8X8 INC /DE/
Form 10-Q
November 02, 2016

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, 2016

OR

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

For the transition period from ________to _________

Commission file number 000-21783

8X8, INC.

(Exact name of Registrant as Specified in its Charter)

Delaware	**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 26, 2016 was 90,551,664.

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Part I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	September 30, 2016	March 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,094	$ 33,576
Short-term investments	137,650	129,274
Accounts receivable, net	11,661	11,070
Inventory	464	520
Deferred cost of goods sold	699	634
Deferred tax asset	-	5,382
Other current assets	6,667	5,444
Total current assets	189,235	185,900
Property and equipment, net	15,315	12,375
Intangible assets, net	18,212	21,464
Goodwill	45,290	47,420
Non-current deferred tax asset	48,565	43,189
Other assets	5,415	3,104
Total assets	$ 322,032	$ 313,452
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 14,026	$ 10,954
Accrued compensation	9,995	10,063
Accrued warranty	333	326
Accrued taxes	5,424	5,200
Accrued outside commissions	2,183	2,186
Deferred revenue	2,281	1,925
Other accrued liabilities	3,033	4,080
Total current liabilities	37,275	34,734
Non-current liabilities	3,321	3,258
Non-current deferred revenue	112	154
Total liabilities	40,708	38,146
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Common stock	90	89
Additional paid-in capital	399,955	389,260
Accumulated other comprehensive loss	(8,361)	(4,184)
Accumulated deficit	(110,360)	(109,859)
Total stockholders' equity	281,324	275,306
Total liabilities and stockholders' equity	$ 322,032	$ 313,452

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Service revenue	$ 57,717	$ 46,951	$ 113,013	$ 91,119
Product revenue	5,466	3,991	10,211	7,715
Total revenue	63,183	50,942	123,224	98,834
Operating expenses:				
Cost of service revenue	10,837	9,186	21,072	17,645
Cost of product revenue	5,782	4,596	11,287	8,978
Research and development	6,505	6,446	13,215	11,526
Sales and marketing	33,691	26,730	65,382	50,554
General and administrative	6,747	5,657	13,548	11,725
Total operating expenses	63,562	52,615	124,504	100,428
Loss from operations	(379)	(1,673)	(1,280)	(1,594)
Other income, net	391	204	801	438
Income (loss) before provision (benefit) for income taxes	12	(1,469)	(479)	(1,156)
Provision (benefit) for income taxes	(15)	423	22	1,208
Net income (loss)	$ 27	$ (1,892)	$ (501)	$ (2,364)
Net income (loss) per share:				
Basic	$ 0.00	$ (0.02)	$ (0.01)	$ (0.03)
Diluted	$ 0.00	$ (0.02)	$ (0.01)	$ (0.03)
Weighted average number of shares:				
Basic	89,987	88,557	89,171	88,397
Diluted	93,447	88,557	89,171	88,397

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Net income (loss)	$ 27	$ (1,892)	$ (501)	$ (2,364)
Other comprehensive income (loss), net of tax				
Unrealized gain (loss) on investments in securities	(39)	(29)	107	(76)
Foreign currency translation adjustment	(1,500)	(1,409)	(4,284)	68
Comprehensive loss	$ (1,512)	$ (3,330)	$ (4,678)	$ (2,372)

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, 2016	Six Months Ended September 30, 2015
Cash flows from operating activities:		
Net loss	$ (501)	$ (2,364)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	2,979	2,275
Amortization of intangible assets	1,868	1,563
Amortization of capitalized software	296	456
Net accretion of discount and amortization of premium on marketable securities	171	435
Stock-based compensation expense	9,559	6,539
Deferred income tax (benefit) provision	(153)	687
Other	328	248
Changes in assets and liabilities:		
Accounts receivable, net	(1,859)	(2,976)
Inventory	38	(200)
Other current and noncurrent assets	(2,216)	(794)
Deferred cost of goods sold	(119)	(77)
Accounts payable	3,133	132
Accrued compensation	46	1,234
Accrued warranty	7	(14)
Accrued taxes	290	891
Deferred revenue	367	(621)
Accrued outside commissions	(3)	874
Other current and noncurrent liabilities	(807)	(1,173)
Net cash provided by operating activities	13,424	7,115
Cash flows from investing activities:		
Purchases of property and equipment	(5,230)	(2,118)
Cost of capitalized software	(2,443)	(708)
Purchase of businesses, net of cash acquired	-	(23,434)
Proceeds from maturity of investments	29,225	24,106
Sales of investments - available for sale	26,863	31,299
Purchases of investments - available for sale	(64,517)	(52,286)
Net cash used in investing activities	(16,102)	(23,141)
Cash flows from financing activities:		
Capital lease payments	(333)	(200)
Payment of contingent consideration and escrow	(200)	(150)
Repurchase of common stock	(842)	(10,133)
Proceeds from issuance of common stock under employee stock plans	2,600	2,076
Net cash provided by (used in) financing activities	1,225	(8,407)
Effect of exchange rate changes on cash	(29)	118
Net decrease in cash and cash equivalents	(1,482)	(24,315)
Cash and cash equivalents, beginning of the period	33,576	53,110
Cash and cash equivalents, end of the period	$ 32,094	$ 28,795
Supplemental cash flow information		
Income taxes paid	$ 286	$ 299
Interest paid	12	17
Property and equipment acquired under capital leases	823	-

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

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

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

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

BASIS OF PRESENTATION

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

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

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

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

RECLASSIFICATION

Certain amounts previously reported within the Company's consolidated balance sheets and statements of cash flows have been reclassified to conform to the current period presentation. The reclassification had no impact on the Company's previously reported net income (loss), cash flows, or basic or diluted net income per share amounts.

PRINCIPLES OF CONSOLIDATION

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

SIGNIFICANT ACCOUNTING POLICIES

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

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

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

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

RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, along with amendments issued in 2015 and 2016, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard will become effective for the Company on April 1, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. The Company has not yet selected a transition method. The Company is currently assessing the impact of this pronouncement and its amendments to its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments -Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which provides guidance for measurement and recognition of expected credit losses for financial assets held based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The amendment is effective for fiscal years beginning after December 15, 2020. Early adoption is permitted for fiscal years beginning after December 15, 2018. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15*, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which provides guidance on how certain cash receipts and cash payments are to be presented and classified in the statement of cash flows. This amendment is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact of this pronouncement to its Consolidated Statements of Cash Flows.

2. FAIR VALUE MEASUREMENTS

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

As of September 30, 2016	**Amortized Costs**	**Gross Unrealized Gain**	**Gross Unrealized Loss**	**Estimated Fair Value**	**Cash and Cash Equivalents**	**Short-Term Investments**
Cash	$ 24,564	$ -	$ -	$ 24,564	$ 24,564	$ -
Level 1:						
Money market funds	7,530	-	-	7,530	7,530	-
Mutual funds	2,000	-	(169)	1,831	-	1,831
Subtotal	34,094	-	(169)	33,925	32,094	1,831
Level 2:						
Commercial paper	15,578	6	-	15,584	-	15,584
Corporate debt	91,244	116	(16)	91,344	-	91,344
Asset backed securities	24,063	26	(1)	24,088	-	24,088
Mortgage backed securities	1,814	-	(14)	1,800	-	1,800
Agency bond	2,000	2	-	2,002	-	2,002
International government securities	1,000	1	-	1,001	-	1,001
Subtotal	135,699	151	(31)	135,819	-	135,819
Total assets	$ 169,793	$ 151	$ (200)	$ 169,744	$ 32,094	$ 137,650
Level 3:						
Contingent consideration	$ -	$ -	$ -	$ 216	$ -	$ -
Total liabilities	$ -	$ -	$ -	$ 216	$ -	$ -

As of March 31, 2016	**Amortized Costs**	**Gross Unrealized Gain**	**Gross Unrealized Loss**	**Estimated Fair Value**	**Cash and Cash Equivalents**	**Short-Term Investments**
Cash	$ 18,596	$ -	$ -	$ 18,596	$ 18,596	$ -
Level 1:						
Money market funds	14,980	-	-	14,980	14,980	-
Mutual funds	2,000	-	(187)	1,813	-	1,813
Subtotal	35,576	-	(187)	35,389	33,576	1,813
Level 2:						
Commercial paper	6,794	2	-	6,796	-	6,796
Corporate debt	85,164	78	(28)	85,214	-	85,214
Municipal securities	1,007	-	(1)	1,006	-	1,006
Asset backed securities	24,614	7	(11)	24,610	-	24,610
Mortgage backed securities	2,045	-	(17)	2,028	-	2,028
Agency bond	6,805	1	-	6,806	-	6,806
International government securities	1,000	1	-	1,001	-	1,001
Subtotal	127,429	89	(57)	127,461	-	127,461
Total assets	$ 163,005	$ 89	$ (244)	$ 162,850	$ 33,576	$ 129,274
Level 3:						
Contingent consideration	$ -	$ -	$ -	$ 341	$ -	$ -
Total liabilities	$ -	$ -	$ -	$ 341	$ -	$ -

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

	Estimated Fair Value
Due within one year	$ 83,100
Due after one year	54,550
Total	$ 137,650

Contingent Consideration and Escrow Liability

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Balance at beginning of period	$ 216	$ 391	$ 341	$ -
Purchase price contingent consideration	-	-	-	391
Contingent consideration payments	-	(150)	(125)	(150)
Balance at end of period	$ 216	$ 241	$ 216	$ 241

3. INVENTORIES

	September 30, 2016	March 31, 2016
Inventory (in thousands)		
Work-in-process	$ -	$ 76
Finished goods	464	444
	$ 464	$ 520

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4. INTANGIBLE ASSETS AND GOODWILL

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

	September 30, 2016			March 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Technology	$ 17,776	$ (5,776)	$ 12,000	$ 18,640	$ (4,622)	$ 14,018
Customer relationships	9,600	(5,562)	4,038	9,993	(4,847)	5,146
Trade names/domains	2,079	-	2,079	2,205	-	2,205
In-process research and development	95	-	95	95	-	95
Total acquired identifiable intangible assets	$ 29,550	$ (11,338)	$ 18,212	$ 30,933	$ (9,469)	$ 21,464

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

	Amount
Remaining 2017	$ 1,803
2018	3,340
2019	3,090
2020	3,090
2021	2,735
Thereafter	1,980
Total	$ 16,038

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

	Americas	Europe	Total
Balance as of March 31, 2016	$ 25,729	$ 21,691	$ 47,420
Foreign currency translation	-	(2,130)	(2,130)
Balance as of September 30, 2016	$ 25,729	$ 19,561	$ 45,290

5. RESEARCH, DEVELOPMENT AND SOFTWARE COSTS

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

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

Other Long-Term Assets

In the first six months of fiscal 2017, the Company capitalized $2.4 million as other long-term assets. In the first six months of fiscal 2016, the Company capitalized $0.7 million as other long-term assets. At September 30, 2016 and March 31, 2016, total completed capitalized software development cost included in other long-term assets was approximately $1.7 million and $0, respectively. At September 30, 2016 and March 31, 2016, accumulated amortization cost related to completed capitalized software in other long term assets was approximately $0.3 million and $0, respectively.

Property and Equipment

In the first six months of fiscal 2017, the Company capitalized $0.5 million as property and equipment. In the first six months of fiscal 2016, the Company capitalized $0.3 million as property and equipment. At September 30, 2016 and March 31, 2016, total completed capitalized software cost included in property and equipment was approximately $1.2 million. At September 30, 2016 and March 31, 2016, accumulated amortization cost related to completed capitalized software in property and equipment was approximately $0.4 million and $0.2 million, respectively.

6. COMMITMENTS AND CONTINGENCIES

Leases

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

The Company has entered into a series of noncancelable capital lease agreements for office equipment bearing interest at various rates. Assets under capital lease at September 30, 2016 totaled $2.4 million with accumulated amortization of $0.7 million.

Guarantees

Indemnifications

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

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

Product Warranties

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Balance at beginning of period	$ 340	$ 342	$ 326	$ 339
Accruals for warranties	113	77	227	175
Settlements	(88)	(70)	(175)	(153)
Adjustments	(32)	(24)	(45)	(36)
Balance at end of period	$ 333	$ 325	$ 333	$ 325

Minimum Third Party Customer Support Commitments

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

Minimum Third Party Network Service Provider Commitments

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

Year ending March 31:		
Remaining 2017	$	1,263
2018		1,363
2019		132
2020		8
Total minimum payments	$	2,766

Legal Proceedings

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

On February 22, 2011, the Company was named a defendant in Bear Creek Technologies, Inc. (BCT) v. 8x8, Inc. *et al.*, filed in the U.S. District Court for the District of Delaware (the Court), along with 20 other defendants. Collectively this patent litigation is collectively referred to as In re Bear Creek Technologies, Inc. (MDL No.: 2344). In August 2011, the suit was dismissed without prejudice and then was refiled against the Company before the same Court. On November 28, 2012, the USPTO initiated and has since maintained a Reexamination Proceeding in which the claims of a patent (asserted against the Company) were rejected as being invalid based on four separate grounds. In response to the USPTO invalidity rejections, the Company filed an informational pleading (on July 10, 2013) to join a motion to stay the proceeding in the District Court, which this motion was granted on July 17, 2013. On May 5, 2015 and presumably in light of the Reexamination Proceeding, the Court administratively closed this case with leave to reopen if needed. The Reexamination Proceeding was appealed to the USPTO Patent Trial and Appeal Board, which affirmed the rejection of all claims in a decision on December 29, 2015. Beginning on February 26, 2016, the patent owner initiated the formal process to appeal that decision to the Court of Appeals for the Federal Circuit. No hearing date has been set.

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

State and Municipal Taxes

From time to time, the Company has received inquiries from a number of state and municipal taxing agencies with respect to the remittance of sales, use, telecommunications, excise, and income taxes. Several jurisdictions currently are conducting tax audits of the Company's records. The Company collects or has accrued for taxes that it believes are required to be remitted. The amounts that have been remitted have historically been within the accruals established by the Company.

7. STOCK-BASED COMPENSATION

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Cost of service revenue	$ 440	$ 263	$ 800	$ 482
Cost of product revenue	-	-	-	-
Research and development	863	726	1,750	1,257
Sales and marketing	1,751	1,422	3,666	2,619
General and administrative	1,454	1,106	3,343	2,181
Total stock-based compensation expense related to employee stock options and employee stock purchases, pre-tax	4,508	3,517	9,559	6,539
Tax benefit	-	-	-	-
Stock-based compensation expense related to employee stock options and employee stock purchases, net of tax	$ 4,508	$ 3,517	$ 9,559	$ 6,539

Stock Options, Stock Purchase Right and Restricted Stock Unit Activity

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

	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding at March 31, 2016	4,793,266	$ 6.29
Granted	308,560	14.40
Exercised	(318,197)	1.83
Canceled/Forfeited	(1)	2.58
Outstanding at September 30, 2016	4,783,628	$ 7.11
Vested and expected to vest at September 30, 2016	4,783,628	$ 7.11
Exercisable at September 30, 2016	3,085,831	$ 5.80

Stock Purchase Right activity for the six months ended September 30, 2016 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, 2016	82,171	$ 6.30	0.76
Granted	-	-	
Vested	(65,006)	5.89	
Forfeited	(250)	7.88	
Balance at September 30, 2016	16,915	$ 7.86	1.21

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

	Number of Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (in Years)
Balance at March 31, 2016	4,544,799	$ 8.08	1.67
Granted	1,899,350	15.08	
Vested	(868,648)	8.27	
Forfeited	(141,143)	8.82	
Balance at September 30, 2016	5,434,358	$ 10.49	1.75

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

	Options Outstanding				Options Exercisable		
	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 to $4.26	995,448	$ 1.44	1.9	$ 13,930,587	995,448	$ 1.44	$ 13,930,587
$4.32 to $6.86	1,288,863	$ 6.26	7.0	11,825,206	925,675	$ 6.02	8,712,685
$7.52 to $8.93	973,650	$ 8.28	8.6	6,963,536	333,871	$ 8.23	2,403,471
$9.21 to $9.74	983,835	$ 9.62	7.0	5,711,928	729,275	$ 9.63	4,232,016
$10.50 to $15.18	541,832	$ 12.92	9.1	1,361,380	101,562	$ 11.10	439,646
	4,783,628			$ 39,792,637	3,085,831		$ 29,718,405

As of September 30, 2016, there was $52.6 million of unamortized stock-based compensation expense related to unvested stock options and awards which is expected to be recognized over a weighted average period of 2.26 years.

Unamortized stock-based compensation expense related to shares issued as part of a prior year acquisition was approximately $1.6 million, which will be recognized over a weighted average period of 2.67 years.

Assumptions Used to Calculate Stock-Based Compensation Expense

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Expected volatility	42%	53%	44%	53%
Expected dividend yield	-	-	-	-
Risk-free interest rate	1.12%	1.59%	1.17%	1.59%
Weighted average expected option term	4.50 years	5.57 years	4.72 years	5.46 years
Weighted average fair value of options granted	$ 5.46	$ 4.00	$ 5.46	$ 4.06

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Expected volatility	40%	45%	40%	45%
Expected dividend yield	-	-	-	-
Risk-free interest rate	0.45%	0.30%	0.45%	0.30%
Weighted average expected ESPP option term	0.76 years	0.75 years	0.76 years	0.75 years
Weighted average fair value of ESPP options granted	$ 4.04	$ 2.78	$ 4.04	$ 2.78

As of September 30, 2016, there were approximately $0.5 million of total unrecognized compensation cost related to employee stock purchases. This cost is expected to be recognized over a weighted average period of 0.5 years.

Performance Stock Units

During the three and six months ended September 30, 2016, the Company issued restricted performance stock units (PSUs) to a group of executives with vesting that is contingent on both market performance and continued service. These PSUs vest (1) 50% on September 22, 2018 and (2) 50% on September 27, 2019, in each case subject to the performance of the Company's common stock relative to the Russell 2000 Index (the benchmark) during the period from grant date through such vesting date. A 2x multiplier will be applied to the total shareholder returns (TSR) for each 1% of positive or negative relative TSR, and the number of shares earned will increase or decrease by 2% of the target numbers. In the event 8x8's common stock performance is below negative 30%, relative to the benchmark, no shares will be issued. These PSU grants are included in the restricted stock unit activity disclosure for the six months ended September 30, 2016.

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

Stock Repurchases

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

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

8. INCOME TAXES

For the three months ended September 30, 2016, the Company recorded a benefit from income taxes of $15,000, which was primarily attributable to income from operations. For the three months ended September 30, 2015, the Company recorded a provision for income taxes of $0.4 million, which was primarily attributable to income from operations.

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

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

The Company is subject to taxation in the U.S., California and various other states and foreign jurisdictions in which it has or had a subsidiary or branch operations or it is collecting sales tax. All tax returns from fiscal 2013 to fiscal 2016 may be subject to examination by the Internal Revenue Service, California and various other states. Net operating losses and tax credits carried forward to March 31, 2016 may still be subject to adjustment by the taxing authorities until the period is closed to examination. As of October 24, 2016, there were no active federal or state income tax audits. Returns filed in foreign jurisdictions may be subject to examination for the fiscal years 2011 to 2016.

9. NET INCOME (LOSS) PER SHARE

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

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Six Months Ended September 30, 2016	Six Months Ended September 30, 2015
Numerator:				
Net income (loss) available to common stockholders	$ 27	$ (1,892)	$ (501)	$ (2,364)
Denominator:				
Common shares	89,987	88,557	89,171	88,397
Denominator for basic calculation	89,987	88,557	89,171	88,397
Employee stock options	1,717	-	-	-
Stock purchase rights	1,743	-	-	-
Denominator for diluted calculation	93,447	88,557	89,171	88,397
Net income (loss) per share				
Basic	$ 0.00	$ (0.02)	$ (0.01)	$ (0.03)
Diluted	$ 0.00	$ (0.02)	$ (0.01)	$ (0.03)

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

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Six Months Ended September 30, 2016	Six Months Ended September 30, 2015
Employee stock options	187	2,640	153	2,544
Stock purchase rights	307	262	154	157
Total anti-dilutive employee stock-based securities	494	2,902	307	2,701

10. SEGMENT REPORTING

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

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

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

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Americas (principally US)	89%	86%	88%	87%
Europe (principally UK)	10%	14%	11%	11%
Asia-Pacific	1%	0%	1%	2%
	100%	100%	100%	100%

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

	September 30, 2016	March 31, 2016
Americas (principally US)	$ 11,231	$ 9,165
Europe (principally UK)	3,902	2,642
Asia-Pacific	182	568
Total	$ 15,315	$ 12,375

The following table provides financial information by segment for the three and six months ended September 30, 2016 and 2015 (in thousands):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Americas (principally US):				
Net revenues	$ 56,635	$ 44,086	$ 110,033	$ 87,674
Net income	$ 2,044	$ 15	$ 3,510	$ 266
Europe (principally UK):				
Net revenues	$ 6,548	$ 6,856	$ 13,191	$ 11,160
Net loss	$ (2,017)	$ (1,907)	$ (4,011)	$ (2,630)

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 of 1933 and Section 21E of the Securities Exchange Act of 1934. 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, market acceptance of new or existing services and features, success of our efforts to target mid-market and larger distributed enterprises, changes in the competitive dynamics of the markets in which we compete, customer cancellations and rate of churn, impact of current economic climate and adverse credit markets on our target customers, our ability to scale our business, 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, continued compliance with industry standards and regulatory requirements in the United States and foreign countries in which we make our software solutions available, 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, introduction and adoption of our cloud software solutions in markets outside of the United States, and general economic conditions that could adversely affect our business and operating results. All forward-looking statements included in this report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. In addition to the factors discussed elsewhere in this Form 10-Q, see the Risk Factors discussion in Item 1A of our 2016 Form 10-K. The forward-looking statements included in this Form 10-Q are made only as of the date of this report, and we undertake no obligation to update the forward-looking statements to reflect subsequent events or circumstances.

BUSINESS OVERVIEW

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

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

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

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

SUMMARY AND OUTLOOK

In the second quarter of fiscal 2017, our service revenue from mid-market and enterprise customers grew 36% year-over year and represented 53% of total service revenue. New monthly recurring revenue (MRR) bookings from mid-market and enterprise customers and by our channel sales teams increased 30% year-over-year, reflecting strong demand for our services in our target market segments. Also, average monthly service revenue per business customer (ARPU) increased 14% to a record $409, compared with $360 in the same period last year. Our ability to offer a broad range of cloud- based mission critical communications services is bringing us larger deals where we continue to displace incumbent, premises-based systems.

Building upon our Global Reach® initiative, during the quarter, we launched a new customer support center in the Philippines, and expect to open an additional support center in Cluj, Romania by the end of the calendar year. These new technical support operations outside of the U.S. will expand our 24/7 worldwide support capabilities while favorably impacting our margins through reduced customer support costs. Additionally, all of the three data datacenters that we announced earlier in the year, Amsterdam, Brazil and Singapore, are in operation and are supporting customers and users based in those regions.

We continued the advancement of our technology and service offerings in the second quarter of fiscal 2017 with two new product releases: Quality Management and Virtual Office for Sales. Our new Quality Management solution leverages cloud technology combined with deep Virtual Contact Center integration to deliver an easy to install, use and manage framework for monitoring and improving the quality of a customer's contact center operations. Our new Virtual Office for Sales solution streamlines the entire sales process with built in Salesforce.com integration across all Virtual-Office connected devices, including mobile, to offer a constantly updated view of communications activities along with detailed analytics on team, individual and account performance.

Despite increases in total revenue year over year, we are expecting a continued depreciation of the British Pound (GBP) to the U.S. Dollar (USD). A significantly weaker GBP compared to the USD could materially reduce our revenues after taking into account foreign currency translation adjustments.

CRITICAL ACCOUNTING POLICIES & ESTIMATES

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

RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

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

RECENT ACCOUNTING PRONOUNCEMENTS

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

SELECTED OPERATING STATISTICS

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

	Selected Operating Statistics				
	Sept. 30, 2016	June 30, 2016	March 31, 2016	Dec. 31, 2015	Sept. 30, 2015
Business customers average monthly service revenue per customer (1)	$ 409	$ 399	$ 385	$ 369	$ 360
Monthly business service revenue churn (2)(3)	0.6%	0.5%	0.4%	1.2%	0.7%
Overall service margin	81%	81%	81%	80%	80%
Overall product margin	-6%	-16%	-18%	-21%	-15%
Overall gross margin	74%	74%	72%	72%	73%

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

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

(3) Excludes DXI business customer service revenue churn for all periods presented.

RESULTS OF OPERATIONS

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

Service revenue	September 30, 2016	September 30, 2015	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ 57,717	$ 46,951	$ 10,766	22.9%
Percentage of total revenue	91.3%	92.2%		
Six months ended	$ 113,013	$ 91,119	$ 21,894	24.0%
Percentage of total revenue	91.7%	92.2%		

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

8x8 service revenues increased in the second quarter of fiscal 2017 compared with the second quarter of the previous fiscal year primarily due to an increase in our business customer subscriber base (net of customer churn), and an increase in the average monthly service revenue per customer. Average monthly service revenue per customer increased from $360 at September 30, 2015 to $409 at September 30, 2016. We expect growth in the number of business customers and average monthly service revenue per customer to continue to increase in fiscal 2017.

We translate revenue denominated in foreign currency into U.S. dollars for our financial statements. If the exchange rate for the GBP to the USD persists at current levels, or declines further, our revenues will be adversely impacted due to the foreign currency translation adjustment. We cannot ascertain how much impact this will have in fiscal 2017, but at the current exchange rate, we estimate a negative impact on revenues of approximately $1.2 million per quarter in comparison with the exchange rate for GBP to USD effective in the first quarter of fiscal 2017.

Product revenue	**September 30, 2016**	**2015**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 5,466	$ 3,991	$ 1,475	37.0%
Percentage of total revenue	8.7%	7.8%		
Six months ended	$ 10,211	$ 7,715	$ 2,496	32.4%
Percentage of total revenue	8.3%	7.8%		

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

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

Cost of service revenue	**September 30, 2016**	**2015**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 10,837	$ 9,186	$ 1,651	18.0%
Percentage of service revenue	18.8%	19.6%		
Six months ended	$ 21,072	$ 17,645	$ 3,427	19.4%
Percentage of service revenue	18.6%	19.4%		

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

Cost of service revenue for the three months ended September 30, 2016 increased over the comparable period in the prior fiscal year primarily due to a $0.8 million increase in third party network services expenses, a $0.2 million increase in payroll and related expenses, a $0.2 million increase in stock-based compensation expenses, and a $0.2 million increase in license and fee expenses.

Cost of service revenue for the six months ended September 30, 2016 increased over the comparable period in the prior fiscal year primarily due to a $1.6 million increase in third party network services expenses, a $0.6 million increase in amortization of intangibles expense, a $0.4 million increase in payroll and related expenses, a $0.3 million increase in license and fee expenses, and a $0.3 million increase in stock-based compensation expenses.

Cost of product revenue	**September 30, 2016**	**2015**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 5,782	$ 4,596	$ 1,186	25.8%
Percentage of product revenue	105.8%	115.2%		
Six months ended	$ 11,287	$ 8,978	$ 2,309	25.7%
Percentage of product revenue	110.5%	116.4%		

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

The cost of product revenue for the three and six months ended September 30, 2016 increased over the comparable period in the prior fiscal year primarily due to an increase in equipment shipped to customers. The decrease in negative margin is due to less discounting of equipment in the current period and to a decrease in our standard costs for certain phone equipment.

	September 30,		Dollar	Percent
Research and development	**2016**	**2015**	**Change**	**Change**
	(dollar amounts in thousands)			
Three months ended	$ 6,505	$ 6,446	$ 59	0.9%
Percentage of total revenue	10.3%	12.7%		
Six months ended	$ 13,215	$ 11,526	$ 1,689	14.7%
Percentage of total revenue	10.7%	11.7%		

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.

The research and development expenses for the three months ended September 30, 2016 increased over the comparable period in the prior fiscal year primarily due to a $1.3 million increase in payroll and related costs, offset by a $1.0 million of payroll and related costs, consulting and outside services capitalized in accordance with ASC 350-40, and an offset of $0.4 million decrease of facility allocation costs (which is based on employee headcount).

The research and development expenses for the six months ended September 30, 2016 increased over the comparable period in the prior fiscal year primarily due to a $0.6 million increase in facility allocation costs, $0.4 million increase in payroll and related costs, a $0.4 million increase in stock-based compensation expenses, and a $0.2 million increase in consulting, temporary personnel, and outside service expenses. We expect research and development expenses to increase for the foreseeable future as we continue to invest in our DXI unit and in the formation of our research and development team in Romania.

	September 30,		Dollar	Percent
Sales and marketing	**2016**	**2015**	**Change**	**Change**
	(dollar amounts in thousands)			
Three months ended	$ 33,691	$ 26,730	$ 6,961	26.0%
Percentage of total revenue	53.3%	52.5%		
Six months ended	$ 65,382	$ 50,554	$ 14,828	29.3%
Percentage of total revenue	53.1%	51.2%		

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

Sales and marketing expenses for the second quarter of fiscal 2017 increased over the same quarter in the prior fiscal year primarily due to a $4.3 million increase in payroll and related costs, a $0.9 million increase in lead generation expenses, a $1.3 million increase in facility allocation costs, a $0.4 million increase in indirect channel commission expenses, and a $0.3 million increase in stock-based compensation expenses.

Sales and marketing expenses for the six months ended September 30, 2016 increased over the same period in the prior fiscal year primarily because of an $8.8 million increase in payroll and related costs, a $2.3 million increase in departmental allocation costs, a $1.0 million increase in stock-based compensation expenses, a $1.0 million increase in indirect channel commissions, a $0.5 million increase in lead generation expenses, and a $0.5 million increase in travel expenses. We expect sales and marketing expenses to increase for the foreseeable future as we continue to increase our efforts to sell to larger businesses and to deploy our cloud communication and collaboration services globally to enterprise customers.

General and administrative	**September 30, 2016**	**2015**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 6,747	$ 5,657	$ 1,090	19.3%
Percentage of total revenue	10.7%	11.1%		
Six months ended	$ 13,548	$ 11,725	$ 1,823	15.5%
Percentage of total revenue	11.0%	11.9%		

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 second quarter of fiscal 2017 increased over the same quarter in the prior fiscal year primarily due to a $0.4 million increase in stock-based compensation expenses, a $0.3 million increase in payroll and related expenses, and a $0.2 million increase in facility expenses.

General and administrative expenses for the six months ended September 30, 2016 increased over the same period in the prior fiscal year primarily because of a $1.2 million increase in stock-based compensation expenses, a $0.5 million increase in facility expenses, a $0.3 million increase in payroll and related expenses, partially offset by a $0.4 million decrease in legal fees, primarily due to the business acquisitions that occurred in the first quarter of fiscal 2016.

Other income, net	**September 30, 2016**	**2015**	**Dollar Change**	**Percent Change**
	(dollar amounts in thousands)			
Three months ended	$ 391	$ 204	$ 187	91.7%
Percentage of total revenue	0.6%	0.4%		
Six months ended	$ 801	$ 438	$ 363	82.9%
Percentage of total revenue	0.7%	0.4%		

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

Provision (benefit) for income tax	September 30, 2016	2015	Dollar Change	Percent Change
	(dollar amounts in thousands)			
Three months ended	$ (15)	$ 423	$ (438)	-103.5%
Percentage of income (loss) before provision for income taxes	-125.0%	-28.8%		
Six months ended	$ 22	$ 1,208	$ (1,186)	-98.2%
Percentage of income (loss) before provision for income taxes	-4.6%	-104.5%		

For the three months ended September 30, 2016, we recorded a benefit from income taxes of $15,000, all of which related to net income (loss) from operations. For the three months ended September 30, 2015, we recorded a provision for income taxes of $0.4 million, all of which related to net income (loss) from operations.

For the six months ended September 30, 2016, we recorded a provision for income taxes of $22,000, all of which related to net income (loss) from operations. For the six months ended September 30, 2015, we recorded a provision for income taxes of $1.2 million, which was primarily attributable to domestic income from operations.

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

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

Liquidity and Capital Resources

As of September 30, 2016, we had approximately $169.7 million in cash, cash equivalents and short-term investments.

Net cash provided by operating activities for the six months ended September 30, 2016 was approximately $13.4 million, compared with $7.1 million for the six months ended September 30, 2015. Cash provided by operating activities has historically been affected by the amount of net income (loss), sales of subscriptions, changes in working capital accounts particularly in deferred revenue due to timing of annual plan renewals, add-backs of non-cash expense items such as the use of deferred tax assets, depreciation and amortization and the expense associated with stock-based awards.

The net cash used in investing activities for the six months ended September 30, 2016 was $16.1 million, during which we purchased approximately $8.4 million of short term investments, net of sales and maturities of short term investments, we spent approximately $5.2 million on the purchase of property and equipment, and we capitalized $2.4 million of internal use software. Net cash used in investing activities was approximately $23.1 million, during the six months ended September 30, 2015, during which we spent approximately $2.1 million on the purchase of property and equipment, spent approximately $23.4 million on acquisitions of two businesses, and we had proceeds of approximately $3.1 million from the sale of short term investments, net of purchases and maturities of short term investments.

Net cash provided by financing activities for the six months ended September 30, 2016 was approximately $1.2 million, which primarily resulted from $2.6 million of cash received from the issuance of common stock under our employee stock purchase plan, reduced by $0.8 million of repurchases of our common stock related to shares withheld for payroll taxes, $0.3 million of payments on capital leases, and $0.2 million of payments of contingent consideration and escrow. Net cash used in financing activities for the six months ended September 30, 2015 were approximately $8.4 million, which was primarily due from cash used to repurchase our common stock as part of our Repurchase Plan in the amount of approximately $10.1 million, partially offset by cash received from the issuance of common stock under our employee stock purchase plan of approximately $2.1 million.

Contractual Obligations

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

In June 2016, we entered into a new lease in London UK for our DXI location for approximately 16,000 square feet under an operating lease that expires in June 2026. We received an 18 month rent holiday from rent payments. After the rent holiday, the lease has a base monthly rent of approximately $95,000, and requires us to pay service charges and normal maintenance costs. The lease contains a break clause, which allows us to end the lease in June 2022, subject to certain conditions.

In August 2016, we entered into a new lease in New York City for additional office space for approximately 5,200 square feet under an operating lease that expires in October 2021. The lease has a base monthly rent of approximately $26,000.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency

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

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

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

Investments

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Effectiveness of Disclosure Controls and Procedures

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

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

Limitations on the Effectiveness of Controls

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

Changes in Internal Control over Financial Reporting

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

PART II -- OTHER INFORMATION

ITEM 1. Legal Proceedings

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

ITEM 1A. Risk Factors

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

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

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

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

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program(1)
July 1 - July 31, 2016	-	$ -	-	$ 15,000,000
August 1 - August 31, 2016	-	-	-	15,000,000
September 1 - September 30, 2016	-	-	-	15,000,000
Total	-	$ -	-	

ITEM 5. OTHER INFORMATION

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

ITEM 6. Exhibits

Exhibit Number	Description
10.34	Amended and Restated 2013 New Employee Inducement Incentive Plan.
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: November 2, 2016

8X8, INC.
(Registrant)

By: /s/ MARYELLEN GENOVESE
MaryEllen Genovese

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