



8x8, Inc.

**8x8, Inc. (Nasdaq: EGHT)
Q2 FY2009 Earnings Conference Call
October 30, 2008 4:30 PM ET**

Executives:

Bryan Martin, Chief Executive Officer & Chairman of the Board
Dan Weirich, Chief Financial Officer and Vice President, Finance
Joan Citelli, Director of Corporate Communications

Joan Citelli, Director of Corporate Communications:

Thanks and welcome everyone to our call. Today I'm joined by 8x8's Chairman and Chief Executive Officer, Bryan Martin, and Chief Financial Officer, Dan Weirich, to discuss our results for 8x8's second fiscal quarter ended September 30, 2008. If you have not yet seen today's financial results, the press release is available on 8x8's corporate website at www.8x8.com.

Following our comments, there will be an opportunity for questions.

Before I turn the call over to Bryan, I would like to remind all participants that during this conference call any forward-looking statements are made pursuant to the Safe Harbor provision of the Private Securities Litigation Reform Act of 1995. Expressions of future goals, including financial guidance and similar expressions, including without limitation, expressions using the terminology "may", "will", "believe", "expect", "plans", "anticipates", "predicts", "forecasts" and expressions which otherwise request something other than historical fact are intended to identify forward-looking statements. These forward-looking statements involve a number of risks and uncertainties, including factors discussed in the risk factor sections of our annual report on Form 10-K, in our quarterly reports on Form 10-Q, and in our other SEC filings and company releases.

Our actual results may differ materially from any forward-looking statements due to such risks and uncertainties. The Company undertakes no obligation to revise or update any forward-looking statements in order to reflect events or circumstances that may arise after this conference call, except as required by law.

Please note that management will be continuing our corporate practice of not offering or providing any forward looking guidance on the Company's financial results, forecasts, or similar future expectations, and your cooperation is appreciated in not asking any questions in this regard. Thank you. And with that I'll turn the call over to Bryan Martin, Chairman and Chief Executive Officer of 8x8.

Bryan Martin, Chief Executive Officer and Chairman of the Board:

Thanks, Joan, and good afternoon, everyone. I'm going to make some opening remarks, and then I will pass the call over to our CFO, Dan Weirich, who will walk you through our detailed operating results and metrics.

I'd like to begin by addressing the effects the macro-economic issues are having on 8x8's market capitalization and on the business communication services we provide to both existing and prospective customers.

First of all, the price per share of EGHT has declined precipitously since our June 30 closing price. We believe that the change in price is due to the macro-economic weakness that is causing sector-wide redemption calls and volatility. As you will see in our results for the quarter, our growth rate of business services revenue has not slowed. I want investors to know that we are very concerned about the decline in 8x8's stock price, and the Board of Directors is evaluating all possible options and opportunities to rectify the disconnect between our market valuation and the positioning and growth of our business. I also want to remind you that 8x8 has no debt on its balance sheet, and no need to access the capital markets at this time. In the September quarter, we added \$938K to our cash and investments vs. the June quarter, and year-over-year we have added \$2.9M to our balance sheet. Cash at September 30 was \$15.8M, the 6th consecutive quarter that we have demonstrated positive cash flow from our business.

Next, I'd like to address how the macro economy is affecting new sales to the prospective businesses we are targeting. Historically, the months of July and August are our slowest and most difficult months of the year for new business sales. In the past two years, we achieved record sales numbers during the month of September, which more than offset the slow sales performance in July and August. For the September quarter, July and August were slow and difficult, as anticipated. This year, however, in the month of September, we began to hear from all of our sales agents that the sales cycles with prospective customers were lengthening, and that customers were pushing out decisions to adopt our business communications services. So, while we saw increased growth in September, we did not see the usual month-end ramp and acceleration that we would have normally expected. New organic sales grew at a linear rate throughout the entire month. The slower organic growth was offset by the inorganic migration of approximately 1,000 businesses from Avtex, LLC on September 30.

In September, we launched a \$24.99 per extension per month unlimited calling plan bundle with our IP phones with 1 year of service, to hammer home the savings message in our quotes to prospective customers. Given the current mix of sales of unlimited extensions and metered extensions, we believe that this IP phone bundle price point will accelerate sales of our IP phone unlimited extensions without dramatically impacting the ARPU numbers that Dan will discuss in a minute.

Even with all of these factors, our revenue growth for business services held steady during the September quarter at 8% growth quarter-over-quarter and 41% growth year-over-year. Business revenues were \$9.8M for the September quarter. Our overall revenues, including business, residential and video, and licensing and royalties for the September quarter were \$16.4M, a 1% quarter over quarter increase, and 11% year over year increase.

Overall revenue growth was impacted by a 12% sequential and 18% year over year decline in the Company's residential and video customers, as all of our former SunRocket residential customers renewed in July and August at a success rate of approximately 80%. This resulted in a one-time drop in monthly residential revenues as approximately 1,900 annual customers and 1,700 monthly subscription customers opted not to continue their service after their one year anniversary. Our overall churn for all services increased to 4.2% from 3.5%, due to the one-time impact of these customers who did not continue service. Carving out the impact of this effect on churn, overall churn would have been unchanged versus the previous quarter at 3.5%.

I also want to address the impact that the macro economy is having on our existing small business customer base. We saw our business service churn remain flat with the previous quarter, and the number of businesses cancelling service due to non-payment or businesses going out of business also remain flat with our historical average of approximately 1/3 of our total business churn. This is good news and implies that, while we know that the macro economic issues are impacting the small businesses we provide service to, our business customers are retaining their 8x8 Virtual Office services at the same historical rate, as the cost savings and operating efficiencies we enable are more valuable and relevant in this cost containment environment than ever.

We added 1,846 net new businesses to our customer base during the September quarter, and ended the quarter with more than 13,700 businesses using our IP communication services. Overall revenue distribution for the quarter was 60% business services, 39% residential and video services, and 1% license and royalties.

During the September quarter, we introduced new products and services that enhance the user experience of our services, and further expand our addressable market. In July, we introduced a family of IP phones designed for use with our 8x8 Virtual Office hosted PBX phone service and our new Hosted Key System services, that emulate the shared line appearance functionality many small office environments or businesses like auto dealerships are accustomed to using. In September, we announced a new technology and marketing partnership with Microsoft and the certification of the 8x8 Business Phone Service with the Microsoft Response Point small business phone system. This partnership is facilitating a significant expansion of our reseller/VAR channel through joint marketing efforts and channel promotions.

We continue to maintain a nationwide presence of our phones and services in Office Depot, Office Max and a small number of Staples locations, and continue to invest in growing the sell-through rates with these partners.

The potential of 8x8 business communication services to cut fixed costs to businesses of any size, and drive increased efficiencies and capabilities into the telecommunications infrastructure of these companies, is more relevant than ever in this economic environment, and is always relevant in a down market cycle. We intend to continue to refine and drive this message home to existing and prospective customers, and we see the current economic environment as a truly unique opportunity to accelerate our growth.

With that, I will now turn the call over to Dan Weirich, the Company's Chief Financial Officer, who will walk you through the detailed financial results and operating metrics of the business. Dan?

Dan Weirich, Chief Financial Officer & VP, Finance:

Thank you, Bryan, and good afternoon to everyone on the call.

The migration of approximately 1,000 former Avtex customers to 8x8 was completed on September 30, 2008. We did not recognize any revenue in the second quarter related to Avtex customers. We expect this customer base to generate approximately \$200K in quarterly revenue with gross margins of approximately 68%.

Overall gross margins were 65.3%, compared to 67.8% in the June quarter. Our service margins declined from 74.6% in the June quarter to 73% in the September quarter while our product margin increased from -13% to -10%. 90 basis points of the 159 basis point decline in the service margin is related to regulatory fee increases we have elected to not pass onto customers and the balance of the margin decline is due to the aggressively priced promotions Bryan mentioned. Business service margins were 81% and residential/video service margins were 61%.

Non cost of sales operating expenses increased from 61% of revenue in the first quarter of 2009 to 67% of revenue in the second quarter of 2009. This is a quarter over quarter increase of approximately \$1M.

\$590K of this increase is related to the one-time release of a sales tax accrual in the first quarter. Approximately \$107K for the acquisition of the Avtex customer base is a one-time commission expense in the second quarter. An additional one-time expense is approximately \$50K in credit card fees related to the renewal of former SunRocket customer's annual service plans.

Approximately 90% of the \$108K increase in research and development is related to compensation and recruiting expenses. A combination of our increasing cash balances for six consecutive quarters, generating net income for four consecutive quarters and a softening in the job market in Silicon Valley has made hiring extremely talented developers easier than in the past. Customer service increased \$70K sequentially. The remaining \$100K is miscellaneous sales and marketing expenses related to growing our sales force and the launch of several new products during the quarter.

Non cash items in our financials this quarter included:

- a \$190K non cash mark-to-market gain on the value of our warrants;
- a \$336K stock compensation charge; and
- a \$322K depreciation charge.

The average monthly recurring service fees billed to a business customer were \$230 and cost to acquire a new business customer was \$1,222. The contribution margin of business services, which is business service revenue less business service cost of services, customer support and billing, was 62%. The payback for a business

customer, which is the cost to acquire a business customer divided by the monthly contribution margin, was approximately 8.6 months.

Cash outflow for inventory purchases was \$1.4M during the second quarter, a decrease of \$315,000 over the first quarter. Capital expenditures for the quarter were \$218,000, or 1.3% of revenues. Advertising, lead generation and promotion-related expenditures totaled \$1.9M for the quarter, which is an approximate decline of \$100K sequentially.

On the balance sheet, accounts receivable declined sequentially by \$848K to \$710K while accounts payable declined by \$1.9M during the same period. We are pleased that the accounts receivable balance is back down to historical levels after two consecutive quarters with accounts receivable balances more than two times the current level. Deferred revenue increased by \$1.2M primarily due to the large number of annual service plans renewed during the quarter. Working capital has increased year to date by \$2.2M to \$8.3M and stockholder equity has increased by \$2.1M to \$10M over the same period.

As of September 30, 2008, total shares outstanding were 62M shares, and total shares fully diluted were 82M shares. The difference between the outstanding and fully diluted share count is 7.8M warrants and 11.3M options. Between November 13, 2008 and December 19, 2008, 2.4M warrants with strike prices between \$2.10 and \$3.61 per share are set to expire. If the warrants with expirations dates in 2008 are not exercised and no additional warrants are exercised before the end of 2008, we will end 2008 with 5.4M warrants outstanding. Also, the Company's \$125 million shelf registration statement is set to expire on December 1, 2008.

That concludes my prepared remarks and I will now turn the call back over to Bryan.

Bryan Martin, Chairman & CEO:

Thank you, Dan. We have posted a transcript of our prepared remarks on 8x8's corporate website at www.8x8.com in the Events section for your reference and convenience.

Our next financial presentation will be at the AeA Classic Financial Conference on November 4th and 5th in San Diego, California. We hope to see you at that event.

That concludes our prepared remarks, and I'll now turn the call back over to the Operator for any questions you may have.

Questions & Answers

Bryan Martin, Chairman & CEO

Thank you everybody for listening. If you're not already a customer, I encourage you to sign-up today for 8x8 Virtual Office services for your business by visiting us at www.8x8.com or www.packet8.net. Go ahead, operator.