and reliability of our services, the prices for our services, customer renewal rates, customer acquisition costs, our ability to compete effectively in the hosted telecommunications and cloud-based computing services business, actions by our competitors, including price reductions for their competitive services, our ability to provide cost-effective and timely service and support to larger distributed enterprises, the impact of risks associated with our international operations, potential federal and state regulatory actions, compliance costs, potential warranty claims and product defects, our need for and the availability of adequate working capital, our ability to innovate technologically, the timely supply of products

by our contract manufacturers, our management's ability to execute its plans, strategies and objectives for future operations, including the execution of integration plans, and to realize the expected benefits of our acquisitions, and potential future intellectual property infringement claims and other litigation that could adversely affect our business and operating results. All forward-looking statements included in this report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. In addition to the factors discussed elsewhere in this Form 10-Q, see the Risk Factors discussion in Item 1A of our 2016 Form 10-K. The forward-looking statements included in this Form 10-Q are made only as of the date of this report, and we undertake no obligation to update the forward-looking statements to reflect subsequent events or circumstances.

## BUSINESS OVERVIEW

We provide cloud-based, enterprise-class software solutions that transform the way businesses communicate and collaborate globally. Delivered through a SaaS (Software as a Service) business model, our solutions are at the forefront of a disruptive technology shift that is occurring in business communications where enterprises are increasingly replacing costly and unwieldy on-premises communications equipment with agile, cloud-based software services delivered over the public Internet.

Our integrated, "pure-cloud" offering combines global voice, conferencing, messaging and video with integrated workflows and big data analytics on a single platform to enable increased team productivity, better customer engagement and real-time insights into business performance. Through a combination of open API's (application program interface) and pre-built integrations, our solutions seamlessly leverage critical customer context from internal data systems and industry-leading Customer Relationship Management (CRM) systems, including cloud-based solutions from Salesforce.com, NetSuite, and Zendesk.

Powered by internally owned and managed technologies, our cloud communications and contact center offerings are uniquely positioned to serve businesses of all sizes and can easily scale to large, globally distributed enterprise customers. Our turnkey solution spans the breadth of communications and collaboration needs, is provided with industry-leading reliability at an affordable cost and is quick and easy-to deploy through our proprietary deployment methodology. This allows customers to focus on their business instead of managing the complexities of disparate communications and collaboration platforms and the integration of these platforms with other cloud-based business applications.

Our fiscal year ends on March 31 of each calendar year. Each reference to a fiscal year in this report refers to the fiscal year ending March 31 of the calendar year indicated (for example, fiscal 2017 refers to the fiscal year ending March 31, 2017).

## SUMMARY AND OUTLOOK

In the first quarter of fiscal 2017, our service revenue from mid-market and enterprise customers grew 44% year-over-year and represented 52% of total service revenue. New monthly recurring revenue (MRR) bookings from mid-market and enterprise customers and by our channel sales teams increased 62% year-over-year, reflecting strong demand for our services in our target market segments. Also, average monthly service revenue per business customer (ARPU) increased 13% to a record \$399, compared with \$353 in the same period last year. Our ability to offer a broad range of cloud-based mission critical communications services is bringing us larger deals where we continue to displace incumbent, premises-based systems.

Building upon our Global Reach® initiative, on July 19, 2016, we announced plans to expand our international footprint with new investments in Europe, Asia Pacific, and Latin America (LATAM) to support growing demand from global and distributed mid-market and enterprise customers. These include the addition of three new co-located data centers in Singapore, The Netherlands and Brazil, full localization capabilities for an additional six languages - French (two dialects), German, Dutch, Spanish, Italian and Portuguese - and new support centers in the Philippines

and Romania delivering 24 x 7 follow-the-sun support. With this expansion, 8x8 will have a total of 12 data centers in eight regions of the world and will be one of the first global cloud communications providers with a presence in LATAM.

We continued the advancement of our technology and service offerings in the first quarter of fiscal 2017 with the release of our new Virtual Office Meeting service - a high definition video conferencing and collaboration solution that enables secure, continuous communication from any device, anywhere in the world. This enables instant, seamless collaboration from a single platform with the ability to share content from cloud applications such as Dropbox, Box, iCloud and Google Drive.

#### CRITICAL ACCOUNTING POLICIES & ESTIMATES

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



## RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

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

## RECENT ACCOUNTING PRONOUNCEMENTS

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

## SELECTED OPERATING STATISTICS

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

|   | Selected Operating Statistics |                   |                  |                   |                  |
|---|-------------------------------|-------------------|------------------|-------------------|------------------|
|   | June 30,<br>2016              | March 31,<br>2016 | Dec. 31,<br>2015 | Sept. 30,<br>2015 | June 30,<br>2015 |
| Business customers average monthly service revenue per customer (1) | \$ 399                        | \$ 385            | \$ 369           | \$ 360            | \$ 353           |
| Monthly business service revenue churn (2)(3)                       | 0.5%                          | 0.4%              | 1.2%             | 0.7%              | 1.0%             |
| Overall service margin  | 81%                           | 81%               | 80%              | 80%               | 81%              |
| Overall product margin  | -16%                          | -18%              | -21%             | -15%              | -18%             |
| Overall gross margin  | 74%                           | 72%               | 72%              | 73%               | 73%              |

- (1) Business customer average monthly service revenue per customer is service revenue from business customers in the period divided by the number of months in the period divided by the simple average number of business customers during the period.
- (2) Business customer service revenue churn is calculated by dividing the service revenue lost from business customers (after the expiration of 30-day trial) during the period by the simple average of business customer service revenue during the same period and dividing the result by the number of months in the period.
- (3) Excludes DXI business customer service revenue churn for all periods presented.

## RESULTS OF OPERATIONS

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

| <u>Service revenue</u>      | 2016      | June 30,<br>2015 | Dollar<br>Change | Percent<br>Change |
|-----------------------------|-----------|------------------|------------------|-------------------|
|                             |           |                  |                  |                   |
|                             |           |                  |                  |                   |
| Three months ended          | \$ 55,296 | \$ 44,168        | \$ 11,128        | 25.2%             |
| Percentage of total revenue | 92.1%     | 92.2%            |                  |                   |

Service revenue consists primarily of revenue attributable to the provision of our 8x8 cloud communication and collaboration services. We expect that cloud software solutions service revenues will continue to comprise nearly all of our service revenues for the foreseeable future.

8x8 service revenues increased in the first quarter of fiscal 2017 compared with the first quarter of the previous fiscal year primarily due to an increase in our business customer subscriber base (net of customer churn), and an increase in the average monthly service revenue per customer. Average monthly service revenue per customer increased from \$353 at June 30, 2015 to \$399 at June 30, 2016. We expect growth in the number of business customers and average

monthly service revenue per customer to continue in fiscal 2017.

We translate revenue denominated in foreign currency into U.S. dollars for our financial statements. If the exchange rate for British Pound Sterling, or GBP, to U.S. dollars, or USD, persists at current levels, or declines further, our revenues will be adversely impacted due to the foreign currency translation adjustment. We cannot ascertain how much impact this will have in fiscal 2017, but at the current exchange rate, we estimate a negative impact on revenues of approximately \$0.6 million per quarter in comparison with the exchange rate for GBP to USD effective in the first quarter of fiscal 2017.

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| <u>Product revenue</u>      | 2016     | June 30,<br>2015              | Dollar<br>Change | Percent<br>Change |
|-----------------------------|----------|-------------------------------|------------------|-------------------|
|                             |          | (dollar amounts in thousands) |                  |                   |
| Three months ended          | \$ 4,745 | \$ 3,724                      | \$ 1,021         | 27.4%             |
| Percentage of total revenue | 7.9%     | 7.8%                          |                  |                   |

Product revenue consists primarily of revenue from sales of IP telephones in conjunction with our 8x8 cloud communication service. Product revenue increased for the three months ended June 30, 2016 primarily due to an increase in equipment sales to business customers.

No customer represented greater than 10% of the Company's total revenues for the three months ended June 30, 2016 or 2015.

| <u>Cost of service revenue</u> | 2016      | June 30,<br>2015              | Dollar<br>Change | Percent<br>Change |
|--------------------------------|-----------|-------------------------------|------------------|-------------------|
|                                |           | (dollar amounts in thousands) |                  |                   |
| Three months ended             | \$ 10,235 | \$ 8,459                      | \$ 1,776         | 21.0%             |
| Percentage of service revenue  | 18.5%     | 19.2%                         |                  |                   |

The cost of service revenue primarily consists of costs associated with network operations and related personnel, communication origination and termination services provided party carriers, technology licenses, and royalty expenses.

Cost of service revenue for the three months ended June 30, 2016 increased over the comparable period in the prior fiscal year primarily due to a \$0.9 million increase in third party network services expenses, a \$0.4 million increase in amortization expense, a \$0.2 million increase in payroll and related expenses, a \$0.2 million increase in depreciation expense, and a \$0.1 million increase in license and fee expenses.

| <u>Cost of product revenue</u> | 2016     | June 30,<br>2015              | Dollar<br>Change | Percent<br>Change |
|--------------------------------|----------|-------------------------------|------------------|-------------------|
|                                |          | (dollar amounts in thousands) |                  |                   |
| Three months ended             | \$ 5,505 | \$ 4,382                      | \$ 1,123         | 25.6%             |
| Percentage of product revenue  | 116.0%   | 117.7%                        |                  |                   |

The cost of product revenue consists primarily of IP Telephones, estimated warranty obligations and direct and indirect costs associated with product purchasing, scheduling, shipping and handling. The amount of revenue allocated to product revenue based on relative selling price under our customer subscription agreements is less than the cost of the IP phone equipment.

The cost of product revenue for the three months ended June 30, 2016 increased over the comparable period in the prior fiscal year primarily due to an increase in equipment shipped to customers. The decrease in negative margin is due to less discounting of equipment in the current period.

| <u>Research and development</u> | 2016     | June 30,<br>2015              | Dollar<br>Change | Percent<br>Change |
|---------------------------------|----------|-------------------------------|------------------|-------------------|
|                                 |          | (dollar amounts in thousands) |                  |                   |
| Three months ended              | \$ 6,710 | \$ 5,080                      | \$ 1,630         | 32.1%             |
| Percentage of total revenue     | 11.2%    | 10.6%                         |                  |                   |

Historically, our research and development expenses have consisted primarily of personnel, system prototype design, and equipment costs necessary for us to conduct our development and engineering efforts. During the three months ended June 30, 2016, we expensed all research and development costs as they were incurred in accordance with ASC 985-20.

The research and development expenses for the three months ended June 30, 2016 increased over the comparable period in the prior fiscal year primarily due to a \$1.5 million increase in payroll and related costs, a \$0.4 million increase in stock-based compensation costs, a \$0.3 million increase in consulting, temporary personnel, and outside service expenses, offset by a \$0.7 million of payroll and related costs, consulting and outside services capitalized in accordance with ASC 350-40. Also, for the three months ended June 30, 2016, the DXI acquisition and our Romanian subsidiary increased total research and development costs by \$0.5 million and \$0.6 million, respectively, compared to the three months ended June 30, 2015. We expect research and development expenses to increase for the foreseeable future as we continue to invest in our DXI unit and in the formation of our research and development team in Romania.

| <b><u>Sales and marketing</u></b> | <b>2016</b> | <b>June 30,<br/>2015</b>      | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> |
|-----------------------------------|-------------|-------------------------------|--------------------------|---------------------------|
|                                   |             | (dollar amounts in thousands) |                          |                           |
| Three months ended                | \$ 31,691   | \$ 23,824                     | \$ 7,867                 | 33.0%                     |
| Percentage of total revenue       | 52.8%       | 49.7%                         |                          |                           |

Sales and marketing expenses consist primarily of personnel and related overhead costs for sales, marketing, and customer service which includes deployment engineering. Such costs also include outsourced customer service call center operations, sales commissions, as well as trade show, advertising and other marketing and promotional expenses.

Sales and marketing expenses for the first quarter of fiscal 2017 increased over the same quarter in the prior fiscal year primarily due to a \$4.6 million increase in payroll and related costs, a \$0.7 increase in stock-based compensation costs, a \$0.6 million increase in indirect channel commission expenses, a \$0.3 million increase in travel costs, and a \$0.3 million increase in recruiting expenses. Also, for the three months ended June 30, 2016, the DXI acquisition increased total sales and marketing costs by \$1.1 million, compared to the three months ended June 30, 2015. We expect sales and marketing expenses to increase for the foreseeable future as we continue to invest in our US sales and marketing efforts and our DXI unit.

| <b><u>General and administrative</u></b> | <b>2016</b> | <b>June 30,<br/>2015</b>      | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> |
|--|-------------|-------------------------------|--------------------------|---------------------------|
|  |             | (dollar amounts in thousands) |                          |                           |
| Three months ended                       | \$ 6,801    | \$ 6,068                      | \$ 733                   | 12.1%                     |
| Percentage of total revenue              | 11.3%       | 12.7%                         |                          |                           |

General and administrative expenses consist primarily of personnel and related overhead costs for finance, human resources and general management.

General and administrative expenses for the first quarter of fiscal 2017 increased over the same quarter in the prior fiscal year primarily due to a \$0.8 million increase in stock-based compensation costs, a \$0.3 million increase in facility lease expenses, and a \$0.1 million increase in recruiting expenses, offset by a \$0.5 million decrease in legal fees, which were primarily related to business acquisitions costs that occurred during the first fiscal quarter of 2015.

| <b><u>Other income, net</u></b> | <b>2016</b> | <b>June 30,<br/>2015</b>      | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> |
|---------------------------------|-------------|-------------------------------|--------------------------|---------------------------|
|                                 |             | (dollar amounts in thousands) |                          |                           |
| Three months ended              | \$ 410      | \$ 234                        | \$ 176                   | 75.2%                     |
| Percentage of total revenue     | 0.7%        | 0.5%                          |                          |                           |

Other income, net, primarily consisted of interest income earned on our cash, cash equivalents and investments and amortization or accretion of investments in fiscal 2017 and 2016.

| <b><u>Provision (benefit) for income tax</u></b>          | <b>2016</b> | <b>June 30,<br/>2015</b>      | <b>Dollar<br/>Change</b> | <b>Percent<br/>Change</b> |
|---|-------------|-------------------------------|--------------------------|---------------------------|
|   |             | (dollar amounts in thousands) |                          |                           |
| Three months ended  | \$ 37       | \$ 785                        | \$ (748)                 | -95.3%                    |
| Percentage of income<br>before provision for income taxes | -7.5%       | 250.8%                        |                          |                           |

For the three months ended June 30, 2016, we recorded a provision for income taxes of \$37,000, all of which related

to net income (loss) from operations. For the three months ended June 30, 2015, we recorded a provision for income taxes of \$0.8 million, all of which related to net income (loss) from operations.

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

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

### Liquidity and Capital Resources

As of June 30, 2016, we had approximately \$167.1 million in cash, cash equivalents and short-term investments.

Net cash provided by operating activities for the three months ended June 30, 2016 was approximately \$6.5 million, compared with \$4.7 million for the three months ended June 30, 2015. Cash provided by operating activities has historically been affected by the amount of net income (loss), sales of subscriptions, changes in working capital accounts particularly in deferred revenue due to timing of annual plan renewals, add-backs of non-cash expense items such as the use of deferred tax assets, depreciation and amortization and the expense associated with stock-based awards.

The net cash used in investing activities for the three months ended June 30, 2016 was \$12.6 million, during which we purchased approximately \$10.3 million of short term investments, net of sales and maturities of short term investments, and we spent approximately \$1.6 million on the purchase of property and equipment. Net cash used in investing activities was approximately \$28.9 million, during the three months ended June 30, 2015, during which we spent approximately \$1.1 million on the purchase of property and equipment, spent approximately \$23.4 million on acquisitions of two businesses, and purchased approximately \$4.0 million of short term investments, net of sales and maturities of short term investments.

Net cash provided by financing activities for the three months ended June 30, 2016 was approximately \$28,000, which primarily resulted from \$1.0 million of cash received from the issuance of common stock under our employee stock purchase plan, reduced by \$0.6 million of repurchases of our common stock related to shares withheld for payroll taxes, \$0.2 million of payments of contingent consideration and escrow, and \$0.2 million of payments on capital leases. Net cash provided by financing activities for the three months ended June 30, 2015 was approximately \$0.3 million, which primarily resulted from cash received from the issuance of common stock under our employee stock purchase plan.

### Contractual Obligations

Except as set forth below, there were no significant changes in our commitments under contractual obligations, as disclosed in the Company's Annual Report on Form 10-K, for the year ended June 30, 2016.

In June 2016, we entered into a new lease in London UK for our DXI location for approximately 16,000 square feet under an operating lease that expires in June 2026. We received an 18 month rent holiday from rent payments. After the rent holiday, the lease has a base monthly rent of approximately \$98,000, and requires us to pay service charges and normal maintenance costs. The lease contains a break clause, which allows us to end the lease in June 2022, subject to certain conditions.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency

Our financial market risk consists primarily of risks associated with international operations and related foreign currencies. We derive a portion of our revenue from customers in Europe and Asia. In order to reduce the risk from fluctuation in foreign exchange rates, the vast majority of our sales are denominated in U.S. dollars. In addition, almost all of our arrangements with our contract manufacturers are denominated in U.S. dollars. We have not entered into any currency hedging activities.

We translate revenue denominated in foreign currency into U.S. dollars for our financial statements. During periods of a strengthening dollar, our reported European revenue is reduced because foreign currencies translate into fewer U.S. dollars. However, our UK segments are currently in a net loss position. Therefore, during periods of a strengthening dollar, our net loss from our UK segment would be reduced as well.

To date, our exposure to exchange rate volatility has not been significant. However, the June 2016 vote on a referendum to exit the European Union decision has resulted in a steep decline in the exchange rate for GBP to USD. The impact of Brexit to our results of operations for the period ended June 30, 2016 was not material. However, there can be no assurance that there will not be a material impact in the future.

#### Investments

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

#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Effectiveness of Disclosure Controls and Procedures

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

As of the end of the period covered by this Quarterly Report on Form 10-Q, under the supervision of our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of our Disclosure Controls. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our Disclosure Controls were effective as of June 30, 2016.

##### Limitations on the Effectiveness of Controls

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

##### Changes in Internal Control over Financial Reporting

During the first quarter of fiscal 2016, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



PART II -- OTHER INFORMATION

ITEM 1. Legal Proceedings

Descriptions of our legal proceedings are contained in Part I, Item 1, Financial Statements - Notes to Condensed Consolidated Financial Statements - "Note 6".

## ITEM 1A. Risk Factors

We face many significant risks in our business, some of which are unknown to us and not presently foreseen. These risks could have a material adverse impact on our business, financial condition and results of operations in the future. We have disclosed a number of material risks under Part I, Item 1A of our annual report on Form 10-K for the fiscal year ended March 31, 2016, which we filed with the Securities and Exchange Commission on May 31, 2016. Except as presented below, there have been no material changes from the risk factors described in our Form 10-K.

Because our long-term growth strategy involves further expansion outside the United States, our business will be susceptible to risks associated with international operations.

In addition, on June 23, 2016, the UK held a referendum in which a majority of voters voted to exit the European Union (Brexit). The result of the Brexit vote adversely impacted global markets and foreign currencies. In particular, the value of the Pound Sterling has sharply declined as compared to the U.S. Dollar and other currencies. This volatility in foreign currencies is expected to continue as the UK negotiates and executes its exit from the European Union but it is uncertain over what time period this will occur. A significantly weaker Pound Sterling compared to the U.S. Dollar could materially reduce our revenues after taking into account foreign currency translation adjustments.

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

|                          | <b>Total Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>Per Share</b> | <b>Total Number<br/>of Shares Purchased<br/>as Part of Publicly<br/>Announced Program</b> | <b>Approximate Dollar<br/>Value of Shares that<br/>May Yet be<br/>Purchased<br/>Under the Program<sup>(1)</sup></b> |
|--------------------------|---|---|---|---|
| April 1 - April 30, 2016 | - \$  | -   | -   | \$ 15,000,000   |
| May 1 - May 31, 2016     | -   | -   | -   | 15,000,000  |
| June 1 - June 30, 2016   | -   | -   | -   | 15,000,000  |
| Total                    | - \$  | -   | -   |   |

## ITEM 5. OTHER INFORMATION

See Item 2 of Part II, "Contractual Obligations", regarding the new DXI operating lease for office space in London, UK.

## ITEM 6. Exhibits

| Exhibit<br>Number | Description  |
|-------------------|--|
| 10.33             | <u>Lease between AG Commercial St. I.B.V. as Landlord, DXI Limited as Tenant, and 8x8 Inc. as Guarantor.</u>   |
| 31.1              | <u>Certification of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2              | <u>Certification of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.1              | <u>Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| 32.2              | <u>Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| 101.INS           | XBRL Instance Document   |
| 101.SCH           | XBRL Taxonomy Extension Schema   |
| 101.CAL           | XBRL Taxonomy Extension Calculation Linkbase   |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase  |
| 101.LAB           | XBRL Taxonomy Extension Label Linkbase   |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase  |

SIGNATURE

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

Date: July 28, 2016

8X8, INC.  
(Registrant)

By: /s/ MARYELLEN GENOVESE

MaryEllen Genovese

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