8X8 INC /DE/
Form 10-Q
October 22, 2014

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 September 30, 2014

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. x YES ¨ NO

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

x NO ¨

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

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

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

The number of shares of the Registrant's Common Stock outstanding as of October 20, 2014 was 89,461,885.

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Part I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2014	March 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 56,048	$ 59,159
Short-term investments	129,519	47,181
Accounts receivable, net	7,266	5,503
Inventory	754	811
Deferred cost of goods sold	591	263
Deferred tax asset	1,732	2,065
Other current assets	2,656	1,951
Total current assets	198,566	116,933
Long-term investments	-	72,021
Property and equipment, net	9,555	7,711
Intangible assets, net	13,826	15,095
Goodwill	38,114	38,461
Non-current deferred tax asset	46,128	47,797
Other assets	1,144	1,185
Total assets	$ 307,333	$ 299,203
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 8,898	$ 6,789
Accrued compensation	5,500	4,583
Accrued warranty	538	660
Accrued taxes	2,570	2,323
Deferred revenue	1,522	1,857
Other accrued liabilities	1,321	1,909
Total current liabilities	20,349	18,121
Non-current liabilities	1,494	1,619
Non-current deferred revenue	1,038	1,285
Total liabilities	22,881	21,025
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock	89	88
Additional paid-in capital	389,755	384,325
Accumulated other comprehensive gain	(26)	430
Accumulated deficit	(105,366)	(106,665)
Total stockholders' equity	284,452	278,178
Total liabilities and stockholders' equity	$ 307,333	$ 299,203

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Service revenue	$ 36,121	$ 27,826	$ 70,397	$ 54,325
Product revenue	3,477	2,989	7,114	5,741
Total revenue	39,598	30,815	77,511	60,066
Operating expenses:				
Cost of service revenue	7,505	5,209	14,502	9,995
Cost of product revenue	3,762	3,783	7,731	7,130
Research and development	3,496	2,640	6,902	4,976
Sales and marketing	19,440	13,745	38,600	26,817
General and administrative	3,893	3,125	7,771	5,897
Gain on patent sale	(1,000)	-	(1,000)	-
Total operating expenses	37,096	28,502	74,506	54,815
Income from operations	2,502	2,313	3,005	5,251
Other income, net	200	1	377	16
Income from continuing operations before provision for income taxes	2,702	2,314	3,382	5,267
Provision for income taxes	1,411	826	2,083	1,787
Income from continuing operations	1,291	1,488	1,299	3,480
Income from discontinued operations, net of income tax provision	-	154	-	301
Gain on disposal of discontinued operations, net of income tax provision of $463	-	589	-	589
Net income	$ 1,291	$ 2,231	$ 1,299	$ 4,370
Income per share - continuing operations:				
Basic	$ 0.01	$ 0.02	$ 0.01	$ 0.05
Diluted	$ 0.01	$ 0.02	$ 0.01	$ 0.05
Income per share - discontinued operations:				
Basic	$ 0.00	$ 0.01	$ 0.00	$ 0.01
Diluted	$ 0.00	$ 0.01	$ 0.00	$ 0.01
Net income per share:				
Basic	$ 0.01	$ 0.03	$ 0.01	$ 0.06
Diluted	$ 0.01	$ 0.03	$ 0.01	$ 0.06
Weighted average number of shares:				
Basic	89,073	72,970	88,861	72,788
Diluted	91,615	76,232	91,568	76,035

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Net income	$ 1,291	$ 2,231	$ 1,299	$ 4,370
Other comprehensive income (loss), net of tax				
Unrealized gain (loss) on investments in securities	(51)	10	35	(55)
Foreign currency translation adjustment	(944)	-	(491)	-
Comprehensive income	$ 296	$ 2,241	$ 843	$ 4,315

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

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

	Six Months Ended September 30, 2014	Six Months Ended September 30, 2013
Cash flows from operating activities:		
Net income	$ 1,299	$ 4,370
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,576	1,287
Amortization of intangible assets	1,133	671
Amortization of capitalized software	170	37
Net accretion of discount and amortization of premium on marketable securities	428	-
Gain on disposal of discontinued operations	-	(589)
Stock-based compensation	3,855	2,013
Deferred income tax provision	2,002	1,589
Other	115	390
Changes in assets and liabilities:		
Accounts receivable, net	(1,883)	(1,179)
Inventory	29	91
Other current and non-current assets	(608)	(431)
Deferred cost of goods sold	(340)	(6)
Accounts payable	980	22
Accrued compensation	918	17
Accrued warranty	(122)	100
Accrued taxes and fees	249	(166)
Deferred revenue	(564)	961
Other current and non-current liabilities	(607)	(166)
Net cash provided by operating activities	8,630	9,011
Cash flows from investing activities:		
Purchases of property and equipment	(2,553)	(1,445)
Cost of capitalized software	(181)	(473)
Proceeds from maturity of investments	21,600	-
Sales of investments - available for sale	25,537	-
Purchases of investments - available for sale	(57,854)	-
Net cash used in investing activities	(13,451)	(1,918)
Cash flows from financing activities:		
Capital lease payments	(81)	(10)
Repurchase of common stock	(80)	(257)
Proceeds from issuance of common stock under employee stock plans	1,699	2,214
Net cash provided by financing activities	1,538	1,947
Effect of exchange rate changes on cash	172	-
Net (decrease) increase in cash and cash equivalents	(3,111)	9,040
Cash and cash equivalents at the beginning of the period	59,159	50,305
Cash and cash equivalents at the end of the period	$ 56,048	$ 59,345
Supplemental cash flow information		
Income taxes paid	$ 93	$ 276
Interest paid	16	2

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

8X8, Inc.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS

1. DESCRIPTION OF THE BUSINESS

THE COMPANY

8x8, Inc. ("8x8" or the "Company") develops and markets a comprehensive portfolio of cloud-based communications and collaboration solutions that include hosted cloud telephony, unified communications, contact center, video conferencing and virtual desktop software and services. These unified communications and collaboration services are offered from the Internet cloud via a software-as-a-service subscription. The Company also provides cloud-based computing services. As of September 30, 2014, the Company had approximately 40,400 business customers.

The Company was incorporated in California in February 1987 and was reincorporated in Delaware in December 1996. The Company's fiscal year ends on March 31 of each calendar year. Each reference to a fiscal year in these notes to the condensed consolidated financial statements refers to the fiscal year ending March 31 of the calendar year indicated (for example, fiscal 2015 refers to the fiscal year ending March 31, 2015).

2. BASIS OF PRESENTATION

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared on substantially the same basis as our annual consolidated financial statements for the fiscal year ended March 31, 2014. In the opinion of the Company's management, these interim condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of our financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from these estimates.

The March 31, 2014 year-end condensed consolidated balance sheet data in this document was derived from audited consolidated financial statements and does not include all of the disclosures required by U.S. generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements as of and for the fiscal year ended March 31, 2014 and notes thereto included in the Company's fiscal 2014 Annual Report on Form 10-K.

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

Service and Product Revenue

The Company recognizes service revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, price is fixed or determinable and collectability is reasonably assured. The Company defers recognition of service revenues in instances when cash receipts are received before services are delivered and recognizes deferred revenues ratably as services are provided.

The Company recognizes revenue from product sales for which there are no related services to be rendered upon shipment to customers provided that persuasive evidence of an arrangement exists, the price is fixed, title has transferred, collection of resulting receivables is reasonably assured, there are no customer acceptance requirements, and there are no remaining significant obligations. Gross outbound shipping and handling charges are recorded as revenue, and the related costs are included in cost of goods sold. Reserves for returns and allowances for customer sales are recorded at the time of shipment. In accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 985-605, the Company records shipments to distributors, retailers, and resellers, where the right of return exists, as deferred revenue. The Company defers recognition of revenue on sales to distributors, retailers, and resellers until products are resold to the customer.

The Company records revenue net of any sales-related taxes that are billed to its customers. The Company believes this approach results in consolidated financial statements that are more easily understood by users.

Under the terms of the Company's typical subscription agreement, new customers can terminate their service within 30 days of order placement and receive a full refund of fees previously paid. The Company has determined that it has sufficient history of subscriber conduct to make a reasonable estimate of cancellations within the 30-day trial period. Therefore, the Company recognizes new subscriber revenue in the month in which the new order was shipped, net of an allowance for expected cancellations.

Multiple Element Arrangements

ASC 605-25 requires that revenue arrangements with multiple deliverables be divided into separate units of accounting if the deliverables in the arrangement meet specific criteria. The provisioning of the 8x8 cloud service with the accompanying 8x8 IP telephone constitutes a revenue arrangement with multiple deliverables. For arrangements with multiple deliverables, the Company allocates the arrangement consideration to all units of accounting based on their relative selling prices. In such circumstances, the accounting principles establish a hierarchy to determine the relative selling price to be used for allocating arrangement consideration to units of accounting as follows: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence of selling price ("TPE"), and (iii) best estimate of the selling price ("BESP").

VSOE generally exists only when the Company sells the deliverable separately, on more than a limited basis, at prices within a relatively narrow range. When VSOE cannot be established, the Company attempts to establish the selling price of deliverables based on relevant TPE. TPE is determined based on manufacturer's prices for similar deliverables when sold separately, when possible. When the Company is unable to establish selling price using VSOE or TPE, it uses a BESP for the allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service was sold on a stand-alone basis. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings. The Company determines BESP for a product or service by considering multiple factors including, but not limited to:

- the price list established by its management which is typically based on general pricing practices and targeted gross margin of products and services sold; and

- analysis of pricing history of new arrangements, including multiple element and stand-alone transactions.

In accordance with the guidance of ASC 605-25, when the Company enters into revenue arrangements with multiple deliverables the Company allocates arrangement consideration, including activation fees, among the 8x8 IP telephones and subscriber services based on their relative selling prices. Arrangement consideration allocated to the IP telephones that is fixed or determinable and that is not contingent on future performance or deliverables is recognized as product revenues during the period of the sale less the allowance for estimated returns during the 30-day trial period. Arrangement consideration allocated to subscriber services that is fixed or determinable and that is not contingent on future performance or deliverables is recognized ratably as service revenues as the related services are provided, which is generally over the initial contract term.

Deferred Cost of Goods Sold

Deferred cost of goods sold represents the cost of products sold for which the end customer or distributor has a right of return. The cost of the products sold is recognized contemporaneously with the recognition of revenue, when the subscriber has accepted the service.

Cash, Cash Equivalents and Investments

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Management determines the appropriate categorization of its investments at the time of purchase and reevaluates the classification at each reporting date. The cost of the Company's investments is determined based upon specific identification.

The Company's investments are comprised of mutual funds, commercial paper, corporate debt, municipal securities, asset backed securities, mortgage backed securities, international government securities, certificates of deposit and money market funds. At September 30, 2014 and March 31, 2014, all investments were classified as available-for-sale and reported at fair value, based either upon quoted prices in active markets, quoted prices in less active markets, or quoted market prices for similar investments, with unrealized gains and losses, net of related tax, if any, included in other comprehensive loss and disclosed as a separate component of consolidated stockholders' equity. Realized gains and losses on sales of all such investments are reported within the caption of "other income, net" in the consolidated statements of income and are computed using the specific identification method.

The Company classifies its investments as current based on the nature of the investments and their availability for use in current operations. The Company's investments in marketable securities are monitored on a periodic basis for impairment. In the event that the carrying value of an investment exceeds its fair value and the decline in value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis for the investment is established. These available-for-sale investments are primarily held in the custody of a major financial institution.

Available-for-sale investments were (in thousands):

As of September 30, 2014	**Amortized Costs**	**Gross Unrealized Gain**	**Gross Unrealized Loss**	**Estimated Fair Value**
Money market funds	$ 22,571	$ -	$ -	$ 22,571
Fixed income				
Mutual funds	2,000	-	(87)	1,913
Commercial paper	18,232	5	(1)	18,236
Corporate debt	67,902	69	(2)	67,969
Municipal securities	5,435	3	(6)	5,432
Asset backed securities	26,038	6	(5)	26,039
Mortgage backed securities	6,955	-	(29)	6,926
International government securities	800	5	-	805
Certificates of deposit	2,200	-	(1)	2,199
Total available-for-sale investments	$ 152,133	$ 88	$ (131)	$ 152,090

Reported as (in thousands):	
Cash and cash equivalents	$ 22,571
Short-term investments	129,519
Total	$ 152,090

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

Due within one year	$	102,300
Due after one year		49,790
Total	$	152,090

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

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

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

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

Intangible Assets

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

	September 30, 2014			March 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Technology	$ 8,242	$ (2,493)	$ 5,749	$ 8,242	$ (2,080)	$ 6,162
Customer relationships	9,686	(2,566)	7,120	9,686	(1,710)	7,976
Trade names/domains	957	-	957	957	-	957
Total acquired identifiable intangible assets	$ 18,885	$ (5,059)	$ 13,826	$ 18,885	$ (3,790)	$ 15,095

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

	Amount
Remaining 2015	$ 1,119
2016	2,238
2017	2,231
2018	1,983
2019	1,737
Thereafter	3,561
Total	$ 12,869

Research, Development and Software Costs

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

In the first six months of fiscal 2015, the Company expensed all research and development costs in accordance with ASC 985-20. At September 30, 2014 and March 31, 2014, total capitalized software development costs included in other long-term assets was approximately $1.1 million and $1.0 million, respectively, and accumulated amortization costs related to capitalized software was approximately $0.3 million and $0.1 million, respectively.

In the first six months of fiscal 2014, the Company capitalized $0.5 million in accordance with ASC 985-20.

The Company accounts for computer software developed or obtained for internal use in accordance with ASC 350-40 - *Internal Use Software*, which requires capitalization of certain software development costs incurred during the application development stage. In the first six months of fiscal 2015, the Company capitalized $0.5 million in accordance with ASC 350-40, of which $0.2 million is classified as other long-term assets and $0.3 million is classified as property and equipment. No such costs were capitalized in the first six months of fiscal 2014.

Foreign Currency Translation

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

Stock Purchase Right/Restricted Stock Unit and Option Activity

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

	Number of Shares	Weighted Average Grant-Date Fair Market Value	Weighted Average Remaining Contractual Term (in Years)
Balance at March 31, 2014	489,627	$ 4.83	1.93
Granted	31,432	7.88	
Vested	(175,038)	3.81	
Forfeited	(34,075)	5.67	
Balance at September 30, 2014	311,946	$ 5.62	1.84

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

	Number of Shares	Weighted Average Purchase Price	Weighted Average Remaining Contractual Term (in Years)
Balance at March 31, 2014	1,134,856	$ -	2.00
Granted	248,492		
Vested	(118,561)		
Forfeited	(93,755)		
Balance at September 30, 2014	1,171,032	$ -	1.87

Option activity for the six months ended September 30, 2014 is summarized as follows (table includes stock purchase rights and RSUs; not limited to options):

	Shares Available for Grant	Shares Subject to Options Outstanding	Weighted Average Exercise Price Per Share
Balance at March 31, 2014	1,613,943	6,002,382	$ 4.14
Change in options available for grant	6,800,000	-	-
Granted - options	(106,684)	106,684	7.56
Stock purchase rights/restricted stock unit (1)	(279,924)	-	-
Exercised	-	(483,184)	1.55
Canceled/forfeited - options	278,098	(278,098)	5.11
Canceled/forfeited - restricted stock unit	93,944	-	5.67
Balance at September 30, 2014	8,399,377	5,347,784	$ 4.16

(1) The reduction to shares available for grant includes awards granted of 279,924 shares.

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

	Options Outstanding					Options Exercisable		
Range of Exercise Price	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value	Shares	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value
$0.55 - $1.26	1,453,500	$ 1.03	3.3	$ 8,208,733	1,453,500	$ 1.03	$ 8,208,733
$1.27 - $1.79	1,103,128	$ 1.54	1.5	5,673,510	1,103,128	$ 1.54	5,673,510
$1.80 - $5.87	1,305,184	$ 4.68	6.1	2,607,072	869,566	$ 4.30	2,059,942
$5.88 - $9.74	1,335,972	$ 9.35	9.0	33,180	294,442	$ 9.40	15,899
$10.97 - $11.26	150,000	$ 11.11	9.3	-	-	$ -	-
	5,347,784			$ 16,522,495	3,720,636		$ 15,958,084

Stock-based Compensation Expense

The Company accounts for its employee stock options, stock purchase rights, restricted stock units including restricted performance stock units granted under the 1996 Stock Plan, 1996 Director Option Plan, the 2006 Stock Plan, the 2003 Contactual Plan, the 2012 Equity Incentive Plan, the 2013 New Employee Inducement Incentive Plan and stock purchase rights under the 1996 Employee Stock Purchase Plan (collectively "Equity Compensation Plans") under the provisions of ASC 718 - *Stock Compensation*. Under the provisions of ASC 718, stock-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant), net of estimated forfeitures.

To value option grants, stock purchase rights and restricted stock units under the Equity Compensation Plans for stock-based compensation, the Company used the Black-Scholes option valuation model. Fair value determined using the Black-Scholes option valuation model varies based on assumptions used for the expected stock prices volatility, expected life, risk-free interest rates and future dividend payments. For the three and six months ended September 30, 2014 and 2013, the Company used the historical volatility of its stock over a period equal to the expected life of the options. The expected life assumptions represent the weighted-average period stock-based awards are expecting to remain outstanding. These expected life assumptions were established through the review of historical exercise behavior of stock-based award grants with similar vesting periods. The risk-free interest rate is based on the closing market bid yields on actively traded U.S. treasury securities in the over-the-counter market for the expected term equal to the expected term of the option. The dividend yield assumption is based on the Company's history and expectation of future dividend payout. Compensation expense for stock-based payment awards is recognized using the straight-line single-option method and includes the impact of estimated forfeitures.

As of September 30, 2014, unamortized stock-based compensation expense related to unvested stock awards was approximately $15.0 million, which is expected to be recognized over a weighted average period of 2.65 years.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Expected volatility	58%	64%	58%	64%
Expected dividend yield	-	-	-	-
Risk-free interest rate	1.74%	1.98%	1.72%	1.88%
Weighted average expected option term	5.30 years	6.20 years	5.20 years	6.10 years
Weighted average fair value of options granted	$ 3.90	$ 5.76	$ 3.91	$ 5.62

In accordance with ASC 718 - *Stock Compensation*, the Company recorded $1.7 million and $1.0 million in compensation expense relative to stock-based awards for the three months ended September 30, 2014 and 2013, and $3.4 million and $1.8 million for the six months ended September 30, 2014 and 2013, respectively.

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan, or ESPP, eligible employees can participate and purchase common stock semi-annually through payroll deductions at a price equal to 85% of the fair market value of the common stock at the beginning of each one year offering period or the end of the applicable six month purchase period within that offering period, whichever is lower. The contribution amount may not exceed 10% of an employee's base compensation, including commissions but not including bonuses and overtime. The Company accounts for the ESPP as a compensatory plan and recorded compensation expense of $0.3 million and $0.1 million for the three months ended September 30, 2014 and 2013, and $0.5 million and $0.3 million for the six months ended September 30, 2014 and 2013, respectively, in accordance with ASC 718.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Expected volatility	46%	38%	46%	38%
Expected dividend yield	-	-	-	-
Risk-free interest rate	0.09%	0.11%	0.09%	0.11%
Weighted average expected ESPP option term	0.75 years	0.75 years	0.75 years	0.75 years
Weighted average fair value of ESPP options granted	$ 2.46	$ 2.60	$ 2.46	$ 2.60

As of September 30, 2014, there were approximately $0.4 million of total unrecognized compensation cost related to employee stock purchases. This cost is expected to be recognized over a weighted average period of 0.5 years.

ASC 718 requires the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow, rather than as an operating cash flow. The future realization of tax benefits related to stock-based compensation is dependent upon the timing of employee exercises and future taxable income, among other factors. The Company did not realize any tax benefit from the stock-based compensation charges incurred during the three and six months ended September 30, 2014 and 2013, respectively.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Cost of service revenue	$ 160	$ 68	$ 275	$ 136
Cost of product revenue	-	-	-	-
Research and development	315	141	629	295
Sales and marketing	910	393	1,654	740
General and administrative	623	504	1,297	842
Total stock-based compensation expense related to employee stock options and employee stock purchases, pre-tax	2,008	1,106	3,855	2,013
Tax benefit	-	-	-	-
Stock-based compensation expense related to employee stock options and employee stock purchases, net of tax	$ 2,008	$ 1,106	$ 3,855	$ 2,013

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* and the IASB has issued IFRS 15, *Revenue from Contracts with Customers*. The issuance of these documents completes the joint effort by the FASB and the IASB to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and IFRS. The new guidance affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. This ASU will supersede the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance. For public entities, the amendments are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

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

3. FAIR VALUE MEASUREMENT

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

September 30, 2014	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Balance at September 30, 2014**
Cash equivalents:				
Money market funds	$ 22,571	$ -	$ -	$ 22,571
Short-term investments:				
Money market funds	1,913	-	-	1,913
Commercial paper	-	18,235	-	18,235
Corporate debt	-	67,968	-	67,968
Municipal securities	-	5,433	-	5,433
Asset backed securities	-	26,039	-	26,039
Mortgage backed securities	-	6,926	-	6,926
International government securities	-	805	-	805
Certificates of deposit	-	2,200	-	2,200
Total	$ 24,484	$ 127,606	$ -	$ 152,090

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

4. BALANCE SHEET DETAIL

	September 30, 2014	March 31, 2014
Inventory (in thousands):		
Work-in-process	$ 12	$ 23
Finished goods	742	788
	$ 754	$ 811

5. NET INCOME PER SHARE

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

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Six Months Ended September 30, 2014	Six Months Ended September 30, 2013
	(in thousands, except per share amounts)			
Numerator:				
Income from continuing operations	$ 1,291	$ 1,488	$ 1,299	$ 3,480
Income from discontinued operations, net of income tax provision	-	743	-	890
Net income available to common stockholders	1,291	2,231	1,299	4,370
Denominator:				
Common shares	89,073	72,970	88,861	72,788
Denominator for basic calculation	89,073	72,970	88,861	72,788
Employee stock options	2,187	2,913	2,335	2,896
Stock awards	355	349	372	351
Denominator for diluted calculation	91,615	76,232	91,568	76,035
Income per share - continuing operations				
Basic	$ 0.01	$ 0.02	$ 0.01	$ 0.05
Diluted	$ 0.01	$ 0.02	$ 0.01	$ 0.05
Income per share - discontinued operations				
Basic	$ 0.00	$ 0.01	$ 0.00	$ 0.01
Diluted	$ 0.00	$ 0.01	$ 0.00	$ 0.01
Net income per share				
Basic	$ 0.01	$ 0.03	$ 0.01	$ 0.06
Diluted	$ 0.01	$ 0.03	$ 0.01	$ 0.06

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

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Six Months Ended September 30, 2014	Six Months Ended September 30, 2013
Employee stock options	1,422	325	1,396	495
Stock purchase rights	62	72	60	55
Total anti-dilutive employee stock-based securities	1,484	397	1,456	550

6. INCOME TAXES

For the three and six months ended September 30, 2014, the Company recorded a provision for income taxes of $1.4 million and $2.1 million which was primarily attributable to income from continuing operations. For the three and six months ended September 30, 2013, the Company recorded a provision for income taxes of $1.4 million and $2.5 million which was primarily attributable to income from continuing operations ($0.8 million and $1.8 million, respectively), income from discontinued operations ($0.1 million and $0.2 million respectively) and gain on disposal of discontinued operations ($0.5 million).

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

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

The Company is subject to taxation in the U.S., California and various other states and foreign jurisdictions in which it has or had a subsidiary or branch operations or it is collecting sales tax. All tax returns from fiscal 1995 to fiscal 2014 may be subject to examination by the Internal Revenue Service, California and various other states. As of October 20, 2014, there were no active federal or state income tax audits. Returns filed in foreign jurisdictions may be subject to examination for the fiscal years 2010 to 2014.

7. SEGMENT REPORTING

ASC 280, "*Segment Reporting*" establishes annual and interim reporting standards for an enterprise's business segments and related disclosures about its products, services, geographic areas and major customers. Under ASC 280, the method for determining what information to report is based upon the way management organizes the operating segments within the Company for making operating decisions and assessing financial performance. The Company has determined that it has only one reportable segment. The Company's chief operating decision makers, the Chief Executive Officer, Chief Financial Officer and Chief Technology Officer, evaluate performance of the Company and make decisions regarding allocation of resources based on total Company results.

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

	Three Months Ended September 30,		**Six Months Ended September 30,**	
	2014	**2013**	**2014**	**2013**
Americas (principally US)	92%	99%	92%	99%
Europe	7%	0%	7%	0%
Asia Pacific	1%	1%	1%	1%
	100%	100%	100%	100%

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

	September 30, 2014	**March 31, 2014**
United States	$ 7,822	$ 6,305
Europe	1,474	1,087
Asia	259	319
Total	$ 9,555	$ 7,711

8. COMMITMENTS AND CONTINGENCIES

Guarantees

Indemnifications

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

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

Product Warranties

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Balance at beginning of period	$ 619	$ 474	$ 660	$ 452
Accruals for warranties	15	293	68	470
Settlements	(96)	(215)	(190)	(370)
Balance at end of period	$ 538	$ 552	$ 538	$ 552

Minimum Third Party Customer Support Commitments

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

Minimum Third Party Network Service Provider Commitments

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

Year ending March 31:	
Remaining 2015	$ 1,196
2016	1,726
2017	1,501
2018	1,035
Total minimum payments	$ 5,458

Legal Proceedings

From time to time, the Company may become involved in various legal claims and litigation that arise in the normal course of its operations. While the results of such claims and litigation cannot be predicted with certainty, the Company is not currently aware of any such matters that it believes would have a material adverse effect on its financial position, results of operations or cash flows.

On February 22, 2011, we were named a defendant in a lawsuit, Bear Creek Technologies, Inc. v. 8x8, Inc. *et al.*, along with 20 other defendants. On August 17, 2011, we were dismissed without prejudice from this lawsuit under Rule 21 of the Federal Rules of Civil Procedure. On August 17, 2011, we were sued again by Bear Creek Technologies, Inc. in the United States District Court for the District of Delaware. We believe we have factual and legal defenses to these claims and are presenting a vigorous defense. Further, on November 28, 2012, the U.S. Patent & Trademark Office initiated a Reexamination proceeding with a Reexamination Declaration explaining that there is a substantial new question of patentability, based on four separate grounds and affecting each claim of the patent which is the basis for the complaint filed against us. On March 26, 2013, the USPTO issued a first Office Action in the Reexamination, with all claims of the '722 patent being rejected on each of the four separate grounds raised in the Request for Reexamination. On July 10, 2013, we filed an informational pleading in support of and joining a motion to stay the proceeding in the District Court; the District Court granted the motion on July 17, 2013, based on the possibility that at least one of the USPTO rejections will be upheld and considering the USPTO's conclusion that Bear Creek's patent suffers from a defective claim for priority. On March 24, 2014, the USPTO issued another Office Action in which the rejections of the claims were maintained. On August 15, 2014, the USPTO issued a Right of Appeal Notice, as the USPTO maintained all rejections of the patent claims. On September 15, 2014, Bear Creek Technologies, Inc. filed a Notice of Appeal of this decision. We cannot estimate potential liability in this case at this early stage of litigation.

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

State and Municipal Taxes

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

9. PATENT SALE

On June 22, 2012, the Company entered into a patent purchase agreement and sold a family of patents to a third party for $12.0 million plus a future payment of up to a maximum of $3.0 million based on future license agreements entered into by the third party purchaser. In August 2014, the Company collected and recognized a gain of $1.0 million attributable to a license agreement obtained by the third party purchaser. As of September 30, 2014, there remained a maximum of $1.0 million of potential future payments under the agreement based on future license agreements obtained by the third party purchaser. Under the terms and conditions of the patent purchase agreement, the Company has retained certain limited rights to continue to use the patents. The patent purchase agreement contains representations and warranties customary for transactions of this type.

10. DISCONTINUED OPERATIONS

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

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

The dedicated server hosting business has been reported as discontinued operations. The results of operations of these discontinued operations were as follows (in thousands):

Results of operations:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$ -	$ 677	$ -	$ 1,430
Operating expense	-	420	-	922
Income before income taxes	-	257	-	508
Provision for income taxes	-	103	-	207
Income from discontinued operations	-	154	-	301
Gain on disposal of discontinued operations, net of income tax provision of $463	-	589	-	589

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

FORWARD-LOOKING STATEMENTS

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

's ability to execute its plans, strategies and objectives for future operations, including the execution of integration plans, and to realize the expected benefits of our acquisitions, and potential future intellectual property infringement claims and other litigation that could adversely affect our business and operating results. All forward-looking statements included in this report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. In addition to the factors discussed elsewhere in this Form 10-Q, see the Risk Factors discussion in Item 1A of our 2013 Form 10-K. The forward-looking statements included in this Form 10-Q are made only as of the date of this report, and we undertake no obligation to update the forward-looking statements to reflect subsequent events or circumstances.

BUSINESS OVERVIEW

We develop and market a comprehensive portfolio of cloud-based communication and collaboration solutions that include hosted cloud telephony, unified communications, contact center, video conferencing and virtual desktop software and services. These communication and collaboration services are offered from the Internet cloud via a software-as-a-service subscription. We also provide cloud-based computing services. As of September 30, 2014, we had approximately 40,400 business customers. Since fiscal 2004, substantially all of our revenue has been generated from the sale, license and provision of these cloud products, services and technology. Prior to fiscal 2003

, our focus was on our Voice over Internet Protocol semiconductor business.

Our fiscal year ends on March 31 of each calendar year. Each reference to a fiscal year in this report refers to the fiscal year ending March 31 of the calendar year indicated (for example, fiscal 2015 refers to the fiscal year ending March 31, 2015).

SUMMARY AND OUTLOOK

In the second quarter of fiscal 2015, we experienced continued momentum with revenue increasing 29% year over year to a record $39.6 million; service revenue increasing 30% year over year; average monthly service revenue per business customer of $299, up 12% compared with $268 in the same period last year; and revenue churn of 0.9%, the second consecutive quarter below 1%. In addition, revenue from our mid-market customers represented 41% of our service revenue in fiscal 2015 compared to 35% for fiscal 2014. We will continue invest in research and development, customer support and sales and marketing to enhance our service offering to target the mid-market and distributed enterprises.

CRITICAL ACCOUNTING POLICIES & ESTIMATES

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

RECENT ACCOUNTING PRONOUNCEMENTS

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

SELECTED OPERATING STATISTICS

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

	Selected Operating Statistics (1)				
	Sept. 30, 2014	**June 30, 2014**	**March 31, 2014**	**Dec 31, 2013**	**Sept. 30, 2013**
Total business customers (2)	40,434	39,340	37,933	36,753	34,674
Business customers average monthly service revenue per customer (3)	$ 299	$ 293	$ 287	$ 274	$ 268
Monthly business service revenue churn	0.9%	0.4%	1.2%	1.5%	1.2%
Overall service margin	79%	80%	79%	81%	81%
Overall product margin	-8%	-9%	-23%	-34%	-27%
Overall gross margin	72%	71%	70%	71%	71%

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

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

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

RESULTS OF OPERATIONS

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

Service revenue	**September 30,** 2014	2013	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 36,121	$ 27,826	$ 8,295	29.8%
Percentage of total revenue	91.2%	90.3%		
Six months ended	$ 70,397	$ 54,325	$ 16,072	29.6%
Percentage of total revenue	90.8%	90.4%		

Service revenue consists primarily of revenue attributable to the provision of our 8x8 cloud communication and collaboration services, and royalties earned from cloud technology licenses. We expect that cloud communication and collaboration service revenues will continue to comprise nearly all of our service revenues for the foreseeable future. Cloud and collaboration service revenues increased in the second quarter of fiscal 2015 primarily due to the increase in our business customer subscriber base (net of customer churn). Our business subscriber base grew from approximately 34,700 business customers on September 30, 2013, to approximately 40,400 on September 30, 2014, and average monthly service revenue per customer increased from $268 at September 30, 2013 to $299 at September 30, 2014.

Cloud communication and collaboration service revenues increased in the six months of fiscal 2015 also primarily due to the increases in our business customer subscriber base (net of customer churn) and average monthly service revenue per customer. Our business service subscriber base increased approximately from 37,900 business customers on April 1, 2014, to approximately 40,400 on September 30, 2014, and average monthly service revenue per customer increased from $287 at April 1, 2014 to $299 at September 30, 2014. The increase in business customers included approximately 1,000 customers obtained through our acquisition of Voicenet Ltd, on November 29, 2013.

Product revenue	**September 30,** 2014	2013	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 3,477	$ 2,989	$ 488	16.3%
Percentage of total revenue	8.8%	9.7%		
Six months ended	$ 7,114	$ 5,741	$ 1,373	23.9%
Percentage of total revenue	9.2%	9.6%		

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

No customer represented greater than 10% of our total revenues for the three months ended September 30, 2014 or 2013.

Cost of service revenue	**September 30,** 2014	2013	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 7,505	$ 5,209	$ 2,296	44.1%
Percentage of service revenue	20.8%	18.7%		
Six months ended	$ 14,502	$ 9,995	$ 4,507	45.1%
Percentage of service revenue	20.6%	18.4%		

The cost of service revenue primarily consists of costs associated with network operations and related personnel, telephony origination and termination services provided by third party carriers and technology license and royalty expenses. Cost of service revenue for the three months ended September 30, 2014 increased over the comparable period in the prior fiscal year primarily due to a $1.3 million increase in third-party network service expenses, a $0.5 million increase in payroll and related expenses, a $0.3 million increase in depreciation, and a $0.1 million increase in stock-based compensation expenses.

Cost of service revenue for the six months ended September 30, 2014 increased over the comparable period in the prior fiscal year primarily due to a $2.4 million increase in third party network services expenses, a $0.9 million increase in payroll and related expenses, a $0.4 million increase in depreciation expense, and a $0.1 million increase in stock-based compensation expenses.

Cost of product revenue	September 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 3,762	$ 3,783	$ (21)	-0.6%
Percentage of product revenue	108.2%	126.6%		
Six months ended	$ 7,731	$ 7,130	$ 601	8.4%
Percentage of product revenue	108.7%	124.2%		

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

Research and development	September 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 3,496	$ 2,640	$ 856	32.4%
Percentage of total revenue	8.8%	8.6%		
Six months ended	$ 6,902	$ 4,976	$ 1,926	38.7%
Percentage of total revenue	8.9%	8.3%		

Historically, our research and development expenses have consisted primarily of personnel, system prototype design, and equipment costs necessary for us to conduct our development and engineering efforts. During the three and six months ended September 30, 2014, we expensed all research and development costs as they were incurred in accordance with ASC 985-20. The research and development expenses for the three months ended September 30, 2014 increased over the comparable period in the prior fiscal year primarily due to a $0.4 million increase in consulting, temporary personnel, and outside service expenses, a $0.4 million increase in payroll and related costs, and a $0.2 million increase in stock-based compensation expenses.

The research and development expenses for the six months ended September 30, 2014 increased over the comparable period in the prior fiscal year primarily due to a $0.8 million increase in consulting, temporary personnel, and outside service expenses, a $0.7 million increase in payroll and related costs, and a $0.4 million increase in stock-based compensation expenses.

Sales and marketing	September 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 19,440	$ 13,745	$ 5,695	41.4%
Percentage of total revenue	49.1%	44.6%		
Six months ended	$ 38,600	$ 26,817	$ 11,783	43.9%
Percentage of total revenue	49.8%	44.6%		

Sales and marketing expenses consist primarily of personnel and related overhead costs for sales, marketing, and customer service. Such costs also include outsourced customer service call center operations, sales commissions, as well as trade show, advertising and other marketing and promotional expenses. Sales and marketing expenses for the three months ended September 30, 2014 increased over the same quarter in the prior fiscal year primarily because of a $2.9 million increase in payroll and related costs, a $0.5 million increase in stock-based compensation expenses, a $0.4 million increase in indirect channel commission expenses, a $0.3 million increase in temporary personnel, consulting and outside service expenses, a $0.2 million increase in travel expenses, a $0.2 million increase in amortization expense, offset by a $0.1 million decrease in bad debt expenses.

Sales and marketing expenses for the six months ended September 30, 2014 increased over the same period in the prior fiscal year primarily because of a $7.0 million increase in payroll and related costs, $0.9 million increase in stock-based compensation expenses, a $0.9 million increase in indirect channel commissions, a $0.7 million increase in temporary personnel, consulting and outside service expenses, a $0.5 million increase in amortization expense, a $0.4 million increase in travel expenses, a $0.2 million increase in sales promotions, and a $0.1 million increase in advertising expenses.

General and administrative	September 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 3,893	$ 3,125	$ 768	24.6%
Percentage of total revenue	9.8%	10.1%		
Six months ended	$ 7,771	$ 5,897	$ 1,874	31.8%
Percentage of total revenue	10.0%	9.8%		

General and administrative expenses consist primarily of personnel and related overhead costs for finance, human resources and general management. General and administrative expenses for the three months ended September 30, 2014 increased over the same quarter in the prior fiscal year primarily because of a $0.5 million increase in payroll and related costs, a $0.2 million increase in recruiting expenses, a $0.1 million increase in stock-based compensation expenses, a $0.1 million increase in rent expense, offset by a $0.2 million decrease in legal fees.

General and administrative expenses for the six months ended September 30, 2014 increased over the same period in the prior fiscal year primarily because of a $0.8 million increase in payroll and related expenses, a $0.4 million increase in stock-based compensation expenses, a $0.3 million increase in recruiting expenses, and a $0.1 million increase in rent expense.

Gain on patent sale	September 30, 2014	2013	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ (1,000)	$ -	$ (1,000)	-100.0%
Percentage of total revenue	-2.5%	0.0%		
Six months ended	$ (1,000)	$ -	$ (1,000)	-100.0%
Percentage of total revenue	-1.3%	0.0%		

In June 2012, we entered into a patent purchase agreement for the sale of a family of United States patents. We recognized a gain of $1.0 million for the three months ended September 30, 2014 due to the third party purchaser entering into a license agreement with its customer. The gain on patent sale has been recorded as a reduction of operating expenses in the consolidated statements of income.

Other income, net	**September 30, 2014**	**2013**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 200	$ 1	$ 199	19900.0%
Percentage of total revenue	0.5%	0.0%		
Six months ended	$ 377	$ 16	$ 361	2256.3%
Percentage of total revenue	0.5%	0.0%		

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

Provision for income tax	**September 30, 2014**	**2013**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 1,411	$ 826	$ 585	70.8%
Percentage of income before provision for income taxes	52.2%	35.7%		
Six months ended	$ 2,083	$ 1,787	$ 296	16.6%
Percentage of income before provision for income taxes	61.6%	33.9%		

For the three months ended September 30, 2014, we recorded a provision for income taxes of $1.4 million which was primarily attributable to income from continuing operations, which included a one-time $1.0 million benefit related to the patent license sale. For the three months ended September 30, 2013, we recorded a provision for income taxes of $0.8 million which was primarily attributable to income from continuing operations.

For the six months ended September 30, 2014, we recorded a provision for income taxes of $2.1 million which was primarily attributable to income from continuing operations.

For the six months ended September 30, 2013, we recorded a provision for income taxes of $1.8 million which was primarily attributable to income from continuing operations, reduced by $0.2 million as an adjustment for prior period city income tax returns that were treated as discrete items for fiscal 2014.

The effective tax rate is calculated by dividing the income tax provision by net income before income tax expense. We estimate our annual effective tax rate at the end of each quarter. In estimating the annual effective tax rate, we, in consultation with our tax advisors, consider, among other things, annual pre-tax income, permanent tax differences, the geographic mix of pre-tax income and the application and interpretations of existing tax laws. Operating losses in non-US tax jurisdictions cannot presently be used to offset profits and therefore increases our effective tax rate.

Income from discontinued operations, net of income tax provision	**September 30, 2014**	**2013**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ -	$ 154	$ (154)	-100.0%
Percentage of total revenue	0.0%	0.5%		
Six months ended	$ -	$ 301	$ (301)	-100.0%
Percentage of total revenue	0.0%	0.5%		

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

Gain on disposal of discontinued operations, net of income tax provision	**September 30, 2014**	**2013**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ -	$ 589	$ (589)	-100.0%
Percentage of total revenue	0.0%	1.9%		
Six months ended	$ -	$ 589	$ (589)	-100.0%
Percentage of total revenue	0.0%	1.0%		

For the three and six months ended September 30, 2013, we recorded a gain on disposal of our dedicated server hosting business of $1.1 million, net of a tax provision of $0.5 million.

Liquidity and Capital Resources

As of September 30, 2014, we had approximately $185.6 million in cash, cash equivalents and short-term investments.

Net cash provided by operating activities for the six months ended September 30, 2014 was approximately $8.6 million, compared with $9.0 million for the six months ended September 30, 2013. Cash provided by operating activities has historically been affected by the amount of net income, sales of subscriptions, changes in working capital accounts particularly in deferred revenue due to timing of annual plan renewals, add-backs of non-cash expense items such as the use of deferred tax assets, depreciation and amortization and the expense associated with stock-based awards.

Net cash used in investing activities was approximately $13.5 million during the six months ended September 30, 2014. We spent approximately $2.6 million on the purchase of property and equipment, and we purchased $10.7 million of short term investments, net of sales, proceeds and maturities of short-term investments. The net cash used in investing activities for the six months ended September 30, 2013 was $1.9 million during which period we spent approximately $1.4 million on the purchase of additional furniture and fixtures and leasehold and capitalized $0.5 million of software costs.

Our financing activities for the six months ended September 30, 2014 consisted primarily of cash from the issuance of shares due to exercise of employee stock options and the purchase of shares under the employee stock purchase plan of $1.7 million offset by cash used to repurchase shares of our common stock of $0.1 million and payments under capital leases of $0.1 million.

Our financing activities for the six months ended September 30, 2013 consisted primarily of cash from the issuance of shares due to exercise of employee stock options and the purchase of shares under the employee stock purchase plan of $2.2 million offset by cash used to repurchase shares of our common stock of $0.3 million.

Contractual Obligations

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

We lease our UK headquarters in Aylesbury UK under an operating lease agreement that expires in March 2017, with a break clause in March 2015 exercisable with six months' notice. The lease has a base monthly rent of $10,087 until March 2015, rising to $13,285 thereafter, and requires us to pay property taxes, service charges, utilities and normal maintenance costs. The lease was amended in September 2014 for additional space.

We entered into a series of noncancelable capital lease agreements for office equipment bearing interest at various rates. Assets under capital lease at September 30, 2014 totaled $0.5 million with accumulated amortization of $0.3 million.

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

We have entered into contracts with multiple vendors for third party network services. At September 30, 2014, future minimum annual payments under these third party network service contracts were $1.2 million in fiscal 2015, $1.7 million for fiscal 2016, $1.5 million for fiscal 2017, and $1.0 million for fiscal 2018.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency

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

Investments

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Effectiveness of Disclosure Controls and Procedures

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

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

Limitations on the Effectiveness of Controls

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

Changes in Internal Control over Financial Reporting

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

PART II -- OTHER INFORMATION

ITEM 1. Legal Proceedings

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

"Note 8".

ITEM 1A. Risk Factors

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

ITEM 6. EXHIBITS

Exhibit Number	Description
10.2	Employment Agreement dated October 6, 2014 between the Company and Mary Ellen Genovese
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

SIGNATURE

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

Date: October 22, 2014

8X8, INC.
(Registrant)

By: /s/ DANIEL WEIRICH
Daniel Weirich

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