8X8 INC /DE/
Form 10-Q
January 30, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2018
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________to _________
Commission file number 000-21783
8X8, INC.
(Exact name of Registrant as Specified in its Charter)

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

2125 O'Nel Drive
San Jose, CA 95131
(Address of Principal Executive Offices)

(408) 727-1885
(Registrant's Telephone Number, including Area Code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days. ý YES ¨ NO
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). YES ý NO ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES ¨ NO ý
The number of shares of the Registrant's Common Stock outstanding as of January 24, 2019 was 95,654,698.

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Part I -- FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

	December 31, 2018	March 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28,325	$ 31,703
Short-term investments	86,507	120,559
Accounts receivable, net	19,068	16,296
Deferred sales commission costs	14,443	—
Other current assets	13,166	10,040
Total current assets	161,509	178,598
Property and equipment, net	47,744	35,732
Intangible assets, net	13,273	11,958
Goodwill	39,442	40,054
Restricted cash	8,100	8,100
Deferred sales commission costs, non-current	30,893	—
Other assets	3,065	2,767
Total assets	$ 304,026	$ 277,209
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 28,318	$ 23,899
Accrued compensation	19,322	17,412
Accrued taxes	14,474	6,367
Deferred revenue	3,523	2,559
Other accrued liabilities	5,598	6,026
Total current liabilities	71,235	56,263
Non-current liabilities	5,063	2,172
Total liabilities	76,298	58,435
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Common stock	96	93
Additional paid-in capital	457,887	425,790
Accumulated other comprehensive loss	(8,085)	(5,645)
Accumulated deficit	(222,170)	(201,464)
Total stockholders' equity	227,728	218,774
Total liabilities and stockholders' equity	$ 304,026	$ 277,209

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

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Service revenue	$85,911	$71,891	$245,378	$205,105
Product revenue	4,001	3,684	13,441	12,051
Total revenue	89,912	75,575	258,819	217,156
Cost of revenue and operating expenses:				
Cost of service revenue	17,043	12,318	47,988	36,737
Cost of product revenue	5,318	4,675	16,996	14,657
Research and development	16,876	8,527	43,919	24,781
Sales and marketing	60,717	48,830	169,952	131,103
General and administrative	14,196	10,003	42,172	28,575
Impairment of equipment, intangible assets and goodwill	—	9,469	—	9,469
Total operating expenses	114,150	93,822	321,027	245,322
Loss from operations	(24,238)	(18,247)	(62,208)	(28,166)
Other income, net	579	569	1,933	3,084
Loss before income taxes	(23,659)	(17,678)	(60,275)	(25,082)
Provision for income taxes	112	70,842	333	66,153
Net loss	$(23,771)	$(88,520)	$(60,608)	$(91,235)
Net loss per share:				
Basic and diluted	$(0.25)	$(0.96)	$(0.64)	$(0.99)
Weighted-average common shares outstanding:				
Basic and diluted	95,370	92,029	94,093	91,709

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

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8X8, Inc.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands, unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Net loss	$(23,771)	$(88,520)	(60,608)	(91,235)
Other comprehensive income (loss), net of tax				
Unrealized gain (loss) on investments in securities	(101)	(213)	160	13
Foreign currency translation adjustment	(549)	198	(2,600)	3,180
Comprehensive loss	$(24,421)	$(88,535)	(63,048)	(88,042)

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

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

	Nine Months Ended December 31, 2018			2017		
Cash flows from operating activities:						
Net loss	$	(60,608	)	$	(91,235	)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:						
Depreciation	6,464			6,049		
Amortization of intangible assets	4,551			3,995		
Amortization of capitalized software	6,452			1,270		
Impairment of goodwill and long-lived assets	—			9,469		
Non-cash lease expenses	3,601			—		
Stock-based compensation	31,574			21,138		
Deferred income tax expense	—			66,273		
Gain on escrow settlement	—			(1,393		)
Other	873			226		
Changes in assets and liabilities:						
Accounts receivable, net	(3,965		)	(3,305		)
Deferred sales commission costs	(7,234		)	—		
Other current and noncurrent assets	(2,565		)	(2,315		)
Accounts payable and accruals	13,198			8,855		
Deferred revenue	986			351		
Net cash (used in) provided by operating activities	(6,673		)	19,378		
Cash flows from investing activities:						
Purchases of property and equipment	(5,778		)	(6,524		)
Purchase of businesses	(5,625		)	—		

Proceeds from escrow settlement	—			1,393		
Capitalized software development costs	(18,210		)	(8,689		)
Proceeds from maturity of investments	44,850			57,150		
Sales of investments	41,780			23,382		
Purchases of investments	(52,353		)	(75,921		)
Net cash provided by (used in) investing activities	4,664			(9,209		)
Cash flows from financing activities:						
Capital lease payments	(771		)	(855		)
Payment of contingent consideration	—			(150		)
Repurchase and tax-related withholding of common stock	(7,631		)	(22,137		)
Proceeds from issuance of common stock under employee stock plans	7,372			3,303		
Net cash used in financing activities	(1,030		)	(19,839		)
Effect of exchange rate changes on cash	(339		)	409		
Net decrease in cash and cash equivalents	(3,378		)	(9,261		)
Cash, cash equivalents, and restricted cash at the beginning of the period	39,803			41,030		
Cash, cash equivalents, and restricted cash at the end of the period	$	36,425		$	31,769	
Supplemental cash flow information						
Income taxes paid	$	290		$	217	
Interest paid	—			28		
Property and equipment acquired under capital leases	—			765		

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

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8X8, Inc.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES
DESCRIPTION OF BUSINESS
A provider of enterprise cloud communications solutions, 8x8, Inc. ("8x8," or the "Company") helps businesses get their employees, customers and applications more connected and productive worldwide. From one technology platform, the Company offers cloud phone, collaboration, conferencing, contact center, data analytics and other services to business customers on a Software-as-a-Service (SaaS) model. The Company's solutions offer a secure, reliable and simplified approach for businesses to transition their legacy, on-premises communications systems to the cloud. The comprehensive solution, built from owned core cloud technologies, enables 8x8 customers to rely on a single provider for their global communications, contact center and customer support requirements. Combining these services allows customers to eliminate information silos and expose vital, real-time communications data spanning multiple services, applications and devices which, in turn, can improve productivity, business performance and the customer experience. The Company's customers are spread across more than 150 countries and range from small businesses to large enterprises with more than 10,000 employees.
BASIS OF PRESENTATION AND CONSOLIDATION
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 2019 refers to the fiscal year ending March 31, 2019).
The accompanying interim 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, 2018, with the exception of new revenue recognition guidance discussed in the recently adopted accounting principles section below. Certain information and note disclosures normally included in the financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC), regarding interim financial reporting.
In the opinion of the Company's management, these interim 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, liabilities, disclosure of contingent assets and liabilities at the date of the 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, 2018 year-end consolidated balance sheet data in this document were derived from audited consolidated financial statements and does not include all of the disclosures required by GAAP. These 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, 2018 and notes thereto included in the Company's fiscal 2018 Annual Report on Form 10-K.
The results of operations and cash flows for the interim periods included in these consolidated financial statements are not necessarily indicative of the results to be expected for any future period or the entire fiscal year.
The consolidated financial statements include the accounts of 8x8 and its subsidiaries. All material intercompany accounts and transactions have been eliminated.
As a result of organizational changes made during the third fiscal quarter of 2019, the Company has transitioned from two reporting segments to a single reporting segment. See Note 9 for additional information.
ACQUISITIONS
In April 2018, the Company entered into an asset purchase agreement with MarianaIQ, Inc., pursuant to which the Company purchased technology and other assets to strengthen the artificial intelligence and machine learning capabilities of the Company's X Series product suite.
In October 2018, the Company entered into an asset purchase agreement with Atlassian Corporation PLC for the purchase of the Jitsi video collaboration technology (Jitsi). Jitsi extends the Company's cloud technology platform

with scalable video routing and interoperability capabilities built on industry standards such as WebRTC.

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See Note 10 for additional information on these acquisitions.

USE OF ESTIMATES

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and equity and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates, including, but not limited to, those related to bad debts, returns reserve for expected cancellations, income and sales tax liabilities, stock-based compensation, and litigation and other contingencies. The Company bases its estimates on historical experience and on various other assumptions. Actual results could differ from those estimates under different assumptions or conditions.

SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in preparation of these consolidated financial statements are disclosed in our Annual Report on Form 10-K for the fiscal year ended March 31, 2018 filed with the SEC on May 30, 2018, and there have been no changes to the Company's significant accounting policies during the three months ended December 31, 2018 except for the accounting policies described below that were updated as a result of adopting Accounting Standards Update (ASU) 2014-9, Revenue from Contracts with Customers: Topic 606 (ASU 2014-9 or ASC 606). ASU 2014-9 also included Subtopic 340-40, Other Assets and Deferred Costs - Contracts with Customers, which sets forth the requirement of deferring incremental costs of obtaining a contract with a customer. All amounts and disclosures set forth herein are in compliance with these standards.

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-9, which replaces numerous requirements in U.S. GAAP and provide companies with a single revenue recognition model for recognizing revenue from contracts with customers. ASC 606 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 in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. It defines a five-step process to achieve this core principle and, in doing so, more judgment and estimates are required with the revenue recognition process than were required under the previous guidance (ASC 605).

The new standard permits the use of either the full retrospective or modified retrospective transition method. The Company adopted the new standard effective April 1, 2018 using the modified retrospective method. Under the modified retrospective method, the comparative periods’ information is not restated and continues to be reported under the accounting standards in effect in those prior periods. Instead, on April 1, 2018, the Company recognized the cumulative effect of initially applying ASC 606 as an adjustment to the opening balance of accumulated deficit and the corresponding balance sheet accounts, which resulted in a net decrease to accumulated deficit of $39.9 million. The impact on the Company’s opening balances primarily relates to the capitalization of additional commission costs under ASC 606 in the amount of $38.2 million. Under ASC 605, the Company expensed all commission costs as incurred. Under ASC 606, the Company defers all incremental commission costs to obtain the contract and amortizes these costs over a benefit period of five years. The remaining $1.7 million impact of adopting the standard relates to revenue being recognized earlier under ASC 606 than it would have been under ASC 605, which resulted in a contract asset as of the adoption date.

See Note 2 for additional disclosure on the impact of adopting this standard.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU 2016-2, Leases (Topic 842), along with amendments issued in 2018, which requires companies to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets. The update also requires qualitative and quantitative disclosures designed to assess the amount, timing, and uncertainty of cash flows arising from leases. The update requires the use of a modified retrospective transition approach, which includes a number of optional practical expedients that entities may elect to apply. Among the subsequent amendments, an optional transition method was provided. This amendment is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company expects the adoption to have a material impact to the consolidated balance sheets for the recording of the "right-to-use" asset and corresponding contract liability. The Company is currently scoping the definition of a lease under ASC 842 to determine the "right-to-use" asset and corresponding liability in accordance with the standard.

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In June 2018, the FASB issued ASU 2018-7, Compensation-Stock Compensation (Topic 718), which now provides guidance for share-based payments to non-employees, resulting in alignment in accounting for employees and non-employees. The amendment is effective for public companies with fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820), which makes modifications to disclosure requirements on fair value measurements. The amendment is effective for public companies with fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

In August 2018, the FASB issued 2018-15, Intangibles-Goodwill and Other-Internal Use Software (Subtopic 350-40), which reduces complexity for the accounting for the accounting for costs of implementing a cloud computing service arrangement. The amendment is effective for public companies with fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

2. REVENUE RECOGNITION

Revenue Recognition under ASC 606

The Company recognizes service revenue, mainly from subscription services to its cloud-based voice, call center, video and collaboration solutions using the five-step model as prescribed by ASC 606:

• Identification of the contract, or contracts, with a customer;
• Identification of the performance obligations in the contract;
• Determination of the transaction price;
• Allocation of the transaction price to the performance obligations in the contract; and
• Recognition of revenue when or as, the Company satisfies a performance obligation.

The Company identifies performance obligations in contracts with customers, which may include subscription services and related usage, product revenue and professional services. The transaction price is determined based on the amount the Company expects to be entitled to receive in exchange for transferring the promised services or products to the customer. The transaction price in the contract is allocated to each distinct performance obligation in an amount that represents the relative amount of consideration expected to be received in exchange for satisfying each performance obligation. Revenue is recognized when performance obligations are satisfied. Revenues are recorded based on the transaction price excluding amounts collected on behalf of third parties such as sales and telecommunication taxes, which are collected on behalf of and remitted to governmental authorities. The Company usually bills its customers on a monthly basis. Contracts typically range from annual to multi-year agreements with payment terms of net 30 days or less. The Company occasionally allows a 30-day period to cancel a subscription and return products shipped for a full refund.

Judgments and Estimates

The estimation of variable consideration for each performance obligation requires the Company to make subjective judgments. The Company has service-level agreements with customers warranting defined levels of uptime reliability and performance. Customers may get credits or refunds if the Company fails to meet such levels. If the services do not meet certain criteria, fees are subject to adjustment or refund representing a form of variable consideration. The Company may impose minimum revenue commitments (MRC) on its customers at the inception of the contract. Thus, in estimating variable consideration for each of these performance obligations, the Company assesses both the probability of MRC occurring and the collectability of the MRC, of which both represent a form of variable consideration.

The Company enters into contracts with customers that regularly include promises to transfer multiple services and products, such as subscriptions, products, and professional services. For arrangements with multiple services, the Company evaluates whether the individual services qualify as distinct performance obligations. In its assessment of whether a service is a distinct performance obligation, the Company determines whether the customer can benefit from the service on its own or with other readily available resources, and whether the service is separately identifiable from other services in the contract. This evaluation requires the Company to assess the nature of each individual service offering and how the services are provided in the context of the contract, including whether the services are significantly integrated, highly interrelated, or significantly modify each other, which may require judgment based on the facts and circumstances of the contract.

When agreements involve multiple distinct performance obligations, the Company allocates arrangement consideration to all performance obligations at the inception of an arrangement based on the relative standalone selling prices (SSP) of each performance obligation. Usage fees deemed to be variable consideration meet the allocation exception for variable consideration. Where the Company has standalone sales data for its performance obligations which are indicative of the price at

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which the Company sells a promised good or service separately to a customer, such data is used to establish SSP. In instances where standalone sales data is not available for a particular performance obligation, the Company estimates SSP by the use of observable market and cost-based inputs. The Company continues to review the factors used to establish list price and will adjust standalone selling price methodologies as necessary on a prospective basis.

Service Revenue

Service revenue from subscriptions to the Company's cloud-based technology platform is recognized over time on a ratable basis over the contractual subscription term beginning on the date that the platform is made available to the customer. Payments received in advance of subscription services being rendered are recorded as a deferred revenue. Usage fees, either bundled or not bundled, are recognized when the Company has a right to invoice. Professional services for configuration, system integration, optimization, customer training or education are primarily billed on a fixed-fee basis and are performed by the Company directly or, alternatively, customers may also choose to perform these services themselves or engage their own third-party service providers. Professional services revenue is recognized over time as the services are rendered.

When a contract with a customer is signed, the Company assesses whether collection of the fees under the arrangement is probable. The Company estimates the amount to reserve for uncollectible amounts based on the aging of the contract balance, current and historical customer trends, and communications with its customers. These reserves are recorded as operating expenses against the contract asset (Accounts Receivable). In the normal course of business, the Company records revenue reductions for customer credits.

Product Revenue

The Company recognizes product revenue for telephony equipment at a point in time, when transfer of control has occurred, which is generally upon shipment. Sales returns are recorded as a reduction to revenue estimated based on historical experience.

Contract Assets

Contract assets are recorded for those parts of the contract consideration not yet invoiced but for which the performance obligations are completed. The revenue is recognized when the customer receives services or equipment for a reduced consideration at the onset of an arrangement, for example when the initial month's services or equipment are discounted. Contract assets are included in other current or non-current assets in the consolidated balance sheets, depending on if their reduction will be recognized during the succeeding twelve-month period or beyond.

Deferred Revenue

Deferred revenues represent billings or payments received in advance of revenue recognition and is recognized upon transfer of control. Balances consist primarily of annual plan subscription services and professional and training services not yet provided as of the balance sheet date. Deferred revenues that will be recognized during the succeeding twelve-month period are recorded as current deferred revenues in the consolidated balance sheets, with the remainder recorded as other non-current liabilities in the consolidated balance sheets.

Costs to Obtain a Customer Contract

Sales commissions and related expenses are considered incremental and recoverable costs of acquiring customer contracts. These costs are capitalized as other current or non-current assets and amortized on a straight-line basis over the anticipated benefit period, which is five years. The benefit period was estimated by taking into consideration the length of customer contracts, technology lifecycle, and other factors. This amortization expense is recorded in sales and marketing expense within the Company's consolidated statement of operations.

Practical Expedients

The new guidance under ASC 340-40, Other Assets and Deferred Costs - Contracts with Customers, sets forth the requirement of deferring incremental costs of obtaining a contract, typically sales commissions, that were expensed as incurred under the previous guidance. The Company applies a practical expedient that permits it to apply Subtopic 340-40 to a portfolio of contracts, instead of on a contract-by-contract basis, as they are similar in their characteristics, and the financial statement effects of applying Subtopic 340-40 to that portfolio would not differ materially from applying it to the individual contracts within that portfolio.

Impact of Adopting ASC 606

The Company recognized the cumulative effect of initially applying ASC 606 as an adjustment to retained earnings in the consolidated balance sheet as of April 1, 2018 (in thousands).

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	Balance at March 31, 2018	Adjustments Due to ASC 606	Balance at April 1, 2018
Current assets:			
Deferred sales commission costs	$—	$ 11,234	$11,234
Other current assets	$10,040	$ 1,725	$11,765
Non-current assets:			
Deferred sales commission costs	$—	$ 26,942	$26,942
Stockholders' Equity			
Accumulated deficit	$(201,464)	$ 39,901	$(161,563)

The following tables summarize the impact of the ASC 606 adoption on the Company's consolidated financial statements for the quarter ended December 31, 2018.

Selected Consolidated Balance Sheet Line Items (in thousands):

	December 31, 2018		
	ASC 605	Adjustments	(As Reported) ASC 606
Current assets:			
Deferred sales commission costs	$—	$ 14,443	$14,443
Other current assets	$10,023	$ 3,143	$13,166
Non-current assets:			
Deferred sales commission costs	$—	$ 30,893	$30,893
Stockholders' Equity			
Accumulated deficit	$(270,649)	$ 48,479	$(222,170)

Selected Consolidated Statement of Operations Line Items (in thousands, except per share amounts):

	Three Months Ended December 31, 2018		
	ASC 605	Adjustments	(As Reported) ASC 606
Service revenue	$86,245	$ (334)	$85,911
Product revenue	3,335	666	4,001
Total revenue	$89,580	$ 332	$89,912
Operating expenses:			
Sales and marketing	$63,276	$ (2,559)	$60,717
Loss from operations	$(27,129)	$ 2,891	$(24,238)
Net loss	$(26,662)	$ 2,891	$(23,771)
Net loss per share:			
Basic and Diluted	$(0.28)	$ 0.03	$(0.25)

	Nine Months Ended December 31, 2018		
	ASC 605	Adjustments	(As Reported) ASC 606
Service revenue	$246,030	$ (652)	$245,378
Product revenue	12,522	919	13,441
Total revenue	$258,552	$ 267	$258,819
Operating expenses:			

Sales and marketing	$177,186	$ (7,234)	$169,952
Loss from operations	$(69,709)	$ 7,501	$(62,208)
Net loss	$(68,109)	$ 7,501	$(60,608)
Net loss per share:			
Basic and Diluted	$(0.72)	$ 0.08	$(0.64)

Selected Consolidated Statements of Cash Flows Line Items (in thousands):

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	Nine Months Ended December 31, 2018		
	ASC 605	Adjustments	(As Reported) ASC 606
Net loss	$(68,109)	$ 7,501	$(60,608)
Deferred sales commission costs	$—	$ (7,234)	$(7,234)
Other current and non-current assets	$(2,298)	$ (267)	$(2,565)
Net cash provided by operating activities	$(6,673)	$ —	$(6,673)

Disaggregation of Revenue

The Company disaggregates its revenue by geographic region. See Note 9 for more information.

Contract Balances

The following table provides information about receivables, contract assets and deferred revenues from contracts with customers (in thousands):

	December 31, 2018
Accounts receivable, net	$ 19,068
Other current assets	$ 3,143
Deferred revenue - current	$ 3,523
Deferred revenue - non-current	$ 8

Changes in the contract assets and the deferred revenue balances during the nine months ended December 31, 2018 are as follows (in thousands):

	April 1, 2018	December 31, 2018	$ Change
Other current assets	$1,725	$ 3,143	$1,418
Deferred revenue	$2,578	$ 3,531	$953

The change in contract assets was primarily driven by the recognition of revenue that has not yet been billed. The increase in deferred revenues was due to billings in advance of performance obligations being satisfied. Revenues of $2.3 million and $5.5 million recognized during the three and nine months ended December 31, 2018, respectively, were included in the deferred revenues balance at the beginning of the period, which was offset by additional deferrals during the period.

Remaining Performance Obligations

The Company's subscription terms typically range from one to four years. Contract revenue as of December 31, 2018, that has not yet been recognized was approximately $160 million. This excludes contracts with an original expected length of one year or less. The Company expects to recognize revenue on the vast majority of the remaining performance obligation over the next 24 months.

3. FAIR VALUE MEASUREMENTS

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

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As of December 31, 2018	Amortized Costs	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value	Cash and Cash Equivalents	Short-Term Investments
Cash	$ 22,005	$ —	$ —	$ 22,005	$ 22,005	$ —
Level 1:						
Money market funds	6,320	—	—	6,320	6,320	—
Subtotal	28,325	—	—	28,325	28,325	—
Level 2:						
Corporate debt	59,480	6	(222)	59,264	—	59,264
Municipal securities	5,504	1	(4)	5,501	—	5,501
Asset backed securities	17,577	5	(50)	17,532	—	17,532
Agency bond	4,240	—	(30)	4,210	—	4,210
Subtotal	86,801	12	(306)	86,507	—	86,507
Total assets	$ 115,126	$ 12	$ (306)	$ 114,832	$ 28,325	$ 86,507

As of March 31, 2018	Amortized Costs	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value	Cash and Cash Equivalents	Short-Term Investments
Cash	$ 16,499	$ —	$ —	$ 16,499	$ 16,499	$ —
Level 1:						
Money market funds	15,204	—	—	15,204	15,204	—
Subtotal	31,703	—	—	31,703	31,703	—
Level 2:						
Commercial paper	13,254	—	(8)	13,246	—	13,246
Corporate debt	70,631	6	(296)	70,341	—	70,341
Municipal securities	3,385	3	(1)	3,387	—	3,387
Asset backed securities	27,063	1	(119)	26,945	—	26,945
Agency bond	4,183	—	(35)	4,148	—	4,148
International government securities	2,497	—	(5)	2,492	—	2,492
Subtotal	121,013	10	(464)	120,559	—	120,559
Total assets	$ 152,716	$ 10	$ (464)	$ 152,262	$ 31,703	$ 120,559

Contractual maturities of investments as of December 31, 2018 are set forth below (in thousands):

	Estimated Fair Value
Due within one year	$ 35,929
Due after one year	50,578
Total	$ 86,507

4. INTANGIBLE ASSETS AND GOODWILL

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

	December 31, 2018			March 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Technology	$ 25,702	$ (14,099)	$ 11,603	$ 19,702	$ (10,535)	$ 9,167
Customer relationships	9,307	(7,732)	1,575	9,776	(7,366)	2,410
Trade names/domains	2,108	(2,013)	95	2,108	(1,727)	381
In-process research and development	95	(95)	—	95	(95)	—

Total acquired identifiable intangible assets	$37,212	$ (23,939)	$13,273	$31,681	$ (19,723)	$11,958

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At December 31, 2018, 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 2019	$1,620
2020	6,100
2021	3,559
2022	1,766
2023	228
Total	$13,273

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

	Total
Balance at March 31, 2018	$40,054
Additions due to acquisitions	500
Foreign currency translation	(1,112)
Balance at December 31, 2018	$39,442

5. COMMITMENTS AND CONTINGENCIES

Facility and Equipment Leases

The Company leases its headquarters' office space in San Jose, California, and also leases office space under non-cancelable operating leases in various domestic and international locations. During the first quarter of fiscal 2019, as it took control of its new corporate headquarters to begin the build out, the Company began to record additional rent expenses on a straight-line basis. Total rent expense for the three and nine months ended December 31, 2018 was $2.6 million and $7.9 million, respectively. Total rent expense for the three and nine months ended December 31, 2017 was $1.4 million and $4.1 million, respectively. Future minimum annual lease payments as of December 31, 2018 were as follows (in thousands):

	Amount
Remaining 2019	$1,476
2020	6,872
2021	8,889
2022	8,782
2023	8,301
Thereafter	54,600
Total	$88,920

The Company has entered into a series of non-cancelable capital lease agreements for data center and office equipment bearing interest at various rates.

Other Commitments, Indemnifications and Contingencies

From time to time, the Company receives inquiries from various 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 from its customers 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. The Company adjusts its accrual when facts relating to specific exposures warrant such adjustment.

During the first nine months of fiscal 2019, the Company determined that additional sales taxes were probable of being assessed and estimable in multiple states as a result of preliminary findings from current sales and use tax audits. As a result, the Company estimated an incremental sales tax liability of $6.5 million, which was recorded as general and administrative expense in the consolidated statements of operations during the first nine months of fiscal 2019.

Legal Proceedings

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The Company from time to time may be involved in a variety of claims, lawsuits, investigations and other proceedings, including patent infringement claims, employment litigation, regulatory compliance matters and contractual disputes, that can arise in the normal course of the Company's operations.
On November 30, 2018, the Company was named as a defendant in Rainey Circuit LLC v. 8x8 Inc., by way of a Complaint filed by Plaintiff Rainey Circuit LLC in the District of Delaware (Civil Action No. Case 1:18-cv-01903-MN, the Complaint). The Complaint alleges that the Company infringes U.S. Patent No. 8,131,824 with regards to alleged activities concerning the Company's sales or or uses of a multimedia messaging system as allegedly implemented in connection with the Company’s Virtual Office application. Given the early stage of this lawsuit, it is not possible as of the date of this filing to provide an estimated amount of any loss or range of loss that may occur.

Litigation is inherently unpredictable and subject to significant uncertainties, and there can be no assurances that favorable final outcomes will be obtained. The above-referenced lawsuit and future litigation could be costly to defend, could impose significant burdens on employees and 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.

6. STOCK-BASED COMPENSATION

The following tables summarize information pertaining to the stock-based compensation expense from stock options and stock awards (in thousands, except weighted-average grant-date fair value and recognition period):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Cost of service revenue	$680	$455	$1,775	$1,319
Research and development	3,570	1,794	8,587	4,445
Sales and marketing	5,590	3,362	13,262	8,577
General and administrative	2,695	2,519	7,950	6,797
Total	$12,535	$8,130	$31,574	$21,138

	Nine Months Ended December 31,	
	2018	2017
Stock options outstanding at the beginning of the period:	3,998	4,462
Options granted	222	427
Options exercised	(641)	(421)
Options canceled and forfeited	(192)	(176)
Options outstanding at the end of the period:	3,387	4,292
Weighted-average fair value of grants during the period	$8.27	$5.30
Total intrinsic value of options exercised during the period	$9,148	$4,312
Weighted-average remaining recognition period at period-end (in years)	2.53	2.14
Stock awards outstanding at the beginning of the period:	5,939	4,950
Stock awards granted	4,993	2,884
Stock awards vested	(2,123)	(1,615)
Stock awards canceled and forfeited	(700)	(447)
Stock awards outstanding at the end of the period:	8,109	5,772
Weighted-average fair value of grants during the period	$20.05	$13.89
Weighted-average remaining recognition period at period-end (in years)	2.4	2.67
Total unrecognized compensation expense at period-end	$112,970	$64,625

Stock Repurchases

In May 2017, the Company's board of directors authorized the Company to purchase up to $25.0 million of its common stock from time to time (the "2017 Repurchase Plan"). The 2017 Repurchase Plan expires when the maximum purchase amount is reached, or upon the earlier revocation or termination by the board of directors. The remaining amount available under the 2017

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Repurchase Plan at December 31, 2018 was approximately $7.1 million. There were no stock repurchases under the 2017 Repurchase Plan during the nine months period ended December 31, 2018.

7. INCOME TAXES

The Company's effective tax rate was -1% and -401% for the three months ended December 31, 2018 and 2017, respectively. The difference in the effective tax rate and the U.S. federal statutory rate was primarily due to the full valuation allowance recorded during the third quarter of fiscal year 2018, the change in pretax profitability, and changes in the Company's geographic mix of profits and losses. The effective tax rate is calculated by dividing the income tax provision by net income (loss) before income tax expense.

8. NET LOSS PER SHARE

The following table summarizes the computation of basic and diluted net loss per share (in thousands, except share and per share data):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Numerator:				
Net loss available to common stockholders	$(23,771)	$(88,520)	$(60,608)	$(91,235)
Denominator:				
Common shares - basic and diluted	95,370	92,029	94,093	91,709
Net loss per share				
Basic and diluted	$(0.25)	$(0.96)	$(0.64)	$(0.99)

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Stock options	3,387	4,292	3,387	4,292
Stock awards	8,109	5,772	8,109	5,772
Total anti-dilutive shares	11,496	10,064	11,496	10,064

9. SEGMENT REPORTING AND GEOGRAPHICAL INFORMATION

Prior to September 30, 2018, the Company had two reporting segments: Americas and Europe. During the third fiscal quarter, the Company instituted a change in its chief operating decision maker ("CODM"). The Company has determined the chief executive officer to be its CODM. The Company’s chief executive officer reviews financial information presented on a consolidated basis for purposes of assessing performance and making decisions on how to allocate resources. Accordingly, the Company has determined that it operates in a single operating segment, and therefore, one reporting segment.

The following tables set forth the geographic information for each period (in thousands):

	Revenue for the Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Americas (principally US)	$80,584	$67,826	$232,549	$195,342
Europe (principally UK)	9,328	7,749	26,270	21,814
	$89,912	$75,575	$258,819	$217,156

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	Property and Equipment	
	December 31, 2018	March 31, 2018
Americas (principally US)	$40,309	$27,270
Europe (principally UK)	7,435	8,462
	$47,744	$35,732

10. ACQUISITIONS

MarianaIQ

On April 12, 2018, the Company entered into an Asset Purchase Agreement with MarianaIQ Inc. (MarianaIQ) for the purchase of certain assets of MarianaIQ to strengthen the artificial intelligence and machine learning capabilities of the Company's X Series product suite.

The Company recorded the acquired developed technology as an identifiable intangible asset with an estimated useful life of two years. The fair value of the technology was based on estimates and assumptions made by management using a cost approach method. The intangible asset is amortized on a straight-line basis over two years.

The excess of the consideration transferred over the aggregate fair value of the asset acquired was recorded as goodwill. The amount of goodwill recognized was primarily attributable to the expected contributions of the acquired assets to the overall corporate strategy in addition to the acquired workforce.

MarianaIQ did not contribute materially to revenue or net loss for the period of acquisition to December 31, 2018. Goodwill recognized upon acquisition is expected to be deductible for income tax purposes.

Jitsi

On October 29, 2018, the Company entered into an Asset Purchase Agreement with Atlassian Corporation PLC (Atlassian) through which the Company purchased certain assets from Atlassian relating to the Jitsi open source video communications technology (Jitsi). The Company intends to integrate Jitsi's video collaboration capabilities into the Company's technology platform to further enhance the Company's video and X Series platform offerings.

The Company recorded the acquired developed technology as an identifiable intangible asset with an estimated useful life of two years. The fair value of the technology was based on estimates and assumptions made by management using a cost approach method. The intangible asset is amortized on a straight-line basis over two years.

The excess of the consideration transferred over the aggregate fair value of the asset acquired was recorded as goodwill. The amount of goodwill recognized was primarily attributable to the expected contributions of the entity to the overall corporate strategy in addition to the acquired workforce.

Jitsi did not contribute materially to revenue or net loss for the period of acquisition to December 31, 2018. Goodwill recognized upon acquisition is expected to be deductible for income tax purposes.

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," "estimate," "predict," "potential," "continue," "strategy," "believe," "anticipate," "plan," "expect," "intend," 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: market acceptance of new or existing services and features; customer acceptance and demand for our cloud communication and collaboration services; changes in the competitive dynamics of the markets in which we compete; the quality and reliability of our services; customer cancellations and rate of churn; our ability to scale our business; customer acquisition costs; our reliance on infrastructure of third-party network services providers; risk of failure in our physical infrastructure; risk of failure of our software; our ability to maintain the compatibility of our software with third-party applications and mobile platforms;

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continued compliance with industry standards and regulatory requirements in the United States and foreign countries in which we make our software solutions available, and the costs of such compliance; risks relating to our strategies and objectives for future operations, including the execution of integration plans and realization of the expected benefits of our acquisitions; the amount and timing of costs associated with recruiting, training and integrating new employees; timing and extent of improvements in operating results from increased spending in marketing, sales, and research and development; timing, extent and outcome of sales and utility tax audits; introduction and adoption of our cloud software solutions in markets outside of the United States; risk of cybersecurity breaches and unauthorized disclosures of customer data; general economic conditions that could adversely affect our business and operating results; implementation and effects of new accounting standards and policies in our reported financial results; and potential future intellectual property infringement claims and other litigation that could adversely affect our business and operating results. For a more detailed description of some of the factors that may cause actual results and trends to differ from those projected in our forward-looking statements, see the discussion under ITEM 1A, "RISK FACTORS," in PART II of this Form 10-Q.

All forward-looking statements included in this report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. The forward-looking statements included in this Form 10-Q are made only as of the date of this report, and we undertake no obligation to update the forward-looking statements to reflect subsequent events or circumstances.

BUSINESS OVERVIEW

A provider of enterprise cloud communications solutions, 8x8 helps businesses get their employees, customers and applications more connected and productive worldwide. From one technology platform, we offer cloud phone, collaboration, conferencing, contact center, data analytics and other services to business customers on a Software-as-a-Service (SaaS) model. Our solutions offer a secure, reliable and simplified approach for businesses to transition their legacy, on-premises communications systems to the cloud. Our comprehensive solution, built from owned core cloud technologies, enables 8x8 customers to rely on a single provider for their global communications, contact center and customer support requirements. Combining these services allows our customers to eliminate information silos and expose vital, real-time communications data spanning multiple services, applications and devices which, in turn, can improve productivity, business performance and the customer experience.

Our customers are spread across more than 150 countries and range from small businesses to large enterprises with more than 10,000 employees. In recent years, we have increased our focus on the mid-market and enterprise customer segments, and in fiscal 2018, we generated a majority of our new subscription services revenue from customers in these business segments.

SUMMARY AND OUTLOOK

Our third quarter results illustrate the fundamental strength in our business as service revenue for the quarter was $85.9 million and grew 20% year-over-year.

We have rolled-out X Series to all business segments in the U.S. and U.K. to help small, mid-market and enterprise businesses connect with customers faster and smarter. We intend to continue investing in X Series, in order to extend its capabilities and enhance existing features.

In October 2018, we announced the acquisition of Jitsi, an open source video collaboration technology, from Atlassian. Jitsi further extends 8x8’s cloud technology platform with scalable video routing and interoperability capabilities, all built on industry standards such as webRTC. Jitsi’s open-source technology and team of video technology personnel are expected to play a leading role in the development of new X Series capabilities, including dedicated video collaboration applications and WebRTC, which we expect to further enhance our 8x8 Meetings service.

We intend to continue to invest in talent, marketing and demand generation activities, product innovation and the global expansion of the X Series for the remainder of fiscal 2019. We expect our operating expenses to grow materially as we continue to invest in accelerating revenue growth. In achieving these objectives, we face many risks, including those described under "RISK FACTORS" below in this Form 10-Q.

RESULTS OF OPERATIONS

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

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Service revenue	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$85,911	$71,891	$14,020	19.5 %
Percentage of total revenue	95.6 %	95.1 %		
Nine months ended	$245,378	$205,105	$40,273	19.6 %
Percentage of total revenue	94.8 %	94.5 %		

Service revenue consists primarily of our cloud communication and collaboration subscription services, and to a lesser extent, usage and professional services fees.

Service revenue increased for the three and nine months ended December 31, 2018 compared with the same period 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 $454 at December 31, 2017 to $506 at December 31, 2018.

We expect service revenue to grow from more customers and increasing service revenue per customer for the remainder of fiscal 2019.

Product revenue	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$4,001	$3,684	$317	8.6 %
Percentage of total revenue	4.4 %	4.9 %		
Nine months ended	$13,441	$12,051	$1,390	11.5 %
Percentage of total revenue	5.2 %	5.5 %		

Product revenue consists of sales of telephones where customers choose to run our cloud communication services on these devices.

Product revenue increased during the three and nine months ended December 31, 2018 compared with the same period in the prior fiscal year, primarily due to an increase in equipment unit sales to customers.

No customer represented greater than 10% of the Company's total revenues for the three and nine months ended December 31, 2018 or 2017.

Cost of service revenue	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$17,043	$12,318	$4,725	38.4 %
Percentage of service revenue	19.8 %	17.1 %		
Nine months ended	$47,988	$36,737	$11,251	30.6 %
Percentage of service revenue	19.6 %	17.9 %		

The cost of service revenue primarily consists of costs associated with network operations and personnel and related costs, communication origination and termination services provided by third-party carriers, amortization of acquired and internally developed software, and technology licenses.

Cost of service revenue for the three months ended December 31, 2018 increased over the same period in the prior fiscal year and faster than revenue growth primarily due to a $2.2 million increase in amortization of intangibles and capitalized software expenses, a $0.6 million increase in consulting and outside services, and a $0.4 million increase in third-party network services expenses.

Cost of service revenue for the nine months ended December 31, 2018 increased over the same period in the prior fiscal year and faster than revenue growth primarily due to a $5.4 million increase in amortization of intangibles and capitalized software expenses, a $1.3 million increase in third-party network services expenses, a $0.9 million increase in consulting and outside services, $0.9 million increase in personnel and related costs, and a $0.8 million increase in licenses and fees expenses.

We expect cost of service revenue to remain at a similar percentage of service revenue during the remainder of fiscal year 2019.

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Cost of product revenue	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$5,318	$4,675	$643	13.8 %
Percentage of product revenue	132.9 %	126.9 %		
Nine months ended	$16,996	$14,657	$2,339	16.0 %
Percentage of product revenue	126.4 %	121.6 %		

The cost of product revenue consists primarily of telephones, estimated warranty obligations and direct and indirect costs associated with product purchasing, shipping and handling.

The cost of product revenue for the three and nine months ended December 31, 2018 increased over the comparable period in the prior fiscal year primarily due to the increase in the number of telephones shipped to customers. The increase in negative margin was due to the consistent practice of discounting of phones in the current period.

Research and development	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$16,876	$8,527	$8,349	97.9 %
Percentage of total revenue	18.8 %	11.3 %		
Nine months ended	$43,919	$24,781	$19,138	77.2 %
Percentage of total revenue	17.0 %	11.4 %		

Research and development expenses consist primarily of personnel and related costs, consulting, and equipment costs necessary for us to conduct our development and engineering efforts.

The research and development expenses for the three months ended December 31, 2018 increased over the comparable period in the prior fiscal year primarily due to a $2.1 million increase in personnel and related costs (partially related to a department reclassification from sales and marketing), net of costs capitalized in accordance with accounting standard ASC 350-40, a $2.0 million increase in consulting and outside services, a $1.8 million increase in stock-based compensation expense, as well as other smaller cost increases.

The research and development expenses for the nine months ended December 31, 2017 increased over the comparable period in the prior fiscal year primarily due to a $6.3 million increase in personnel and related costs (partially related to a department reclassification from sales and marketing), net of costs capitalized in accordance with ASC 350-40, a $4.7 million increase in consulting and outside services, a $3.9 million increase in stock-based compensation expenses, a $1.1 million increase in purchased software expenses, as well as other smaller cost increases.

We expect research and development expenses to increase as a percentage of total revenue during the remainder of fiscal year 2019 as we continue to invest in our technology platform and product offerings.

Sales and marketing	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$60,717	$48,830	$11,887	24.3 %
Percentage of total revenue	67.5 %	64.6 %		
Nine months ended	$169,952	$131,103	$38,849	29.6 %
Percentage of total revenue	65.7 %	60.4 %		

Sales and marketing expenses consist primarily of personnel and related costs for sales, marketing, and customer service which includes deployment engineering. Such costs also include 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 three months ended December 31, 2018 increased over the comparable period in the prior fiscal year primarily due to a $5.6 million increase in personnel and related costs (partially offset by a department reclassification to research and development), a $3.0 million increase in marketing expenses, a $2.2 million increase in stock-based compensation costs, and a $0.8 million increase in consulting, temporary personnel, and outside services, as well as other smaller cost increases.

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Sales and marketing expenses for the nine months ended December 31, 2018 increased over the comparable period in the prior fiscal year primarily due to a $15.6 million increase in personnel and related costs (partially offset by a department reclassification to research and development), a $7.5 million increase in marketing expenses, a $4.8 million increase in stock-based compensation costs, a $2.9 million increase in consulting, temporary personnel, and outside services, as well as other smaller cost increases.
We expect sales and marketing expenses to increase as a percentage of total revenue during the remainder of fiscal year 2019.

General and administrative	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$14,196	$10,003	$4,193	41.9 %
Percentage of total revenue	15.8 %	13.2 %		
Nine months ended	$42,172	$28,575	$13,597	47.6 %
Percentage of total revenue	16.3 %	13.2 %		

General and administrative expenses consist primarily of personnel and related costs for finance, human resources, legal and general management, as well as professional services fees.
General and administrative expenses for the three months ended December 31, 2018 increased over the comparable period in the prior fiscal year primarily due to a $1.7 million increase related to personnel and related costs, $1.5 million increase in sales and use tax expense, $1.2 million increase in rent expense related to our new headquarters, which we started to build out during the first quarter of fiscal 2019, as well as other smaller cost increases.
General and administrative expenses for the nine months ended December 31, 2018 increased over the comparable period in the prior fiscal year primarily due to a $6.5 million increase in sales and use tax expense, a $3.8 million increase related to personnel and related costs, a $3.6 million increase in rent expense related to our new headquarters, which we started to build out during the first quarter of fiscal 2019, as well as other smaller cost increases.
We expect general and administrative expenses to remain at a similar level as a percentage of total revenue during the remainder of fiscal year 2019.

Impairment of goodwill, intangible assets and equipment	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three and nine months ended	$—	$9,469	$(9,469)	(100.0)%

In the third quarter of fiscal 2018, we recorded a $9.5 million impairment charge for goodwill and other assets associated with DXI.

Other income, net	December 31, 2018	2017	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$579	$569	$10	1.8 %
Percentage of total revenue	0.6 %	0.8 %		
Nine months ended	$1,933	$3,084	$(1,151)	(37.3)%
Percentage of total revenue	0.7 %	1.4 %		

Other income, net, primarily consisted of interest income earned on our cash, cash equivalents and investments, as well as foreign exchange gains or losses. During the first quarter of fiscal year 2018, $1.4 million of the cash held in an escrow fund from our 2015 acquisition of DXI was returned to us and recorded as other income.

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Provision for income tax	December 31, 2018	2017	Dollar Change
	(dollar amounts in thousands)		
Three months ended	$112	$70,842	$(70,730)
Percentage of loss before provision for income taxes	-0.5 %	-400.7 %	
Nine months ended	$333	$66,153	(65,820)
Percentage of loss before provision for income taxes	-0.6 %	-263.7 %	

For the three months and nine months ended December 31, 2018, we recorded income tax expense of $0.1 million and $0.3 million, respectively, related to state minimum taxes and income from our foreign operations. For the three months and nine months ended December 31, 2017, we recorded income tax expense of $70.8 million and $66.1 million, respectively, mostly related to the recording of a full valuation allowance established against our deferred tax assets in the period ended December 31, 2017.

Our effective tax rate was -0.5% and -0.6% for the three months ended December 31, 2018 and 2017, respectively. The change in our effective tax rate was due primarily to the full valuation allowance recorded in fiscal 2018, the change in pretax profitability, and the geographic mix of profits and losses.

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

Liquidity and Capital Resources

As of December 31, 2018, we had $123 million in cash, restricted cash, cash equivalents and short-term investments. Net cash used in operating activities for the nine months ended December 31, 2018 was $6.7 million, compared to cash provided by operating activities of $19.4 million for the nine months ended December 31, 2017. Net cash provided by operating activities has historically been affected by the amount of net income (loss), changes in working capital accounts particularly in the timing and collection of payments, add-backs of non-cash expense items such as impairments, depreciation and amortization, and stock-based compensation.

Net cash provided by investing activities for the nine months ended December 31, 2018 was $4.7 million, during which we had proceeds from maturity and sale of short-term investments of approximately $34.3 million, net of purchases of short-term investments, we capitalized $18.2 million of software costs in accordance with ASC 350-40, and we spent $5.8 million on the purchase of property and equipment. Net cash used in investing activities for the nine months ended December 31, 2017 was $9.2 million, during which we had proceeds from maturity and sale of short-term investments of $4.6 million, net of purchases of short-term investments. We spent approximately $6.5 million on the purchase of property and equipment, and we capitalized $8.7 million of internal use software. Investing activities also include a gain of $1.4 million from the settlement of an escrow fund from our 2015 acquisition of DXI.

Net cash used in financing activities for the nine months ended December 31, 2018 was $1.0 million, which primarily consisted of $7.4 million of cash received from the issuance of common stock under our employee stock plans and $7.6 million of repurchases of our common stock related to shares withheld for payroll taxes. Net cash used in financing activities for the nine months ended December 31, 2017 was $19.8 million, which primarily consisted of by $22.1 million of repurchases of our common stock related to shares withheld for payroll taxes, offset by $3.3 million of cash received from the issuance of common stock under our employee stock plans.

Contractual Obligations

There were no significant changes in our commitments under contractual obligations during the nine months ended December 31, 2018, as disclosed in the Company's Annual Report on Form 10-K, for the year ended March 31, 2018.

CRITICAL ACCOUNTING POLICIES & ESTIMATES

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The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, 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. There have been no significant changes during the three months ended December 31, 2018 to our critical accounting policies and estimates previously disclosed in our Form 10-K for the fiscal year ended March 31, 2018, except for our adoption of ASC 606 as discussed in Notes 1 and 2 of the Notes to the Consolidated Financial Statements.

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."

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Fluctuation Risk

The primary objective of our investment activities is to preserve principal while generating 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 shorter term 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 hypothetical change in interest rates of 100 basis points would have a significant impact on our interest income.

We do not have any outstanding debt instruments other than equipment under capital leases and, therefore, we did not have direct funding exposure to interest rate risks.

Foreign Currency Exchange Risk

We have foreign currency risks related to our revenue and operating expenses denominated in currencies other than the U.S. dollar, primarily the British Pound, causing both our revenue and our operating results to be impacted by fluctuations in the exchange rates.

Gains or losses from the translation of certain cash balances, accounts receivable balances and intercompany balances that are denominated in non-US dollar currencies impact our net income (loss). A hypothetical decrease in all foreign currencies against the US dollar of 10 percent, would not result in a material foreign currency loss on foreign-denominated balances. As our foreign operations expand, our results may be more impacted by fluctuations in the exchange rates of the currencies in which we do business.

To date we have not, but we may in the future, enter into financial instruments to hedge our foreign currency exchange risk.

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,

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our Chief Executive Officer and our Chief Financial Officer have concluded that our Disclosure Controls were effective as of December 31, 2018.

Limitations on the Effectiveness of Controls

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

Changes in Internal Control over Financial Reporting

During the third quarter of fiscal year 2019, 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

The information set forth in Note 5, “Legal Proceedings” under ITEM 1. FINANCIAL STATEMENTS of PART I is incorporated by reference in response to this item.

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ITEM 1A. RISK FACTORS

The risks and uncertainties described below in this Quarterly Report on Form 10-Q update the discussion of risks and uncertainties disclosed in our annual report on Form 10-K for the fiscal year ended March 31, 2018, which we filed with the Securities and Exchange Commission on May 30, 2018. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that adversely affect our business. If any of the risks described below, or others not specified below, materialize, our business, financial condition and results of operations could be materially adversely affected, which may, in turn, adversely impact the trading price of our common stock.

Our success depends on acquiring new customers, and retaining and selling additional services to existing customers.

Our future success depends on our ability to significantly increase revenue generated from sales of our cloud software solutions to business customers, including small and mid-size businesses (SMBs) and mid-market and larger enterprises. To increase our revenue, we must add new customers and encourage existing customers to continue their subscriptions (on terms favorable to us), increase their usage of our services, and/or purchase additional services from us. For customer demand and adoption of our cloud communications solutions to grow, the quality, cost and feature benefits of these services must compare favorably to those of competing services. For example, our cloud unified communications and contact center services must continue to evolve so that high-quality service and features can be consistently offered at competitive prices. As our target markets mature, or as competitors introduce lower cost and/or more differentiated products or services that compete or are perceived to compete with ours, we may be unable to renew or extend our agreements with existing customers or attract new customers, or new business from existing customers, on favorable terms, or at all, which could have an adverse effect on our revenue and growth.

The rate at which our existing customers purchase any new or enhanced services we may offer depends on a number of factors, including general economic conditions, the importance of these additional features and services to our customers, the quality and performance of our cloud communications solutions, and the price at which we offer them. If our customers react negatively to our new or enhanced service offerings, such as our recently launched X Series suite of products, or our efforts to upsell are otherwise not as successful as we anticipate, our business may suffer. Our sales strategies must also continue to evolve and adapt as our market matures, for example through the offering of additional customer self-service tools and automation for the SMB segment and the development of new and more sophisticated sales channels that leverage the strengths of our partners. In addition, marketing and selling new and enhanced features and services may require increasingly sophisticated and costly sales and marketing efforts that may require us to incur additional expenses and negatively impact the results of our operations.

To support the successful marketing and sale of our services to new and existing customers, we must continue to offer high-quality training, implementation, and customer support. Providing these services effectively requires that our customer support personnel have industry-specific technical knowledge and expertise, which may make it difficult and costly for us to locate and hire qualified personnel, particularly in the competitive labor market in Silicon Valley where we are headquartered. Our support personnel also require extensive training on our products, which may make it difficult to scale up our support operations rapidly or effectively. The importance of high-quality customer support will increase as we expand our business globally and pursue new mid-market and enterprise customers. If we do not help our customers quickly resolve post-implementation issues and provide effective ongoing support, our ability to sell additional features and services to existing customers will suffer and our reputation may be harmed.

If the emerging market for cloud communications services does not continue to grow and if we do not increase our market share, our future business could be harmed.

The market for cloud communications services is evolving rapidly and is characterized by an increasing number of market entrants. As is typical of a rapidly evolving industry, the demand for and market acceptance of, cloud communications services is uncertain. Our success will depend to a substantial extent on the widespread adoption of cloud communications services as a replacement for legacy on-premise systems. Many larger organizations have invested substantial technical and financial resources and personnel to integrate legacy on-premise communications systems into their businesses and, therefore, may be reluctant or unwilling to migrate to cloud communications services such as ours. It is difficult to predict client adoption rates and demand for our solution, the future growth rate and size of the cloud communications service market, or the entry of competitive products and services. The expansion of the cloud communications services market depends on a number of factors, including the refresh rate for legacy on-premise systems, cost, performance and perceived value associated with cloud communications services, as well as the ability of providers of cloud communications solutions to address security, stability and privacy concerns. If we or other cloud communications service providers experience security incidents, loss of client data, disruptions in service or other problems, the market for cloud communications services as a whole, including our services, may be harmed. If the demand for cloud communications services fails to develop or develops more slowly than we anticipate, it could significantly harm our business.

Our success in the cloud communications market depends in part on developing and maintaining effective distribution channels. If we fail to develop and maintain these channels, it could harm our ability to increase our revenues.

A portion of our revenue is generated through our direct sales. This channel consists of sales agents—generally consisting of inside and field-based sales agents—that market and sell our services products to customers. Our future success requires continuing to develop and maintain a successful direct sales organization that identifies and closes a significant portion of sales opportunities in the market for cloud communications services. If we fail to do so, or if our sales agents are not successful in their sales efforts, we may be unable to meet our revenue growth targets.

A portion of our business revenue is generated through indirect channel sales. These channels consist of master agents, independent software vendors (ISVs), system integrators, value-added resellers (VARs), and service providers. We typically contract directly with the end customer and use these channel partners to identify, qualify and manage prospects throughout the sales cycle—although we also have arrangements with a number of partners who resell our services to their own customers, with whom we do not contract or contract only to a limited extent. These channels may generate an increasing portion of our revenue in the future. Our continued success requires continuing to develop and maintain successful relationships with these channel partners and increasing the portion of sales opportunities that they refer to us. If we fail to do so, or if our channel partners are not successful in their sales efforts, we may be unable to meet our revenue growth targets.

As more of our sales efforts are targeted at enterprise customers, our sales cycle has become more time-consuming and expensive, we may encounter pricing pressure and implementation and customization challenges, and may have to delay revenue recognition for some complex transactions, all of which could harm our business and operating results.

We currently derive a majority of our revenues from sales of our cloud software solutions to mid-market and larger enterprises, and we believe that increasing our sales to these customers is key to our future growth. Our sales cycle, which is the time between initial contact with a potential customer and the ultimate sale to that customer, is often lengthy and unpredictable for larger enterprise customers. Many of our prospective enterprise customers do not have prior experience with cloud-based communications and, therefore, typically spend significant time and resources evaluating our solutions before they purchase from us. Similarly, we typically spend more time and effort determining their requirements and educating these customers about the benefits and uses of our solutions. Enterprise customers also tend to demand more customizations, integrations and additional features than SMB customers. As a result, we may be required to divert more sales and engineering resources to a smaller number of large transactions than we have in the past, which means that we will have less personnel available to support other segments, or that we will need to hire additional personnel, which would increase our operating expenses.

It is often difficult for us to forecast when a potential enterprise sale will close, the size of the customer's initial service order and the period over which the implementation will occur, any of which may impact the amount of revenue we recognize or the

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timing of revenue recognition. Enterprise customers may delay their purchases from one quarter to another as they assess their budget constraints, negotiate early contract terminations with their existing providers or wait for us to develop new features. Any delay in closing, or failure to close, a large enterprise sales opportunity in a particular quarter or year could significantly harm our projected growth rates and cause the amount of new sales we book to vary significantly from quarter to quarter. We also may have to delay revenue recognition on some of these transactions until the customer's technical or implementation requirements have been met.

In some cases, we may enter into a contract with a large enterprise customer, such as a preferred vendor agreement, that has little or no minimum purchase commitment but establishes the terms on which the customer's affiliates, clients or franchisees (as the case may be) may order services from us in the future. We may expend significant time and resources becoming a preferred vendor without booking significant sales from the opportunity until months or years after we sign the initial agreement. If we are unsuccessful in selling our services to the prospective purchasers under these agreements, we may not recognize revenue in excess of the expenses we incur in pursuing these opportunities, which could adversely impact our results of operations and cash flow.

We face significant risks in implementing and supporting the services we sell to mid-market and larger enterprises and, if we do not manage these efforts effectively, our recurring service revenue may not grow at the rate we expected, and our business and results of operations could be materially and adversely affected.

We have a limited history of selling our services to larger businesses and have experienced, and may continue to experience, new challenges in configuring and providing ongoing support for the solutions we sell to large customers. Larger customers' networks are often more complex than those of smaller customers, and the configuration of our services for these customers generally require participation from the customer’s information technology (IT) team. There is no guarantee that the customer will make available to us the necessary personnel and other resources for a successful configuration of services. The lack of local resources may prevent us from properly configuring our services for the customer, which can in turn adversely impact the quality of services that we deliver over our customers' networks, and/or may result in delays in the implementation of our services. This may create a public perception that we are unable to deliver high quality of service to our customers, which could harm our reputation and make it more difficult to attract new customers and retain existing customers. Moreover, larger customers tend to require higher levels of customer service and individual attention (including periodic business reviews and in-person visits, for example), which may increase our costs for implementing and delivering services. If a customer is unsatisfied with the quality of services we provide or the quality of work performed by us or a third party, we may decide to incur costs beyond the scope of our contract with the customer in order to address the situation and protect our reputation, which may in turn reduce or eliminate the profitability of our contract with the customer. In addition, negative publicity related to our larger customer relationships, regardless of its accuracy, could harm our reputation and make it more difficult for us to compete for new business with current and prospective customers.

We also face challenges building and training an integrated sales force capable of addressing the services and features of our comprehensive product suite, as well as a staff of expert engineering and customer support personnel capable of addressing the full range of implementation and configuration issues that tend to arise more frequently with larger customers. Also, we have only limited experience in developing and managing sales channels and distribution arrangements for larger businesses. If we fail to effectively execute the sale, configuration and ongoing support of our services to mid-market and larger enterprises, our results of operations and our overall ability to grow our customer base could be materially and adversely affected.

Intense competition in the markets in which we compete could prevent us from increasing or sustaining our revenue growth and increasing or maintaining profitability.

The cloud communications industry is competitive, and we expect it to become increasingly competitive in the future. We may also face competition from companies in adjacent or overlapping industries.

In connection with our unified communication services, we face competition from other providers of cloud communication services, such as RingCentral, Fuze, Vonage, Dialpad, Nextiva and Shoretel (acquired by Mitel in 2017). In connection with our cloud contact center services, we face competition from other providers of cloud and premise-based contact center software services, such as NICE/inContact, Five9 and Interactive Intelligence.

In addition, because many of our target customers have historically purchased communications services from incumbent telephone companies along with legacy on-premises communication equipment, we compete with these customers' existing providers. These competitors include, for example, AT&T, CenturyLink, Comcast and Verizon Communications in the United States, as well as local incumbent communications providers in the international markets where we operate, such as Vodafone, Telefonica, Orange, America Movil and Deutsche Telekom, all in conjunction with on-premises hardware solutions from companies like Avaya, Cisco and Mitel. We may face competition from large Internet and cloud service companies such as Google Inc., Amazon Inc., Oracle Corporation and Microsoft Corporation, any of which might launch a new cloud-based business communications service, expand its existing offerings or acquire other cloud-based business communications companies in the future.

Many of our current and potential competitors have longer operating histories, significantly greater resources and brand awareness, and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers. They also may adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products. Our competitors may also offer bundled service arrangements that present a more differentiated or better integrated product to customers. Increased competition could require us to lower our prices, reduce our sales revenue, lower our gross profits and/or cause us to lose market share. In addition, many of our customers are not subject to long-term contractual commitments and have the ability to switch from our services to our competitors' offerings on relatively short notice. Given the significant price competition in the markets for our services, we may be at a disadvantage compared with those competitors who have substantially greater resources than us or may otherwise be better positioned to withstand an extended period of downward pricing pressure. The adverse impact of a shortfall in our revenues may be magnified by our inability to adjust our expenses to compensate for such shortfall. Announcements, or expectations, as to the introduction of new products and technologies by our competitors or us could cause customers to defer purchases of our existing products, which also could have a material adverse effect on our business, financial condition or operating results.

The market for cloud software solutions is subject to rapid technological change, and we depend on new product and service introductions in order to maintain and grow our business, including in particular our recently launched X Series product line.

We operate in an emerging market that is characterized by rapid changes in customer requirements, frequent introductions of new and enhanced products and services, and continuing and rapid technological advancement. To compete successfully in this emerging market, we must continue to design, develop, manufacture, and sell highly scalable new and enhanced cloud software solutions products and services that provide higher levels of performance and reliability at lower cost. If we are unable to develop new products and services that address our customers' needs, to deliver our cloud software solutions applications in one seamless integrated product offering that addresses our customers' needs, or to enhance and improve our products and services in a timely manner, we may not be able to achieve or maintain adequate market acceptance of our services. Our ability to grow is also subject to the risk of future disruptive technologies. Access and use of our products and services is provided via the cloud, which, itself, has been disruptive to the previous premises-based model.

If new technologies emerge that are able to deliver communications and collaboration solutions services at lower prices, more efficiently, more conveniently or more securely, such technologies could adversely impact our ability to compete.

If we are unable to develop new features and services internally due to factors such as competitive labor markets, high employee turnover, lack of management ability or a lack of other research and development resources, we may miss market opportunities. Further, many of our competitors have historically spent a greater amount of funds on their research and development programs, and those that do not may be acquired by larger companies that would allocate greater resources to our competitors' research and development programs. In addition, there is no guarantee that our research and development efforts will succeed, or that our new products and services will enable us to maintain or grow our revenue or recover our development costs. Our failure to maintain adequate research and development resources, to compete effectively with the research and development programs of our competitors and to successfully monetize our research and development efforts could materially and adversely affect our business and results of operations.

We launched our new product line, branded "X Series," in June 2018. We market X Series as an array of packaged offerings (designated X2, X4, etc.), which start at the most basic version of our unified communications solution, and add engagement capabilities at each new level, with the top-tier X Series packages combining unified communications and contact center services into a single offering. Customer demand for our X Series product line will depend on a number of factors, including, for example, factors inherent to the product itself, such as quality of service, reliability, feature availability, and ease of use; and factors relating to our ability to implement, support and market and sell the service effectively. More fundamentally, the success of X Series may depend on whether the market for unified communications, collaborations and contact center services is trending towards convergence of these three solutions into a single system, as we are predicting. We cannot be certain that this market trend will occur according to the timeline we are expecting, or at all. For example, if the various components of our service were to become commoditized and standardized in a way that diminishes the benefits of a single platform for customers, there may be less demand for a unified suite of services like X Series. Low customer demand could make it more difficult for us to win the business of new customers or gain additional business from existing customers, either of which in turn could cause our service revenue to grow more slowly than we expect, or to remain flat or even decrease in future periods.

We have a history of losses and are uncertain of our future profitability.

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We recorded an operating loss of approximately $60 million for the nine months ended December 31, 2018 and ended the period with an accumulated deficit of approximately $222 million. We expect to continue to incur operating losses in the near future as we continue to invest in growth. As we expand our geographic reach and range of service offerings, and further invest in research and development, sales and marketing, and other areas of our business, we will need to increase revenues in order to generate and sustain operating profitability. Given our history of fluctuating revenues and operating losses, we cannot be certain that we will be able to achieve or maintain operating profitability on an annual basis or on a quarterly basis in the future.

Our churn rate may increase in future periods due to customer cancellations or other factors, which may adversely impact our revenue or require us to spend more money to grow our customer base.

Our customers may discontinue their subscriptions for our services after the expiration of their initial subscription period, which typically range from one to four years. In addition, our customers may renew for lower subscription amounts or for shorter contract lengths. We may not accurately predict cancellation rates for our customers. Our cancellation rates may increase or fluctuate as a result of a number of factors, including customer usage, pricing changes, number of applications used by our customers, customer satisfaction with our service, the acquisition of our customers by other companies, the availability of alternative technologies, and deteriorating general economic conditions. If our customers do not renew their subscriptions for our service or decrease the amount they spend with us, our revenue will decline and our business will suffer.

Our average monthly business service revenue churn was less than 1% during our two most recent fiscal years. Our method of computing this revenue churn rate may be different from methods used by our competitors and other companies in our industry to compute their publicly disclosed churn rates. As a result, only limited reliance can be placed on our churn rate when attempting to compare it with other companies.

Because of churn, we must acquire new customers on an ongoing basis to maintain our existing level of customers and revenues. As a result, marketing expenditures are an ongoing requirement of our business. If our churn rate increases, we will have to acquire even more new customers in order to maintain our existing revenues. We incur significant costs to acquire new customers, and those costs are an important factor in determining our net profitability. Therefore, if we are unsuccessful in retaining customers or are required to spend significant amounts to acquire new customers beyond those budgeted, our revenue could decrease and our net loss could increase.

Our rate of customer cancellations may increase in future periods due to a number of factors, some of which are beyond our control, such as the financial condition of our customers or the state of credit markets. In addition, a single, protracted service outage or a series of service disruptions, whether due to our services or those of our carrier partners, may result in a sharp increase in customer cancellations.

Due to the length of our sales cycle, especially in adding new mid-market and larger enterprises as customers, we may also experience delays in acquiring new customers to replace those that have terminated our services. Such delays would be exacerbated if general economic conditions worsen. An increase in churn, particularly in challenging economic times, could have a negative impact on the results of our operations.

We may not be able to scale our business efficiently or quickly enough to meet our customers' growing needs, in which case our operating results could be harmed.

As usage of our cloud software solutions by mid-market and larger enterprises expands and as customers continue to integrate our services across their enterprises, we are required to devote additional resources to improving our application architecture, integrating our products and applications across our technology platform, integrating with third-party systems, and maintaining infrastructure performance. To the extent we increase our customer base and as our customers gain more experience with our services, the number of users and transactions managed by our services, the amount of data transferred, processed and stored by us, the number of locations where our service is being accessed, and the volume of communications managed by our services have in some cases, and may in the future, expand rapidly. In addition, we will need to appropriately scale our internal business systems and our services organization, including customer support and services and regulatory compliance, to serve our growing customer base. Any failure of or delay in these efforts could cause impaired system performance and reduced customer satisfaction. These issues could reduce the attractiveness of our cloud software solutions to customers, resulting in decreased sales to new customers, lower renewal rates by existing customers, the issuance of service credits, or requested refunds, which could hurt our revenue growth and our reputation. These system upgrades and the expansion of our support and services have been and will continue to be expensive and complex, requiring management time and attention and increasing our operating expenses. We could also face inefficiencies or operational failures as a result of our efforts to scale our infrastructure and information technology systems. There are inherent risks associated with upgrading, improving and expanding our information technology systems and we cannot be sure that the expansion and improvements to our infrastructure and systems will be fully or effectively implemented on a timely basis, if at all. These efforts may reduce revenue and our margins and adversely impact our financial results.

To provide our services, we rely on third parties for all of our network connectivity and co-location facilities.
We currently use the infrastructure of third-party network service providers, including the services of Equinix, Inc. and CenturyLink, Inc. in the United States, to provide all of our cloud services over their networks rather than deploying our own network connectivity.
We also rely on third-party network service providers to originate and terminate substantially all of the PSTN calls using our cloud-based services. We leverage the infrastructure of third-party network service providers to provide telephone numbers, PSTN call termination and origination services, and local number portability for our customers rather than deploying our own network throughout the United States and internationally. This decision has resulted in lower capital and operating costs for our business in the short-term, but has reduced our operating flexibility and ability to make timely service changes. If any of these network service providers cease operations or otherwise terminate the services that we depend on, the delay in switching our technology to another network service provider, if available, and qualifying this new service provider could have a material adverse effect on our business, financial condition or operating results. The rates we pay to our network service providers may also increase, which may reduce our profitability and increase the retail price of our service.
There can be no assurance that these service providers will be able or willing to supply cost-effective services to us in the future or that we will be successful in signing up alternative or additional providers. Although we believe that we could replace our current providers, if necessary, our ability to provide service to our subscribers could be impacted during any such transition, which could have an adverse effect on our business, financial condition or results of operations. The loss of access to, or requirement to change, the telephone numbers we provide to our customers also could have a material adverse effect on our business, financial condition or operating results.
Due to our reliance on these service providers, when problems occur in a network, it may be difficult to identify the source of the problem. The occurrence of hardware and software errors, whether caused by our service or products or those of another vendor, may result in the delay or loss of market acceptance of our products and any necessary revisions may force us to incur significant expenses. Under the terms of the "end-to-end" service level commitments that we make for the benefit of qualifying customers, we are potentially at risk for service problems experienced by these service providers. Customers who do not qualify for these enhanced service level commitments may nevertheless hold us responsible for these service issues and seek service credits, early termination rights or other remedies. Accordingly, service issues experienced by our service provider partners may harm our reputation as well as our business, financial condition or operating results.
Internet access providers and Internet backbone providers may be able to block, degrade or charge for access to or bandwidth use of certain of our products and services, which could lead to additional expenses and the loss of users.
Our products and services depend on the ability of our users to access the Internet, and certain of our products require significant bandwidth to work effectively. In addition, users who access our services and applications through mobile devices, such as smartphones and tablets, must have a high-speed connection, such as Wi-Fi, 3G, 4G or LTE, to use our services and applications. Currently, this access is provided by companies that have significant and increasing market power in the broadband and Internet access marketplace, including incumbent telephone companies, cable companies and mobile communications companies. Some of these providers offer products and services that directly compete with our own offerings, which give them a significant competitive advantage. Some of these broadband providers have stated that they may exempt their own customers from data-caps or offer other preferred treatment to their customers. Other providers have stated that they may take measures that could degrade, disrupt or increase the cost of user access to certain of our products by restricting or prohibiting the use of their infrastructure to support or facilitate our offerings, or by charging increased fees to us or our users to provide our offerings, while others, including some of the largest providers of broadband Internet access services, have committed to not engaging in such behavior. These providers have the ability generally to increase their rates, which may effectively increase the cost to our customers of using our cloud software solutions.
On January 4, 2018, the Federal Communications Commission, or FCC, released an order that largely repeals rules that the FCC had in place which prevented broadband internet access providers from degrading or otherwise disrupting a broad range of services provisioned over consumers' and enterprises' broadband Internet access lines. The FCC's order became effective on June 11, 2018. The order has been appealed by numerous parties including: a number

of state attorneys' general, public interest groups, associations, and companies. The appeal is before the U.S. Court of Appeals for the District of Columbia. We cannot predict whether the FCC's January 4, 2018 order (the "January 4, 2018 Order") will withstand appeal, either in whole or in part, nor when the appeal will be resolved.

Following the adoption of the January 4, 2018 Order, a number of states have passed laws establishing rules similar to those that existed prior to the effective date of the January 4, 2018 Order. States have adopted a variety of approaches in attempting to preserve the rules in place prior to the FCC Order. For example, some states have passed narrow laws where rules addressing degradation or otherwise disrupting the provision of broadband internet access services are limited to parties that offer services

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to government agencies whereas other states have passed laws that apply generally. For example, California passed legislation of general applicability that would prevent providers of broadband internet access services from degrading and disrupting such services when offered to third parties. The law’s effective date was January 1, 2019.

There is legal uncertainty as to whether states that have passed such laws have the authority to do so if such laws could be interpreted to conflict with the January 4, 2018, Order. Due to this legal uncertainty, the U.S. Department of Justice filed a Motion for Preliminary Injunction on September 30, 2018, seeking to prevent California from enforcing its law set to become effective January 1, 2019. In response, California state officials have agreed to delay enforcement of the new law at least until appeal of the January 4, 2018, Order is resolved by the U.S. Court of Appeals for the District of Columbia Circuit.

Many of the largest providers of broadband services, like cable companies and traditional telephone companies, have publicly stated that they will not degrade or disrupt their customers' use of applications and services, like ours. If such providers were to degrade, impair or block our services, it would negatively impact our ability to provide services to our customers, likely result in lost revenue and profits, and we would incur legal fees in attempting to restore our customers' access to our services. Broadband internet access providers may also attempt to charge us or our customers additional fees to access services like ours that may result in the loss of customers and revenue, decreased profitability, or increased costs to our offerings that may make our services less competitive. We cannot predict the potential impact of the January 4, 2018, Order on us at this time.

Our physical infrastructure is concentrated in a few facilities and any failure in our physical infrastructure or services could lead to significant costs and disruptions and could reduce our revenue, harm our business reputation and have a material adverse effect on our financial results.

Our leased network and data centers are subject to various points of failure. Problems with cooling equipment, generators, uninterruptible power supply, routers, switches, or other equipment, whether or not within our control, could result in service interruptions for our customers as well as equipment damage. Because our services do not require geographic proximity of our data centers to our customers, our infrastructure is consolidated into a few large data center facilities. Any failure or downtime in one of our data center facilities could affect a significant percentage of our customers. The total destruction or severe impairment of any of our data center facilities could result in significant downtime of our services and the loss of customer data. Because our ability to attract and retain customers depends on our ability to provide customers with highly reliable service, even minor interruptions in our service could harm our reputation. Additionally, in connection with the expansion or consolidation of our existing data center facilities from time to time, there is an increased risk that service interruptions may occur as a result of server relocation or other unforeseen construction-related issues.

We have experienced interruptions in service in the past. While we have not experienced a material increase in customer attrition following these events, the harm to our reputation is difficult to assess. We have taken and continue to take steps to improve our infrastructure to prevent service interruptions, including upgrading our electrical and mechanical infrastructure. However, service interruptions continue to be a significant risk for us and could materially impact our business.

Any future service interruptions could:

- cause our customers to seek service credits, or damages for losses incurred;
- require us to replace existing equipment or add redundant facilities;
- affect our reputation as a reliable provider of communications services;
- cause existing customers to cancel or elect to not renew their contracts; or
- make it more difficult for us to attract new customers.

Any of these events could materially increase our expenses or reduce our revenue, which would have a material adverse effect on our operating results.

We may be required to transfer our servers to new data center facilities in the event that we are unable to renew our leases on acceptable terms, or at all, or the owners of the facilities decide to close their facilities, and we may incur significant costs and possible service interruption in connection with doing so. In addition, any financial difficulties, such as bankruptcy or foreclosure, faced by our third-party data center operators, or any of the service providers with which we or they contract, may have negative effects on our business, the nature and extent of which are difficult to predict. Additionally, if our data centers are unable to keep up with our increasing needs for capacity, our ability to grow our business could be materially and adversely impacted.

We depend on third-party vendors for IP phones and software endpoints, and any delay or interruption in supply by these vendors would result in delayed or reduced shipments to our customers and may harm our business.

We rely on third-party vendors for IP phones and software endpoints required to utilize our service. We currently do not have long-term supply contracts with any of these vendors. As a result, most of these third-party vendors are not obligated to provide products or services to us for any specific period, in any specific quantities or at any specific price, except as may be provided in a particular purchase order. The inability of these third-party vendors to deliver IP phones of acceptable quality and in a timely manner, particularly the sole source vendors, could adversely affect our operating results or cause them to fluctuate more than anticipated. Additionally, some of our products may require specialized or high-performance component parts that may not be available in quantities or in time frames that meet our requirements.

If we do not or cannot maintain the compatibility of our communications and collaboration software with third-party applications and mobile platforms that our customers use in their businesses, our revenue will decline.

The functionality and popularity of our cloud software solutions depends, in part, on our ability to integrate our services with third-party applications and platforms, including enterprise resource planning, customer relations management, human capital management and other proprietary application suites. Third-party providers of applications and application programmable interfaces, or APIs, may change the features of their applications and platforms, restrict our access to their applications and platforms or alter the terms governing use of their applications and APIs and access to those applications and platforms in an adverse manner. Such changes could functionally limit or terminate our ability to use these third-party applications and platforms in conjunction with our services, which could negatively impact our offerings and harm our business. If we fail to integrate our software with new third-party back-end enterprise applications and platforms used by our customers, we may not be able to offer the functionality that our customers need, which would negatively impact our ability to generate revenue and adversely impact our business.

Our services also allow our customers to use and manage our cloud software solutions on smartphones, tablets and other mobile devices. As new smart devices and operating systems are released, we may encounter difficulties supporting these devices and services, and we may need to devote significant resources to the creation, support, and maintenance of our mobile applications. In addition, if we experience difficulties in the future integrating our mobile applications into smartphones, tablets or other mobile devices or if problems arise with our relationships with providers of mobile operating systems, such as those of Apple Inc. or Google Inc., our future growth and our results of operations could suffer.

If our software fails due to defects, bugs, vulnerabilities or similar problems, and if we fail to correct any defect or other software problems, we could lose customers, become subject to service performance or warranty claims or incur significant costs.

Our customers use our service to manage important aspects of their businesses, and any errors, defects, disruptions to our service or other performance problems with our service could hurt our reputation and may damage our customers' businesses. Our services and the systems infrastructure underlying our cloud communications platform incorporate software that is highly technical and complex. Our software has contained, and may now or in the future contain, undetected errors, bugs, or vulnerabilities, which have caused, and may in the future cause, temporary service outages for some customers. Some errors in our software code may not be discovered until after the code has been released. Any errors, bugs, or vulnerabilities discovered in our code after release could result in damage to our reputation, loss of customers, loss of revenue, or liability for service credits or damages, any of which could adversely affect our business and financial results. We implement bug fixes and upgrades as part of our regularly scheduled system maintenance, which may lead to system downtime. Even if we are able to implement the bug fixes and upgrades in a timely manner, any history of defects, or the loss, damage or inadvertent release of confidential customer data, could cause our reputation to be harmed, and customers may elect not to purchase or renew their agreements with us and subject us to service performance credits, warranty claims or increased insurance costs. The costs associated with any material defects or errors in our software or other performance problems may be substantial and could materially adversely affect our operating results.

Vulnerabilities to security breaches, cyber intrusions and other malicious acts could adversely impact our business.

Our operations depend on our ability to protect our network from interruption by damage from unauthorized entry, computer viruses or other events beyond our control. In the past, we may have been subject to denial or disruption of service, or DDOS, and we may be subject to DDOS attacks in the future. We cannot assure you that our backup systems, regular data backups, security protocols, DDOS mitigation and other procedures that are currently in place, or that may be in place in the future, will be adequate to prevent significant damage, system failure or data loss. Critical to our provision of service is the storage, processing, and transmission of our customers' data, which may include confidential and sensitive information. Customers may use our services to store, process and transmit a wide variety of confidential and sensitive information such as credit card, bank account and other financial information, proprietary information, trade secrets or other data that may be protected by sector-specific laws and regulations like intellectual property laws, laws addressing the protection of personally identifiable information (or personal data in the European Union), as well as the Federal Communications Commission’s, or the FCC’s, customer proprietary network information (“CPNI”) rules. We may be targets of cyber threats and security breaches, given the nature of the information we store, process and transmit and the fact that we provide communications services to a broad range of businesses.

In addition, we use third-party vendors which in some cases have access to our data and our customers' data. Despite the implementation of security measures by us or our vendors, our computing devices, infrastructure or networks, or our vendors computing devices, infrastructure or networks may be vulnerable to hackers, computer viruses, worms, other malicious software programs or similar disruptive problems due to a security vulnerability in our or our vendors' infrastructure or network, or our vendors, customers, employees, business partners, consultants or other internet users who attempt to invade our or our vendors' public and private computers, tablets, mobile devices, software, data networks, or voice networks. If there is a security vulnerability in our or our vendors' infrastructure or networks that is successfully targeted, we could face increased costs, liability claims, government investigations, fines, penalties or forfeitures, class action litigation, reduced revenue, or harm to our reputation or competitive position.

Depending on the evolving nature of cyber threats, we may have to significantly increase our investment in maintaining the security of our networks and data, and our profitability may be adversely impacted, or we may have to increase the price of our services which may make our offerings less competitive with other communications providers.

If an individual obtains unauthorized access to our network, or if our network is penetrated, our service could be disrupted and sensitive information could be lost, stolen or disclosed which could have a variety of negative impacts, including legal liability, investigations by law enforcement and regulatory agencies, exposure to fines, penalties, or forfeitures, or class action litigation, any of which could harm our business reputation and have a material negative impact on our business. In addition, to the extent we market our services as compliant with particular laws governing data privacy and security, such as the Health Insurance Portability and Accountability Act and foreign data protection laws, or provide representations or warranties as to such compliance in our customer contracts, a security breach that exposes protected information may make us susceptible to a number of contractual claims as well as claims related to our marketing. It could also potentially expose us to liability to individuals impacted by such a security breach.

Many governments have enacted laws requiring companies to notify individuals of data security incidents involving certain types of personal data including CPNI, personally identifiable information (or personal data in the European Union), financial account information, government-issued identification numbers, and other information that may lead to harming individuals if subject to an unauthorized disclosure. In addition, some of our customers contractually require notification of any data security compromise. Security compromises experienced by our competitors, by our customers or by us may lead to public disclosures, which may lead to widespread negative publicity. Any security compromise in our industry, whether actual or perceived, could harm our reputation, erode customer confidence in the effectiveness of our security measures, negatively impact our ability to attract new customers, cause existing customers to elect not to renew their subscriptions or subject us to third-party lawsuits, federal and state government investigations, regulatory fines, penalties and forfeitures or other causes of action or liability, which could materially and adversely affect our business and operating results.

In contracts with larger enterprises, we often agree to assume liability for security breaches in excess of the amount of committed revenue from the contract. In addition, there can be no assurance that any limitations of liability provisions in our contracts for a security breach would be enforceable or adequate or would otherwise protect us from any such liabilities or damages with respect to any particular claim. Also, certain classes of information, like CPNI and information subject to state data breach notification laws in the U.S., or personal data in the European Union, can expose us to liability in the form of fines, expenses associated with federal and state government investigations, penalties and forfeitures, in addition to civil liability, if such data is breached. We cannot be sure that our existing cybersecurity insurance will continue to be available on acceptable terms or will be available in sufficient amounts to cover one or more large claims, or that the insurer will not deny coverage as to any future claim. The successful assertion of one or more large claims against us that exceed available insurance coverage, or the occurrence of changes in our insurance policies, including premium increases or the imposition of large deductible or co-insurance requirements, could have a material adverse effect on our business, financial condition and operating results.

Failure to comply with laws and contractual obligations related to data privacy and protection could have a material adverse effect on our business, financial condition and operating results.

We are subject to the data privacy and protection laws and regulations adopted by federal, state and foreign governmental agencies, including the European Union’s General Data Protection Regulation ("GDPR"). Data privacy and protection is highly regulated in many jurisdictions and may become the subject of additional regulation in the future. For example, lawmakers and regulators worldwide are considering proposals that would require companies, like us, that encrypt users' data to ensure access to such data by law enforcement authorities. Privacy laws restrict our storage, use, processing, disclosure, transfer and protection of personal information, including credit card data, provided to us by our customers as well as data we collect from our customers and employees. We strive to comply with all applicable laws, regulations, policies and legal obligations relating to privacy and data protection. However, if we fail to comply, we may be subject to fines, penalties and lawsuits, statutory

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damages at both the federal and state levels in the U.S., substantial fines and penalties under the European Union's GDPR, class action lawsuits, and our reputation may suffer. We may also be required to make modifications to our data practices that could have an adverse impact on our business.

Governmental entities, class action lawyers and privacy advocates are increasingly examining companies' data collection, processing, use, storing, sharing, transferring and transmitting or personal data and data linkable to individuals. Self-regulatory codes of conduct, enforcement actions by regulatory agencies, and lawsuits by private parties could impose additional compliance costs on us, negatively impacting our profitability, as well as subject us to unknown potential liabilities. These evolving laws, rules and practices may also curtail our current business activities which may also result in slimmer profit margins and reduce new opportunities.

We are also subject to the privacy and data protection-related obligations in our contracts with our customers and other third parties. Any failure, or perceived failure, by us to comply with federal, state, or international laws, including laws and regulations regulating privacy, data or consumer protection, or to comply with our contractual obligations related to privacy, could result in proceedings or actions against us by governmental entities, contractual parties or others, which could result in significant liability to us as well as harm to our reputation. Additionally, third parties on which we rely enter into contracts to protect and safeguard our customers' data. Should such parties violate these agreements or suffer a breach, we could be subject to proceedings or actions against us by governmental entities, contractual parties or others, which could result in significant liability to us as well as harm to our reputation.

On July 12, 2016, the European Commission adopted the "Privacy Shield" which replaced the European Union ("EU")-U.S. Safe Harbor Framework. We are currently participating in Privacy Shield and we also rely on other methods recognized under relevant EU law to transfer personal data between the EU and the U.S. Additionally, GDPR became effective on May 25, 2018, and replaces the Data Protection Directive 95/46/EC. GDPR imposes new obligations on all companies, including us, and substantially increases potential liability for all companies, including us, for failure to comply with data protection rules.

The regulatory landscape applicable to data transfers between the EU and other countries with similar data protection laws, and the U.S. remains unsettled. There is ongoing litigation in the EU, as well as calls by certain political and governmental bodies in the EU to re-evaluate data transfers between the EU and the U.S., that could negatively impact the existing legally acceptable methods for transferring data between the EU and the U.S. on which we rely as do many other companies. Moreover, while we established alternative methods to transfer data between the EU and U.S. that addressed certain legal uncertainties that previously existed, some independent data regulators have adopted the position that other forms of compliance, including the methods we rely upon now as do many other companies, are also invalid.

Like many other companies, we continue to face uncertainty with respect to the measures we have implemented. Additionally, there is continued uncertainty regarding the legality of transferring certain data between the EU and U.S. caused by: (i) ongoing litigation that could invalidate the existing method that we, along with many other companies, rely upon for compliance with relevant law; and (ii) the possibility that political and other governmental bodies may invalidate the method we, along with many other companies, rely upon to comply with relevant law. We cannot predict how or if this issue will be resolved nor can we evaluate our potential liability at this time.

Although GDPR has already gone into effect, there is still considerable uncertainty as to how to interpret and implement many of its provisions. It is particularly challenging for companies operating in the cloud services space, like us, to interpret and implement GDPR. If we fail to properly implement GDPR for any reason, we may be subject to fines and penalties. GDPR may also change our business operations in ways that we cannot currently predict that could increase our operating costs, decrease our profitability, or result in increased prices for our retail offerings that may make our services less competitive. We cannot evaluate our potential liability at this time.

We could be liable for breaches of security on our website, fraudulent activities of our users, or the failure of third-party vendors to deliver credit card transaction processing services.

A fundamental requirement for operating an Internet-based, worldwide cloud software solutions and electronically billing our customers is the secure transmission of confidential information and media over public networks. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches, failure to mitigate such fraud or breaches may subject us to costly breach notification and other mitigation obligations, class action lawsuits, investigations, fines, forfeitures or penalties from governmental agencies that could adversely affect our operating results.

The law relating to the liability of providers of online payment services is currently unsettled and states may enact their own rules with which we may not comply. We rely on third-party providers to process and guarantee payments made by our subscribers up to certain limits, and we may be unable to prevent our customers from fraudulently receiving goods and

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services. Our liability risk will increase if a larger fraction of transactions effected using our cloud-based services involve fraudulent or disputed credit card transactions.

We may also experience losses due to subscriber fraud and theft of service. Subscribers have, in the past, obtained access to our service without paying for monthly service and international toll calls by unlawfully using our authorization codes or by submitting fraudulent credit card information. If our existing anti-fraud procedures are not adequate or effective, consumer fraud and theft of service could have a material adverse effect on our business, financial condition and operating results.

Natural disasters, war, terrorist attacks or malicious conduct could adversely impact our operations and could degrade or impede our ability to offer services.

Our cloud communications services rely on uninterrupted connection to the Internet through data centers and networks. Any interruption or disruption to our network, or the third parties on which we rely, could adversely impact our ability to provide service. Our network could be disrupted by circumstances outside of our control including natural disasters, acts of war, terrorist attacks or other malicious acts including, but not limited to, cyber-attacks. Our headquarters, global networks operations center and one of our third-party data center facilities are located in the San Francisco Bay Area, a region known for seismic activity. Should any of these events occur and interfere with our ability to operate our network even for a limited period of time, we could incur significant expenses, lose substantial amounts of revenue, suffer damage to our reputation, and lose customers. Such an event may also impede our customers' connections to our network, since these connections also occur over the Internet, and would be perceived by our customers as an interruption of our services, even though such interruption would be beyond our control. Any of these events could have a material adverse impact on our business.

Our infringement of a third party's proprietary technology could disrupt our business.

There has been substantial litigation in the communications, cloud communication services, semiconductor, electronics, and related industries regarding intellectual property rights and, from time to time, third parties may claim that we, our customers, our licensees or parties indemnified by us are infringing, misappropriating or otherwise violating their intellectual property rights. Third parties may also claim that our employees have misappropriated or divulged their former employers' trade secrets or confidential information. Our broad range of current and former technology, including IP telephony systems, digital and analog circuits, software, and semiconductors, increases the likelihood that third parties may claim infringement by us of their intellectual property rights.

We were recently named as a defendant in a complaint filed in United States District Court for the District of Delaware (Rainey Circuit LLC v. 8x8, Inc.). This lawsuit was brought by a non-practicing entity and alleges infringement of a single patent. In the past, we have been able to resolve similar kinds of litigation against us without a material adverse impact on our business, cash flows or results of operations, and do not currently believe that this lawsuit will have any such material adverse impact. Certain technology necessary for us to provide our services may, in fact, be patented by other parties either now or in the future. If such technology were held under patent by another person, we would have to negotiate a license for the use of that technology, which we may not be able to negotiate at a price that is acceptable or at all. The existence of such a patent, or our inability to negotiate a license for any such technology on acceptable terms, could force us to cease using such technology and offering products and services incorporating such technology.

If we are found to be infringing on the intellectual property rights of any third-party in lawsuits or proceedings that may be asserted against us, we could be subject to monetary liabilities for such infringement, which could be material. We could also be required to refrain from using, manufacturing or selling certain products or using certain processes, either of which could have a material adverse effect on our business and operating results. We may continue to receive in the future, notices of claims of infringement, misappropriation or misuse of other parties' proprietary rights. There can be no assurance that we will prevail in these discussions and actions or that other actions alleging infringement by us of third-party patents will not be asserted or prosecuted against us. Furthermore, lawsuits like these may require significant time and expense to defend, may divert management's attention away from other aspects of our operations and, upon resolution, may have a material adverse effect on our business, results of operations, financial condition and cash flows.

Inability to protect our proprietary technology would disrupt our business.

We rely, in part, on trademark, copyright, and trade secret law to protect our intellectual property in the United States and abroad. We seek to protect our software, documentation, and other written materials under trade secret and copyright law, which afford only limited protection. We currently have several United States patent applications pending. We cannot predict whether such pending patent applications will result in issued patents, and if they do, whether such patents will effectively protect our intellectual property. The intellectual property rights we obtain may not be sufficient to provide us with a competitive advantage, and could be challenged, invalidated, infringed or misappropriated. We may not be able to protect our proprietary rights in the United States or internationally (where effective intellectual property protection may be unavailable or

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limited), and competitors may independently develop technologies that are similar or superior to our technology, duplicate our technology or design around any patent of ours.

We attempt to further protect our proprietary technology and content by requiring our employees and consultants to enter into confidentiality and assignment of inventions agreements and third parties to enter into nondisclosure agreements. These agreements may not effectively prevent unauthorized use or disclosure of our confidential information, intellectual property or technology and may not provide an adequate remedy in the event of unauthorized use or disclosure of our confidential information, intellectual property or technology.

Litigation may be necessary in the future to enforce our intellectual property rights, to determine the validity and scope of our proprietary rights or the rights of others, or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of management time and resources and could have a material adverse effect on our business, financial condition, and operating results. Any settlement or adverse determination in such litigation would also subject us to significant liability.

We also may be required to protect our proprietary technology and content in an increasing number of jurisdictions, a process that is expensive and may not be successful, or which we may not pursue in every location. In addition, effective intellectual property protection may not be available to us in every country, and the laws of some foreign countries may not be as protective of intellectual property rights as those in the United States. Additional uncertainty may result from changes to intellectual property legislation enacted in the United States and elsewhere, and from interpretations of intellectual property laws by applicable courts and agencies. Accordingly, despite our efforts, we may be unable to obtain and maintain the intellectual property rights necessary to provide us with a competitive advantage.

We may have difficulty attracting or retaining personnel with the technical skills and experience necessary to support our growth.

Companies in the cloud communications industry compete aggressively for top talent in all areas of business, but particularly sales and marketing, professional services and engineering, where employees with industry experience, technical knowledge and specialized skill sets are particularly valued. Demand can be expected to increase if cloud communications continues to gain a greater share of the global communications market. Some of our competitors may respond to these competitive pressures by increasing employee compensation, paying more on average than we pay for the same position. Any such disparity in compensation could make us less attractive to candidates as a potential employer, which in turn may make it more difficult for us to hire and retain qualified employees. Training an individual who lacks prior cloud communications experience to be successful in a sales or technical role can take months or even years.

When an employee of 8x8 leaves to work for a competitor, not only are we impacted by the loss of the individual resource, but we also face the risk that the individual will share our trade secrets with the competitor in violation of their contractual and legal obligations to us. Our competitors have in the past and may in the future target their hiring efforts on a particular department, and if we lose a group of employees to a competitor over a short time period, our day-to-day operations may be impaired. While we may have remedies available to us through litigation, they would likely take significant time and expense and divert management attention from other areas of the business.

If we increase employee compensation (beyond levels that reflect customary performance-based and/or cost-of-living adjustments) in response to competitive pressures, we may sustain greater operating losses than we predicted in the near term, and we may not achieve profitability within the timeframe we had expected, or at all.

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

An important component of our growth strategy involves the further expansion of our operations and customer base internationally. We have formed several subsidiaries outside the United States, including a Romanian subsidiary that contributes significantly to our research and development efforts. We have also acquired two UK-based companies. The risks and challenges associated with sales and other operations outside the United States are different in some ways from those associated with our operations in the United States, and we have a limited history addressing those risks and meeting those challenges. Our current international operations and future initiatives will involve a variety of risks, including:

- localization of our services, including translation into foreign languages and associated expenses;
- regulation of our services as traditional telecommunications services, requiring us to obtain authorizations or licenses to operate in foreign jurisdictions, or alternatively preventing us from selling our full suite of services, or any services at all, in such jurisdictions;
- changes in a specific country or region's regulatory requirements, taxes, trade laws, or political or economic conditions;

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- more stringent regulations relating to data security and the unauthorized use of, access to, and transfer of, commercial and personal information, particularly in the EU;
- differing labor regulations, especially in the EU and Latin America, where labor laws are generally more advantageous to employees as compared to the United States, including deemed hourly wage and overtime regulations in these locations;
- challenges inherent in efficiently managing an increased number of employees over large geographic distances, including the need to implement appropriate systems, policies, benefits and compliance programs;
- difficulties in managing a business in new markets with diverse cultures, languages, customs, legal systems, alternative dispute systems and regulatory systems;
- increased travel, real estate, infrastructure and legal compliance costs associated with international operations;
- different pricing environments, longer sales cycles, longer accounts receivable payment cycles and other collection difficulties;
- currency exchange rate fluctuations and the resulting effect on our revenue and expenses, and the cost and risk of entering into hedging transactions if we chose to do so in the future;
- limitations on our ability to reinvest earnings from operations in one country to fund the capital needs of our operations in other countries;
- laws and business practices favoring local competitors or general preferences for local vendors;
- limited or insufficient intellectual property protection;
- political instability or terrorist activities;
- exposure to liabilities under anti-corruption and anti-money laundering laws, including the U.S. Foreign Corrupt Practices Act, the UK Bribery Act 2010, trade and export laws such as those enforced by the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury, and similar laws and regulations in other jurisdictions; and
- adverse tax burdens and foreign exchange controls that could make it difficult to repatriate earnings and cash.

We have limited experience in operating our business internationally, which increases the risk that any potential future expansion efforts that we may undertake will not be successful. We expect to invest substantial time and resources to expand our international operations. If we are unable to do this successfully and in a timely manner, our business and operating results could be materially adversely affected.

Acquisitions may divert our management's attention, result in dilution to our stockholders and consume resources that are necessary to sustain our business.

We have acquired several businesses in recent years. If appropriate opportunities present themselves, we may make additional acquisitions or investments or enter into joint ventures or strategic alliances with other companies. Risks commonly encountered in such transactions include:

- the difficulty of assimilating the operations and personnel of the combined companies:
- the risk that we may not be able to integrate the acquired services or technologies with our current services, products, and technologies;
- the potential disruption of our ongoing business;
- the diversion of management attention from our existing business;
- the inability of management to maximize our financial and strategic position through the successful integration of the acquired businesses;
- difficulty in maintaining controls, procedures, and policies;
- the impairment of relationships with employees, suppliers, and customers as a result of any integration;
- the loss of an acquired base of customers and accompanying revenue;
- the loss of an acquired base of customers and accompanying revenue while trying to transition the customer from the legacy systems to 8x8's technology due to mismatch of the features, usability, packaging, or pricing at the renewal times;
- the loss of an acquired base of customers and accompanying revenue due to failure and/or lack of maintenance/support for the legacy services and/or equipment/software/services being end of life;
- additional regulatory compliance obligations and costs associated with the acquired operations;
- litigation arising from or relating to the transaction;

- the assumption of leased facilities, other long-term commitments or liabilities that could have a material adverse impact on our profitability and cash flow; and
- the dilution to our existing stockholders from the issuance of additional shares of common stock or reduction of earnings per outstanding share in connection with an acquisition that fails to increase the value of our company.

As a result of these potential problems and risks, among others, businesses that we may acquire or invest in may not produce the revenue, earnings, or business synergies that we anticipate. For example, during our 2018 fiscal year, we discontinued marketing EasyContactNow, which we had acquired through our purchase of DXI Limited in 2015, as a stand-alone product, and we recorded a related $9 million impairment of goodwill and other assets. In addition, there can be no assurance that any potential transaction will be successfully completed or that, if completed, the acquired business or investment will generate sufficient revenue to offset the associated costs or other potential harmful effects on our business.

The United Kingdom's withdrawal from the EU may adversely impact our operations in the United Kingdom and elsewhere.

On June 23, 2016, voters in the United Kingdom approved an advisory referendum to withdraw from the EU. The timing of the proposed exit is scheduled for March 29, 2019, with a transition period expected to run through December 31, 2020. The political uncertainty that it has raised extends to regulatory uncertainty associated with the proposed exit from the EU. Since the vote to withdraw from the EU, negotiations and arrangements between the United Kingdom, the EU and other countries outside of the EU have been, and will continue to be, complex and time consuming. The potential withdrawal could adversely impact our UK subsidiary, 8x8 UK Limited (previously referred to as Voicenet Solutions Ltd.), and add operational complexities that did not previously exist. Currently, the most immediate impact may be to the relevant regulatory regimes under which 8x8 UK Limited operates, including the offering of communications services, as well as to data privacy regulations. The impact on regulatory regimes remains uncertain. For example, while the United Kingdom government has announced its intent to introduce domestic legislation that would largely reconcile United Kingdom domestic law with many EU laws, including GDPR, it remains unknown what will actually occur it what the departure from the EU may mean with respect to data privacy regulation including its impact on data transfers from the EU to the United Kingdom, and vice versa, as well as data transfers from the United Kingdom to jurisdictions outside of the EU. Also, it remains unclear what impact a United Kingdom withdrawal may have on taxes which may increase the cost of our services sold in the United Kingdom, or reduce our profit margins, or make our services less competitive with traditional communications service providers, or some combination of any of these potential issues. Additionally, the impending withdrawal of the United Kingdom from the EU has resulted in significant volatility in the international financial currency markets. Although most of our services revenues are denominated in U.S. dollars, we also receive payments in international currencies including the pound and the euro. Like all business that derive revenue in differing currencies, we incur risks with respect to currency translation when there are fluctuations in exchange rates and when the U.S. dollar is valued higher as compared to other currencies. While we cannot predict the impact that an actual exit from the EU will have on 8x8 UK Limited, the potential collateral impact it may have on our operations elsewhere including the U.S., nor its potential impact on our financial results, the United Kingdom’s vote to leave the European Union and the uncertainties associated with whether it will be with or without a formal plan has created legal, regulatory, and currency risk that may have a materially adverse impact on our business.

Our future operating results may vary substantially from period to period and may be difficult to predict.

Our historical operating results have fluctuated significantly and will likely continue to fluctuate in the future, and a decline in our operating results could cause our stock price to fall. On an annual and a quarterly basis, there are a number of factors that may affect our operating results, some of which are outside our control. These include, but are not limited to:

- changes in market demand;
- the timing of customer subscriptions for our cloud software solutions;
- customer cancellations;
- changes in the competitive dynamics of our market, including consolidation among competitors or customers;
- lengthy sales cycles and/or regulatory approval cycles;
- new product introductions by us or our competitors;
- extent of market acceptance of new or existing services and features;
- the mix of our customer base and sales channels;
- the mix of services sold;
- the number of additional customers, on a net basis;
- the amount and timing of costs associated with recruiting, training and integrating new employees;
- unforeseen costs and expenses related to the expansion of our business, operations and infrastructure;
- continued compliance with industry standards and regulatory requirements;
- material security breaches or service interruptions due to cyberattacks or infrastructure failures or unavailability;

- introduction and adoption of our cloud software solutions in markets outside of the United States;
- changes in the recognition pattern of revenues and operating expenses as a result of new regulations, accounting principles and their interpretations, such as Financial Accounting Standards Board's Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606); and
- general economic conditions.

Due to these and other factors, we believe that period-to-period comparisons of our results of operations are not meaningful and should not be relied upon as indicators of our future performance. It is possible that in some future periods our results of operations may be below the expectations of public market analysts and investors. If any of these were to occur, the price of our common stock would likely decline significantly.

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In addition, changes in regulatory and accounting principles, and our interpretation of these and judgments used in applying them to our facts and circumstances, could have a material effect on our results of operations and financial condition. We also need to revise our business processes, systems and controls which requires significant management attention and may negatively affect our financial reporting obligations.

Our products must comply with industry standards, FCC regulations, state, local, country-specific and international regulations, and changes may require us to modify existing products and/or services.

In addition to reliability and quality standards, the market acceptance of telephony over broadband IP networks is dependent upon the adoption of industry standards so that products from multiple manufacturers are able to communicate with each other. Our cloud-based communications and collaboration services rely heavily on communication standards such as SIP, MGCP and network standards such as TCP/IP and UDP to interoperate with other vendors' equipment. There is currently a lack of agreement among industry leaders about which standard should be used for a particular application, and about the definition of the standards themselves. These standards, as well as audio and video compression standards, continue to evolve. We also must comply with certain rules and regulations of the FCC regarding electromagnetic radiation and safety standards established by Underwriters Laboratories, as well as similar regulations and standards applicable in other countries. Standards are frequently modified or replaced. As standards evolve, we may be required to modify our existing products or develop and support new versions of our products. We must comply with certain federal, state and local requirements regarding how we interact with our customers, including marketing practices, consumer protection, privacy, and billing issues, the provision of 9-1-1 or other international emergency services, including location data and the quality of service we provide to our customers. The failure of our products and services to comply, or delays in compliance, with various existing and evolving standards could delay or interrupt volume production of our communications and collaboration services, subject us to fines or other imposed penalties, or harm the perception and adoption rates of our service, any of which would have a material adverse effect on our business, financial condition or operating results.

For example:

- Regulation of our services as telecommunications services may require us to obtain authorizations or licenses to operate in foreign jurisdictions and comply with legal requirements applicable to traditional telephony providers. Regulators around the world, including those in the European Union generally do not distinguish between our cloud-based communications services and traditional telephony services. By entering additional international markets we may subject ourselves to significant regulation from foreign telecommunications authorities, including obligations to obtain telecommunications licenses and authorizations, complying with consumer protection laws and cooperating with local law enforcement authorities. This regulation impacts our ability to differentiate ourselves from incumbent service providers and imposes substantial compliance costs on us. Regulation restricts our ability to compete and, in some jurisdictions, it may restrict how we are able to expand our service offerings. Moreover, the regulatory environment is constantly evolving and changes to the applicable regulations may have an adverse effect upon our business by imposing additional compliance costs, modifying our technology and operations and in general affecting our profitability.

- Reform of federal and state Universal Service Fund programs and payment of regulatory and other fees in international markets, could increase the cost of our service to our customers diminishing or eliminating our pricing advantage. The FCC and a number of states are considering reform or other modifications to Universal Service Fund programs. Furthermore, the FCC has ruled that states can require us to contribute to state Universal Service Fund programs. A number of states already require us to contribute, while others are actively considering extending their programs to include the services we provide. At the same time, foreign regulatory authorities may impose regulatory fees or other contributions on our services. Should the FCC, states or foreign regulators adopt new contribution mechanisms or otherwise modify contribution obligations that increase our contribution burden, we will either need to raise the amount we currently collect from our customers to cover these obligations or absorb the costs, which would reduce our profit margins. We currently pass-through Universal Service Fund contributions and certain other fees to our customers, which may result in our services becoming less competitive as compared to those provided by others.

- We may become subject to state regulation for certain service offerings. Certain states take the position that offerings by VoIP providers, like us, are intrastate and therefore subject to state regulation. These states argue that if the beginning and end points of communications are known, and if some of these communications occur entirely within the boundaries of a state, the state can regulate that offering. We believe that the FCC has preempted states from regulating VoIP services like ours in the same manner as providers of traditional telecommunications services. We cannot predict how this issue will be resolved or its impact on our business at this time.

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- The FCC adopted rules concerning call completion rates to rural areas of the United States. It is possible that we, like other providers in the communications marketplace, may be subject to fines or other enforcement actions should the FCC determine that our call completion rates to rural areas are, or have been, unacceptable.

- The FCC and foreign regulators may require providers like us to comply with regulations related to how we present bills to customers. The adoption of such obligations may require us to revise our bills and may increase our costs of providing service which could either result in price increases or reduce our profitability.

- There may be risk associated with our ability to comply with U.S. and foreign rules concerning disabilities access requirements and the FCC and foreign regulators may expand disabilities access requirements to additional services we offer. We cannot predict whether we will be subject to additional accessibility requirements or whether any of our service offerings that are not currently subject to disabilities access requirements will be subject to such obligations. It is possible that we, like other providers in the communications marketplace, may be subject to fines or other enforcement actions if we are found not to be in compliance with the FCC's and foreign accessibility requirements.

- There may be risks associated with our ability to comply with requirements of the Telecommunications Relay Service and similar foreign statutes. The FCC requires providers of interconnected VoIP services to comply with certain regulations pertaining to people with disabilities and to contribute to the Telecommunications Relay Services fund. We are also required to offer 7-1-1 abbreviated dialing for access to relay services. At the same time, several foreign regulators also mandate accessibility requirements for people with disabilities. It is possible that we, like other providers in the communications marketplace, may be subject to fines or other enforcement actions if we are found not to be in compliance with these requirements, including the FCC's 7-1-1 abbreviated dialing obligations.

- There may be risks associated with our ability to comply with the requirements of U.S. and foreign law enforcement agencies. The FCC requires all interconnected VoIP providers to comply with the Communications Assistance for Law Enforcement Act, or CALEA. Similarly, foreign regulatory frameworks require VoIP providers to comply with local assistance to law enforcement laws and cooperation with local authorities in conducting wiretaps, pentraps and other surveillance activities. The FCC and other regulators may allow VoIP providers to comply with CALEA and similar statutes through the use of a service provided by a trusted third-party with the ability to extract call content and call-identifying information from a VoIP provider's network. Regardless of our reliance on a third party for compliance, it is possible that we, like other providers in the communications marketplace, may be subject to fines or other enforcement actions if we are found not to be in compliance with our obligations under CALEA or other similar assistance with law enforcement statutes.

- U.S. and foreign regulations may require us to deploy an E-911 or access to emergency service that automatically determines the location of our customers. In 2007, the FCC released a Notice of Proposed Rulemaking, in which it tentatively concluded that all interconnected VoIP providers that allow customers to use their service in more than one location (nomadic VoIP service providers, such as us), must utilize an automatic location technology that meets the same accuracy standards which apply to providers of commercial mobile radio services (mobile phone service providers). Since then, the FCC has been conducting proceedings and inquiries concerning the implementation of such a rule, including possible changes to the manner providers provision E-911 services on mobile applications. At the same time, foreign regulatory authorities, have conducted similar proceedings mandating VoIP providers in the applicable jurisdiction to provide caller location data when completing calls to the local emergency service numbers. The outcome of these proceedings cannot be determined at this time and we may or may not be able to comply with any such obligations that may be adopted. At present, we currently have no means to automatically identify the physical location of one of our customers on the Internet. We cannot guarantee that emergency calling service consistent with the FCC's order and other similar foreign orders will be available to all of our customers, especially those accessing our services from outside of the United States. Compliance with these obligations could result in service price increases and could have a material adverse effect on our business, financial condition or operating results.

The FCC adopted orders reforming the system of payments between regulated carriers that we partner with to interface with the public switch telephone network. The FCC reformed the system under which regulated providers of telecommunications services compensate each other for various types of traffic, including VoIP traffic that terminates on the PSTN and applied new call signaling requirements to VoIP providers and other service providers. The FCC's new rules require, among other things, interconnected VoIP providers, like us, that originate interstate or intrastate traffic destined for the PSTN, to transmit the telephone number associated with the calling party to the next provider in the call path. Intermediate providers must pass calling party number or charge number signaling information they receive from other providers unaltered, to subsequent providers in the call path. While we believe we

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are in compliance with this rule, to the extent that we pass traffic that does not have appropriate calling party number or charge number information, we could be subject to fines, cease and desist orders, or other penalties. The FCC's Order reforming payments between carriers for various types of traffic may result in increasing the payments we make to underlying carriers to access the PSTN, which may result in us increasing the retail price of our service, potentially making our offering less competitive with traditional providers of telecommunications services, or may reduce our profitability.

Our emergency and E-911 calling services are different from those offered by traditional wireline telephone companies and may expose us to significant liability.

There may be risks associated with limitations of E-911 and other emergency dialing with the 8x8 service.

Both our emergency calling service and our E-911 calling service are different, in significant respects, from the emergency calling services offered by traditional wireline telephone companies in the United States and abroad. In each case, the differences may cause significant delays, or even failures, in callers' receipt of the emergency assistance they need.

The FCC may determine that our nomadic emergency calling service does not satisfy the requirements of its VoIP E-911 order because, in some instances, our nomadic emergency calling service requires that we route an emergency call to a national emergency call center instead of connecting our customers directly to a local public-safety answering point through a dedicated connection and through the appropriate selective router. Similarly, foreign telecommunications regulators may determine that our nomadic emergency calling service does not meet applicable local emergency dialing and location requirements.

Delays our customers may encounter when making emergency services calls and any inability of the answering point to automatically recognize the caller's location or telephone number can result in life threatening consequences. Customers may, in the future, attempt to hold us responsible for any loss, damage, personal injury or death suffered as a result of any failure of our E-911 services and other emergency dialing services.

The New and Emerging Technologies 911 Improvement Act of 2008 provides public safety entities, interconnected VoIP providers and others involved in handling 911 calls the same liability protections when handling 911 calls from interconnected VoIP users as from mobile or wired telephone service users. The applicability of the liability protections to our national call center service is unclear at the present time.

Alleged or actual failure of our solutions to comply with regulations governing outbound dialing, including regulations under the Telephone Consumer Protection Act of 1991 and similar foreign statutes, could harm our business, financial condition, results of operations and cash flows.

The legal and contractual environment surrounding calling consumers and wireless phone numbers is complex and evolving. In the United States, two federal agencies, the Federal Trade Commission ("FTC") and the FCC, and various states have enacted laws including, at the federal level, the Telephone Consumer Protection Act of 1991, or TCPA, that restrict the placing of certain telephone calls and texts to residential and wireless telephone subscribers by means of automatic telephone dialing systems, prerecorded or artificial voice messages and fax machines. Internationally, we are also subject to similar laws imposing limitations on marketing calls to wireline and wireless numbers and compliance with do not call rules. These laws require companies to institute processes and safeguards to comply with these restrictions. Some of these laws can be enforced by the FTC, FCC, State Attorneys General, foreign regulators or private party litigants. In these types of actions, the plaintiff may seek damages, statutory penalties, costs and/or attorneys' fees.

It is possible that the FTC, FCC, foreign regulators, state attorneys general, private litigants or others may attempt to hold our customers, or us as a software provider, responsible for alleged violations of these laws. In the event that litigation is brought, or fines are assessed, against us, we may not successfully enforce or collect upon any contractual indemnities we may have from our customers. Additionally, any changes to these laws or their interpretation that further restrict calling consumers, any adverse publicity regarding the alleged or actual failure by companies, including our customers and competitors, to comply with such laws, or any governmental or private enforcement actions related thereto, could result in the reduced use of our solution by our clients and potential clients, which could harm our business, financial condition, results of operations and cash flows.

Failure of our back-end information technology systems to function properly could result in significant business disruption.

We rely on IT systems to manage numerous functions of our internal operations, some of which were internally developed IT systems that were not fully integrated among themselves, or with our third-party ERP system. These IT systems require specialized knowledge for which we have to train new personnel, and if we were to experience an unusual increase in attrition of our IT personnel, we may not be adequately equipped to respond to an IT system failure. These IT systems were developed

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at a time when we provided services primarily to SMB customers and they may not be able to accommodate the requirements of larger enterprises as effectively as more modern and flexible solutions. Continued reliance on these systems may harm us competitively and impede our efforts to sell to larger enterprises.

Although we are in the process of upgrading a number of our IT systems, including our ERP software, our quote-to-cash software and our customer service and support software, we face risks relating to these transitions. For example, we may incur greater costs than we anticipate to train our personnel on the new systems; we may experience more errors in our records during the transition; and we may be delayed in meeting our various reporting obligations. To the extent any of these risks or events impact our customer service, we may experience an increase in customer attrition, which could have a material adverse impact on our results of operations.

Our inability to use software licensed from third parties, or our use of open source software under license terms that interfere with our proprietary rights, could disrupt our business.

Our technology platform incorporates software licensed from third parties, including some software, known as open source software, which we use without charge. Although we monitor our use of open source software, the terms of many open source licenses to which we are subject have not been interpreted by U.S. or foreign courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to provide our platform to our customers. In the future, we could be required to seek licenses from third parties in order to continue offering our platform, which licenses may not be available on terms that are acceptable to us, or at all. Alternatively, we may need to re-engineer our platform or discontinue use of portions of the functionality provided by our platform. In addition, the terms of open source software licenses may require us to provide software that we develop using such software to others on unfavorable license terms. Our inability to use third-party software could result in disruptions to our business, or delays in the development of future offerings or enhancements of existing offerings, which could impair our business.

Taxing authorities may successfully assert that we should have collected or in the future should collect sales and use, value added, or similar taxes, and we could be subject to liability with respect to past or future sales, which could adversely affect our business.

The applicability of state and local taxes, fees, surcharges or similar taxes to our services is complex, ambiguous and subject to interpretation and change. In the United States, for example, we collect state and local taxes, fees and surcharges based on our understanding of the applicable laws in the relevant jurisdiction. The taxing authorities may challenge our interpretation of the laws and may assess additional taxes, penalties and interests which could have adverse effects on the results of operations and, to the extent we pass these through to our customers, demand for our services. We currently file more than 1,000 state and municipal tax returns monthly. Periodically, we have received inquiries from state and municipal taxing agencies with respect to the remittance of state or municipal taxes, fees or surcharges. Currently, several jurisdictions are conducting audits of 8x8. As of December 31, 2018, we have accrued for state or municipal taxes, fees or surcharges that we believe are required to be remitted.

We have accrued a contingent liability of approximately $7.1 million as our best estimate of the probable amount of taxes, fees and surcharges that may be imposed by states, municipalities and other taxing jurisdictions on our services to date. Historically, the amounts that have been remitted for uncollected state, municipal and other similar indirect taxes, fees, or surcharges have been within the accruals we established. We adjust our accrual when facts relating to specific exposures warrant such adjustment. This accrued contingent liability is based on our analysis of several factors, including the location where our services are used, our nexus to that jurisdiction for tax purposes, and the taxability of our services under the rules and regulations in each state or municipality (as these may be interpreted by regulatory and judicial authorities from time to time). While we have accrued for these potential liabilities based on our analyses and best estimates at the time, state, municipal and other taxing and regulatory authorities may challenge our position, which could result in us being liable for sales and use taxes, fees, or surcharges, as well as related penalties and interest, above our accrued contingent liability. To the extent we collect or otherwise recover these taxes, fees or surcharges from our customers, our services may become less competitive, our churn rate may increase, and our revenue from new and existing customers may be materially adversely affected.

Our ability to use our net operating losses or research tax credits to offset future taxable income may be subject to certain limitations.

As of March 31, 2018, we had net operating loss (“NOL”) carryforwards for federal and state income tax purposes of $157.6 million and $27.5 million, respectively, which expire at various dates between 2029 and 2039. We also had research and development credit carryforwards for federal and California tax purposes of approximately $7.2 million and $9.1 million, respectively. The federal income tax credit carryforwards related to research and development will expire at various dates between 2021 and 2038, while the California income tax credits will carry forward indefinitely. Utilization of our NOL and tax credit carryforwards can become subject to a substantial annual limitation due to the ownership change limitations provided by

Section 382 of the Internal Revenue Code and similar state provisions. A Section 382 ownership change generally occurs if one or more stockholders or groups of stockholders who own at least 5% of the stock increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. Similar rules may apply under state tax laws. Such an ownership change, or any future ownership change, could have a material effect on our ability to utilize the net operating loss or research credit carryforwards. In addition, under the Tax Cuts and Jobs Act, or the Tax Act, the amount of NOLs that we are permitted to deduct in any taxable year is limited to 80% of the taxable income in such year. There is a risk that due to changes under the Tax Act, regulatory changes, or other unforeseen reasons, the existing NOLs could expire or otherwise be unavailable to offset future income tax liabilities, which could have a material impact on our net income (loss) in future periods.

If we fail to establish and maintain proper and effective internal control over financial reporting, our operating results and our ability to operate our business could be harmed.

The Sarbanes-Oxley Act of 2002 requires, among other things, that we establish and maintain internal control over financial reporting and disclosure controls and procedures. In particular, under the current rules of the Securities and Exchange Commission (“SEC”), we must perform system and process evaluation and testing of our internal control over financial reporting to allow management to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our independent registered public accounting firm is also required to report on our internal control over financial reporting. Our and our auditor’s testing may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses and render our internal control over financial reporting ineffective. We have incurred and we expect to continue to incur substantial accounting and auditing expense and expend significant management time in complying with the requirements of Section 404. If we are not able to comply with the requirements of Section 404, or if we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to investigations or sanctions by the SEC, The NYSE Stock Market, or other regulatory authorities, or subject to litigation. To the extent any material weaknesses in our internal control over financial reporting are identified in the future, we could be required to expend significant management time and financial resources to correct such material weaknesses or to respond to any resulting regulatory investigations or proceedings.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported operating results.

The accounting rules and regulations that we must comply with are complex and subject to interpretation by the Financial Accounting Standards Board (the “FASB”), the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. Recent actions and public comments from the FASB and the SEC have focused on the integrity of financial reporting and internal controls. In addition, many companies’ accounting policies are being subjected to heightened scrutiny by regulators and the public. Further, the accounting rules and regulations are continually changing in ways that could materially impact our financial statements.

For example, in May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Accounting Standards Codification 606 or ASC 606), which replaces numerous requirements in U.S. GAAP and provide companies with a single revenue recognition model for recognizing revenue from contracts with customers. The impact of adopting the new standard on our total revenues and deferred revenue has not been and is not expected to be material. With the adoption of ASC 606 we also adopted ASC 340-40, Other Assets and Deferred Costs—Contracts with Customers, which requires the deferral of incremental costs of obtaining a customer contract which, under the old guidance, were expensed as incurred. Adoption of the new standard resulted in changes to our accounting policies for revenue recognition and deferred commissions.

We cannot predict the impact of future changes to accounting principles or our accounting policies on our financial statements going forward, which could have a significant effect on our reported financial results and could affect the reporting of transactions completed before the announcement of the change. In addition, if we were to change our critical accounting estimates, including those related to the recognition of subscription revenue and other revenue sources, our operating results could be significantly affected.

We may not be able to secure financing on favorable terms, or at all, to meet our future capital needs.

We may need to pursue financing in the future to make expenditures or investments to support the growth of our business (whether through acquisitions or otherwise) and may require additional capital to pursue our business objectives and respond to new competitive pressures, pay extraordinary expenses such as litigation settlements or judgments or fund growth, including through acquisitions. Additional funds, however, may not be available when we need them on terms that are acceptable to us, or at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to grow and support our business and to respond to business challenges could be significantly limited.

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Decreasing telecommunications rates and increasing regulatory charges may diminish or eliminate our competitive pricing advantage versus legacy providers.

Decreasing telecommunications rates may diminish or eliminate the competitive pricing advantage of our services, while increased regulation and the imposition of additional regulatory funding obligations at the federal, state, local and foreign level could require us to either increase the retail price for our services, thus making us less competitive, or absorb such costs, thus decreasing our profit margins. International and domestic telecommunications rates have decreased significantly over the last few years in most of the markets in which we operate, and we anticipate these rates will continue to decline in all of the markets in which we do business or expect to do business. Users who select our services to take advantage of the current pricing differential between traditional telecommunications rates and our rates may switch to traditional telecommunications carriers if such pricing differentials diminish or disappear, and we will be unable to use such pricing differentials to attract new customers in the future. Continued rate decreases would require us to lower our rates to remain competitive in the United States and abroad and would reduce or possibly eliminate any gross profit from our services. In addition, we may lose subscribers for our services.

Adverse economic conditions may harm our business.

Our business depends on the overall demand for cloud communications services and on the economic health of our current and prospective customers, which consist primarily of businesses (both for-profit and non-profit). If economic conditions deteriorate globally or in the jurisdictions that account for a material amount of our revenue (in particular, the United States, Europe and Canada, Australia), the size of our target market may decrease, and existing and prospective customers may delay or reduce their cloud communications spending. If our existing and prospective customers experience economic hardship, this could reduce the demand for our cloud services, delay and lengthen sales cycles, force us to lower the prices for our services, and lead to slower growth or even a decline in our revenues, operating results and cash flows.

We currently rely on small and medium-sized businesses for a significant portion of our revenue. Customers in this market generally have more limited financial resources, and may be affected by economic downturns, to a greater extent than larger or more established businesses. If small and medium-sized businesses experience financial hardship as a result of a weak economy, the demand for our services could be materially and adversely affected, and our revenue may not increase from period to period as rapidly as our competitors who have less dependence on sales to these segments, or may even decrease from period to period.

Certain provisions in our charter documents and Delaware law could discourage takeover attempts.

Our restated certificate of incorporation and by-laws contain provisions that could have the effect of delaying or preventing changes in control or changes in our management without the consent of our board of directors, including, among other things:

- no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
- the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;
- the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of our board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;
- a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;
- the requirement that a special meeting of stockholders may be called only by a majority vote of our Board of Directors or by stockholders holdings shares of our common stock representing in the aggregate a majority of votes then outstanding, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors;
- the ability of our board of directors, by majority vote, to amend our by-laws, which may allow our board of directors to take additional actions to prevent a hostile acquisition and inhibit the ability of an acquirer to amend our by-laws to facilitate a hostile acquisition; and

- advance notice procedures with which stockholders must comply to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of us.

We are also subject to certain anti-takeover provisions under the General Corporation Law of the State of Delaware, or the DGCL. Under Section 203 of the DGCL, a corporation may not, in general, engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or (i) our board of directors approves the

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transaction prior to the stockholder acquiring the 15% ownership position, (ii) upon consummation of the transaction that resulted in the stockholder acquiring the 15% ownership position, the stockholder owns at least 85% of the outstanding voting stock (excluding shares owned by directors or officers and shares owned by certain employee stock plans) or (iii) the transaction is approved by the board of directors and by the stockholders at an annual or special meeting by a vote of 66 2/3% of the outstanding voting stock (excluding shares held or controlled by the interested stockholder). These provisions in our restated certificate of incorporation and by-laws and under Delaware law could discourage potential takeover attempts.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

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

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SIGNATURE

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

Date: January 29, 2019

8X8, INC.
(Registrant)
By: /s/ Steven Gatoff
Steven Gatoff
Chief Financial Officer
(Principal Financial and Duly Authorized Officer)