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

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): March 31, 2004

8X8, INC.

(Exact name of registrant as specified in its charter)

Delaware	000-21783	77-0142404
(State of other jurisdiction of incorporation)	*(Commission File Number)*	*(I.R.S. Employer Identification Number)*

2445 Mission College Blvd.
Santa Clara, CA 95054
(Address of principal executive offices including zip code)

(408) 727-1885
(Registrant's telephone number, including area code)

Not Applicable
(Former Name or Former Address, if Changed Since Last Report)

Item 5. Other Events

The information included in this Current Report on Form 8-K affects only disclosures related to liquidity and reportable segments, and does not in any way restate or revise the financial position, results of operations or cash flows in any reported Balance Sheets, Statements of Operations or Statements of Cash Flows of 8x8, Inc. and subsidiaries.

During the third quarter of fiscal 2004, which ended December 31, 2003, the Company changed its internal reporting processes and determined that it had only one reportable segment. Accordingly, the Company ceased preparing operational data on the former segment basis. The change in internal reporting processes was consistent with the change in business focus as the Company is primarily focusing its efforts on its Packet8 voice and video communication service. The Company reported its new segment structure in its Quarterly Report on Form 10-Q for the quarter ended December 31, 2003. As required by Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information," consolidated financial statements issued by us in the future will reflect modifications to our reportable segments resulting from these organizational changes, including reclassification of all comparative prior period segment information. This Current Report on Form 8-K provides an update to the Company's Annual Report on Form 10-K for the year ended March 31, 2003 ("Annual Report"). This update only relates to the Company's liquidity and segment disclosures and provides updated liquidity disclosures and required reclassified segment information for prior periods for Item 7 and Item 8 of the Company's Annual Report.

Since this update relates only to liquidity and segments, this document should be read with reference to the Quarterly Reports on Form 10-Q for the quarters ended June 30, 2003, September 30, 2003 and December 31, 2003, which describe significant developments since the preparation of the Annual Report

Item 7. Financial Statements and Exhibits.

(c) Exhibits.

Exhibit Number	Description
23.1	Consent of PricewaterhouseCoopers LLP.
99.1	

	Management's Discussion and Analysis of Results of Operation under Item 7 of our Annual Report on Form 10-K for the fiscal year ended March 31, 2003 conformed to reflect these changes.
99.2	Our audited consolidated financial statements for the fiscal year ended March 31, 2003 under Item 8 of our Annual report on Form 10-K for the fiscal year ended March 31, 2003 conformed to reflect these changes. Also included is the independent accountants' report dated May 2, 2003, except as to the liquidity paragraph in Note 1 and Note 12, for which the date is March 26, 2004.

SIGNATURES

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 hereunto duly authorized.

8x8, INC.

Dated: March 31, 2004

By: /s/ James Sullivan
James Sullivan
Chief Financial Officer, Vice President of Finance and Secretary

EXHIBIT INDEX

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Exhibit 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-32930, 333-49414, 333-80379, 333-75402, 333-108289 and 333-111120) and Form S-8 (Nos. 333-30943, 333-50519, 333-41594, 333-49410, 333-66296, 333-90172, and 333-108290) of 8x8, Inc. of our report dated May 2, 2003, except as to the Liquidity paragraph in Note 1 and Note 12, for which the date is March 26, 2004, relating to the consolidated financial statements and financial statement schedule, which appears in this Current Report on Form 8-K.

/s/ PricewaterhouseCoopers LLP

San Jose, California
March 30, 2004

Exhibit 99.1

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This 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, including our statements regarding anticipated cost savings arising from the restructuring activities implemented during fiscal 2003; our assumptions underlying our critical accounting determinations concerning revenue, allowances for doubtful accounts, valuation of goodwill, tax allowances and reserves for legal issues; factors that could impact our gross margins; our cost estimates under contracts accounted for using the percentage of completion method; efforts to raise additional financing; commitment of resources, and reduction in operating costs including the possible sale or cessation of certain business segments and the possible further reduction of personnel and suspension of salary increases and capital expenditures. You should not place undue reliance on these forward-looking statements. Actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including our good faith assumptions being incorrect, our business expenses being greater than anticipated due to competitive factors or unanticipated development or sales costs; revenues not resulting in the manner anticipated due to a continued slow down in technology spending, particularly in the telecommunications market; our failure to generate investor interest or to sell certain of our assets or business segments. The forward-looking statements may also be impacted by the additional risks faced by us as described in this Report, including those set forth under the section entitled "Factors that May Affect Future 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.

OVERVIEW

8x8, Inc., or 8x8, and its subsidiaries (collectively, the Company) develop and market communication technology and services for internet protocol or, IP, telephony and video applications. The Company was incorporated in California in February 1987, and in December 1996 was reincorporated in Delaware. In August 2000, the Company changed its name from 8x8, Inc. to Netergy Networks, Inc. The Company changed its name back to 8x8, Inc. in July 2001. During the fiscal year ended March 31, 2001, 8x8 formed two subsidiaries, Netergy Microelectronics, Inc. (Netergy) and Centile, Inc. (Centile) and reorganized its operations more clearly along its three product lines. The Company's three product lines are:

- The Packet8 voice and video communications service (Packet8), which enables broadband internet users to add digital voice and video communications services to their high-speed internet connection. Packet8 was launched in November 2002 and enables anyone with high-speed Internet access to sign up for voice over internet protocol (VoIP) and video communications service at http://www.packet8.net. Customers can choose a direct-dial phone number from any of the rate centers offered by the service, and then use an 8x8-supplied terminal adapter to connect any telephone to a broadband internet connection and make or receive calls from a regular telephone number. All Packet8 telephone accounts come with voice mail, caller ID, call waiting, call waiting caller ID, call forwarding, hold, line-alternate, 3-way conferencing, web access to account controls, and real-time online billing. In addition, 8x8 offers a videophone for use with the Packet8 service;

- VoIP semiconductors and related communication software that are used to make IP telephones and to voice-enable cable and digital subscriber line modems, wireless devices, and other broadband technologies, including the voice and videophone endpoints that are currently used by Packet8 and sold by the Company; and

- Hosted iPBX solutions that allow service providers to offer to small and medium-sized businesses over broadband networks the features and functions that a user commonly expects to find in a typical business phone system. A hosted iPBX solution is a software application that implements the functionality of a business phone system over the same data connection that a business uses for connection to the internet.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States. Note 1 to the consolidated financial statements in Part II, Item 8 of this Report describes the significant accounting policies and methods used in the preparation of our consolidated financial statements.

We have identified the policies below as some of the more critical to our business and the understanding of our results of operations. These policies may involve a higher degree of judgment and complexity in their application and represent the critical accounting policies used in the preparation of our financial statements. Although we believe our judgments and estimates are appropriate and correct, actual future results may differ from our estimates. If different assumptions or conditions were to prevail, the results could be materially different from our reported results. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results.

Use of estimates

The preparation of our consolidated financial statements, in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and equity and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates, particularly estimates relating to litigation and other contingencies, have a material impact on our financial statements, and are discussed in detail throughout our analysis of the results of operations.

In addition to evaluating estimates relating to the items discussed above, we also consider other estimates, including, but not limited to, those related to bad debts, the valuation of inventories, goodwill, income taxes, and financing operations. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets, liabilities and equity that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions. Additional information regarding risk factors that may impact our estimates is included below under "Factors that May Affect Future Results."

Revenue recognition

Our revenue recognition policies are described in Note 1 to the consolidated financial statements in Part II, Item 8 of this Report. As described below, significant management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of our revenue for any period if our management made different judgments or utilized different estimates.

At the time of each revenue transaction we assess whether the revenue amount is fixed and determinable and whether or not collection is reasonably assured. We assess whether the fee is fixed and determinable based on the payment terms associated with the transaction. If a significant portion of a fee is due after our normal payment terms, which are thirty to ninety days from invoice date, we account for the fee as not being fixed and determinable. In these cases, we recognize revenue as the fees become due. We assess collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We generally do not request collateral from our customers. If we determine that collection of a fee is not reasonably assured, we defer the fee and recognize revenue at the time collection becomes reasonably assured, which is generally upon receipt of payment.

For arrangements with multiple obligations (for example, undelivered maintenance and support), we allocate revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements, which is specific to the Company. This means that we defer revenue from the arranged fee that is equivalent to the fair value of the undelivered elements. Fair values for the ongoing maintenance and support obligations for our technology licenses are based upon separate sales of renewals to other customers or upon renewal rates quoted in the contracts. We base the fair value of services, such as training or consulting, on separate sales of these services to other customers. We recognize revenue for maintenance services ratably over the contract term. Our training and consulting services are billed based on hourly rates and we generally recognize revenue as these services are performed.

For sales generated from long-term contracts, we use the percentage of completion method of accounting. In doing so, management makes important judgments in costs and in measuring progress towards completion. These judgments underlie our determinations regarding overall contract value, contract profitability and timing of revenue recognition. Revenue and cost estimates are revised quarterly based on changes in circumstances, and any losses on contracts are recognized immediately.

If an arrangement includes acceptance criteria, revenue is not recognized until we can objectively demonstrate that the software or service can meet the acceptance criteria or when the customer has signed formal acceptance documentation. If a software license arrangement obligates us to deliver unspecified future products, revenue is recognized on a subscription basis, ratably over the term of the contract.

For all sales, except those completed via the internet, we use either a binding purchase order or other signed agreement as evidence of an arrangement. For sales over the internet, we use a credit card authorization as evidence of an arrangement.

Our ability to enter into revenue generating transactions and recognize revenue in the future is subject to a number of business and economic risks discussed below under "Factors that May Affect Future Results."

Collectibility of accounts receivable

We must make estimates of the collectibility of our accounts receivable. Management specifically analyzes accounts receivable, including historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. The accounts receivable balance was $1.4 million, net of an allowance for doubtful accounts of $141,000 as of March 31, 2003, and one customer represented 30% of our gross accounts receivable. Based upon this customer's past payment history, discussions with the customer and our review of their financial condition, the outstanding balance was considered collectible and therefore no portion of this balance was specifically reserved for at March 31, 2003.

Valuation of inventories

We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by us, additional inventory write-downs may be required.

Valuation of goodwill

We assess the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important that could trigger an impairment review include the following:

- significant underperformance relative to projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and
- our market capitalization relative to net book value.

Goodwill is included in our Centile reporting unit. During our impairment assessment, we compare the carrying value of our Centile reporting unit to its fair value. If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the fair value of the goodwill within the reporting unit is less than the carrying value. The fair value for goodwill is determined based on discounted cash flows, market multiples or appraised values, as appropriate.

In the fourth quarter of fiscal 2003, the Company recorded an impairment charge of $1.5 million to write-off its remaining goodwill. The impairment assessment resulted from our plan implemented in the fourth quarter of fiscal 2003 to reduce the workforce of Centile's France office by seventy percent.

Income taxes

As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves us estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. In the event that we determine that we would be able to realize deferred tax assets in the future in excess of the net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made.

Significant management judgment is required in determining the valuation allowance recorded against our net deferred tax assets, which primarily consist of net operating loss and tax credit carryforwards. We have recorded a valuation allowance of $51 million as of March 31, 2003, due to uncertainties related to our ability to utilize most of our deferred tax assets before they expire. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable.

Litigation

Management's current estimated range of liability related to pending litigation involving the Company is based on claims for which our management can estimate the amount and range of loss. We have recorded the minimum estimated liability related to those claims, where there is a range of loss. At March 31, 2003, liabilities related to litigation matters were not significant. Because of the uncertainties related to both the amount and range of loss on pending litigation, management is unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. As additional information becomes available, we will assess the potential liability, if any, related to our pending litigation and revise our estimates. Such revisions in our estimates of the potential liability could materially impact our results of operation and financial position.

RESULTS OF OPERATIONS

The following table sets forth consolidated statement of operations data for each of the years ended March 31, 2003, 2002, and 2001, expressed as the percentage of our total revenues represented by each item. Cost of product revenues is presented as a percentage of product revenues and cost of license and other revenues is presented as a percentage of license and other revenues. You should read this information in conjunction with our Consolidated Financial Statements and related notes included elsewhere in this Report.

	Year Ended March 31,		
	2003	2002	2001
Product revenues	52 %	41 %	70 %
License and other revenues	48 %	59 %	30 %
Total revenues	100 %	100 %	100 %
Cost of product revenues	48 %	43 %	41 %
Cost of license and other revenues	29 %	2 %	32 %
Total cost of revenues	39 %	19 %	38 %
Gross profit	61 %	81 %	62 %
Operating expenses:			
Research and development	71 %	85 %	109 %
Selling, general and administrative	68 %	59 %	93 %
In-process research and development	-- %	-- %	25 %
Amortization of intangibles	-- %	5 %	60 %
Restructuring and other charges	31 %	-- %	183 %
Total operating expenses	170 %	149 %	470 %
Loss from operations	(109)%	(68)%	(408)%
Other income, net	5 %	7 %	14 %
Interest expense	-- %	(6)%	(8)%
Loss before provision for income taxes	(104)%	(67)%	(402)%
Provision for income taxes	-- %	-- %	-- %
Net loss before extraordinary gain and cumulative effect of change in accounting principle	(104)%	(67)%	(402)%
Extraordinary gain on extinguishment of debt, net	-- %	5 %	-- %
Cumulative effect of change in accounting principle	-- %	-- %	(6)%
Net loss	(104)%	(62)%	(408)%

REVENUES

Product revenues were $5.7 million in fiscal 2003, a decrease of $300,000 from the $6 million reported in fiscal 2002. The decrease in fiscal 2003 was due to a $1.1 million decrease in videoconferencing semiconductor sales, offset by a $300,000 increase in voice over internet protocol (VoIP) semiconductor sales and a $500,000 increase in sales of videophones and media hub systems. The significant decrease in videoconferencing semiconductor revenues was due primarily to a slight decrease in unit shipments, combined with decreases in average selling prices, or ASPs. The decrease in unit shipments of our videoconferencing semiconductors as compared to the prior year is primarily attributable to our announcement during fiscal 2003 of the end of life of our existing videoconferencing semiconductors, as well as the factors set forth below explaining the decline for fiscal 2002 versus fiscal 2001. Our remaining videoconferencing semiconductor customers have been designing out our products in anticipation of the end of life. The increase in VoIP semiconductor sales was attributable to a significant increase in unit shipments, offset by decreases in ASPs. The increase in videophone system sales was attributable to our commencement of sales of these products in the fourth quarter of fiscal 2002, and as a result, fiscal 2003 includes four quarters of sales versus only one quarter of sales in fiscal 2002. The increase in media hub system revenues was attributable to the increase in licenses of our hosted iPBX product.

Product revenues were $6.0 million in fiscal 2002, a decrease of $6.8 million from the $12.8 million reported in fiscal 2001. The decrease in product revenues in fiscal 2002 was due to decreases in sales of video monitoring and consumer videophone systems approximating $1 million, resulting from our decision to terminate further development and sales of these product lines in prior years, a slight decrease in IP telephony semiconductor sales, a $300,000 decrease in media hub system revenues, and a $5.4 million decrease in revenue derived from our videoconferencing semiconductor products. The decrease in media hub system revenues as compared to the prior year period was due primarily to a decline in sales to a significant customer. The significant decrease in videoconferencing semiconductor revenues was due primarily to a significant decrease in unit shipments, offset partially by increases in average selling prices, or ASPs. Factors that contributed to the significant decrease in unit shipments of our videoconferencing semiconductors as compared to the prior year include:

- Increased competition from other developers of semiconductors used in videoconferencing applications;
- The acquisition of two of our customers by a company that appears to have standardized its product development efforts around technology supplied by one or more of our competitors;
- Increased competition from evolving PC-based videoconferencing applications which has resulted in reduced demand for products marketed and sold by our customers that incorporate our videoconferencing semiconductors; and
- Decreased corporate and consumer spending.

License and other revenues were $5.3 million in fiscal 2003, a decrease of $3.3 million from the $8.6 million recorded in fiscal 2002. License and other revenues, the majority of which are considered to be non- recurring in nature, consisted primarily of technology licenses and related maintenance revenues, as well as royalties earned under such licenses. License and other revenues for both fiscal 2003 and 2002 included approximately $1.6 million of non-cash revenue recognition associated with the license of our video monitoring technology to Interlogix in fiscal 2001. The decrease in fiscal 2003 was primarily attributable to:

- A $1.2 million decrease in royalties earned under a license agreement for certain of our video compression technology. Royalty revenue recognized under this agreement totaled $750,000 for fiscal 2003 as compared to approximately $2 million for fiscal 2002. The licensee's obligations to pay royalties on shipments of products that incorporate our technology terminated in the first quarter of fiscal 2003 upon payment of the $750,000;
- A decrease of approximately $1 million in revenues associated with our license of service creation environment (SCE) technology to Lucent and unified messaging technology to Milinx;
- A $1.1 million decrease in license revenue associated with our embedded IP telephony firmware technology, e.g., Veracity VoIP software and Audacity-T2 semiconductor based reference design kits; and
- A decrease of approximately $1.5 million in non-recurring license and maintenance revenues associated with our videoconferencing technology.

These decreases were partially offset by:

- A $380,000 increase in license and maintenance revenues associated with our hosted iPBX product; and
- Approximately $1.1 million of revenues recognized under a contract to develop our next-generation video compression semiconductor product that is accounted for using the percentage of completion method. Profit estimates on this contract are revised periodically based on changes in facts; any loss is required to be recognized immediately. Based on our cost estimates as of March 31, 2003, we recognized a loss approximating $300,000 on this development contract in the quarter ended March 31, 2003, which has been recorded in the Cost of License and Other Revenues line in the consolidated statements of operations. Subsequent changes in our cost estimates could require us to recognize additional losses in a future period as the revenues under this contract are fixed.

License revenues were $8.6 million in fiscal 2002, an increase of $3.2 million from the $5.4 million recognized in fiscal 2001. License and other revenues recognized in fiscal 2002 consisted primarily of technology licenses and related maintenance revenues, as well as royalties earned under such licenses. License and other revenues for fiscal 2001 also included $1.2 million of professional service revenues associated with our Canadian operations. No professional service revenues were recognized in fiscal 2002 due to the elimination of the professional services organization as part of the restructuring of our Canadian operations in the fourth quarter of fiscal 2001. The negative impact of eliminating professional service revenues in fiscal 2002 was more than offset by the following:

- An increase in royalties earned under a license agreement for certain of our video compression technology. Royalty revenue recognized under this agreement approximated $2.0 million for fiscal 2002 as compared to $768,000 for fiscal 2001;
- A $1.3 million increase in license revenue associated with our embedded IP telephony firmware technology;
- The recognition of $309,000 of previously deferred revenue associated with our license of unified messaging technology to Milinx. Also, license revenues in fiscal 2002 included $680,000 of non-recurring revenue associated with the license of our SCE technology to Lucent;
- A $1.6 million increase in revenue in fiscal 2002 associated with the license of our video monitoring technology to Interlogix in fiscal 2001. Recognition of the approximately $3.9 million of revenue ascribed to the license of video monitoring technology to Interlogix had been deferred until we satisfied certain remaining obligations in the quarter ended March 31, 2001. Revenue associated with the license is being recognized ratably over the license term, which expires in May 2003. All cash receipts associated with this license were received in fiscal 2001; and
- A decrease of approximately $700,000 in non-recurring license and maintenance revenues associated with our videoconferencing technology.

Revenues from our ten largest customers in the fiscal years ended March 31, 2003, 2002, and 2001 accounted for approximately 63%, 73%, and 48%, respectively, of our total revenues. Two customers represented more than 10% of our total revenues in fiscal 2003. These customers, GE Interlogix, Inc. and Leadtek Research, Inc. represented 17% and 11% of our total revenues, respectively. Three customers represented more than 10% of our total revenues in fiscal 2002. These customers, ESS Technology, Inc., Leadtek Research, Inc. and GE Interlogix, Inc. represented 13%, 13% and 12% of our total revenues, respectively. During the fiscal year ended March 31, 2001 no customer accounted for 10% or more of total revenues.

Sales to customers outside the United States represented 62%, 61%, and 69%, and of total revenues in the fiscal years ended March 31, 2003, 2002, and 2001, respectively. The following table illustrates our net revenues by geographic area. Revenues are attributed to countries based on the destination of shipment (in thousands):

	Year Ended March 31,		
	2003	2002	2001
United States	$ 4,218	$ 5,777	$ 5,632
Europe	2,657	4,126	5,862
Taiwan	1,569	2,026	2,739
Japan	919	1,119	1,188
Other	1,640	1,643	2,807
	$ 11,003	$ 14,691	$ 18,228

COST OF REVENUES AND GROSS PROFIT

The cost of product revenues consists of costs associated with system manufacturing, components, semiconductor wafer fabrication, system and semiconductor assembly and testing performed by third-party vendors, and direct and indirect costs associated with purchasing, scheduling, and quality assurance. Gross profit from product revenues was $3 million, $3.4 million, and $7.6 million, for the fiscal years ended March 31, 2003, 2002, and 2001, respectively. Product gross margin was 52%, 57%, and 59% for the fiscal years ended March 31, 2003, 2002, and 2001, respectively.

The $400,000 decrease in gross profit from product revenues was primarily due to a decrease in product revenues primarily attributable to lower ASPs, and a charge of approximately $270,000 for non-cancelable purchase orders for IP telephony semiconductors recorded in the quarter ended March 31, 2003. The decreases in gross profit were partially mitigated by lower costs for our IP telephony semiconductors resulting from a change in suppliers during fiscal 2003.

The $4.1 million decrease in gross profit from fiscal 2001 to fiscal 2002 was due primarily to a significant decrease in sales of our videoconferencing semiconductors and video monitoring systems. Gross profit in fiscal 2002 was also impacted by a decrease in product gross margins due to lower average selling prices realized on sales of our IP telephony semiconductors, and to a lessor extent, an increase in inventory reserves associated with our media hub products in the first quarter of fiscal 2002. The decrease in margins was mitigated to some extent by an increase in average selling prices realized on the sale of our videoconferencing semiconductors and the reversal of $143,000 of reserves associated with our semiconductor products in the fourth quarter of fiscal 2002 due to the sale of inventory that had been specifically reserved for in fiscal 2001.

Gross profit from license and other revenues, which were largely nonrecurring, was $3.8 million, $8.4 million, and $3.7 million, in fiscal 2003, 2002, and 2001, respectively. Associated gross margins were 71%, 98%, and 68% in fiscal 2003, 2002, and 2001. The decrease in gross margin from fiscal 2002 to fiscal 2003 was due primarily to the reduction in license and other revenues, and costs incurred to perform development services under revenue generating contracts in fiscal 2003, which included a loss approximating $300,000 in the quarter ended March 31, 2003. The significant increase in gross margin from fiscal 2001 to fiscal 2002 was due to the elimination of our professional service organization as part of the restructuring of our Canadian operations in the fourth quarter of fiscal 2001.

Our gross margin is affected by a number of factors including product mix, product pricing, the percentage of direct sales and sales to resellers, and manufacturing and component costs. The markets for our products are characterized by falling average selling prices. Average selling prices realized to date for our IP telephony semiconductors have been lower than those historically attained for our videoconferencing semiconductor products, resulting in lower gross margins. We have encountered significant price competition in the markets for our products, and are at a significant disadvantage compared to our competitors, many of whom have substantially greater resources, and therefore may be better able to withstand an extended period of downward pricing pressure. To respond to competitive pricing pressures, we will be required to introduce differentiated products and continue to reduce costs as a means of maintaining or improving our margins. We may not be successful in our development efforts or product cost reduction measures and may face continued erosion of margins.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses consist primarily of personnel, system prototype design and fabrication, mask, prototype wafer, and equipment costs necessary for us to conduct our development efforts. Research and development costs, including software development costs, are expensed as incurred. Research and development expenses were $7.8 million, $12.6 million, and $20 million for fiscal 2003, 2002, and 2001, respectively. The $4.8 million decrease in research and development expenses in fiscal 2003 as compared to fiscal 2002 was due to the following:

- The shift in engineering resources from research and development functions to revenue generating contracts; these costs approximated $1.3 million for fiscal 2003 and were included in cost of license and other revenue;
- Lower compensation costs due to a reduction in research and development personnel as compared to the comparable prior year period;
- Reduced purchases of software and related maintenance contracts;
- Reduced consulting expenses related to our SCE technology;
- Lower depreciation expense due to the retirement of assets; and
- Our overall efforts to reduce discretionary operating costs.

The $7.4 million decrease in research and development expenses during fiscal 2002 as compared to fiscal 2001 was due to the following:

- The elimination of our Canadian operations in the fourth quarter of fiscal 2001. Research and development expenses incurred by our Canadian operations in fiscal 2001 approximated $2.5 million;
- Reductions in research and development personnel staffing levels in the first and second quarters of fiscal 2002;
- Lower tooling and other project related expenses associated with semiconductor and system-level reference design projects in fiscal 2002;
- Lower third-party consulting expenses associated with development of the graphical user interface for our hosted iPBX product;
- A decrease in stock compensation charges of approximately $435,000; and
- Our overall efforts to reduce discretionary operating costs.

SELLING, GENERAL, AND ADMINISTRATIVE EXPENSES

Selling, general, and administrative expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, human resources, and general management. Such costs also include advertising, sales commissions, trade show, and other marketing and promotional expenses. Selling, general, and administrative expenses were $7.4 million, $8.6 million, and $16.9 million in fiscal 2003, 2002, and 2001, respectively. The $1.2 million decrease in selling, general, and administrative expenses in fiscal 2003 as compared to fiscal 2002 was due to the following:

- Reductions in sales, marketing and administrative personnel staffing levels; and
- Lower legal, financial reporting, corporate function, telephone, travel, corporate marketing, public relations and trade show expenditures resulting from our efforts to reduce discretionary operating costs.

The decrease in selling, general, and administrative expenses during fiscal 2002 as compared to fiscal 2001 was due primarily to the reasons set forth above, as well as:

- a $3.7 million decrease due to the elimination of our Canadian operations in the fourth quarter of fiscal 2001; and
- a $325,000 decrease in stock compensation expense.

IN-PROCESS RESEARCH AND DEVELOPMENT AND AMORTIZATION OF INTANGIBLES

We incurred in-process research and development charges of $4.6 million in the second quarter of fiscal 2001 related to the acquisition of U|Force, Inc. (U|Force). Our consolidated financial statements reflect the acquisition of all of the outstanding stock of U|Force, Inc. on June 30, 2000 for a total purchase price of $46.8 million. U|Force, based in Montreal, Canada, was a developer of IP-based software applications and a provider of professional services. U|Force was also developing a Java-based service creation environment (SCE) designed to allow telecommunication service providers to develop, deploy, and manage telephony applications and services to their customers. The purchase price was comprised of 8x8 common stock with a fair value of approximately $38.0 million comprised of: (i) 1,447,523 shares issued at closing of the acquisition, and (ii) 2,107,780 shares to be issued upon the exchange or redemption of the exchangeable shares (the Exchangeable Shares) of Canadian entities held by former employee shareholders or indirect owners of U|Force stock. The Exchangeable Shares held by U|Force employees were subject to certain restrictions, including our right to repurchase the Exchangeable Shares if an employee departed prior to vesting. In addition, we also agreed to issue one share of preferred stock (the Special Voting Share) that provides holders of Exchangeable Shares with voting rights equivalent to the shares of common stock into which their shares are convertible. We also assumed outstanding stock options to purchase shares of U|Force common stock for which the Black-Scholes pricing model value of approximately $6.5 million was included in the purchase price. Direct transaction costs related to the merger were approximately $747,000. Additionally, the Company advanced $1.5 million to U|Force upon signing the acquisition agreement, but prior to the close of the transaction. This amount was accounted for as part of the purchase price. The following table summarizes the composition of the purchase price (in thousands):

Value of common stock and Exchangable Shares issued..........	$ 38,042
Value of stock otions assumed................................	6,546
Cash advanced to U|Force prior to closing....................	1,500
Direct transaction costs.....................................	747

	$ 46,835
	=========

The purchase price was allocated to tangible assets acquired and liabilities assumed based on the book value of U|Force's assets and liabilities, which we believe approximated their fair value. Intangible assets acquired included amounts allocated to U|Force's in-process research and development. The in-process research and development related to U|Force's initial products, the SCE and a unified messaging application, for which technological feasibility had not been established and the technology had no alternative future use. The estimated percentage complete for the unified messaging and SCE products was approximately 44% and 34%, respectively, at June 30, 2000. The fair value of the in-process technology was based on a discounted cash flow model, similar to the traditional "Income Approach," which discounts expected future cash flows to present value, net of tax. In developing cash flow projections, revenues were forecasted based on relevant factors, including estimated aggregate revenue growth rates for the business as a whole, characteristics of the potential market for the technology, and the anticipated life of the technology. Projected annual revenues for the in-process research and development projects were assumed to ramp up initially and decline significantly at the end of the in-process technology's economic life. Operating expenses and resulting profit margins were forecasted based on the characteristics and cash flow generating potential of the acquired in-process technologies. Risks that were considered as part of the analysis included the scope of the efforts necessary to achieve technological feasibility, rapidly changing customer markets, and significant competitive threats from numerous companies. We also considered the risk that if we failed to bring the products to market in a timely manner, it could adversely affect sales and profitability of the combined company in the future. The resulting estimated net cash flows were discounted at a rate of 25%. This discount rate was based on the estimated cost of capital plus an additional discount for the increased risk associated with in-process technology. The value of the acquired U|Force in-process research and development, which was expensed in the second quarter of fiscal 2001, approximated $4.6 million. The excess of the purchase price over the net tangible and intangible assets acquired and liabilities assumed was allocated to goodwill. Amounts allocated to goodwill, the value of an assumed distribution agreement, and workforce were being amortized on a straight-line basis over three, three, and two years, respectively. The allocation of the purchase price was as follows (in thousands):

In-process research and development..........................	$ 4,563
Distribution agreement.......................................	1,053
Workforce..	1,182
U|Force net tangible assets..................................	1,801
Goodwill...	38,236

	$ 46,835
	=========

Amortization of goodwill and intangible assets charged to operations was $763,000 and $11 million for the fiscal years ended March 31, 2002 and 2001, respectively. Amortization expense included amounts related to the amortization of goodwill and intangible assets arising from the acquisitions of U|Force in fiscal 2001 and Odisei S.A. in fiscal 2000. Beginning our fiscal year 2003, Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," was adopted, and we ceased to amortize approximately $1.5 million of goodwill, net of amortization, including intangibles related to the acquisition of Odisei S.A. that were classified as goodwill upon the adoption of SFAS No. 142.

RESTRUCTURING AND OTHER CHARGES

2003 Restructuring Actions

During the third and fourth quarters of fiscal 2003, we continued our cost reduction activities to better align expense levels with current revenue levels and ensure conservative spending during the current economic downturn. As a result of these activities, we recorded restructuring and other asset impairment charges of approximately $3.4 million. These charges included severance and benefits of approximately $1.2 million, as we reduced our workforce, under voluntary and involuntary separation plans, by thirty-two employees or thirty percent. The majority of the affected employees were employees of our semiconductor business based in Santa Clara, California, Tempe, Arizona and Marlow, United Kingdom and included employees from sales and marketing and research and development, as well as four executives of the semiconductor business. Severance of approximately $325,000 attributable to involuntary terminations was paid during the year ended March 31, 2003.

We closed our facility in Marlow, United Kingdom, and recorded $434,000 of charges related to the termination of the operating leases for the facility and related services. In addition, we recorded asset impairment charges of $212,000 related to assets in the United Kingdom that were abandoned or disposed of.

We also recorded a charge of approximately $74,000 for our remaining lease liability for office space in Tempe, Arizona that was vacated as a result of the restructuring actions during the fourth quarter.

In the fourth quarter of fiscal 2003, we also implemented a plan to reduce the workforce at our Sophia Antipolis, France office by ten employees or seventy percent. This downsizing and its potential impact on our iPBX business prompted an assessment of the key assumptions underlying our goodwill valuation judgments. As a result of the analysis, we determined that an impairment charge of $1.5 million was required because the estimated fair value of the goodwill was less than the book value of the goodwill that arose from the acquisition of Odisei S.A. in fiscal 2000.

The following table illustrates the charges, credits and balances of the restructuring reserves as of March 31, 2003 and summarizes asset impairment charges (in thousands):

	Total	Cash	Non-Cash	Liability at

	Charges	Payments	Charges	March 31, 2003
Restructuring Charges:				
Severance......................	$ 1,177	$ (1,002)	$ --	$ 175
Facility related..............	508	(161)	(273)	74
Total restructuring charges..	1,685	(1,163)	(273)	249
Asset Impairments:				
Fixed Assets...................	212	--	(212)	--
Goodwill.......................	1,539	--	(1,539)	--
Total impairment charges.....	1,751	--	(1,751)	--
Total restructuring and impairment charges.........	$ 3,436	$ (1,163)	$ (2,024)	$ 249

We expect annual savings of approximately $3 million related to voluntary and involuntary employee terminations. Future expected cost reductions will be reflected in the Cost of Sales, Selling, General and Administrative, and Research and Development line items in the consolidated statements of operations.

2001 Restructuring Actions

During the fourth quarter of fiscal 2001, after a significant number of employees had resigned, we discontinued our Canadian operations acquired in conjunction with the acquisition of U|Force in June 2000. We closed our offices in Montreal and Hull, Quebec and laid-off all remaining employees resulting in the cessation of the research and development efforts and the sales and marketing and professional services activities associated with the U|Force business. As a result of the restructuring, we recorded a one-time charge of $33.3 million in the quarter ended March 31, 2001. The restructuring and other charges consisted of the following (in thousands):

Employee separation..	$ 765
Fixed asset losses and impairments............................	2,084
Intangible asset impairments.................................	30,247
Lease obligation and termination..............................	220
	$ 33,316

Employee separation costs represent severance payments related to the 96 employees in the Montreal and Hull offices who were laid-off.

The impairment charges for fixed assets of approximately $2.1 million included write-offs of abandoned and unusable assets of approximately $1.4 million, a loss on sale of assets of $567,000, and a charge for assets to be disposed of $172,000. The loss on sale of assets of $567,000 was attributable to the sale of office, computer, and other equipment of the Montreal facility. We received common stock of the purchaser valued at approximately $412,000 as of the date of sale. Fair value of assets to be disposed of was measured based on expected salvage value, less costs to sell. Assets to be disposed of consist of computer equipment with a fair value of $57,000 at March 31, 2001. Substantially all of these assets were liquidated during fiscal 2002.

The impairment charges for intangible assets represented the write-off of the unamortized intangible assets recorded in connection with the acquisition of U|Force. The charges of approximately $30.2 million included: $28.7 million for the goodwill related to the acquisition, $739,000 for the assembled workforce, and $789,000 related to a distribution agreement. The impairments were directly attributable to the cessation of operations in Canada. We performed an evaluation of the recoverability of the intangible assets related to these operations in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." The lack of estimated future net cash flows related to the acquired products necessitated an impairment charge to write-off the remaining unamortized goodwill. The distribution agreement asset was written off because we will no longer provide products and services to customers under that agreement.

We terminated the lease for our primary facility in Montreal in March 2001, but we were required to pay rent on the facility through May 31, 2001. We terminated the lease for our facility in Hull, Quebec in fiscal 2002. Accrued obligations related to remaining lease commitments on the Montreal and Hull facilities totaled $212,000 at March 31, 2001. Payments made in fiscal 2002 related to the terminations of the Montreal and Hull facility leases totaled $225,000.

Cash payments related to the restructuring during the quarter ended March 31, 2001, which included all employee separation costs and certain lease termination costs, approximated $920,000.

OTHER INCOME, NET

In fiscal 2003, 2002, and 2001, other income, net, was approximately $600,000, $1.0 million, and $2.6 million, respectively. The decrease in other income, net, in fiscal 2003 compared to fiscal 2002 was due primarily to an approximately $440,000 decrease in interest income resulting from lower average cash and cash equivalent balances and lower interest rates, a $131,000 non-recurring gain realized on the sale of an investment in fiscal 2002, and a $100,000 increase in foreign exchange losses. These decreases were offset by an increase in other income from our former Canadian operations of approximately $175,000. The increase in Canadian other income was primarily attributable to the collection of Canadian research and development and other tax credits in fiscal 2003, which was partially offset by a write off of $92,000, which represented the balance of the cumulative translation adjustment generated from the translation of the financial statements of our Canadian subsidiary. Our Canadian subsidiary has been substantially liquidated. We collected $560,000 of Canadian tax credits in fiscal 2003, but no further refundable tax credits are expected from Canada. Apart from the tax credit receipt in fiscal 2003 and investment gain in 2002 described above, other income, net, consists primarily of interest income earned on our cash and cash equivalents and foreign exchange gains and losses. Interest income has continued to decrease due to significantly lower average cash and cash equivalent balances combined with lower interest rates. See "Item 3. Quantitative And Qualitative Disclosures About Market Risk" elsewhere in this Report for further discussion of our exposure to currency risk.

The decrease in other income, net, in fiscal 2002 compared to fiscal 2001 was due primarily to a significant decrease in interest income resulting from lower average cash and cash equivalent balances and lower interest rates. Gains realized on the sale of investments also decreased by approximately $94,000 in fiscal 2002 as compared to fiscal 2001.

INTEREST EXPENSE

Interest expense in each of the two years ended March 31, 2002 consisted mainly of charges associated with the 4% convertible subordinated debentures, or the Debentures, that we issued in December 1999, including the amortization of the related debt discount and debt issuance costs. We redeemed the Debentures in December 2001. Interest expense for the year ended March 31, 2001 also included approximately $128,000 associated with lease lines of credit and a bank loan assumed as part of the U|Force acquisition. All of the U|Force debt obligations were repaid in the quarter ended March 31, 2001.

PROVISION FOR INCOME TAXES

The provisions of $15,000 and $17,000 for the years ended March 31, 2002 and 2001, respectively, were comprised primarily of certain foreign taxes. We had no provision for the fiscal year ended March 31, 2003. The provision for the year ended March 31, 2002 also reflected a $10,000 refund of U.S. federal income taxes received in fiscal 2002.

At March 31, 2003, we had net operating loss carryforwards for federal and state income tax purposes of approximately $115 million and $42 million, respectively, which expire at various dates beginning in 2005. In addition, at March 31, 2002, we had research and development credit carryforwards for federal and state tax reporting purposes of approximately $3 million and $2.3 million, respectively. The federal credit carryforwards will begin expiring in 2010 while the California credit will carryforward indefinitely. Under the ownership change limitations of the Internal Revenue Code of 1986, as amended, the amount and benefit from the net operating losses and credit carryforwards may be impaired or limited in certain circumstances.

At March 31, 2003 and 2002, we had gross deferred tax assets of approximately $51 million and $47 million. We believe that, based on a number of factors, the weight of objective available evidence indicates that it is more likely than not that we will not be able to realize our deferred tax assets, and a full valuation allowance was recorded at March 31, 2003 and March 31, 2002.

EXTRAORDINARY GAIN

We realized an extraordinary gain of $779,000 in the third quarter of fiscal 2002 resulting from the early extinguishment of our convertible subordinated debentures. See Note 5 to the consolidated financial statements in Part II, Item 8 of this Report for further discussion of this transaction.

CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE

In November 2000, the Emerging Issues Task Force of the Financial Accounting Standards Board reached several conclusions regarding the accounting for debt and equity securities with beneficial conversion features, including a consensus requiring the application of the "accounting conversion price" method, versus the use of the stated conversion price, to calculate the beneficial conversion feature for such securities. The Securities and Exchange Commission (SEC) required companies to record a cumulative catch-up adjustment in the fourth quarter of calendar 2000 related to the application of the "accounting conversion price" method to securities issued after May 21, 1999. Accordingly, we recorded a $1.1 million non-cash expense during the quarter ended December 31, 2000 to account for a beneficial conversion feature associated with Debentures and related warrants issued in December 1999, and we presented it as a cumulative effect of a change in accounting principle as required by the SEC.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2003, we had cash and cash equivalents totaling $3.4 million, representing a decrease of $9 million from March 31, 2002. We currently have no borrowing arrangements.

Cash used in operations of $8.8 million in fiscal 2003 primarily resulted from the net loss of $11.4 million, a $249,000 decrease in accrued compensation, a $1.9 million decrease in deferred revenue, and a $71,000 increase in accounts receivable. Cash used in operations was partially offset by a $298,000 decrease in inventory and non-cash items, including depreciation and amortization of $1.8 million, $2.3 million for the non-cash portion of restructuring and asset impairment charges, and $83,000 related to the provision for inventory. Cash used in investing activities in fiscal 2003 was attributable to purchases of short-term investments of $208,000 and capital expenditures of $137,000, partially offset by proceeds from the sale of equipment of $42,000. Cash provided by financing activities during fiscal 2003 consisted of proceeds of $89,000 resulting from the sale of our common stock to employees through our employee stock purchase and stock option plans.

Cash used in operations of $7.9 million in fiscal 2002 reflected a net loss of $9.1 million, a decrease in accounts payable of $839,000, a decrease in accrued compensation of $610,000, a decrease of $579,000 in other accrued liabilities, a $3.5 million decrease in deferred revenue and a non-cash extraordinary gain of $779,000 due to redemption of the convertible subordinated debentures. Cash used in operations was partially offset by a decrease in accounts receivable of $1.7 million, a $501,000 decrease in inventory, a $1.6 million decrease in other current assets, and non-cash items including depreciation and amortization of $3.9 million. Cash provided by investing activities in fiscal 2002 was attributable to proceeds from the sale of an investment in marketable equity securities of $543,000 and proceeds from the sale of equipment of $116,000, partially offset by capital expenditures of $172,000. Cash used in financing activities during fiscal 2002 consisted of the $4.6 million payment associated with the redemption of the convertible subordinated debentures and certain costs incurred in connection with the redemption, offset partially by proceeds of $335,000 resulting from the sale of our common stock to employees through our employee stock purchase and stock option plans.

Cash used in operations of $24.6 million in fiscal 2001 reflected a net loss of $74.4 million, decreases in accounts payable and accrued compensation of $2.2 million and $623,000, an increase in other current and non- current assets of $1.3 million, and a non-cash adjustment for a gain on sale of investments of $225,000. Cash used in operations was partially offset by cash provided by a decrease in accounts receivable of $851,000, an increase in other accrued liabilities of $378,000, and non-cash items, including restructuring charges of $32.3 million, depreciation and amortization of $14.4 million, in- process research and development of $4.6 million, the cumulative effect of a change in accounting principle of $1.1 million, and stock compensation charges of $753,000. Cash provided by investing activities in fiscal 2001 is primarily attributable to net proceeds from the sale of assets and the license of technology associated with our video monitoring product line of $5.2 million, offset by acquisitions of property and equipment of $6.1 million and cash paid for acquisitions, net, of $558,000. Cash flows from financing activities in fiscal 2000 consisted primarily of proceeds from sales of the Company's common stock totaling $2.8 million, offset by debt repayments of $891,000 and repurchases of common stock and Exchangeable Shares of $514,000. For the year, cash and cash equivalents decreased $24.5 million.

As of March 31, 2003, our principal commitments consisted of obligations outstanding under non-cancelable operating leases. At March 31, 2003, future minimum annual lease payments under noncancelable operating leases, net of sublease income, were as follows (in thousands):

YEAR ENDING MARCH 31,	
2004	$ 544
2005	280
2006	37
Total minimum payments	$ 861

As noted previously, we redeemed our convertible subordinated debentures in December 2001. The consideration included issuing 1,000,000 shares of our common stock to the lenders. We have committed to maintaining the effectiveness of the registration statement filed with the SEC covering the resale of these shares. Should we fail to maintain the effectiveness of the registration statement we may be required to pay cash penalties and redeem all or a portion of the shares at the higher of $0.898 or the market price of our common stock at the time of the redemption which could have a material adverse effect on our cash flows. The value of the shares still held by the lenders of $669,000 at March 31, 2003, based upon the $0.898 per share minimum potential redemption price, is reflected as contingently redeemable common stock in the consolidated balance sheet.

We have sustained net losses and negative cash flows from operations since fiscal 1999 that have been funded primarily through the issuance of equity securities and borrowings. We believe that current cash and cash equivalents, including net cash proceeds of approximately $7.9 million from the August and November 2003 sales of approximately 4.9 million shares of common stock and warrants to purchase approximately 6.0 million shares of common stock, will be sufficient to finance our operations for the next twelve months. However, we are evaluating our cash needs and may pursue additional equity or debt financing in order to achieve our overall business objectives. There can be no assurance that such financing will be available, or, if available, at a price that is acceptable to us. If we issue additional equity or convertible debt securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock. Failure to generate sufficient revenues, raise additional capital or reduce certain discretionary spending could have an adverse impact on our ability to achieve our longer term business objectives.

RELATED PARTY TRANSACTIONS

During the fourth quarter of fiscal 2000, the Company sold 3.7 million shares of its common stock to STMicroelectronics NV (STM) at a purchase price of $7.50 per share and received net proceeds of $27.7 million. During fiscal 2003, we purchased semiconductors from a subsidiary of STM. Such purchases approximated $550,000. In addition, during fiscal 2003 we contracted with a subsidiary of STM for non-recurring engineering services related to the development of our new semiconductor product. As of March 31, 2003, we had recorded liabilities to STM of $392,000 for semiconductor purchases and purchase commitments and engineering services.

In March 2002 the Board authorized us to open securities trading accounts and make investments of up to $1.0 million on behalf of 8x8, Inc. as directed by our Chairman, Joe Parkinson, Chief Executive Officer, or Chief Financial Officer. Mr. Parkinson has agreed to personally reimburse 8x8 on a quarterly basis for any losses resulting from his trading activities in order to maintain a minimum investment account balance of $1.0 million. The Board has been assured of Mr. Parkinson's ability to cover any such losses; however, should he be unable to do so it could have a material impact on our cash flows and results of operations. As part of the arrangement, our Board has expressed its intent, but not obligation, to pay Mr. Parkinson a quarterly bonus in an amount equal to 25% of the profits attributable to investments made on our behalf by Mr. Parkinson to the extent such a bonus exceeds his salary for the corresponding period. The Company or Mr. Parkinson can terminate this arrangement at any time, subject to the terms of an agreement between 8x8 and Mr. Parkinson. Under the arrangement, we are required to return to Mr. Parkinson the amount representing the increase in value of the investment account over $1.0 million to the extent required to restore replenishment payments made by Mr. Parkinson in prior quarters. Through March 31, 2003, Mr. Parkinson had made cumulative replenishment payments of approximately $137,000 to offset losses incurred. As of March 31, 2003, the investment account balance approximated $1,018,000. Accordingly, we had a payable of approximately $18,000 to Mr. Parkinson at March 31, 2003. As of March 31, 2003, approximately $200,000 of the $1.0 million allocated for such investment activities was invested in marketable equity securities. The remaining $800,000 was invested in money market funds.

RECENT ACCOUNTING PRONOUNCEMENTS

On October 3, 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 applies to all long-lived assets (including discontinued operations) and consequently amends Accounting Principles Board Opinion No. 30. SFAS No. 144 develops one accounting model for long-lived assets that are to be disposed of by sale and requires that long-lived assets that are to be disposed of by sale be measured at the lower of book value or fair value less cost to sell. Additionally, SFAS No. 144 expands the scope of discontinued operations to include all components of an entity with operations that (i) can be distinguished from the rest of the entity, and (ii) will be eliminated from the ongoing operations of the entity in a disposal transaction. We adopted SFAS No. 144 in the first quarter of fiscal 2003, and its adoption did not have a material impact on our results of operations or financial position.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses accounting for restructuring and similar costs. SFAS No. 146 supercedes previous accounting guidance, principally Emerging Issues Task Force Issue (EITF) No. 94- 3. SFAS No. 146 requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of the entity's commitment to an exit plan. SFAS No. 146 also requires that the liability be initially measured and recorded at fair value. SFAS No. 146 will be effective for exit or disposal activities that are initiated after December 31, 2002. We adopted SFAS No. 146 in the fourth quarter of fiscal 2003, and its adoption did not have a material impact on our results of operations or financial position.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," which expands previously issued accounting guidance and disclosure requirements for certain guarantees. FIN45 requires an entity to recognize an initial liability for the fair value of an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of the liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002. We do not expect FIN 45 to have a material impact on our consolidated results of operations or financial position. We have included additional disclosures in accordance with FIN 45 in the footnotes to the consolidated financial statements presented in Part II, Item 8 of this Report.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, SFAS No. 148 requires disclosure of the pro forma effect in interim financial statements. The additional disclosure requirements of SFAS No. 148 are effective for fiscal years ended after December 15, 2002. We will continue to account for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25. We have included additional disclosures in accordance with SFAS No. 148 in the footnotes to the consolidated financial statements presented in Part II, Item 8 of this Report.

FACTORS THAT MAY AFFECT FUTURE RESULTS

We will need to raise additional capital to support our operations, and failure to do so in a timely manner may cause us to implement additional cost reduction strategies

As of March 31, 2003, we had approximately $3.6 million in cash and cash equivalents and short-term investments. The possibility that we will not be able to meet our obligations as and when they become due over the next twelve months raises substantial doubt about our ability to continue as a going concern. Accordingly, we have been pursuing, and will continue to pursue, the implementation of certain cost reduction strategies. Additionally, we are seeking additional financing and evaluating financing alternatives in order to meet our cash requirements for fiscal 2004. We may not be able to obtain additional financing as needed on acceptable terms, or at all, which may require us to further reduce our operating costs and other expenditures, including additional reductions of personnel and capital expenditures. Alternatively, or in addition to such potential measures, we may elect to implement other cost reduction actions as we may determine are necessary and in our best interests, including the possible sale or cessation of certain of our businesses. Any such actions undertaken might limit our opportunities to realize plans for revenue growth and we might not be able to reduce our costs in amounts sufficient to achieve break-even or profitable operations. If we issue additional equity or convertible debt securities to raise funds, the ownership percentage of our existing stockholders would be reduced and they may experience significant dilution. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock. If we are not successful in these actions, we may be forced to cease operations.

We have a history of losses and we are uncertain as to our future profitability

We recorded an operating loss of approximately $4 million in the quarter ended March 31, 2003 and we ended the period with an accumulated deficit of $149 million. In addition, we recorded operating losses of $12 million, $10.0 million and $74.5 million for the fiscal years ended March 31, 2003, 2002 and 2001, respectively. We expect that we will continue to incur operating losses for the foreseeable future, and such losses may be substantial. We will need to generate significant revenue growth to achieve an operating profit. Given our history of fluctuating revenues and operating losses, we cannot be certain that we will be able to achieve profitability on either a quarterly or annual basis in the future.

We may not be able to maintain our listing on the Nasdaq SmallCap Market

In April 2002, we were notified by the Nasdaq staff that the bid price for our common stock must close at $1.00 per share or more for a minimum of ten consecutive trading days during the ninety calendar day period ending July 9, 2002 or we might be delisted. As we were not in compliance under the Nasdaq National Market minimum bid price listing standard by July 9, 2002, we transferred to and began trading on the Nasdaq SmallCap Market on July 26, 2002. As a result of our transfer to the Nasdaq SmallCap Market, our delisting determination was extended an additional ninety days until October 7, 2002. Although our common stock did not achieve a closing bid price of $1.00 for at least ten consecutive trading days before October 7, 2002, we met the initial listing criteria for the Nasdaq SmallCap Market as of October 7, 2002. As a result, we remained eligible to be quoted on the Nasdaq SmallCap Market for an additional 180-calendar day grace period, which expired on April 7, 2003, subject to our compliance with the continued listing requirements during the extended grace period. On April 8, 2003, the Nasdaq staff notified us that we have been granted an additional ninety days, or until July 7, 2003 to regain compliance with the minimum bid price listing standard. However, there is no assurance that we will be able to maintain the continued listing requirements, and, as a result, may be delisted from trading on that system. Delisting could reduce the ability of our shareholders to purchase or sell shares as quickly and as inexpensively as they have done historically. For instance, failure to obtain listing on another market or exchange may make it more difficult for traders to sell our securities. Broker-dealers may be less willing or able to sell or make a market in our common stock. Not maintaining a listing on a major stock market may:

- result in a decrease in the trading price of our common stock;
- lessen interest by institutions and individuals in investing in our common stock;
- make it more difficult to obtain analyst coverage; and
- make it more difficult for us to raise capital in the future.

Our stock price has been highly volatile

The market price of the shares of our common stock has been and is likely to be highly volatile. It may be significantly affected by factors such as:

- actual or anticipated fluctuations in our operating results;
- announcements of technical innovations;
- loss of key personnel;
- new products or new contracts by us, our competitors or their customers;
- developments with respect to patents or proprietary rights, general market conditions, changes in financial estimates by securities analysts, and other factors which could be unrelated to, or outside our control; and
- the potential delisting of our common stock.

The stock market has from time to time experienced significant price and volume fluctuations that have particularly affected the market prices for the common stocks of technology companies and that have often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the market price of our common stock. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been initiated against the issuing company. If our stock price is volatile, we may also be subject to such litigation. Such litigation could result in substantial costs and a diversion of management's attention and resources, which would disrupt business and could cause a decline in our operating results. Any settlement or adverse determination in such litigation would also subject us to significant liability.

If we fail to maintain effectiveness of a registration statement for the resale of shares of our common stock issued in connection with the redemption of our previously outstanding convertible debt, we may be forced to pay a cash penalty or redeem all or a portion of the shares, causing our business to suffer

Under the terms of a registration rights agreement we entered into in connection with the redemption of our outstanding convertible debt, we agreed to register the 1,000,000 shares of our common stock issued to the former note holders for resale. If we fail to maintain the effectiveness of the registration statement, we may be required to pay cash penalties and may be required to redeem all or a portion of the shares of common stock held by the former note holders. Under the agreement, the redemption price would be the higher of $0.898 or the market price of our common stock at the time of the redemption. If we are required to pay a cash penalty or to redeem any of the shares, this will deplete our cash reserves, which may cause significant harm to our business, results of operations and financial condition.

The growth of our business and future profitability depends on future IP telephony revenue

We believe that our business and future profitability will be largely dependent on widespread market acceptance of our IP telephony technology and products. Our videoconferencing semiconductor business has not provided sufficient revenues to profitably operate our business, and we have announced the end of life of these products and expect to make our final shipments in the first quarter of fiscal 2004. To date, we have not generated significant revenue from the sale of our IP telephony products and services. If we are not able to generate significant revenues selling into the IP telephony market, our business and operating results would be seriously harmed.

Success of our IP telephony strategy assumes that there will be future demand for IP telephony systems and services. In order for the IP telephony market to continue to grow, several things need to occur. Telephone service providers must continue to invest in the deployment of high speed broadband networks to residential and commercial customers. IP networks must improve quality of service for real-time communications, managing effects such as packet jitter, packet loss, and unreliable bandwidth, so that toll-quality service can be provided. IP telephony equipment must achieve the 99.999% reliability that users of the public switched telephone network have come to expect from their telephone service. IP telephony service providers must offer cost and feature benefits to their customers that are sufficient to cause the customers to switch away from traditional telephony service providers. If any or all of these factors fail to occur, our business may not grow.

Our business has been adversely affected by the downturn in the telecommunications industry and these developments will continue to impact our revenues and operating results

Through the end of 2000, the telecommunications market was experiencing rapid growth spurred by a number of factors including deregulation in the industry, entry of a large number of new emerging service providers, growth in data traffic and the availability of significant capital from the financial markets. In 2001, the telecommunications industry began a reversal of some of these trends, marked by a dramatic reduction in current and projected future capital expenditures by service providers, financial difficulties and, in some cases, bankruptcies experienced by emerging service providers, as well as a sharp contraction in the availability of capital. These conditions caused a substantial reduction in demand for telecommunications equipment and related software, which has had a resulting impact on demand for our IP telephony semiconductor and software products and for our hosted iPBX solution. If our current or potential customers are forced to defer or further curtail their capital spending programs, sales of our hosted iPBX product and Packet8 IP telephone service to telecommunication service providers and sales of our IP telephony semiconductors to manufacturers of telecommunication equipment may continue to be adversely affected, which would negatively impact our business, financial condition, and results of operations. In addition, many of the industries in which telecommunication service providers operate have experienced consolidation. The loss of one or more of our current or potential telecommunication service provider or telecommunication equipment OEM customers, through industry consolidation or otherwise, could reduce or eliminate our sales to such a customer and consequently harm our business, financial condition, and results of operations.

We expect the developments described above to continue to affect our business for at least the next several quarters in the following manner:

- our ability to accurately forecast revenue will be diminished;
- our revenues could be reduced; and
- our losses may increase because operating expenses are largely based on anticipated revenue trends and a high percentage of our expenses are and will continue to be fixed in the short-term.

Our business, operating results and financial condition could be materially and adversely impacted by any one or a combination of the above.

Our future operating results may not follow past or expected trends due to many factors and any of these could cause our stock price to fall

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

- changes in market demand;
- the timing of customer orders;
- competitive market conditions;
- lengthy sales cycles and/or regulatory approval cycles;
- new product introductions by us or our competitors;
- market acceptance of new or existing products;
- the cost and availability of components;
- the mix of our customer base and sales channels;
- the mix of products sold;
- the management of inventory;
- the level of international sales;
- continued compliance with industry standards; and
- general economic conditions.

Our gross margin is affected by a number of factors including product mix, the recognition of license and other revenues for which there may be little or no corresponding cost of revenues, product pricing, the allocation between international and domestic sales, the percentages of direct sales and sales to resellers, and manufacturing and component costs. The markets for our products are characterized by falling average selling prices. We expect that, as a result of competitive pressures, our product end of life announcement, and other factors, gross profit as a percentage of revenue for our videoconferencing semiconductor products will continue to decrease. Average selling prices realized to date for our IP telephony semiconductors have been lower than those historically attained for our videoconferencing semiconductor products, resulting in lower gross margins. In the likely event that we encounter significant price competition in the markets for our products, we could be at a significant disadvantage compared to our competitors, many of whom have substantially greater resources, and therefore may be better able to withstand an extended period of downward pricing pressure.

Variations in timing of sales may cause significant fluctuations in future operating results. Because a significant portion of our business may be derived from orders placed by a limited number of large customers, including original equipment manufacturers, the timing of such orders can cause significant fluctuations in our operating results. Anticipated orders from customers may fail to materialize. Delivery schedules may be deferred or canceled for a number of reasons, including changes in specific customer requirements or economic conditions. The adverse impact of a shortfall in our revenues may be magnified by our inability to adjust spending to compensate for such shortfall. Announcements by our competitors or us of new products and technologies could cause customers to defer purchases of our existing products, which would also have a material adverse effect on our business and operating results. As a result of these and other factors, it is likely that in some or all future periods our operating results will be below the expectations of investors, which would likely result in a significant reduction in the market price of our common stock.

We depend on purchase orders from key customers and failure to receive significant purchase orders in the future would cause a decline in our operating results

Historically, a significant portion of our sales has been to relatively few customers, although the composition of these customers has varied. Revenues from our ten largest customers for the fiscal years ended March 31, 2003, 2002 and 2001, accounted for approximately 62%, 73% and 48%, respectively, of total revenues. Substantially all of our product sales have been made, and are expected to continue to be made, on a purchase order basis. None of our customers has entered into a long-term agreement requiring it to purchase our products. In the future, we will need to gain purchase orders for our products to earn additional revenue. Further, substantially all of our license and other revenues are nonrecurring.

The IP telephony market is subject to rapid technological change and we depend on new product introduction in order to maintain and grow our business

IP telephony is an emerging market that is characterized by rapid changes in customer requirements, frequent introductions of new and enhanced products, and continuing and rapid technological advancement. To compete successfully in this emerging market, we must continue to design, develop, manufacture, and sell new and enhanced semiconductor and IP telephony software products and services that provide increasingly higher levels of performance and reliability at lower cost. These new and enhanced products must take advantage of technological advancements and changes, and respond to new customer requirements. Our success in designing, developing, manufacturing, and selling such products and services will depend on a variety of factors, including:

- the identification of market demand for new products;
- the scalability of our IP telephony software products;
- product and feature selection;
- timely implementation of product design and development;
- product performance;
- cost-effectiveness of products under development;
- effective manufacturing processes; and
- success of promotional efforts.

Additionally, we may also be required to collaborate with third parties to develop our products and may not be able to do so on a timely and cost-effective basis, if at all. We have in the past experienced delays in the development of new products and the enhancement of existing products, and such delays will likely occur in the future. If we are unable, due to resource constraints or technological or other reasons, to develop and introduce new or enhanced products in a timely manner, if such new or enhanced products do not achieve sufficient market acceptance, or if such new product introductions decrease demand for existing products, our operating results would decline and our business would not grow.

The long and variable sales and deployment cycles for our IP telephony products may cause our revenue and operating results to vary

Our IP telephony software and semiconductor products, including our hosted iPBX, Packet8 telephone service and our Audacity family of semiconductors, have lengthy sales cycles, and we may incur substantial sales and marketing expenses and expend significant management effort without making a sale. A customer's decision to purchase our products often involves a significant commitment of its resources and a lengthy product evaluation and qualification process. We do not possess the capital infrastructure required to invest in extensive marketing or advertising campaigns that may be required in order to sell these products. In addition, the length of our sales cycles will vary depending on the type of customer to whom we are selling and the product being sold. Even after making the decision to purchase our products, our customers may deploy our products slowly. Timing of deployment can vary widely and will depend on various factors, including:

- the size of the network deployment;
- the complexity of our customers' network environments;
- our customers' skill sets;
- the hardware and software configuration and customization necessary to deploy our products; and
- our customers' ability to finance their purchase of our products.

As a result, it is difficult for us to predict the quarter in which our customers may purchase our IP telephony products, and our revenue and operating results may vary significantly from quarter to quarter.

We need to retain key personnel to support our products and ongoing operations

The development and marketing of our IP telephony products will continue to place a significant strain on our limited personnel, management, and other resources. While the pace of economic growth in the San Francisco Bay Area (where our corporate headquarters are located) has slowed, competition for highly-skilled engineering, sales, marketing, and support personnel has remained strong. Our future success depends upon the continued services of our executive officers and other key employees who have critical industry experience and relationships that we rely on to implement our business plan. None of our officers or key employees are bound by employment agreements for any specific term. The loss of the services of any of our officers or key employees could delay the development and introduction of, and negatively impact our ability to sell our products which could adversely affect our financial results and impair our growth. We currently do not maintain key person life insurance policies on any of our employees.

We depend on contract manufacturers to manufacture substantially all of our products, and any delay or interruption in manufacturing by these contract manufacturers would result in delayed or reduced shipments to our customers and may harm our business

We outsource the manufacturing of our semiconductor products to independent foundries and as such do not have internal manufacturing capabilities to meet our customers' demands. We have shifted the manufacture of our voice over IP semiconductors to an affiliate of STMicroelectronics NV, or STM, from Taiwan Semiconductor Manufacturing Corporation, or TSMC. STM or its contract manufacturer, TSMC, will be the sole manufacturer of our semiconductor products. Furthermore, to the extent TSMC is utilized, Taiwan is always subject to geological or geopolitical disturbances that could instantly cut off such supply. We also rely on other third party manufacturers for packaging and testing of our semiconductors.

We do not have long-term purchase agreements with our contract manufacturers or our component suppliers. There can be no assurance that our subcontract manufacturers will be able or willing to reliably manufacture our products, in volumes, on a cost-effective basis or in a timely manner. For our semiconductor products, the time to port our technology to another foundry, the time to qualify the new versions of product, and the cost of this effort as well as the tooling associated with wafer production would have a material adverse effect on our business, operating results, and financial condition. For our consumer videophones, IP telephones and media hub devices that are used with our hosted iPBX and Packet8 voice and video IP telephone service, we rely on the availability of these semiconductor products. These devices are also sourced solely from certain overseas contract manufacturers and partners, and are not available from any other manufacturer.

We may not be able to manage our inventory levels effectively, which may lead to inventory obsolescence that would force us to lower our prices

Our products have lead times of up to several months, and are built to forecasts that are necessarily imprecise. Because of our practice of building our products to necessarily imprecise forecasts, it is likely that, from time to time, we will have either excess or insufficient product inventory. Excess inventory levels would subject us to the risk of inventory obsolescence and the risk that our selling prices may drop below our inventory costs, while insufficient levels of inventory may negatively affect relations with customers. For instance, our customers rely upon our ability to meet committed delivery dates, and any disruption in the supply of our products could result in legal action from our customers, loss of customers or harm to our ability to attract new customers. Any of these factors could have a material adverse effect on our business, operating results, and financial condition.

If our products do not interoperate with our customers' networks, orders for our products will be delayed or canceled and substantial product returns could occur, which could harm our business

Many of the potential customers for our hosted iPBX product and Packet8 voice and video IP telephone service have requested that our products and services be designed to interoperate with their existing networks, each of which may have different specifications and use multiple standards. Our customers' networks may contain multiple generations of products from different vendors that have been added over time as their networks have grown and evolved. Our products must interoperate with these products as well as with future products in order to meet our customers' requirements. In some cases, we may be required to modify our product designs to achieve a sale, which may result in a longer sales cycle, increased research and development expense, and reduced operating margins. If our products do not interoperate with existing equipment or software in our customers' networks, installations could be delayed, orders for our products could be canceled or our products could be returned. This could harm our business, financial condition, and results of operations. Our Packet8 telephone service depends on the availability of third party network service providers that provide telephone numbers and PSTN call termination and origination services for our customers. Many of these network service providers are financially affected by the downturn in the telecommunications industry and may be forced to terminate the services that we depend on. The time to interface our technology to another network service provider, if available, and qualify this new service could have a material adverse effect on our business, operating results, and financial condition.

We may have difficulty identifying the source of the problem when there is a problem in a network

Our hosted iPBX and Packet8 IP telephone service must successfully integrate with products from other vendors, such as gateways to traditional telephone systems. As a result, when problems occur in a network, it may be difficult to identify the source of the problem. The occurrence of hardware and software errors, whether caused by our hosted iPBX solution, Packet8 service or another vendor's products, may result in the delay or loss of market acceptance of our products and any necessary revisions may force us to incur significant expenses. The occurrence of some of these types of problems may seriously harm our business, financial condition and results of operations.

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

We expect our competitors to continue to improve the performance of their current products and introduce new products or new technologies. If our competitors successfully introduce new products or enhance their existing products, this could reduce the sales or market acceptance of our products and services, increase price competition or make our products obsolete. To be competitive, we must continue to invest significant resources in research and development, sales and marketing, and customer support. We may not have sufficient resources to make these investments or to make the technological advances necessary to be competitive, which in turn will cause our business to suffer.

In addition, our focus on developing a range of technology products, including semiconductors and related embedded software, hosted iPBX solutions, and the Packet8 telephone service products, places a significant strain on our research and development resources. Competitors that focus on one aspect of technology, such as software or semiconductors, may have a considerable advantage over us. In addition, many of our current and potential competitors have longer operating histories, are substantially larger, and have greater financial, manufacturing, marketing, technical, and other resources. For example, certain competitors in the market for our semiconductor products maintain their own semiconductor foundries and may therefore benefit from certain capacity, cost and technical advantages. Many also have greater name recognition and a larger installed base of products than we have. Competition in our markets may result in significant price reductions. As a result of their greater resources, many current and potential competitors may be better able than us to initiate and withstand significant price competition or downturns in the economy. There can be no assurance that we will be able to continue to compete effectively, and any failure to do so would harm our business, operating results, and financial condition.

If we do not develop and maintain successful partnerships for IP telephony products, we may not be able to successfully market our solutions

We are entering into new market areas and our success is partly dependent on our ability to forge new marketing and engineering partnerships. IP telephony communication systems are extremely complex and few, if any, companies possess all the required technology components needed to build a complete end to end solution. We will likely need to enter into partnerships to augment our development programs and to assist us in marketing complete solutions to our targeted customers. We may not be able to develop such partnerships in the course of our product development. Even if we do establish the necessary partnerships, we may not be able to adequately capitalize on these partnerships to aid in the success of our business.

Inability to protect our proprietary technology or our infringement of a third party's proprietary technology would disrupt our business

We rely in part on trademark, copyright, and trade secret law to protect our intellectual property in the United States and abroad. We seek to protect our software, documentation, and other written materials under trade secret and copyright law, which afford only limited protection. We also rely in part on patent law to protect our intellectual property in the United States and internationally. We hold fifty-four United States patents and have a number of United States and foreign patent applications pending. We cannot predict whether such pending patent applications will result in issued patents. We may not be able to protect our proprietary rights in the United States or internationally (where effective intellectual property protection may be unavailable or limited), and competitors may independently develop technologies that are similar or superior to our technology, duplicate our technology or design around any patent of ours. We have in the past licensed and in the future expect to continue licensing our technology to others; many of who are located or may be located abroad. There are no assurances that such licensees will protect our technology from misappropriation. Moreover, litigation may be necessary in the future to enforce our intellectual property rights, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of management time and resources and could have a material adverse effect on our business, financial condition, and operating results. Any settlement or adverse determination in such litigation would also subject us to significant liability.

There has been substantial litigation in the semiconductor, electronics, and related industries regarding intellectual property rights, and from time to time third parties may claim infringement by us of their intellectual property rights. Our broad range of technology, including systems, digital and analog circuits, software, and semiconductors, increases the likelihood that third parties may claim infringement by us of their intellectual property rights. If we were found to be infringing on the intellectual property rights of any third party, we could be subject to liabilities for such infringement, which could be material. We could also be required to refrain from using, manufacturing or selling certain products or using certain processes, either of which could have a material adverse effect on our business and operating results. From time to time, we have received, and may continue to receive in the future, notices of claims of infringement, misappropriation or misuse of other parties' proprietary rights. There can be no assurance that we will prevail in these discussions and actions or that other actions alleging infringement by us of third party patents will not be asserted or prosecuted against the Company.

We rely upon certain technology, including hardware and software, licensed from third parties. There can be no assurance that the technology licensed by us will continue to provide competitive features and functionality or that licenses for technology currently utilized by us or other technology which we may seek to license in the future will be available to us on commercially reasonable terms or at all. The loss of, or inability to maintain existing licenses could result in shipment delays or reductions until equivalent technology or suitable alternative products could be developed, identified, licensed and integrated, and could harm our business. These licenses are on standard commercial terms made generally available by the companies providing the licenses. The cost and terms of these licenses individually are not material to our business.

The failure of IP networks to meet the reliability and quality standards required for voice and video communications could render our products obsolete

Circuit-switched telephony networks feature very high reliability, with a guaranteed quality of service. In addition, such networks have imperceptible delay and consistently satisfactory audio quality. Emerging broadband IP networks, such as LANs, WANs, and the internet, or emerging last mile technologies such as cable, digital subscriber lines, and wireless local loop, may not be suitable for telephony unless such networks and technologies can provide reliability and quality consistent with these standards.

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

In addition to reliability and quality standards, the market acceptance of telephony over broadband IP networks is dependent upon the adoption of industry standards so that products from multiple manufacturers are able to communicate with each other. Our IP telephony products rely heavily on standards such as SIP, H.323, MGCP and Megaco to interoperate with other vendors' equipment. There is currently a lack of agreement among industry leaders about which standard should be used for a particular application, and about the definition of the standards themselves. These standards, as well as audio and video compression standards, continue to evolve. We also must comply with certain rules and regulations of the Federal Communications Commission (FCC) regarding electromagnetic radiation and safety standards established by Underwriters Laboratories, as well as similar regulations and standards applicable in other countries. Standards are continuously being modified and replaced. As standards evolve, we may be required to modify our existing products or develop and support new versions of our products. The failure of our products to comply, or delays in compliance, with various existing and evolving industry standards could delay or interrupt volume production of our IP telephony products, which would have a material adverse effect on our business, financial condition and operating results.

Future legislation or regulation of the internet and/or voice and video over IP services could restrict our business or increase our cost of doing business

At present there are few laws, regulations or rulings that specifically address access to or commerce on the internet, including IP telephony. We are unable to predict the impact, if any, that future legislation, legal decisions or regulations concerning the internet may have on our business, financial condition, and results of operations. Regulation may be targeted towards, among other things, assessing access or settlement charges, imposing taxes related to internet communications, imposing tariffs or regulations based on encryption concerns or the characteristics and quality of products and services, imposing regulations and requirements related to the handling of emergency 911 services, any of which could restrict our business or increase our cost of doing business. The increasing growth of the broadband IP telephony market and popularity of broadband IP telephony products and services heighten the risk that governments or other legislative bodies will seek to regulate broadband IP telephony and the internet. In addition, large, established telecommunication companies may devote substantial lobbying efforts to influence the regulation of the broadband IP telephony market, which may be contrary to our interests. Recent federal legislation provides for a significant deregulation of the U.S. telecommunications industry, including the local exchange, long distance and cable television industries. This legislation remains subject to judicial review and additional Federal Communications Commission, or FCC, rulemaking. As a result, we cannot predict the legislation's effect on our future operations. Many regulatory actions are under way or are being contemplated by federal and state authorities regarding important items. These actions could have a material adverse effect on our business, financial condition and operating results.

Potential regulation of internet service providers could adversely affect our operations

To date, the FCC has treated internet service providers as data service providers. Data service providers are currently exempt from federal and state regulations governing common carriers, including the obligation to pay access charges and contribute to the universal service fund. The FCC is currently examining the status of internet service providers and the services they provide. If the FCC were to determine that internet service providers, or the services they provide, are subject to FCC regulation, including the payment of access charges and contribution to the universal service funds, it could have a material adverse effect on our business, financial condition and operating results.

The Company may lose customers if it experiences system failures that significantly disrupt the availability and quality of the services that it provides

The operation of our Packet8 voice and video service depends on our ability to avoid and mitigate any interruptions in service or reduced capacity for customers. Interruptions in service or performance problems, for whatever reason, could undermine confidence in our services and cause us to lose customers or make it more difficult to attract new ones. In addition, because our services may be critical to the businesses of our customers, any significant interruption in service could result in lost profits or other loss to our customers. Although we attempt to disclaim liability in our service agreements, a court might not enforce a limitation on liability, which could expose us to financial loss. In addition, we may provide our customers with guaranteed service level commitments. If we are unable to meet these guaranteed service level commitments as a result of service interruptions, we may be obligated to provide credits, generally in the form of free service for a short period of time, to our customers, which could negatively affect our operating results.

The failure of any equipment or facility on our network, or those of our partners or customers, could result in the interruption of customer service until necessary repairs are made or replacement equipment is installed. Network failures, delays and errors could also result from natural disasters, terrorist acts, power losses, security breaches and computer viruses. These failures, faults or errors could cause delays, service interruptions, expose us to customer liability or require expensive modifications that could have a material adverse effect on our business, financial condition and operating results.

Intellectual property and proprietary rights of others could prevent us from using necessary technology to provide IP voice and video services

While we do not know of any technologies that are patented by others that we believe are necessary for us to provide our services, this necessary technology may in fact be patented by other parties either now or in the future. If this technology were held under patent by another person, we would have to negotiate a license for the use of that technology. We may not be able to negotiate such a license at a price that is acceptable. The existence of such a patent, or our inability to negotiate a license for any such technology on acceptable terms, could force us to cease using the technology and offering products and services incorporating the technology.

We may transition to smaller geometry process technologies and higher levels of design integration, which could disrupt our business

We continuously evaluate the benefits, on an integrated circuit, product-by-product basis, of migrating to smaller geometry process technologies in order to reduce costs related to the development and production of our semiconductors or to improve their performance. We believe that the transition of our products to increasingly smaller geometries will be important for us to remain competitive. We have in the past experienced difficulty in migrating to new manufacturing processes - which has resulted and could continue to result in reduced yields, delays in product deliveries, and increased expense levels. Moreover, we are dependent on relationships with our foundry and their partners to migrate to smaller geometry processes successfully. If any such transition is substantially delayed or inefficiently implemented, we may experience delays in product introductions and incur increased expenses. As smaller geometry processes become more prevalent, we expect to integrate greater levels of functionality, as well as customer and third party intellectual property, into our products. We cannot predict whether higher levels of design integration or the use of third party intellectual property will adversely affect our ability to deliver new integrated products on a timely basis, or at all.

If we discover product defects, we may have product- related liabilities which may cause us to lose revenues or delay market acceptance of our products

Products as complex as those we offer frequently contain errors, defects, and functional limitations when first introduced or as new versions are released. We have in the past experienced such errors, defects or functional limitations. We sell products into markets that are extremely demanding of robust, reliable, fully functional products. Therefore, delivery of products with production defects or reliability, quality or compatibility problems could significantly delay or hinder market acceptance of such products, which could damage our credibility with our customers and adversely affect our ability to retain our existing customers and to attract new customers. Moreover, such errors, defects or functional limitations could cause problems, interruptions, delays or a cessation of sales to our customers. Alleviating such problems may require significant expenditures of capital and resources by us. Despite our testing, our suppliers or our customers may find errors, defects or functional limitations in new products after commencement of commercial production. This could result in additional development costs, loss of, or delays in, market acceptance, diversion of technical and other resources from our other development efforts, product repair or replacement costs, claims by our customers or others against us, or the loss of credibility with our current and prospective customers.

We have significant international operations, which subject us to risks that could cause our operating results to decline

Sales to customers outside of the United States during the years ended March 31, 2003, 2002 and 2001 were 62%, 61% and 69% of total revenues, respectively. The following table illustrates our net revenues by geographic area. Revenues are attributed to countries based on the destination of shipment (in thousands):

	Year Ended March 31,		
	2003	2002	2001
United States	$ 4,218	$ 5,777	$ 5,632
Europe	2,657	4,126	5,862
Taiwan	1,569	2,026	2,739
Japan	919	1,119	1,188
Other	1,640	1,643	2,807
	$ 11,003	$ 14,691	$ 18,228

Substantially all of our current semiconductor and system- level products are, and substantially all of our future products will be, manufactured, assembled, and tested by independent third parties in foreign countries. International sales and manufacturing are subject to a number of risks, including general economic conditions in regions such as Asia, changes in foreign government regulations and telecommunication standards, export license requirements, tariffs and other trade barriers, potentially adverse tax consequences, fluctuations in currency exchange rates, greater difficulty in collecting accounts receivable and longer collection periods, the impact of recessions in economies outside of the United States, and difficulty in staffing and managing foreign operations. We are also subject to geopolitical risks, such as political, social, and economic instability, potential hostilities, and changes in diplomatic and trade relationships, in connection with our international operations. Taiwan in particular is subject to a high rate of natural disasters, such as earthquakes or typhoons, which could have significant impact on our suppliers and customers due to a delay in operations within that country. In addition, Taiwan's tenuous relationship with mainland China is a source of continuing concern due to potential hostilities. A significant decline in demand from foreign markets could have a material adverse effect on our business, operating results, and financial condition.

The location of our headquarters facility subjects us to the risk of earthquakes

Our corporate headquarters is located in the San Francisco Bay area of Northern California, a region known for seismic activity. A significant natural disaster, such as an earthquake, could have a material adverse impact on our business, operating results, and financial condition.

We may face interruption of production and services due to increased security measures in response to recent and potential future terrorist activities

Our business depends on the free flow of products and services through the channels of commerce. Recently, in response to terrorists' activities and threats aimed at the United States, transportation, mail, financial and other services have been slowed or stopped altogether. Further delays or stoppages in transportation, mail, financial or other services, particularly any such delays or stoppages which harm our ability to obtain an adequate supply of products from our independent suppliers, could harm our business, results of operations and financial condition. Furthermore, we may experience an increase in operating costs, such as costs for transportation, insurance and security as a result of the terrorist activities and potential activities. We may also experience delays in receiving payments from customers that have been affected by the terrorist activities and potential activities. The United States economy in general is being adversely affected by terrorist activities and potential terrorist activities. Any economic downturn could adversely impact our results of operations, impair our ability to raise capital or otherwise adversely affect our ability to grow our business. Moreover, we cannot determine whether other attacks may occur in the future and the effects of such attacks on our business.

These risk factors could cause actual results to differ materially from the results anticipated in forward-looking statements

The reports that we file with the SEC and our other communications may contain forward-looking statements that involve risks and uncertainties. We consider forward-looking statements to be those statements that describe intentions, beliefs, and current expectations with respect to future operating performance. Our actual results could differ materially from those anticipated in our forward-looking statements as a result of certain factors.

Exhibit 99.2

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Accountants

To the Board of Directors and Stockholders of 8x8, Inc.

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of 8x8, Inc. and its subsidiaries, at March 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2003, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and the financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 3 to the consolidated financial statements, as of April 1, 2002, the Company ceased amortization of goodwill to conform with the provisions of Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets."

PRICEWATERHOUSECOOPERS LLP

San Jose, California
May 2, 2003, except as to the Liquidity paragraph in Note 1 and Note 12,
for which the date is March 26, 2004

8X8, INC.

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	March 31, 2003	March 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,371	$ 12,422
Short term investments	208	--
Accounts receivable, net of allowance of $141 and $286, respectively	1,290	1,239
Inventory	352	733
Other current assets	595	612
Total current assets	5,816	15,006
Property and equipment, net	841	2,740
Intangibles and other assets	48	1,907
	$ 6,705	$ 19,653
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 652	$ 548
Accrued compensation	847	921
Accrued warranty	477	478
Deferred revenue	545	2,421
Other accrued liabilities	1,125	958
Income taxes payable	226	280
Total current liabilities	3,872	5,606
Contingently redeemable common stock	669	813
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock, $0.001 par value:		

Authorized: 5,000,000 shares; Issued and outstanding: 1 share at March 31, 2003 and March 31, 2002	--	--
Common stock, $0.001 par value: Authorized: 100,000,000 shares at March 31, 2003 and March 31, 2002; Issued and outstanding: 28,470,987 shares at March 31, 2003 and 28,228,215 shares at March 31, 2002	28	27
Additional paid-in capital	150,827	150,612
Deferred compensation	(12)	(30)
Accumulated other comprehensive loss	--	(99)
Accumulated deficit	(148,679)	(137,276)
Total stockholders' equity	2,164	13,234
	$ 6,705	$ 19,653

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

8X8, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Year Ended March 31,		
	2003	2002	2001
Product revenues	$ 5,739	$ 6,044	$ 12,808
License and other revenues	5,264	8,647	5,420
Total revenues	11,003	14,691	18,228
Cost of product revenues	2,781	2,626	5,225
Cost of license and other revenues	1,509	197	1,761
Total cost of revenues	4,290	2,823	6,986
Gross profit	6,713	11,868	11,242
Operating expenses:			
Research and development	7,835	12,559	19,950
Selling, general and administrative	7,441	8,560	16,899
In-process research and development	--	--	4,563
Amortization of intangibles	--	763	10,987
Restructuring and other charges	3,437	--	33,316
Total operating expenses	18,713	21,882	85,715
Loss from operations	(12,000)	(10,014)	(74,473)
Other income, net	597	1,029	2,628
Interest expense	--	(884)	(1,456)
Loss before provision for income taxes	(11,403)	(9,869)	(73,301)
Provision for income taxes	--	15	17
Net loss before extraordinary gain and cumulative effect of change in accounting principle	(11,403)	(9,884)	(73,318)
Extraordinary gain on extinguishment of debt, net	--	779	--
Cumulative effect of change in accounting principle	--	--	(1,081)
Net loss	$ (11,403)	$ (9,105)	$ (74,399)
Basic and diluted per share amounts:			
Net loss before extraordinary gain and cumulative effect of change in accounting principle	$ (0.40)	$ (0.36)	$ (2.95)
Extraordinary gain on extinguishment of debt, net	--	0.03	--
Cumulative effect of change in accounting principle	--	--	(0.04)
Net loss	$ (0.40)	$ (0.33)	$ (2.99)

Basic and diluted shares outstanding..................	28,386	27,271	24,846

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

8X8, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (IN THOUSANDS, EXCEPT SHARES)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Notes Receivable from Stock-holders	Deferred Compensa-tion	Accumulated other Comprehen-sive Loss	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount						
Balance at March 31, 2000........	--	$ --	22,958,921	$ 23	$ 101,559	$ (69)	$ (376)	$ --	$ (53,747)	$ 47,390
Acquisition of UForce, Inc.	1	--	3,555,303	4	44,584	--	--	--	--	44,588
Issuance of common stock under stock plans....................	--	--	1,206,591	1	2,761	--	--	--	--	2,762
Repayment of notes receivable from stockholders..............	--	--	--	--	--	60	--	--	--	60
Repurchase of common stock and Exchangeable Shares............	--	--	(1,040,089)	(1)	(521)	8	--	--	--	(514)
Deferred compensation related to stock options...............	--	--	--	--	551	--	202	--	--	753
Value of beneficial conversion feature associated with the convertible subordinated debentures.....................	--	--	--	--	1,081	--	--	--	--	1,081
Change in unrealized loss on investments....................	--	--	--	--	--	--	--	(24)	--	
Cumulative translation adjustment.....................	--	--	--	--	--	--	--	(65)	--	
Net loss.........................	--	--	--	--	--	--	--	--	(74,399)	
Total comprehensive loss.........	--	--	--	--	--	--	--	--	--	(74,488)
Balance at March 31, 2001........	1	$ --	26,680,726	$ 27	$ 150,015	$ (1)	$ (174)	$ (89)	$ (128,146)	$ 21,632
Redemption of convertible subordinated debentures........	--	--	1,000,000	--	321	--	--	--	(25)	296
Issuance of common stock under stock plans....................	--	--	457,346	--	335	--	--	--	--	335
Issuance of common stock to debt holders to satisfy interest obligations....................	--	--	95,699	--	97	--	--	--	--	97
Forgiveness of note receivable...	--	--	(5,556)	--	(1)	1	--	--	--	--
Deferred compensation related to stock options...............	--	--	--	--	(155)	--	144	--	--	(11)
Cumulative translation adjustment.....................	--	--	--	--	--	--	--	(10)	--	
Net loss.........................	--	--	--	--	--	--	--	--	(9,105)	
Total comprehensive loss.........	--	--	--	--	--	--	--	--	--	(9,115)
Balance at March 31, 2002........	1	$ --	28,228,215	$ 27	$ 150,612	$ --	$ (30)	$ (99)	$ (137,276)	$ 13,234
Issuance of common stock under stock plans....................	--	--	242,772	1	88	--	--	--	--	89
Common stock no longer contingently redeemable........	--	--	--	--	144	--	--	--	--	144
Deferred compensation related to stock options...............	--	--	--	--	(17)	--	18	--	--	1
Cumulative translation adjustment.....................	--	--	--	--	--	--	--	99	--	
Net loss.........................	--	--	--	--	--	--	--	--	(11,403)	
Total comprehensive loss.........	--	--	--	--	--	--	--	--	--	(11,304)
Balance at March 31, 2003........	1	$ --	28,470,987	$ 28	$ 150,827	$ --	$ (12)	$ --	$ (148,679)	$ 2,164

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

8X8, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (IN THOUSANDS)

	Year Ended March 31,		
	2003	2002	2001
Cash flows from operating activities:			
Net loss	$ (11,403)	$ (9,105)	$ (74,399)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,780	3,862	14,355
Extraordinary gain due to debt redemption	--	(779)	--
Stock compensation expense	1	(11)	753
Cumulative effect of change in accounting principle	--	--	1,081
In-process research and development	--	--	4,563
Gain on sale of investments, net	--	(131)	(225)
Non-cash portion of restructuring and other charges	2,273	--	32,331
Other	204	26	(20)
Changes in assets and liabilities, net of effects of businesses acquired and sold:			
Accounts receivable	(71)	1,668	851
Inventory	298	501	(85)
Other current and noncurrent assets	64	1,607	(1,281)
Accounts payable	104	(839)	(2,197)
Accrued compensation	(249)	(610)	(623)
Accrued warranty	(1)	(47)	(169)
Deferred revenue	(1,876)	(3,482)	197
Other accrued liabilities	93	(579)	378
Income taxes payable	(54)	(26)	(78)
Net cash used in operating activities	(8,837)	(7,945)	(24,568)
Cash flows from investing activities:			
Acquisitions of property and equipment	(137)	(172)	(6,127)
Cash paid for acquisitions, net	--	--	(558)
Proceeds from sale of investments	--	543	225
Proceeds from the sale of video monitoring assets, net	--	--	5,160
Proceeds from the sale of equipment	42	116	--
Purchases of short-term investments	(208)	--	--
Net cash (used in) provided by investing activities	(303)	487	(1,300)
Cash flows from financing activities:			
Debt repayments	--	(4,581)	(891)
Proceeds from issuance of common stock, net	89	335	2,763
Repayment of notes receivable from stockholders	--	--	60
Repurchase of common stock and Exchangeable Shares	--	--	(514)
Net cash provided by (used in) financing activities	89	(4,246)	1,418
Net decrease in cash and cash equivalents	(9,051)	(11,704)	(24,450)
Cash and cash equivalents, beginning of year	12,422	24,126	48,576
Cash and cash equivalents, end of year	$ 3,371	$ 12,422	$ 24,126
Supplemental and non-cash disclosures:			
Income taxes paid	$ 36	$ 12	$ 25
Interest paid	$ --	$ 204	$ 308
Common stock issued to satisfy interest obligations	$ --	$ 97	$ --
Issuance of shares and repricing of warrants in connection with the debt extinguishment	$ --	$ 1,109	$ --
Issuance of shares and assumption of options in connection with the acquisition of U|Force	$ --	$ --	$ 44,586
Marketable securities received in exchange for furniture and equipment	$ --	$ --	$ 412

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE COMPANY AND ITS SIGNIFICANT ACCOUNTING POLICIES

THE COMPANY

8x8, Inc., or 8x8, and its subsidiaries (collectively, the Company) develop and market communication technology and services for internet protocol or, IP, telephony and video applications. The Company was incorporated in California in February 1987, and in December 1996 was reincorporated in Delaware. In August 2000, the Company changed its name from 8x8, Inc. to Netergy Networks, Inc. The Company changed its name back to 8x8, Inc. in July 2001. During the fiscal year ended March 31, 2001, 8x8 formed two subsidiaries, Netergy Microelectronics, Inc. (Netergy) and Centile, Inc. (Centile) and reorganized its operations more clearly along its three product lines. The Company's three product lines are:

- The Packet8 voice and video communications service (Packet8), which enables broadband internet users to add digital voice and video communications services to their high-speed internet connection. Packet8 was launched in November 2002 and enables anyone with high-speed Internet access to sign up for voice over internet protocol (VoIP) and video communications service at http://www.packet8.net . Customers can choose a direct-dial phone number from any of the rate centers offered by the service, and then use an 8x8-supplied terminal adapter to connect any telephone to a broadband internet connection and make or receive calls from a regular telephone number. All Packet8 telephone accounts come with voice mail, caller ID, call waiting, call waiting caller ID, call forwarding, hold, line-alternate, 3-way conferencing, web access to account controls, and real-time online billing. In addition, 8x8 offers a videophone for use with the Packet8 service;

- VoIP semiconductors and related communication software that are used to make IP telephones and to voice-enable cable and digital subscriber line modems, wireless devices, and other broadband technologies, including the voice and videophone endpoints that are currently used by Packet8 and sold by the Company; and

- Hosted iPBX solutions that allow service providers to offer to small and medium-sized businesses over broadband networks the features and functions that a user commonly expects to find in a typical business phone system. A hosted iPBX solution is a software application that implements the functionality of a business phone system over the same data connection that a business uses for connection to the internet.

LIQUIDITY

The Company has sustained net losses and negative cash flows from operations since fiscal 1999 that have been funded primarily through the issuance of equity securities and borrowings. Management believes that current cash and cash equivalents, including net cash proceeds of approximately $7.9 million from the August and November 2003 sales of approximately 4.9 million shares of common stock and warrants to purchase approximately 6.0 million shares of common stock, will be sufficient to finance the Company's operations for the next twelve months. However, the Company is evaluating its cash needs and may pursue additional equity or debt financing in order to achieve the Company's overall business objectives. There can be no assurance that such financing will be available, or, if available, at a price that is acceptable to the Company. Failure to generate sufficient revenues, raise additional capital or reduce certain discretionary spending could have an adverse impact on the Company's ability to achieve its longer term business objectives.

FISCAL YEAR

Effective beginning in fiscal 2001, the Company changed its fiscal year from a year ending on the Thursday closest to March 31 to a year ending on March 31. Fiscal 2001 was 52 weeks and 2 days, while fiscal 2002 and fiscal 2003 were each 52 weeks.

PRINCIPLES OF CONSOLIDATION

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

USE OF ESTIMATES

The preparation of the consolidated financial statements, in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and equity and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, the Company evaluates its estimates, including, but not limited to, those related to bad debts, investments, goodwill and intangible assets, income taxes, restructuring and impairment charges, and other contingencies. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions.

REVENUE RECOGNITION

Product revenue -- The Company recognizes revenue from product sales upon shipment to OEMs and end users 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. Reserves for returns and allowances for OEM and end user sales are recorded at the time of shipment. The Company defers recognition of revenue on sales to distributors and resellers where the right of return exists until products are resold to the end user.

License and other revenue -- The Company recognizes revenue from license contracts when a non-cancelable, non-contingent license agreement has been signed, the software product has been delivered, no uncertainties exist surrounding product acceptance, fees from the agreement are fixed and determinable, and collection is probable. The Company uses the residual method to recognize revenue when a license agreement includes one or more elements to be delivered at a future date if evidence of the fair value of all undelivered elements exists. If evidence of the fair value of the undelivered elements does not exist, revenue is deferred and recognized when delivery occurs. When the Company enters into a license agreement requiring that the Company provide significant customization of the software products, the license and consulting revenue is recognized using contract accounting. Revenue from maintenance agreements is recognized ratably over the term of the maintenance agreement, which in most instances is one year. The Company recognizes royalties upon notification of sale by its licensees. Revenue from consulting, training, and development services is recognized as the services are performed. For sales generated from long-term contracts, the Company uses the percentage of completion method of accounting. In doing so, management makes important judgments in estimating costs and in measuring progress towards completion. These judgments underlie the Company's determinations regarding overall contract value, contract profitability and timing of revenue recognition. Revenue and cost estimates are revised periodically based on changes in circumstances, and any losses on contracts are recognized immediately.

CASH, CASH EQUIVALENTS, AND SHORT-TERM 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 classification of debt and equity securities 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.

Investments classified as available-for-sale are reported at fair value, based upon quoted market prices, with unrealized gains and losses, net of related tax, if any, included in Accumulated Other Comprehensive Loss in the Consolidated Balance Sheet. At March 31, 2002 and 2003, there were no investments classified as available-for-sale.

Investments classified as trading securities are carried at fair value, with unrealized holding gains and losses included in earnings. Realized gains and losses are determined using the specific identification method based on the trade date of a transaction. The Company had $208,000 of investments classified as trading securities at March 31, 2003, and no investments classified as trading securities at March 31, 2002.

In March 2002 8x8's board of directors (the Board) authorized the Company to open securities trading accounts and make investments of up to $1.0 million, as directed by the Company's Chairman, Joe Parkinson, the Chief Executive Officer, or the Chief Financial Officer. Mr. Parkinson has agreed to personally reimburse 8x8 on a quarterly basis for any losses resulting from his trading activities in order to maintain a minimum investment account balance of $1.0 million. The Board has been assured of Mr. Parkinson's ability to cover any such losses; however, should he be unable to do so, it could have a material impact on the Company's cash flows and results of operations. As part of the arrangement, the Board has expressed its intent, but not obligation, to pay Mr. Parkinson a quarterly bonus in an amount equal to 25% of the profits attributable to investments made on the Company's behalf by Mr. Parkinson to the extent such a bonus exceeds his salary for the corresponding period. The Company or Mr. Parkinson can terminate this arrangement at any time. Under the arrangement, the Company is required to return to Mr. Parkinson the amount representing the increase in value of the investment account over $1.0 million to the extent required to restore replenishment payments made by Mr. Parkinson in prior quarters. Through March 31, 2003, Mr. Parkinson had made cumulative replenishment payments of approximately $137,000 to offset losses incurred. As of March 31, 2003, the investment account balance approximated $1,018,000. Accordingly, the Company had a payable of approximately $18,000 to Mr. Parkinson at March 31, 2003. As of March 31, 2003, $208,000 of the $1.0 million allocated for such investment activities was invested in marketable equity securities, and the remainder was invested in money market funds.

INVENTORY

Inventory is stated at the lower of standard cost, which approximates actual cost using the first-in, first-out method, or market. Inventory reserves are established when conditions indicate that the selling price could be less than cost due to physical deterioration, obsolescence, changes in price levels, or other causes. Reserves are established for excess inventory generally based on inventory levels in excess of demand, as determined by management, for each specific product. If actual product demand or selling prices are less favorable than the Company's estimate, the Company may be required to take additional inventory write-downs. Conversely, if the Company sells more inventory or at higher prices than the Company's forecast, future margins may be higher.

Inventory at March 31, 2003 and 2002 was comprised of the following:

	March 31, 2003	March 31, 2002
	(in thousands)	
Raw materials and work-in-process	147	528
Finished goods	205	205
	$ 352	$ 733

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method. Estimated useful lives of three years are used for equipment and software and five years for furniture and fixtures. Amortization of leasehold improvements is computed using the shorter of the remaining facility lease term or the estimated useful life of the improvements. Property and equipment at March 31, 2003 and 2002, was comprised of the following components:

	March 31, 2003	March 31, 2002
	(in thousands)	
Machinery and computer equipment	$ 7,378	$ 8,076
Furniture and fixtures	847	1,084
Licensed software	4,142	4,105
Leasehold improvements	914	991
	13,281	14,256
Less: accumulated depreciation and amortization	(12,440)	(11,516)
	$ 841	$ 2,740

Maintenance, repairs and ordinary replacements are charged to expense. Expenditures for improvements that extend the physical or economic life of the property are capitalized. Gains or losses on the disposition of property and equipment are reflected in Other Income, net.

IMPAIRMENT OF LONG-LIVED ASSETS

8x8 reviews the recoverability of its long-lived assets, such as plant and equipment when events or changes in circumstances occur that indicate that the carrying value of the asset or asset group may not be recoverable. The assessment of possible impairment is based on the Company's ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. The measurement of impairment requires management to estimate future cash flows and the fair value of long-lived assets.

WARRANTY EXPENSE

The Company accrues for the estimated cost that may be incurred under its product warranties upon revenue recognition. Changes in the Company's product warranty liability during the year ended March 31, 2003 were not material.

RESEARCH AND SOFTWARE DEVELOPMENT COSTS

Research and development costs are charged to operations as incurred. Software development costs incurred prior to the establishment of technological feasibility are included in research and development and are expensed as incurred. The Company defines establishment of technological feasibility as the completion of a working model. 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. To date, all software development costs have been expensed as incurred.

FOREIGN CURRENCY TRANSLATION

Assets and liabilities of the Company's foreign subsidiaries are translated from their respective functional currencies at exchange rates in effect at the balance sheet date, and revenues and expenses are translated at average exchange rates prevailing during the year. If the functional currency is the local currency, resulting translation adjustments are reflected as a separate component of stockholders' equity. If the functional currency is the U.S. dollar, resulting conversion adjustments are included in the results of operations. Foreign currency transaction gains and losses, which have been immaterial, are also included in results of operations. Total assets of the Company's foreign subsidiaries were $508,000, $1.6 million and $3.8 million as of March 31, 2003, 2002, and 2001, respectively. During the year ended 2003, the Company substantially completed the liquidation of its investment in its Canadian operations acquired in conjunction with the acquisition of U|Force, Inc. in June 2000. As a result, the $92,000 attributable to that entity and accumulated in the translation adjustment component of equity was removed and reported in other income. At March 31, 2003, the U.S. dollar was the functional currency for all foreign subsidiaries. The Company does not undertake any foreign currency hedging activities.

INCOME TAXES

Income taxes are accounted for using the asset and liability approach. Under the asset and liability approach, a current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the current year. A deferred tax liability or asset is recognized for the estimated future tax effects attributed to temporary differences and carryforwards. If necessary, the deferred tax assets are reduced by the amount of benefits that, based on available evidence, are not expected to be realized.

TAX CREDITS

Research and development and other refundable tax credits are accounted for using the cost reduction method. Under this method, tax credits relating to eligible expenditures are accounted for as a reduction of related expenses in the period during which the expenditures are incurred, provided there is reasonable assurance of realization.

CONCENTRATIONS

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents and trade accounts receivable. At March 31, 2003, approximately 55% of the Company's cash equivalents were placed in an institutional money market fund of a reputable, U.S. based financial institution. The Company has not experienced any material losses relating to any investment instruments.

The Company sells its products to OEMs and distributors throughout the world. The Company performs ongoing credit evaluations of its customers' financial condition, and for certain transactions requires collateral from its customers. For each of the three years ended March 31, 2003, the Company experienced minimal write-offs for bad debts and doubtful accounts. At March 31, 2003, three customers accounted for 30%, 18% and 15% of gross accounts receivable. At March 31, 2002, one customer accounted for 45% of accounts receivable.

The Company outsources the manufacturing of its semiconductor and system products to independent contract manufacturers. The inability of any contract manufacturer to fulfill supply requirements of the Company could materially impact future operating results, financial position and cash flows.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value of financial instruments is determined by the Company using available market information and valuation methodologies considered to be appropriate. The carrying amounts of the Company's cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to their short maturities.

ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company accounts for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB Opinion No. 25) and related interpretations thereof. As required under Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), the Company provides pro forma disclosure of net income and earnings per share. If the Company had elected to recognize compensation costs based on the fair value at the date of grant of the awards, consistent with the provisions of SFAS No. 123, net income and earnings per share amounts would have been as follows (in thousands, except per share amounts):

	Year Ended March 31,		
	2003	2002	2001
Net loss:	$ (11,403)	$ (9,105)	$ (74,399)
Add: Stock-based compensation expense included in reported net income.......	1	(11)	753
Deduct: Total stock-based compensation determined pursuant to SFAS No.123*	(4,446)	(9,483)	(10,486)
Pro forma net loss (basic and diluted)	$ (15,848)	$ (18,599)	$ (84,132)
As reported net loss per share............	$ (0.40)	$ (0.33)	$ (2.99)
Pro forma net loss per share..............	$ (0.56)	$ (0.68)	$ (3.39)

*These amounts have been adjusted to reflect a correction to the forfeiture rate, which resulted in reductions in the pro forma net losses for 2002 and 2001 of $6.5 million and $3.1 million, respectively.

COMPREHENSIVE LOSS

Comprehensive loss, as defined, includes all changes in equity (net assets) during a period from non-owner sources. The difference between net loss and comprehensive loss is due primarily to unrealized losses on short-term investments classified as available-for-sale and foreign currency translation adjustments. Comprehensive loss is reflected in the Consolidated Statements of Stockholders' Equity.

RECLASSIFICATIONS

Certain prior year balances have been reclassified to conform with the current year presentation.

NET LOSS PER SHARE

Basic net loss per share is computed by dividing net loss available to common stockholders (numerator) by the weighted average number of vested, unrestricted common and Exchangeable Shares (see Note 2) outstanding during the period (denominator). Net loss available to common stockholders was as follows (in thousands):

	Year Ended March 31,		
	2003	2002	2001
Net loss	$ (11,403)	$ (9,105)	$ (74,399)
Accretion of dividends on contingently redeemable common stock	--	(25)	--
Net loss available to common stockholders	$ (11,403)	$ (9,130)	$ (74,399)

Due to net losses incurred for all periods presented, weighted average basic and diluted shares outstanding for the respective periods are the same. The following equity instruments were not included in the computations of net loss per share because the effect on the calculations would be anti-dilutive (in thousands):

	Year Ended March 31,		
	2003	2002	2001
Common stock options	7,615	9,900	7,732
Warrants	--	701	701
Convertible subordinated debentures	--	--	638
Unvested restricted common stock	--	--	30
	7,615	10,601	9,101

RECENT ACCOUNTING PRONOUNCEMENTS

On October 3, 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 applies to all long-lived assets (including discontinued operations) and consequently amends Accounting Principles Board Opinion No. 30. SFAS No. 144 develops one accounting model for long-lived assets that are to be disposed of by sale and requires that long-lived assets that are to be disposed of by sale be measured at the lower of book value or fair value less cost to sell. Additionally, SFAS No. 144 expands the scope of discontinued operations to include all components of an entity with operations that (i) can be distinguished from the rest of the entity, and (ii) will be eliminated from the ongoing operations of the entity in a disposal transaction. The Company adopted SFAS No. 144 in the first quarter of fiscal 2003, and its adoption did not have a material impact on the Company's results of operations and financial condition.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses accounting for restructuring and similar costs. SFAS No. 146 supercedes previous accounting guidance, principally Emerging Issues Task Force Issue (EITF) No. 94-3. SFAS No. 146 requires that a liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of the entity's commitment to an exit plan. SFAS No. 146 also requires that the liability be initially measured and recorded at fair value. SFAS No. 146 was effective for exit or disposal activities that are initiated after December 31, 2002. The Company adopted SFAS No. 146 in the fourth quarter of fiscal 2003, and its adoption did not have a material impact on its results of operations and financial condition.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," which expands previously issued accounting guidance and disclosure requirements for certain guarantees. FIN 45 requires an entity to recognize an initial liability for the fair value of an obligation assumed by issuing a guarantee. The provision for initial recognition and measurement of the liability will be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The Company does not expect this interpretation to have a material impact on its consolidated results of operations or financial position. The Company has included additional disclosures in accordance with FIN 45 in the footnotes to these consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, SFAS No. 148 requires disclosure of the pro forma effect in interim financial statements. The additional disclosure requirements of SFAS No. 148 are effective for fiscal years ended after December 15, 2002. 8x8 will continue to account for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25. The Company has included additional disclosures in accordance with SFAS No. 148 in the footnotes to these consolidated financial statements.

2. ACQUISITION OF U|FORCE, INC.

The Company's consolidated financial statements reflect the purchase acquisition of all of the outstanding stock of U|Force, Inc. (U|Force) on June 30, 2000 for a total purchase price of $46.8 million. U|Force, based in Montreal, Canada, was a developer of IP-based software applications and a provider of professional services. U|Force was also developing a Java-based service creation environment (SCE) designed to allow telecommunication service providers to develop, deploy, and manage telephony applications and services to their customers. The purchase price was comprised of 8x8 common stock with a fair value of approximately $38.0 million comprised of: (i) 1,447,523 shares issued at closing of the acquisition, and (ii) 2,107,780 shares to be issued upon the exchange or redemption of the exchangeable shares (the Exchangeable Shares) of Canadian entities held by former employee shareholders or indirect owners of U|Force stock. See Note 10 regarding further discussion of the Exchangeable Shares. 8x8 also assumed outstanding stock options to purchase shares of U|Force common stock for which the Black-Scholes option-pricing model value of approximately $6.5 million was included in the purchase price. Direct transaction costs related to the merger were approximately $747,000. Additionally, the Company advanced $1.5 million to U|Force upon signing the acquisition agreement, but prior to the close of the transaction. This amount was accounted for as part of the purchase price. The following table summarizes the composition of the purchase price (in thousands):

Value of common stock and Exchangable Shares issued	$ 38,042
Value of stock otions assumed	6,546
Cash advanced to U|Force prior to closing	1,500
Direct transaction costs	747
	$ 46,835

The purchase price was allocated to tangible assets acquired and liabilities assumed based on the book value of U|Force's assets and liabilities, which approximated their fair value. Intangible assets acquired included amounts allocated to U|Force's in-process research and development. The in-process research and development related to U|Force's initial products, the SCE and a unified messaging application, for which technological feasibility had not been established and the technology had no alternative future use. The estimated percentage complete for the unified messaging and SCE products was approximately 44% and 34%, respectively, at June 30, 2000. The fair value of the in-process technology was based on a discounted cash flow model, similar to the traditional "Income Approach," which discounts expected future cash flows to present value, net of tax. In developing cash flow projections, revenues were forecasted based on relevant factors, including aggregate revenue growth rates for the business as a whole, characteristics of the potential market for the technology, and the anticipated life of the technology. Projected annual revenues for the in-process research and development projects were assumed to ramp up initially and decline significantly at the end of the in-process technology's economic life. Operating expenses and resulting profit margins were forecasted based on the characteristics and cash flow generating potential of the acquired in-process technologies. Risks that were considered as part of the analysis included the scope of the efforts necessary to achieve technological feasibility, rapidly changing customer markets, and significant competitive threats from numerous companies. The Company also considered the risk that if the products were not brought to market in a timely manner, it could adversely affect sales and profitability of the combined company in the future. The resulting estimated net cash flows were discounted at a rate of 25%. This discount rate was based on the estimated cost of capital plus an additional discount for the increased risk associated with in-process technology. The value of the acquired U|Force in-process research and development, which was expensed in the second quarter of fiscal 2001, approximated $4.6 million. The excess of the purchase price over the net tangible and intangible assets acquired and liabilities assumed was allocated to goodwill. Amounts allocated to goodwill, the value of an assumed distribution agreement, and workforce were being amortized on a straight-line basis over three, three, and two years, respectively, prior to the write-off of the unamortized balances in the fourth quarter of fiscal 2001 as discussed in Note 4. The allocation of the purchase price was as follows (in thousands):

In-process research and development	$ 4,563
Distribution agreement	1,053
Workforce	1,182
U|Force net tangible assets	1,801
Goodwill	38,236
	$ 46,835

3. ADOPTION OF SFAS NO. 142, GOODWILL AND OTHER INTANGIBLE ASSETS

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). Under SFAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized but are reviewed annually (or more frequently if impairment indicators arise) for impairment. Furthermore, SFAS No. 142 requires purchased intangible assets other than goodwill to be amortized over their useful lives unless these lives are determined to be indefinite. In accordance with SFAS No. 142, the effect of this accounting change was reflected prospectively. Supplemental comparative disclosure as if the change had been retroactively applied to the prior year period is as follows (in thousands, except per share amounts):

	Year Ended March 31,		
	2003	2002	2001
Reported net loss	$ (11,403)	$ (9,105)	$ (74,399)
Add back: Goodwill and intangibles amortization	--	763	10,987
Adjusted net loss	$ (11,403)	$ (8,342)	$ (63,412)
Basic and diluted earnings per share:			
Reported net loss per share	$ (0.40)	$ (0.33)	$ (2.99)
Goodwill and intangibles amortization	--	0.03	0.44
Adjusted net loss per share	$ (0.40)	$ (0.30)	$ (2.55)

In accordance with SFAS No. 142, 8x8 is required to perform an annual impairment test for goodwill. Goodwill SFAS No. 142 requires 8x8 to compare the fair value of the reporting unit to its carrying amount on an annual basis to determine if there is potential impairment. If the fair value of the reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the fair value of the goodwill within the reporting unit is less than the carrying value. The fair value for goodwill is determined based on discounted cash flows, market multiples or appraised values as appropriate. As described in Note 4 below, the Company recorded a $1.5 million goodwill impairment charge in the fourth quarter of fiscal 2003.

4. RESTRUCTURING AND OTHER CHARGES

2003 Restructuring Actions

During the third and fourth quarters of fiscal 2003, the Company continued its cost reduction activities to better align expense levels with current revenue levels and ensure conservative spending during the current economic downturn. As a result of these activities, the Company recorded restructuring and other asset impairment charges of approximately $3.4 million. These charges included severance and benefits of approximately $1.2 million, as the Company reduced its workforce, under voluntary and involuntary separation plans, by thirty-two employees or thirty percent. The majority of the affected employees were employees of the semiconductor business based in Santa Clara, California, Tempe, Arizona and Marlow, United Kingdom and included employees from sales and marketing and research and development, as well as four executives of the semiconductor business. Severance of approximately $325,000 attributable to involuntary terminations was paid during the year ended March 31, 2003.

The Company closed its facility in Marlow, United Kingdom, and recorded charges of $434,000 related to the termination of the operating leases for the facility and related services. In addition, the Company recorded asset impairment charges of $212,000 related to assets in the United Kingdom that were abandoned or disposed of.

The Company also recorded a charge of approximately $74,000 for its remaining lease liability for office space in Tempe, Arizona that was vacated as a result of the restructuring actions during the fourth quarter.

In the fourth quarter of fiscal 2003, the Company also implemented a plan to reduce the workforce at its Sophia Antipolis, France office by ten employees or seventy percent. This downsizing and its potential impact on the iPBX business prompted an assessment of the key assumptions underlying the Company's goodwill valuation judgments. As a result of the analysis, the Company determined that an impairment charge of $1.5 million was required because the estimated fair value of the goodwill was less than the book value of the goodwill that arose from the acquisition of Odisei S.A. in fiscal 2000.

The following table illustrates the charges, credits and balances of the restructuring reserves as of March 31, 2003 and summarizes impairment charges (in thousands):

	Total Charges	Cash Payments	Non-Cash Charges	Liability at March 31, 2003
Restructuring Charges:				
Severance	$ 1,177	$ (1,002)	$ --	$ 175
Facility related	508	(161)	(273)	74
Total restructuring charges	1,685	(1,163)	(273)	249
Asset Impairments:				
Fixed Assets	212	--	(212)	--
Goodwill	1,539	--	(1,539)	--
Total impairment charges	1,751	--	(1,751)	--
Total restructuring and impairment charges	$ 3,436	$ (1,163)	$ (2,024)	$ 249

2001 Restructuring Actions

During the fourth quarter of fiscal 2001, after a significant number of employees had resigned, the Company discontinued its Canadian operations acquired in conjunction with the acquisition of U|Force in June 2000. The Company closed its offices in Montreal and Hull, Quebec and laid-off all remaining employees resulting in the cessation of most of the research and development efforts and all of the sales and marketing and professional services activities associated with the U|Force business. As a result of the restructuring, the Company recorded a one-time charge of $33.3 million in the quarter ended March 31, 2001. The restructuring charge consisted of the following (in thousands):

Employee separation	$ 765
Fixed asset losses and impairments	2,084
Intangible asset impairments	30,247
Lease obligation and termination	220
	$ 33,316

Employee separation costs represent severance payments related to the 96 employees in the Montreal and Hull offices who were terminated.

The impairment charges for fixed assets approximated $2.1 million which included write-offs of abandoned and unusable assets of approximately $1.4 million, a loss on sale of assets of $567,000, and a charge for assets to be disposed of $172,000. The asset write-offs of $1.4 million included approximately $850,000 related to leasehold improvements and $560,000 related to computer equipment, furniture, and software. The loss on sale of assets of $567,000 was attributable to the sale of office, computer, and other equipment of the Montreal office. The Company received common stock of the purchaser valued at approximately $412,000 at the date of sale. Fair value of assets to be disposed of was measured based on expected salvage value, less costs to sell. Assets to be disposed of consist of computer equipment with a fair value of $57,000 at March 31, 2001. Substantially all of these assets were liquidated during fiscal 2002.

The impairment charges for intangible assets represented the write-off of the unamortized intangible assets recorded in connection with the acquisition of U|Force. The charges of approximately $30.2 million included: $28.7 million for the goodwill related to the acquisition, $739,000 for the assembled workforce, and $789,000 related to a distribution agreement. The impairments were directly attributable to the cessation of operations in Canada. The Company performed an evaluation of the recoverability of the intangible assets related to these operations in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." The lack of estimated future net cash flows related to the acquired products necessitated an impairment charge to write-off the remaining unamortized goodwill. The distribution agreement asset was written off because the Company will no longer provide products and services to customers under that agreement.

Cash payments related to the restructuring during the quarter ended March 31, 2001, which included all employee separation costs and certain lease termination costs, approximated $920,000. Accrued obligations related to remaining lease commitments on the Montreal and Hull facilities totaled $212,000 at March 31, 2001. The Company terminated the lease for its primary facility in Montreal in March 2001, but was required to pay rent on the facility through May 31, 2001. The Company terminated the lease for the facility in Hull, Quebec, in fiscal 2002. The payments made in fiscal 2002 related to the terminations of the Montreal and Hull facility leases totaled $225,000. There were no remaining restructuring related accruals at March 31, 2002.

5. DEBT

Convertible Subordinated Debentures

Issuance of the Debentures

In December 1999, the Company issued $7.5 million of 4% Series A and Series B convertible subordinated debentures (the Debentures) due in December 2002. In conjunction with the issuance of the Debentures, the lenders received warrants to purchase 531,915 8x8 common shares at $7.05 per share and 105,634 shares at $35.50 per share (the Lender Warrants). The Company also issued warrants to the placement agent to purchase 53,191 8x8 common shares at $7.05 per share and 10,563 shares at $35.50 per share. All of the warrants expired in December 2002 without being exercised.

Using the Black-Scholes pricing model, the Company determined that the debt discount associated with the fair value of the warrants issued to the lenders approximated $2.2 million. The costs of issuing the Debentures totaled $864,000, including a non-cash charge for the value of warrants issued to the placement agent. The debt discount and debt issuance costs were amortized to interest expense on a straight-line basis over the term of the Debentures.

Cumulative Effect of Change in Accounting Principle - Beneficial Conversion Feature

In November 2000, the Emerging Issues Task Force reached several conclusions regarding the accounting for debt and equity securities with beneficial conversion features, including a consensus requiring the application of the "accounting conversion price" method, versus the use of the stated conversion price, to calculate the beneficial conversion feature for such securities. The SEC required companies to record a cumulative catch-up adjustment in the fourth quarter of calendar 2000 related to the application of the "accounting conversion price" method to securities issued after May 21, 1999. Accordingly, the Company recorded a $1.1 million non-cash expense during the quarter ended December 31, 2000 to account for a beneficial conversion feature associated with the Debentures and related warrants. The Company has presented the charge in the Consolidated Statements of Operations as a cumulative effect of a change in accounting principle.

Extraordinary Item - Early Extinguishment of Debentures

In December 2001, the Company redeemed the Debentures for $4.5 million in cash and 1,000,000 contingently redeemable shares of common stock. Additionally, the Company agreed to reduce the exercise price of the Lender Warrants to $0.898 per share. This transaction resulted in an extraordinary gain of $779,000, net of the incremental fair value of the repriced warrants, the write-off of unamortized debt discount and debt issue costs, and other costs associated with the early extinguishment of the Debentures.

Contingently Redeemable Common Stock

Under the terms of the registration rights agreement that the Company and the lenders entered into in connection with the issuance of the 1,000,000 shares of common stock associated with the extinguishment described above, the Company agreed to register the shares for resale and maintain the effectiveness of the registration statement for specified periods of time until the shares are resold or can be resold without the registration statement (the Maintenance Requirements). The Company further agreed that if it does not comply with the Maintenance Requirements in the future, it may be required to pay cash penalties and redeem all or a portion of the shares held by the lenders at the higher of $0.898 per share or the market price of the Company's stock at the time of the redemption. The remaining shares held by the lenders at March 31, 2003 and March 31, 2002 were recorded at their potential redemption values of $669,000 and $813,000, respectively, and classified as contingently redeemable common stock due to the redemption rights described above. The Company will not mark the contingently redeemable common stock to the higher of $0.898 per share or market unless it becomes probable that the Company will not be able to comply with the Maintenance Requirements.

The approximately $25,000 difference between the potential redemption value of the shares held by the lenders at March 31, 2002 and the value of those shares on the date of issuance has been treated as a deemed dividend and included as an adjustment to net income (loss) available to common stockholders for purposes of calculating the Company's net income (loss) per share for fiscal 2002.

6. DISPOSITION OF VIDEO MONITORING PRODUCT LINE

On May 19, 2000, the Company entered into an Asset Purchase Agreement with Interlogix, Inc. (Interlogix) providing for the sale of certain assets comprising the Company's video monitoring business (the Business) to Interlogix. The assets sold included certain accounts receivable, inventories, technical information, machinery, equipment, contract rights, intangibles, records, and supplies. Concurrently with the execution of the Asset Purchase Agreement, the Company and Interlogix entered into a Technology License Agreement (the License Agreement) providing for the licensing of certain related intellectual property to Interlogix, a Development Agreement providing Interlogix continuing rights in certain products to be developed by the Company, a Transition Services Agreement providing for certain services to be rendered by the Company to Interlogix in respect of the Business, and a Supply Agreement providing for the continuing sale of certain products to Interlogix by the Company. The aggregate purchase price paid by Interlogix was approximately $5.2 million in cash.

The Company's obligations under the Transition Services Agreement expired in fiscal 2001. The cost of services provided under the Transition Services Agreement was reimbursed by Interlogix. Pursuant to the Asset Purchase Agreement, the Company is responsible for reimbursing Interlogix for costs they incur associated with warranty obligations related to video monitoring products manufactured prior to May 19, 2000. The Company's estimated remaining exposure to such warranty obligations is reflected in the warranty accrual at March 31, 2003.

At signing, the Company's continuing obligations under the License and Development Agreements included: (i) providing future updates and upgrades to the licensed technology, if any, over the initial three-year term of the License Agreement (the Maintenance Obligations) and (ii) certain potential obligations to assist Interlogix in the development of future products (the Development Obligations). The Company deferred the recognition of the approximately $3.9 million of revenue ascribed to the license of video monitoring technology to Interlogix until the Development Obligations expired in the quarter ended March 31, 2001. Upon expiration of the Development Obligations, the Company commenced recognition of the previously deferred revenue and is recognizing the revenue ratably over the license term, which expires in May 2003, due to the remaining Maintenance Obligations. The remaining balance in deferred revenue at March 31, 2003 is approximately $285,000.

7. TRANSACTIONS WITH RELATED PARTIES

Strategic Relationship with STMicroelectronics NV

During the fourth quarter of fiscal 2000, the Company sold 3.7 million shares of its common stock to STMicroelectronics NV (STM) at a purchase price of $7.50 per share and received net proceeds of $27.7 million. In addition, the Company granted STM the right to a seat on the Company's Board of Directors as long as it holds at least 10% of the Company's outstanding shares. STM was also granted certain rights to maintain its percentage ownership interest of the Company's outstanding voting securities, including certain rights to participate in future securities offerings of the Company, or, in certain circumstances, the right to acquire additional shares through market purchases. The Company also granted to an STM subsidiary a non-exclusive, royalty-bearing license to certain technology and undertook certain joint development activities with a subsidiary of STM. Under the terms of the agreement, the STM subsidiary guaranteed certain minimum payments to the Company totaling $1.0 million; $500,000 for prepaid royalties and $500,000 for certain non-recurring engineering services (the Minimum Payments). The Company received the Minimum Payments in fiscal 2001.

During fiscal 2003, the Company purchased semiconductors from a subsidiary of STM. Such purchases approximated $550,000. In addition, during fiscal 2003 the Company contracted with a subsidiary of STM for non-recurring engineering services related to the development of a new semiconductor product by the Company. As of March 31, 2003, the Company had recorded liabilities to STM of $392,000 for semiconductor purchases and purchase commitments and engineering services.

Other Transactions

In March 2002 the Board of Directors authorized the Company to open securities trading accounts and make investments in other classes of securities that may generate higher returns than the currently low yields on governmental and corporate debt securities and money market funds. The amount allocated for such investments was $1.0 million to be invested on behalf of 8x8, Inc. as directed by the Company's Chairman, Joe Parkinson; Chief Executive Officer; or Chief Financial Officer. Mr. Parkinson has agreed to personally reimburse 8x8, Inc. on a quarterly basis for any losses resulting from his trading activities in order to maintain a minimum investment account balance of $1.0 million. As part of the arrangement, the Company's Board of Directors has expressed its intent, but not obligation, to pay Mr. Parkinson a quarterly bonus in an amount equal to 25% of the profits attributable to investments made on the Company's behalf by Mr. Parkinson to the extent such a bonus exceeds his salary for the corresponding period. The Company or Mr. Parkinson can terminate this arrangement at any time, subject to the terms of an agreement between Mr. Parkinson and the Company. Under the arrangement, the Company is required to return to Mr. Parkinson the amount representing the increase in value of the investment account over $1.0 million to the extent required to restore replenishment payments made by Mr. Parkinson in prior quarters. Through March 31, 2003, Mr. Parkinson had made cumulative replenishment payments of approximately $137,000 to offset losses incurred. As of March 31, 2003, the investment account balance approximated $1,018,000. Accordingly, the Company had a payable of approximately $18,000 to Mr. Parkinson at March 31, 2003. As of March 31, 2003, approximately $200,000 was invested in equity securities, and the remaining $800,000 was invested in money market accounts.

During fiscal 2001, Dr. Bernd Girod, a director of 8x8 and its subsidiary, Netergy, received $22,000 in consideration for technical consulting services that he provided to the Company. In addition, the Company contributed $150,000 during fiscal 2001 to a Stanford University research program managed by Dr. Girod.

8. INCOME TAXES

The Company's loss before income taxes included $65,000, $161,000 and $162,000 of foreign subsidiary income for the fiscal years ended March 31, 2003, 2002, and 2001, respectively.

The components of the consolidated provision for income taxes consisted of the following (in thousands):

	Year Ended March 31, 2003	2002	2001
Current:			
Federal	$ --	$ (10)	$ --
State	--	--	--
Foreign	--	25	17
	$ --	$ 15	$ 17

Deferred tax assets were comprised of the following (in thousands):

	March 31, 2003	2002
Research and development credit carryforwards	$ 5,459	$ 4,809
Net operating loss carryforwards	41,543	23,954
Inventory valuation	419	569
Reserves and allowances	349	471
Goodwill	--	14,193
Other	2,806	3,335
	50,576	47,331
Valuation allowance	(50,576)	(47,331)
Total	$ --	$ --

Management believes that, based on a number of factors, the weight of objective available evidence indicates that it is more likely than not that the Company will not be able to realize its deferred tax assets, and thus a full valuation allowance was recorded at March 31, 2003 and March 31, 2002.

At March 31, 2003, the Company had net operating loss carryforwards for federal and state income tax purposes of approximately $115 million and $42 million, respectively, which expire at various dates beginning in 2005. The net operating loss carryforwards include approximately $5 million resulting from employee exercises of non-qualified stock options or disqualifying dispositions, the tax benefits of which, when realized, will be accounted for as an addition to additional paid-in capital rather than as a reduction of the provision for income taxes. In addition, at March 31, 2003, the Company had research and development credit carryforwards for federal and state tax reporting purposes of approximately $3 million and $2.3 million, respectively. The federal credit carryforwards will begin expiring in 2010 while the California credit will carryforward indefinitely. Under applicable tax laws, the amount of and benefits from net operating losses and credits that can be carried forward may be impaired or limited in certain circumstances. Events which may cause limitations in the amount of net operating loss carryforwards that the Company may utilize in any one year include, but are not limited to, a cumulative ownership change of more than 50% over a three year period.

A reconciliation of the tax provision (benefit) to the amounts computed using the statutory U.S. federal income tax rate of 34% is as follows (in thousands):

	Year Ended March 31, 2003	2002	2001
Benefit at statutory rate	$ (3,877)	$ (3,090)	$ (25,296)
State income taxes (benefit) before valuation allowance, net of federal effect	(684)	229	(3,909)
In-process research and development	--	--	1,551
Non-deductible goodwill	523	259	--
Discount on issuance of Common Stock	--	558	--
Research and development credits	--	(216)	(1,162)
Change in valuation allowance	4,030	2,302	29,027
Non-deductible compensation	--	(4)	256
Foreign rate differences	--	(30)	1
Other	8	7	(451)
	$ --	$ 15	$ 17

9. COMMITMENTS AND CONTINGENCIES

Leases

The Company leases its primary facility in Santa Clara, California under a non-cancelable operating lease agreement that expires in November 2004. The Company also has leased facilities in Arizona, France and Canada. The facility leases include rent escalation clauses, and require the Company to pay taxes, insurance, and normal maintenance costs. At March 31, 2003, future minimum annual lease payments under non-cancelable operating leases, net of sublease income, were as follows (in thousands):

YEAR ENDING MARCH 31,	
2004	$ 544
2005	280
2006	37
Total minimum payments	$ 861

Rent expense for the years ended March 31, 2003, 2002 and 2001, was $1.5 million, $1.5 million and $1.8 million, respectively.

The Company subleases office space under operating lease agreements expiring at various dates through 2005. The total future minimum rentals to be received under these noncancelable sublease agreements approximate $18,000 in each of fiscal 2004, 2005 and 2006 and $12,000 in fiscal 2007.

Legal Proceedings

In November 2001, the Company settled a lawsuit that was filed against it in April 2001 in British Columbia, Canada by Milinx Business Services, Inc. and Milinx Business Group, Inc (collectively, Milinx). The Company was released of any further obligations to Milinx in exchange for returning a portion of the original license fee. As a result of the settlement agreement, in fiscal 2002 the Company recognized $309,000 of previously deferred revenue stemming from a March 2000 license agreement with Milinx.

The Company is also involved in various other legal claims and litigation that have arisen in the normal course of the Company's operations. While the results of such claims and litigation cannot be predicted with certainty, the Company believes that the final outcome of such matters will not have a significant adverse effect on the Company's financial position or results of operations. However, should the Company not prevail in any such litigation, its operating results and financial position could be adversely impacted.

10. STOCKHOLDERS' EQUITY

Common Stock

In August 2000, the Company's stockholders authorized an amendment to the restated certificate of incorporation to increase the authorized number of shares of common stock to 100,000,000 shares from 40,000,000 shares.

Exchangeable Shares and Preferred Stock

In conjunction with the acquisition of U|Force (see Note 2), the Company agreed to issue up to 2,107,780 shares of 8x8 common stock upon the exchange or redemption of the exchangeable shares (the Exchangeable Shares) of Canadian entities held by employee shareholders of U|Force stock. The Exchangeable Shares held by U|Force employees were subject to certain restrictions, including the Company's right to repurchase the Exchangeable Shares if an employee departed the Company prior to vesting. Upon vesting, the Exchangeable Shares were convertible into 8x8 common stock on a 1-for-1 basis. The Company also issued one share of preferred stock (the Special Voting Share) that provides holders of Exchangeable Shares with voting rights that are equivalent to the shares of common stock into which their shares are convertible.

During the fourth quarter of fiscal 2001, the Company repurchased a total of 1,034,107 unvested Exchangeable Shares at an average price of $0.49 per share when the beneficial holders of such shares resigned from the Company. In addition, 812,866 Exchangeable Shares were converted into an equivalent number of shares of the Company's common stock in the fourth quarter of fiscal 2001. The remaining 260,807 Exchangeable Shares were exchanged for shares of the Company's common stock during the year ended March 31, 2002.

1992 Stock Option Plan

The Board of Directors reserved 2,000,000 shares of the Company's common stock for issuance under the 1992 Stock Option Plan (the 1992 Plan). The 1992 Plan expired in fiscal 2003.

Key Personnel Plan

In July 1995, the Board of Directors adopted the Key Personnel Plan. The Board of Directors reserved 2,200,000 shares of the Company's common stock for issuance under this plan. The Key Personnel Plan provided for granting incentive and nonstatutory stock options to officers of the Company at prices equal to the fair market value of the stock at the grant dates. Options generally vest over four years. Shares issued under the Key Personnel Plan were subject to repurchase at the original issuance price of $0.50 per share if the employee left the Company prior to vesting. During fiscal 2001, the Company repurchased 5,982 unvested shares. As of March 31, 2003, all shares were vested and no shares are available for grant under the Key Personnel Plan. The Company is no longer issuing options under this plan.

1996 Stock Plan

In June 1996, the Board of Directors adopted the 1996 Stock Plan (the 1996 Plan) and reserved 1,000,000 shares of the Company's common stock for issuance under this plan. The Company's stockholders subsequently authorized increases in the number of shares of the Company's common stock reserved for issuance under the 1996 Plan of 500,000 shares in June 1997 and 2,000,000 shares in August 2000. The 1996 Plan also provides for an annual increase in the number of shares reserved for issuance under the 1996 Plan on the first day of the Company's fiscal year in an amount equal to 5% of the Company's common stock issued and outstanding at the end of the immediately preceding fiscal year, subject to a maximum annual increase of 1,000,000 shares. The annual increase was 1,000,000 shares in each of fiscal 2003, 2002 and 2001. To date, this provision has resulted in increases in shares reserved for issuance under the 1996 Plan totaling 4,535,967. The 1996 Plan provides for granting incentive stock options to employees and nonstatutory stock options to employees, directors or consultants. The stock option price of incentive stock options granted may not be less than the determined fair market value at the date of grant. Options generally vest over four years and expire ten years after grant.

1996 Director Option Plan

The Company's 1996 Director Option Plan (the Director Plan) was adopted in June 1996 and became effective in July 1997. A total of 150,000 shares of common stock were initially reserved for issuance under the Director Plan. The Company's stockholders subsequently authorized an increase in the number of shares of common stock reserved for issuance under the Director Plan to 500,000 shares in August 2000, and 1,000,000 in July 2002. The Director Plan provides for both discretionary and periodic grants of nonstatutory stock options to non-employee directors of the Company (the Outside Directors). The exercise price per share of all options granted under the Director Plan will be equal to the fair market value of a share of the Company's common stock on the date of grant. Options generally vest over a period of four years. Options granted to Outside Directors under the Director Plan have a ten year term, or shorter upon termination of an Outside Director's status as a director. If not terminated earlier, the Director Plan will have a term of ten years.

1999 Nonstatutory Stock Option Plan

In fiscal 2000, the Company's Board of Directors approved the 1999 Nonstatutory Stock Option Plan (the 1999 Plan) with 600,000 shares initially reserved for issuance thereunder. In fiscal 2001, the number of shares reserved for issuance was increased to 3,600,000 shares by the Board of Directors. Under the terms of the 1999 Plan, options may not be issued to either officers or directors of the Company provided, however, that options may be granted to an officer in connection with the officer's initial employment by the Company. Options generally vest over four years and expire ten years after grant. The 1999 Plan has not been approved by the stockholders of the Company.

UForce Company -- Societe UForce Amended and Restated 1999 Stock Option Plan

In connection with the acquisition of U|Force (see Note 2), the Company assumed the UForce Company -- Societe UForce Amended and Restated 1999 Stock Option Plan (the U|Force Plan), and reserved 1,023,898 shares of the Company's common stock related to options issued thereunder. The U|Force Plan provided for the grant of nonstatutory stock options to employees and consultants of U|Force at prices equal to the fair market value of the stock at the grant dates. Due to the cessation of the Company's Canadian operations (see Note 4), 1,016,408 and 7,490 of the options previously granted under the U|Force Plan were forfeited and returned to the U|Force Plan in fiscal 2001 and fiscal 2002, respectively. In fiscal 2002, the Company's Board of Directors terminated the U|Force Plan.

Option activity under the Company's stock option plans since March 31, 2000, excluding the Netergy and Centile stock option plans, is summarized as follows:

	Shares Available for Grant	Shares Subject to Options Outstanding	Weighted Average Exercise Price Per Share
Balance at March 31, 2000	15,437	4,173,762	$ 5.25
Change in options available for grant	7,373,898	--	--
Granted or assumed	(8,116,100)	8,116,100	6.26
Exercised	--	(925,008)	2.30
Returned to plan	3,632,963	(3,632,963)	8.29
Balance at March 31, 2001	2,906,198	7,731,891	5.24
Change in options available for grant	(23,898)	--	--
Granted	(4,901,073)	4,901,073	1.09
Exercised	--	(40,757)	0.01
Returned to plan	2,692,381	(2,692,381)	6.18
Balance at March 31, 2002	673,608	9,899,826	2.95
Change in options available for grant	1,370,187	--	--
Granted	(857,800)	857,800	0.48
Exercised	--	(53,040)	0.37
Returned to plan	3,089,997	(3,089,997)	3.05
Balance at March 31, 2003	4,275,992	7,614,589	2.65

Significant option groups outstanding at March 31, 2003 and related weighted average exercise price and contractual life information for 8x8, Inc.'s stock option plans are as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Shares	Weighted Average Exercise Price Per Share
$ 0.01 to $ 3.16	5,974,588	$ 1.38	8.0	2,394,740	$ 1.66
$ 3.16 to $ 6.32	811,511	3.84	6.8	791,165	3.82
$ 6.32 to $ 9.49	311,327	7.42	5.4	249,693	7.43
$ 9.49 to $12.65	445,268	11.72	6.7	318,470	11.72
$12.65 to $15.81	33,895	14.56	5.4	26,537	14.56
$15.81 to $28.46	38,000	21.25	6.9	28,852	21.20
	7,614,589	$ 2.65	7.7	3,809,457	$ 3.57

The Company recorded a deferred compensation charge of approximately $7,267,000 with respect to options repriced and certain additional options granted in fiscal 1997. In addition, the Company recorded deferred compensation charges of approximately $503,000 and $406,000 in connection with certain options granted to non-officer employees in fiscal 2001 and 2000, respectively. The Company recognizes deferred compensation over the related vesting period of the options (which is generally forty-eight months). The Company recognized $753,000 as compensation expense in the fiscal year ended March 31, 2001. Stock compensation expense in fiscal 2003 and 2002 was not significant. Deferred compensation is subject to reduction for any employee who terminates employment prior to the expiration of such employee's option vesting period.

Netergy Microelectronics, Inc. 2000 Stock Option Plan

Netergy's 2000 Stock Option Plan (the Netergy Plan) was adopted in December 2000 by the Netergy Board of Directors. The Netergy Plan provides for granting incentive stock options (ISO) to employees and nonstatutory stock options (NSO) to employees, directors, and consultants of Netergy. Options granted under the Netergy Plan may be granted for periods up to ten years and at prices no less than 85% of the estimated fair value of the shares on the date of grant as determined by the Netergy Board of Directors, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than 100% and 85% of the estimated fair value of the shares on the date of grant, respectively, and (ii) the exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the shares on the date of grant, respectively. To date, options granted vest over four years. However, in the event of a change in control (as defined in the Netergy Plan document) vesting for certain options will be accelerated. Option activity during each of the three years ended March 31, 2003 was as follows:

	Shares Available for Grant	Shares Subject to Options Outstanding	Weighted Average Exercise Price Per Share
Shares reserved at Netergy Plan's inception	5,000,000	--	$ --
Granted	(3,572,000)	3,572,000	0.50
Returned to plan	400,000	(400,000)	0.50
Balance at March 31, 2001	1,828,000	3,172,000	0.50
Granted	(136,000)	136,000	0.50
Exercised	--	--	--
Returned to plan	264,834	(264,834)	0.50
Balance at March 31, 2002	1,956,834	3,043,166	$ 0.50
Granted	(617,000)	617,000	0.50
Exercised	--	--	--
Returned to plan	1,945,490	(1,945,490)	0.50
Balance at March 31, 2003	3,285,324	1,714,676	$ 0.50

As of March 31, 2003, 991,702 options were exercisable, the weighted average remaining contractual life was 5.9 years, and the weighted average exercise price was $0.50 per share.

Centile, Inc. 2001 Stock Option Plan

Centile's 2001 Stock Option Plan (the Centile Plan) was adopted in March 2001 by the Centile Board of Directors. The Centile Plan provides for granting ISOs to employees and NSOs to employees, directors, and consultants of Centile. Options granted under the Centile Plan may be granted for periods up to ten years and at prices no less than 85% of the estimated fair value of the shares on the date of grant as determined by the Centile Board of Directors, provided, however, that (i) the exercise price of an ISO and NSO shall not be less than 100% and 85% of the estimated fair value of the shares on the date of grant, respectively, and (ii) the exercise price of an ISO and NSO granted to a 10% shareholder shall not be less than 110% of the estimated fair value of the shares on the date of grant, respectively. To date, options granted vest over four years. Option activity during each of the three years ended March 31, 2003 was as follows:

	Shares Available for Grant	Shares Subject to Options Outstanding	Weighted Average Exercise Price Per Share
Shares reserved at Centile Plan's inception	4,500,000	--	--
Granted	(4,107,000)	4,107,000	0.43
Balance at March 31, 2001	393,000	4,107,000	0.43
Granted	(846,000)	846,000	0.43
Exercised	--	--	
Returned to plan	2,688,000	(2,688,000)	0.43
Balance at March 31, 2002	2,235,000	2,265,000	0.43
Granted	(96,000)	96,000	0.43
Exercised	--	--	--
Returned to plan	459,128	(459,128)	0.43
Balance at March 31, 2003	2,598,128	1,901,872	$ 0.43

As of March 31, 2003, 767,051 options were exercisable, the weighted average remaining contractual life was 7.5 years, and the weighted average exercise price was $0.43 per share.

1996 Employee Stock Purchase Plan

The Company's 1996 Stock Purchase Plan (the Purchase Plan) was adopted in June 1996 and became effective upon the closing of the Company's initial public offering in July 1997. Under the Purchase Plan, 500,000 shares of common stock were initially reserved for issuance. At the start of each fiscal year, the number of shares of common stock subject to the Purchase Plan increases so that 500,000 shares remain available for issuance. This provision resulted in increases of 416,589, 281,583 and 180,910 shares issuable under the Purchase Plan during the fiscal years ended March 31, 2003, 2002 and 2001, respectively. During fiscal 2003, 2002 and 2001, 189,575, 416,589 and 281,583 shares, respectively, were issued under the Purchase Plan.

The Purchase Plan permits eligible employees to purchase common stock through payroll deductions at a price equal to 85% of the fair market value of the common stock at the beginning of each two year offering period or the end of a six month purchase period, whichever is lower. The contribution amount may not exceed ten percent of an employee's base compensation, including commissions but not including bonuses and overtime. In the event of a merger of the Company with or into another corporation or the sale of all or substantially all of the assets of the Company, the Purchase Plan provides that a new exercise date will be set for each option under the plan which exercise date will occur before the date of the merger or asset sale.

Certain pro forma disclosures

The Company accounts for its stock plans in accordance with the provisions of APB Opinion No. 25. Had compensation cost for the Company's stock plans been determined based on the fair value of options at their grant dates, as prescribed in SFAS No. 123, the Company's net loss would have been as follows (in thousands, except per share amounts):

	Year Ended March 31,		
	2003	2002	2001
Net loss:			

	2003	2002	2001
As reported	$ (11,403)	$ (9,105)	$ (74,399)
Pro forma*	$ (15,869)	$ (18,588)	$ (84,885)
Basic and diluted loss per share:			
As reported	$ (0.40)	$ (0.33)	$ (2.99)
Pro forma	$ (0.56)	$ (0.68)	$ (3.39)

*These amounts have been adjusted to reflect a correction to the forfeiture rate, which resulted in reductions in the pro forma net losses for 2002 and 2001 of $6.5 million and $3.1 million, respectively.

For the purposes of the disclosure above, the fair value of each of the Company's option grants, excluding those options issued under the Netergy and Centile Plans, has been estimated on the date of grant using the Black-Scholes pricing model with the following assumptions:

	Year Ended March 31,		
	2003	2002	2001
Expected volatility	162%	135%	141%
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	2.8% to 4.7%	3.5% to 4.9%	4.7% to 6.8%
Weighted average expected option term	5.1 years	5.1 years	5 years
Weighted average fair value of options granted	$ 0.45	$ 0.96	$ 5.17

The fair value of grants under the Netergy and Centile stock option plans, for purposes of the pro forma disclosure, have also been estimated on the date of grant using the Black-Scholes pricing model using the weighted average assumptions noted below. The expected volatility factors for the Netergy and Centile plans reflect the fact that the underlying shares of Netergy and Centile are not publicly traded and therefore the Company's overall volatility factor has been reduced by 50% for these plans. The various risk free interest rates used in the computations reflect the different rates in effect at the respective grant dates.

	Year Ended March 31,		
	2003	2002	2001
Expected volatility	81%	67%	70%
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	2.8% to 4.8%	4.1% to 4.8%	4.7% to 5.1%
Weighted average expected option term	5.16 years	5.25 years	5 years
Netergy weighted average fair value of options granted	$ 0.34	$ 0.31	$ 0.31
Centile weighted average fair value of options granted	$ 0.29	$ 0.26	$ 0.26

For the purpose of providing pro forma disclosures, the estimated fair value of stock purchase rights granted under the Purchase Plan were estimated using the Black-Scholes pricing model with the following weighted-average assumptions:

	Year Ended March 31,		
	2003	2002	2001
Expected volatility	162%	135%	141%
Expected dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	1.53%	3.82%	4.92%
Weighted average expected rights term	1.25 years	1.25 years	1.25 years
Weighted average fair value of rights granted	$ 0.30	$ 1.16	$ 3.00

11. EMPLOYEE BENEFIT PLANS

401(k) Savings Plan

In April 1991, the Company adopted a 401(k) savings plan (the Savings Plan) covering substantially all of its U.S. employees. Eligible employees may contribute to the Savings Plan from their compensation up to the maximum allowed by the Internal Revenue Service. The Company made matching contributions of $85,000 and $125,000 to the Savings Plan during fiscal 2002 and 2001, respectively. The matching contributions vest over three years. The Savings Plan does not allow employee contributions to be invested in 8x8 common stock.

12. SEGMENT REPORTING

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," 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 SFAS No. 131, 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. In the fourth quarter of fiscal 2001, management began evaluating the Company's results based on three reportable segments: Packet8 (formerly known as Corporate and Other), Netergy, which consisted of the semiconductor business, and Centile, which consisted of the hosted iPBX business. During the third quarter of fiscal 2004, the Company changed its internal reporting processes and determined that it had only one reportable segment, and ceased preparing operational data on the former segment basis. The change in internal reporting processes is consistent with the change in business focus as the Company is primarily focusing its efforts on its Packet8 broadband communications service.

The following table presents net revenues by groupings of similar products (in thousands).

	Year Ended March 31,		
	2003	2002	2001
Revenues:			
Semiconductors and related software	$ 9,719	$ 13,350	$ 15,850
Hosted iPBX solutions	861	260	198
Packet8, videophones/equipment and other	423	1,081	2,180
Total revenues	$ 11,003	$ 14,691	$ 18,228

The following table illustrates net revenues by geographic area. Revenues are attributed to countries based on the destination of shipment (in thousands):

	Year Ended March 31, 2003	2002	2001
United States	$ 4,218	$ 5,777	$ 5,632
Europe	2,657	4,126	5,862
Taiwan	1,569	2,026	2,739
Japan	919	1,119	1,188
Other	1,640	1,643	2,807
	$ 11,003	$ 14,691	$ 18,228

The majority of the Company's long-lived assets were located in the United States. Long-lived assets consist primarily of property and equipment and deposits. The following table illustrates long-lived assets by country (in thousands):

	March 31, 2003	2002
	(in thousands)	
United States	$ 645	$ 2,051
United Kingdom	--	602
France	244	452
	$ 889	$ 3,104

Two customers represented more than 10% of our total revenues in fiscal 2003. These customers represented 17%, and 11% of our total revenues, respectively. During the fiscal year ended March 31, 2002, three customers represented more than 10% of our total revenues. These customers represented 13%, 13%, and 12% of our total revenues. During the fiscal year ended March 31, 2001, no customer accounted for 10% or more of total revenues.