

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

## FORM 10-Q

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

For the quarterly period ended December 31, 1997

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

Commission File Number: 333-15627

8X8, INC.

Delaware	77-0142404
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2445 Mission College Blvd.  
Santa Clara, CA 95054

(408) 727-1885

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

The number of shares of the Registrant's Common Stock outstanding as of January 20, 1998 was 15,038,391.

The Exhibit Index begins on page 22.

## 8X8, INC.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

	December 31, 1997	March 31, 1997
	-----	-----
<b>ASSETS</b>		
Current assets:		
Cash, cash equivalents and short-term investments .....	\$ 33,187	\$ 8,724
Accounts receivable, net .....	4,569	1,012
Inventory .....	8,766	1,178
Prepaid expenses and other assets .....	1,007	354
	-----	-----
Total current assets .....	47,529	11,268
Property and equipment, net .....	1,377	1,344
Deposits and other assets .....	161	115
	-----	-----
	\$ 49,067	\$ 12,727
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable .....	\$ 4,855	\$ 1,379
Accrued compensation .....	1,688	926
Accrued warranty .....	1,494	1,603
Deferred revenue .....	2,817	363
Other accrued liabilities .....	2,264	2,343
	-----	-----
Total current liabilities .....	13,118	6,614
	-----	-----
Minority interest .....	103	72
	-----	-----
Stockholders' equity:		
Convertible noncumulative preferred stock ...	-	4
Common stock .....	15	7
Additional paid-in capital .....	47,704	23,291
Notes receivable from stockholders .....	(930)	(1,078)
Deferred compensation .....	(1,186)	(2,781)
Accumulated deficit .....	(9,757)	(13,402)
	-----	-----
Total stockholders' equity.....	35,846	6,041
	-----	-----
	\$ 49,067	\$ 12,727
	=====	=====

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

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

	Three months ended December 31,		Nine months ended December 31,	
	1997	1996	1997	1996
Product revenues.....	\$12,325	\$ 3,932	\$25,381	\$ 11,646
License and other revenues.....	2,813	650	12,266	3,011
Total revenues.....	15,138	4,582	37,647	14,657
Cost of product revenues.....	6,475	1,283	13,006	10,728
Cost of license and other revenues....	404	-	954	-
Gross profit.....	8,259	3,299	23,687	3,929
Operating expenses:				
Research and development.....	3,284	3,141	9,479	7,886
Selling, general and administrative.	5,358	2,003	12,658	7,058
Total operating expenses....	8,642	5,144	22,137	14,944
Income (loss) from operations.....	(383)	(1,845)	1,550	(11,015)
Other income, net.....	515	265	1,095	392
Income (loss) before (benefit) provision for income taxes.....	132	(1,580)	2,645	(10,623)
(Benefit) provision for income taxes..	-	-	(1,000)	146
Net income (loss) .....	\$ 132	\$(1,580)	\$ 3,645	\$(10,769)
Basic earnings per share.....	\$ 0.01			
Weighted average number of common shares.....	14,985			
Pro forma basic earnings (loss) per share.....		\$ (0.15)	\$ 0.27	\$ (1.12)
Pro forma weighted average number of common shares.....		10,653	13,442	9,583
Diluted earnings per share.....	\$ 0.01			
Weighted average number of common and common equivalent shares.....	16,850			
Pro forma diluted earnings (loss) per share.....		\$ (0.13)	\$ 0.24	\$ (0.91)
Pro forma weighted average number of common and common equivalent shares..		12,246	15,093	11,863

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

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

	Nine months ended December 31,	
	1997	1996
Cash flows from operating activities:		
Net income (loss) .....	\$ 3,645	\$(10,769)
Charges to net income (loss) not affecting cash .....	1,978	4,674
Net effect of changes in current and other assets and current liabilities .....	(5,340)	3,213
	283	(2,882)
Cash flows from investing activities:		
Purchase of property and equipment .....	(722)	(590)
Sales of short-term investments, net .....	2	5,202
	(720)	4,612
Cash flows from financing activities:		
Proceeds from issuance of convertible noncumulative preferred stock, net.....	-	3,765
Proceeds from issuance of common stock, net...	24,776	22
Repayment of notes receivable from stockholders	126	-
Proceeds from minority interest in subsidiary.....	-	52
	24,902	3,839
Net increase in cash and cash equivalents.....	24,465	5,569
Cash and cash equivalents at the beginning of the period.....	8,722	4,652
Cash and cash equivalents at the end of the period.....	\$33,187	\$10,221

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

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

1. DESCRIPTION OF THE BUSINESS

The Company designs, manufactures, and markets video phones, referred to herein as its family of VideoCommunicator products, for use by the consumer market. The Company also designs, develops and markets highly integrated proprietary video compression semiconductors and associated software for video phones and video conferencing.

2. BASIS OF PRESENTATION

The Company's fiscal year ends on the last Thursday on or before March 31. The Company's fiscal quarters end on the last Thursday on or before the end of each calendar quarter. The three and nine month periods ended December 25, 1997 and December 26, 1996 included 13 weeks and 39 weeks of operations, respectively. For purposes of these condensed consolidated financial statements, the Company has indicated its fiscal year as ending on March 31 and its interim periods as ending on December 31.

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared on substantially the same basis as the Company's annual financial statements for the year ended March 31, 1997. In the opinion of management, these financial statements reflect all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the periods presented. These financial statements should be read in conjunction with the Company's audited financial statements for the year ended March 31, 1997, including notes thereto, included in the Company's Registration Statement on Form S-1, as amended July 2, 1997.

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

3. INITIAL PUBLIC OFFERING

In the first week of July 1997, the Company completed an initial public offering of its common stock, selling 4,140,000 shares at \$6.50 per share. Net proceeds to the Company were approximately \$24.7 million after deducting related issuance costs. As of the closing date of the offering, all of the convertible noncumulative preferred stock outstanding was converted into an aggregate of 3,726,373 shares of common stock.

4. BALANCE SHEET DETAIL  
 (in thousands)

	December 31, 1997	March 31, 1997
	-----	-----
Inventories:		
Raw materials.....	\$2,778	\$ 418
Work-in-process.....	2,596	613
Finished goods.....	3,392	147
	-----	-----
	\$ 8,766	\$ 1,178
	=====	=====

## 5. COMPUTATION OF HISTORICAL AND PRO FORMA EARNINGS (LOSS) PER SHARE

In the quarter ended December 31, 1997, the Company has adopted Statement of Financial Accounting Standards No. 128 (FAS 128), "Earnings Per Share." The Statement replaces the presentation of primary EPS with a presentation of basic EPS. Basic EPS excludes common stock equivalents and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Income available to common stockholders is equivalent to net income (loss) for all periods presented. Diluted EPS is computed similarly to fully diluted EPS under APB Opinion No. 15. The Statement also requires dual presentation of basic and diluted EPS on the face of the financial statements for all periods for which a statement of operations is presented.

Pro forma basic earnings (loss) per share for the three months ended December 31, 1996 and the nine months ended December 31, 1997 and 1996, respectively, is computed by dividing income available to common stockholders by the sum of the weighted-average number of common shares outstanding for the period and the weighted average number of convertible preferred shares outstanding for the period (as each share of preferred stock was converted into one share of common stock in conjunction with the Company's initial public offering). Pro forma diluted earnings (loss) per share for the three months ended December 31, 1996 and the nine months ended December 31, 1997 and 1996, respectively, is computed using the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares consist of convertible preferred stock (using the as-if converted method) and stock options (using the treasury stock method). Common equivalent shares are excluded from the computation if their effect is antidilutive, except that, pursuant to a Securities and Exchange Commission Staff Accounting Bulletin, shares of common stock, convertible preferred stock (using the as-if converted method) and common stock options (using the treasury stock method and the initial public offering price of \$6.50) issued from October 1, 1995 to June 30, 1997 have been included in the computations as if they were outstanding for each period presented.

## 6. RECENTLY ISSUED ACCOUNTING STANDARDS

In June 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130 (FAS 130), "Reporting Comprehensive Income." The Statement establishes standards for the reporting of comprehensive income and its components in a full set of general-purpose financial statements for periods beginning after December 15, 1997. Comprehensive income as defined includes all changes in equity (net assets) during a period from nonowner sources. Reclassification of financial statements for earlier periods for comparative purposes is required. The Company will adopt FAS 130 in its fiscal 1999 annual report; however, it is not expected to have a significant effect on the Company's disclosure requirements.

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

This Report on Form 10-Q contains forward-looking statements, including but not limited to those specifically identified as such, that involve risks and uncertainties. The statements contained in this Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act, including without limitation statements regarding the Company's expectations, beliefs, intentions or strategies regarding the future. All forward-looking statements included in this Report on Form 10-Q are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including, but not limited to, those set forth below under the heading "Factors That May Affect Future Results" and elsewhere in this Report on Form 10-Q.

Overview

The Company was incorporated in February 1987 in California and reincorporated in Delaware in December 1996. Since June 1995, the Company has been executing a business strategy designed to focus the Company's efforts towards video conferencing. As part of this strategy, the Company discontinued sales of its MPEG semiconductor product line and reduced its workforce in the quarter ended June 30, 1996.

In each of the third quarters ended December 31, 1997 and 1996, sales of the Company's video conferencing products accounted for 100% of product revenues. For the nine months ended December 31, 1997 and 1996, sales of the Company's video conferencing products accounted for 100% and 81%, respectively, of product revenues. In the fiscal years ended March 31, 1997 and 1996, sales of the Company's video conferencing products accounted for 86% and 65%, respectively, of product revenues.

To address new video conferencing opportunities, the Company has leveraged its strengths in semiconductor design and related software to develop and market video conferencing systems for the consumer market. The Company began shipping the first product in its planned family of VideoCommunicator products, the ViaTV (VC100), in February 1997. The VC105, an upgraded VC100, was introduced in August 1997. The Company added two new models, the VC50 and VC55, to the ViaTV product line in September 1997. The Company received foreign approvals and began shipping its ViaTV (VC105e) as designed for European markets in December 1997.

The ViaTV products (VC100, VC105, VC105e, VC50 and VC55) connect to a television set and a standard touch-tone telephone adding video to an otherwise normal telephone call, without the need for a personal computer (PC). While similar to the other ViaTV products described above, the VC50 and VC55 are additionally designed without a camera and utilize an external camera device such as a camcorder or digital still camera. In addition to video conferencing capability, the VC55 includes an Internet web browser. The Company is currently demonstrating prototypes of additional VideoCommunicators, all of which are non-PC based video telephones running on standard analog telephone lines (POTS). The Company first publicly demonstrated its VC150 which incorporates a liquid crystal display (LCD) into the unit in January 1998. The Company is marketing its VideoCommunicators through retail channels, catalogs and original equipment manufacturers (OEMs) as well as through direct marketing efforts utilizing a combination of advertising, toll-free telemarketing and direct mail supported by co-marketing arrangements with third parties. The Company sells its video conferencing semiconductors and related software to OEMs and distributors.



## Results of Operations

The following discussion should be read in conjunction with the Company's Condensed Consolidated Statements of Operations and the notes thereto:

## Revenues

(In millions)	Three months ended December 31,				Nine months ended December 31,			
	1997		1996		1997		1996	
Product revenues	\$ 12.3	81%	\$ 3.9	85%	\$ 25.4	67%	\$ 11.7	80%
License and other revenues .....	2.8	19%	0.7	15%	12.3	33%	3.0	20%
Total revenues ..	\$ 15.1	100%	\$ 4.6	100%	\$ 37.7	100%	\$ 14.7	100%

Total revenues were \$15.1 million and \$4.6 million in the third quarters of fiscal 1998 and 1997, respectively. Total revenues for the third quarter of fiscal 1998 were divided among video conferencing semiconductors (41%), video phone systems (40%) and nonrecurring license and other revenues (19%). Total revenues for the third quarter of fiscal 1997 were divided between video conferencing semiconductors and reference designs (85%) and nonrecurring license and other revenues (15%).

Product revenues were \$12.3 million in the third quarter of fiscal 1998, a 215% increase over the \$3.9 million in product revenues reported in the third quarter of fiscal 1997. The increase in product revenues is due primarily to sales generated from the Company's VideoCommunicators, which were introduced in February 1997, combined with an increase in sales of the Company's video conferencing semiconductors.

License and other revenues, all of which were nonrecurring, were \$2.8 million and \$650,000 in the third quarters of fiscal 1998 and 1997, respectively. License and other revenues consist of technology licenses including royalties required under such licenses, and nonrecurring engineering charges for work performed by the Company for its customers. In the third quarter of fiscal 1998, license and other revenues included approximately \$550,000 related to certain development work performed under the terms of a contract between the Company and one of its customers. There can be no assurance that the Company will receive any revenues from licensing or other such arrangements in the future.\* See "Factors That May Affect Future Results -- No Assurance of Future License and Other Revenues."

In the quarter ended December 31, 1997, approximately fifty-six percent (56%) of video phone systems revenues were derived from one OEM customer. This customer has not placed further product orders with the Company. Accordingly, OEM video phone systems revenues will be lower in the fourth quarter of fiscal 1998. Failure of the Company to obtain sufficient compensating orders could have a material adverse effect on the Company's operating results.\* See "Factors That May Affect Future Results - Potential Fluctuations in Operating Results".

Total revenues were \$37.7 million and \$14.7 million in the first nine months of fiscal 1998 and 1997, respectively. Product revenues were \$25.4 million in the first nine months of fiscal 1998, an increase of \$13.7 million above the \$11.7 million reported in the first nine months of fiscal 1997, and

\* This statement is a forward looking statement reflecting current expectations. There can be no assurance that the Company's actual future performance will meet the Company's current expectations. See "Factors That May Affect Future Results" commencing on page 12 for a discussion of certain factors that could affect future performance.

represented 67% and 80% of total revenues, respectively. In the first nine months of fiscal 1998 and 1997 license and other revenues, all of which were nonrecurring, were \$12.3 million and \$3.0 million, respectively. In the first nine months of fiscal 1998, license and other revenues included approximately \$1.6 million related to certain development work performed under the terms of a contract between the Company and one of its customers. There can be no assurance that the Company will receive any revenues from such arrangements in the future.\* See "Factors That May Affect Future Results -- No Assurance of Future License and Other Revenues."

Sales to one customer represented approximately 22% and 26% of total revenues for the quarter and nine months ended December 31, 1997, respectively. Sales to one customer represented approximately 20% and 13% of total revenues for the quarter and nine months ended December 31, 1996, respectively. See "Factors That May Affect Future Results -- Potential Fluctuations in Operating Results and Dependence on Key Customers."

Sales to customers outside of the United States decreased to 40% of total revenues in both the quarter and nine months ended December 31, 1997 from 45% and 57% in the quarter and nine months ended December 31, 1996, respectively.

The Company's sales to Europe represented 18% and 14% of total revenues for the quarter and nine months ended December 31, 1997, respectively. The Company's sales to Europe represented 23% of total revenues for both the quarter and nine months ended December 31, 1996. The Company's sales to the Asia Pacific region represented 22% and 26% of total revenues for the quarter and nine months ended December 31, 1997, respectively. The Company's sales to the Asia Pacific region represented 23% and 34% of total revenues for the quarter and nine months ended December 31, 1996. See "Factors That May Affect Future Results -- International Operations."

#### Cost of Revenues

(In millions)	Three months ended December 31,		Nine months ended December 31,	
	1997	1996	1997	1996
Cost of product revenues	\$ 6.4	\$1.3	\$ 13.0	\$10.7
As a percentage of product revenues	52%	33%	51%	91%
Cost of license and other revenues	\$ 0.4	--	\$ 1.0	--
As a percentage of license and other revenues	14%	0%	8%	0%

The cost of product revenues consists of costs associated with VideoCommunicator components, semiconductor wafer fabrication, VideoCommunicator and semiconductor assembly and testing performed by third-party vendors and direct and indirect costs associated with purchasing, scheduling and quality assurance. Costs of product revenues were \$6.4 million and \$1.3 million in the third quarters of fiscal 1998 and 1997, respectively. The cost of product revenues in the quarter ended December 31, 1997 included costs associated with increased shipments of its VideoCommunicator products, which the Company began shipping in February 1997, as well as increased shipments of the Company's video conferencing semiconductor products.

Cost of license and other revenues in the third quarter and nine month period ended December 31, 1997 was \$404,000 and \$1.0 million, respectively, and consisted of personnel and other costs incurred to perform certain development work under terms of a nonrecurring engineering contract between the

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Company and one of its customers. This development work was performed by research and development personnel of the Company. There were no costs associated with license and other revenues in the nine month period ended December 31, 1996. Cost of product revenues were \$13.0 million and \$10.7 million in the first nine months of fiscal 1998 and 1997, respectively. The cost structure of the Company's ViaTV product line, the Company's first line of VideoCommunicator products, is substantially different from the Company's video conferencing semiconductor products and the cost of sales for the ViaTV product line is generally greater as a percentage of revenues. Further, costs in the first nine months of fiscal 1998 include startup costs associated with the ViaTV, which began shipping in volume in fiscal 1998. In the first nine months of fiscal 1997, costs of product revenues included a \$4.0 million charge associated with the write-off of inventories related to the Company's discontinuation of the MPEG product line in September 1996. As a result of this writeoff, costs for the period increased and were equal to 91% of product revenue.

## Gross Profit

(In millions)	Three months ended December 31,		Nine months ended December 31,	
	1997	1996	1997	1996
Gross profit	\$8.3	\$3.3	\$23.7	\$4.0
As a percentage of total revenues	55%	72%	63%	27%

Gross profit was \$8.3 million and \$3.3 million in the third quarters of fiscal 1998 and 1997, respectively. Gross profit from product revenues increased by 127% and was \$5.9 million and \$2.6 million in the third quarters of fiscal 1998 and 1997, respectively. The increase in gross profit from product revenues was due to higher video conferencing semiconductor revenues and sales of the Company's VideoCommunicator products. The markets for the Company's products are characterized by falling average selling prices, which could have a material adverse effect on the Company's future business and operating results if the Company cannot achieve lower cost of sales and/or higher sales volumes.\* In addition, gross profit as a percent of revenue is generally lower for the sales of ViaTV products than for sales of the Company's semiconductors. If ViaTV revenue continues to grow as a percentage of product revenue, the Company expects that gross profit as a percentage of total product revenue will decrease.\* Gross profit from license and other revenues, all of which were nonrecurring, less related costs, contributed \$2.4 million and \$650,000 to gross profit in the third quarters of fiscal 1998 and 1997, respectively. There can be no assurance that the Company will receive any revenues from such license and other revenues sources in the future.\* See "Factors That May Affect Future Results - No Assurance of Future License and Other Revenues."

Gross profit was \$23.7 million and \$4.0 million in the first nine months of fiscal of 1998 and 1997, respectively. License and other revenues, net of associated costs, contributed \$11.3 million and \$3.0 million to gross profit in the first nine months of fiscal 1998 and 1997, respectively.

\* This statement is a forward looking statement reflecting current expectations. There can be no assurance that the Company's actual future performance will meet the Company's current expectations. See "Factors That May Affect Future Results" commencing on page 12 for a discussion of certain factors that could affect future performance.

## Operating Expenses

## Research and Development

(In millions)	Three months ended December 31,		Nine months ended December 31,	
	1997	1996	1997	1996
Research and development	\$3.3	\$ 3.1	\$9.5	\$ 7.9
As a percentage of total revenues	22%	67%	25%	54%

Research and development expenses consist primarily of personnel, system prototype design and fabrication, mask, prototype wafer and equipment costs necessary for the Company to conduct its development efforts. Research and development costs, including software development costs, are expensed as incurred. Research and development expenses were \$3.3 million and \$3.1 million in the third quarters of fiscal 1998 and 1997, respectively. Higher research and development expenses during the third quarter of fiscal 1998 were due to increased headcount, increased engineering and prototype expenses associated with the Company's VideoCommunicator products, and mask and prototype costs associated with the ongoing development of the Company's next generation video conferencing semiconductor product. The overall increase in research and development expenses was partially offset by the use of research and development personnel to perform nonrecurring engineering services under a revenue generating contract. The costs associated with this contract are included in the cost of license and other revenues. The Company expects to continue to allocate substantial resources to research and development.\* However, future research and development costs may vary both in absolute dollars and as a percentage of total revenues.\* See "Factors That May Affect Future Results - Rapid Technological Change; Dependence on New Product Introduction."

In the first nine months of fiscal 1998 and 1997, research and development expenses were \$9.5 million and \$7.9 million, respectively, which is an increase of \$1.6 million. Although total research and development expenses increased as a result of the factors listed above, the non-cash compensation expense recognized on certain stock option grants and charged to research and development decreased to \$354,000 in the first nine months of fiscal 1998 from \$946,000 in the first nine months of fiscal 1997.

## Selling, General and Administrative

(In millions)	Three months ended December 31,		Nine months ended December 31,	
	1997	1996	1997	1996
Selling, general and administrative	\$5.4	\$ 2.0	\$12.7	\$ 7.1
As a percentage of total revenues	36%	43%	34%	48%

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 \$5.4 million and \$2.0 million in the third quarters of fiscal 1998 and 1997, respectively. Expenses increased due to additional headcount, higher compensation costs and costs associated with the

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marketing, advertising and promotion of the Company's VideoCommunicator product line. The Company expects that its sales and marketing expenses may increase as the Company launches new VideoCommunicator products and promotes its current VideoCommunicator products.\* Therefore, future selling, general and administrative costs may vary both in absolute dollars and as a percentage of total revenues.\* See "Factors That May Affect Future Results -- Management of Growth and Change; Dependence on Key Personnel."

Selling, general and administrative expenses were \$12.7 million and \$7.1 million in the first nine months of fiscal 1998 and 1997, respectively. While total expenses increased as a result of the factors listed above, the non-cash compensation expense recognized on certain stock option grants and charged to selling, general and administrative decreased to \$877,000 in the first nine months of fiscal 1998 from \$2.7 million in the first nine months of fiscal 1997.

#### Other Income, Net

In the third quarters of fiscal 1998 and 1997, other income, net was \$515,000 and \$265,000, respectively, and consisted primarily of interest income. Interest income in the third quarter of fiscal 1998 included interest earned on the proceeds from the Company's initial public offering in July 1997.

#### (Benefit) Provision for Income Taxes

In the first nine months of fiscal 1998 and 1997, income taxes were a benefit of \$1.0 million and an expense of \$146,000, respectively. In August 1995, the Internal Revenue Service (IRS) asserted a deficiency against the Company for the taxable year 1992. The IRS alleged that as of March 31, 1992, the Company had accumulated earnings beyond the reasonable needs of its business. The Company contested this assessment. On May 15, 1997, the Company received a notice from the IRS indicating that the IRS has fully reversed its assertion of deficiency. As a result, the Company reversed approximately \$1.0 million of its income tax liability during the first quarter of fiscal 1998. In the first nine months of fiscal 1997, the provision for income taxes represents certain foreign withholding taxes.

#### Liquidity and Capital Resources

As of December 31, 1997, the Company had cash and liquid investments totaling \$33.2 million, representing a \$24.5 million increase in the first nine months of fiscal 1998. In the first week of July 1997, the Company completed an initial public offering of its common stock, selling 4,140,000 shares at \$6.50 per share. Net proceeds to the Company were approximately \$24.7 million after deducting related issuance costs. Prior to the Company's initial public offering, the Company had satisfied its liquidity needs principally from proceeds generated from two issuances of its equity securities after 1994 and from cash generated from operations in fiscal 1994 and prior years. The Company currently has no bank borrowing arrangements.

Operations provided \$283,000 of net cash during the first nine months of fiscal 1998, as compared to net cash used in operations of \$2.9 million during the first nine months of fiscal 1997. Cash provided by operations in the first nine months of fiscal 1998 reflects net income of \$3.6 million, increases of \$2.5 million in deferred revenue, \$3.5 million in accounts payable, \$762,000 in accrued compensation, and noncash items, including a deferred compensation charge of \$1.3 million. Cash used in operations during this period includes a \$3.6 million increase in accounts receivable, \$7.6 million increase in

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inventory, and a \$653,000 increase in prepaid expenses and other assets. In addition to increased revenues, the increase in accounts receivable in the first nine months of fiscal 1998 was partially due to increased ViaTV sales to customers in the retail channel, which typically negotiate payment terms greater than 30 days. The increase in inventory in the first nine months of fiscal 1998 was due to increases in both ViaTV inventory held by the Company and inventory balances held by retailers. Because the Company does not recognize revenue on the shipment of its VideoCommunicator products to retailers or distributors until sell-through to the end user, product inventories at retailers and distributors are reflected in the Company's inventories and are expected to increase if the Company succeeds in further broadening its distribution channels.

Cash used in operations in the first nine months of fiscal 1997 reflects a net loss of \$10.8 million, and a decrease in accounts payable of \$4.8 million. Cash used in operations was partially offset by cash provided by decreases in inventory and accounts receivable of \$6.7 million and \$2.4 million, respectively, and a non-cash deferred compensation charge of \$4.0 million. Cash used in investing activities for the first nine months of fiscal 1998 is primarily attributable to capital expenditures of approximately \$722,000. Cash provided by investing activities for the first nine months of fiscal 1997 is primarily attributable to net sales of short-term investments of \$5.2 million, offset by capital expenditures of approximately \$590,000. At December 31, 1997, the Company did not have any material capital commitments outstanding.

Cash flows from financing activities in the first nine months of fiscal 1998 and 1997 consisted primarily of \$24.7 million in proceeds from the sale of the Company's common stock in its initial public offering and \$3.8 million in proceeds from the sale of convertible preferred stock, respectively.

The Company believes its existing cash balances, and funds, if any, generated from operations, will be sufficient to meet the Company's capital and operating requirements for the next twelve months.\* However, the Company is operating in a rapidly changing industry. There can be no assurance that the Company will not seek to exploit business opportunities that will require it to raise additional capital from equity or debt sources to finance its growth and capital requirements. In particular, the development and marketing of new products could require a significant commitment of resources, which could in turn require the Company to obtain additional financing earlier than otherwise expected. There can be no assurance that the Company will be able to raise such capital on acceptable terms, if at all.

#### FACTORS THAT MAY AFFECT FUTURE RESULTS

The following factors should be considered in conjunction with the information in this Report on Form 10-Q.

##### History of Losses; Uncertainty of Future Profitability

The Company recorded operating losses of \$383,000 in the third quarter of fiscal 1998 and \$13.6 million, \$4.1 million and \$6.5 million in the years ended March 31, 1997, 1996 and 1995, respectively. The Company would not have been profitable in the first nine months of fiscal 1998 had it not received nonrecurring license and other revenues. Revenues fluctuated from \$19.9 million in fiscal 1995 to \$28.8 million in fiscal 1996 to \$19.1 million in fiscal 1997. In view of the Company's historical operating losses, there can be no assurance that the Company will be able to sustain profitability on either an annual or quarterly basis. Future losses will likely occur in the

\* This statement is a forward looking statement reflecting current expectations. There can be no assurance that the Company's actual future performance will meet the Company's current expectations. See "Factors That May Affect Future Results" commencing on page 12 for a discussion of certain factors that could affect future performance.

event that the Company's initial VideoCommunicators do not achieve widespread consumer market acceptance, of which there can be no assurance.

#### No Assurance of Future License and Other Revenues

The Company has in the past received substantial revenues from licensing of technology. Licenses and other revenues, all of which were nonrecurring, were \$12.3 million and \$3.0 million for the nine month periods ended December 31, 1997 and 1996, respectively. License and other revenues were \$3.9 million, \$9.0 million and \$1.3 million in the fiscal years ended March 31, 1997, 1996 and 1995, respectively. There can be no assurance that the Company will receive revenues from licensing of its technology in the future, which could have a material adverse effect on the Company's business and operating results.

#### Potential Fluctuations in Future Operating Results

The Company's future operating results are expected to fluctuate as the Company proceeds with the development and marketing of its family of VideoCommunicators. The Company believes that its future profitability will be largely dependent on the success of its VideoCommunicator business. As a result, the Company believes that its historical operating results will not be comparable to, and should not be relied upon as an indication of, future operating results. In addition, the Company's operating results have fluctuated significantly and may continue to fluctuate in the future, on an annual and a quarterly basis, as a result of a number of factors, many of which are outside the Company's control, including changes in market demand, the timing of customer orders, competitive market conditions, lengthy sales cycles, regulatory approval cycles, new product introductions by the Company or its competitors, market acceptance of new or existing products, the cost and availability of components, the mix of the Company's customer base and sales channels, the mix of products sold, the management of inventory and the accuracy of the reporting of sell-through by resellers of the Company's products, the level of international sales, continued compliance with industry standards and general economic conditions.

The Company's gross margin is affected by a number of factors, including product mix, the recognition of license and other revenues for which there may be no corresponding cost of revenues, product pricing, the allocation between international and domestic sales, the percentage of direct sales and sales to distributors, and manufacturing and component costs. The Company may also be required to reduce prices in response to competitive pressure or other factors or to increase spending to pursue new market opportunities. Any decline in the average selling price of a particular product that is not offset by a reduction in production costs or by sales of other products with higher gross margins would decrease the Company's overall gross margin and adversely affect the Company's operating results. In particular, in the event that the Company encounters significant price competition in the markets for its products, the Company could be at a significant disadvantage compared to its competitors, many of which have substantially greater resources, and therefore may be better able to withstand an extended period of downward pricing pressure. Moreover, the Company believes that the marketing of its family of VideoCommunicators may adversely impact its gross margins due in part to higher unit costs associated with the production of system level products, including the current ViaTV models, as well as substantially different cost and pricing structures related to the manufacture and sale of consumer products. The markets for the Company's products are characterized by falling average selling prices. If the Company cannot adequately compensate for such falling average selling prices

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\* This statement is a forward looking statement reflecting current expectations. There can be no assurance that the Company's actual future performance will meet the Company's current expectations. See "Factors That May Affect Future Results" commencing on page 12 for a discussion of certain factors that could affect future performance.

with lower costs of sales and/or higher volumes, there may be a material adverse effect on the Company's business and operating results.

Variations in timing of sales may cause significant fluctuations in future operating results. In addition, because a significant portion of the Company's business, including sales of its VideoCommunicator products, may be derived from orders placed by a limited number of large customers, including but not limited to OEM customers, the timing of such orders can also cause significant fluctuations in the Company's 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 international economic conditions. The adverse impact of a shortfall in the Company's revenues may be magnified by the Company's inability to adjust spending to compensate for such shortfall. Announcements by the Company or its competitors of new products and technologies could cause customers to defer purchases of the Company's existing products, which would also have a material adverse effect on the Company's business and operating results.

Certain of the Company's licensees, including 3Com and KME, may choose to purchase system level VideoCommunicators to label under their own brand name, may choose to purchase video conferencing semiconductors and pay a system level royalty, may choose to produce both a system level product and the semiconductors incorporated therein and pay only royalties, or may not make any purchases from the Company. Sales to one such licensee totaled approximately fifty-six percent (56%) of video phone systems sold by the Company in the quarter ended December 31, 1997. This licensee has not placed orders with the Company for additional ViaTVs. Accordingly, revenue from OEM systems sales will be lower in the fourth quarter of fiscal 1998.

Any change in the ordering patterns of such licensees, who were major customers of the Company during the first nine months of fiscal 1998, may have a substantial impact on business and operating results of the Company. Moreover, the failure of such licensees to continue to purchase substantial quantities of VideoCommunicators or to produce their own system level products in such a manner to produce significant royalty or semiconductor income for the Company, of which there can be no assurance, may have a material adverse effect on the Company's business and operating results.

The Company's strategic shift towards the production and marketing of VideoCommunicators may result in substantially different patterns in operating results. For example, the Company's operating results may be subject to increased seasonality with sales higher during the Company's third fiscal quarter, corresponding to the Christmas shopping season. The Company intends to spend substantial additional amounts on advertising, toll-free marketing and customer support. There can be no assurance as to the amount of such spending or that revenues adequate to justify such spending will result. As a result of its shift to selling VideoCommunicators, the Company may experience different inventory, product return, price protection, receivable collection and warranty cost patterns.

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\* This statement is a forward looking statement reflecting current expectations. There can be no assurance that the Company's actual future performance will meet the Company's current expectations. See "Factors That May Affect Future Results" commencing on page 12 for a discussion of certain factors that could affect future performance.



As a result of these and other factors, it is likely that in some future period the Company's operating results will be below the expectations of securities analysts or investors, which would likely result in a significant reduction in the market price for the Company's common stock.

#### Dependence on Key Customers

Historically, a significant portion of the Company's sales has been to relatively few customers, although the composition of these customers has varied. Product revenues from the Company's ten largest customers in the third quarter and the nine months ended December 31, 1997, and in the years ended March 31, 1997, 1996 and 1995 accounted for approximately 55%, 34%, 54%, 39% and 44%, respectively, of its total revenues. Substantially all the Company's sales have been made, and are expected to be made, on a purchase order basis. None of the Company's customers has entered into a long-term agreement requiring it to purchase the Company's products. The loss of, or any reduction in orders from, significant customers could have a material adverse effect on the Company's business and operating results.

#### Competition

The Company competes with independent manufacturers of video compression semiconductors and, as a result of the introduction of the its VideoCommunicator product line, now competes with manufacturers of video conferencing products targeted at the consumer market. The markets for the Company's products are characterized by intense competition, declining average selling prices and rapid technological change. The competitive factors in the market for the Company's VideoCommunicators include audio and video quality, phone line connectivity at high transmission rates, ability to connect and maintain stable connections, ease of use, price, access to enabling technologies, product design, time-to-market, adherence to industry standards, interoperability, strength of distribution channels, customer support, reliability and brand name. In addition to these factors, the Company's ability to compete depends upon its future success in developing and manufacturing new generations of video compression semiconductors that integrate additional functions and reduce costs. Otherwise, competing semiconductor manufacturers may in the future have competitive advantages in cost, size and performance which could make systems based on competing semiconductors preferable to the Company's VideoCommunicators. The Company expects intense competition for its VideoCommunicators from:

Large consumer electronics manufacturers. The Company will face intense competition from many well known, established suppliers of consumer electronics products, which may include Lucent Technologies, Matsushita Electric Industrial Co., Ltd. ("Matsushita"), Philips, Samsung and Sony. Many of these potential competitors sell television and telephone products into which they may integrate video conferencing systems, thereby eliminating a consumer's need to purchase a separate video conferencing system, such as the Company's ViaTV product line.

Licensees and purchasers of the Company's VideoCommunicator technology and components. A number of companies have licensed portions of the Company's technology, including 3Com and KME, an affiliate of Matsushita, which have each licensed all or substantially all of the Company's technology underlying its VideoCommunicators. The Company may in the future enter into similar license agreements with respect to substantial portions of its technology. In addition, the Company has sold ViaTVs to its licensees for resale under such licensee's own brand name. Further, other companies have chosen or may choose to manufacture and sell products competitive with the Company's VideoCommunicators by incorporating video compression semiconductors purchased from the Company into products that are based on the Company's video phone reference board designs or other video phone

designs. For example, Leadtek, which is currently both a licensee of certain of the Company's technology and a purchaser of the Company's video compression semiconductors is shipping a product that is directly competitive with the Company's ViaTV to consumer electronics stores.

Purchasers of other companies' video compression semiconductors and reference designs. Companies may choose to manufacture and sell products based upon video compression semiconductors manufactured by suppliers other than the Company or upon reference designs based upon such semiconductors. Certain of these other suppliers of video compression semiconductors, including Analog Devices, Chromatic Research, Lucent Technologies, Philips, Texas Instruments and Winbond Electronics, may have significantly greater resources than the Company. In order to increase the sale of their video compression semiconductors, these manufacturers may provide marketing, financial and other support to the purchasers of these products. Certain companies have publicly announced that they are developing consumer video conferencing products based upon video compression semiconductors manufactured by suppliers other than the Company. In addition, one company has announced that it will be making available for sale to third parties a video phone reference design incorporating Lucent Technologies' semiconductors. The Company's ability to compete depends upon its future success in developing and manufacturing new generations of video compression semiconductors that integrate additional functions and reduce costs. Otherwise, competing semiconductor manufacturers may in the future have competitive advantages in cost, size and performance which could make systems based on competing semiconductors preferable to the Company's VideoCommunicators.

Personal computer system and software manufacturers. Potential customers for the Company's VideoCommunicators may elect instead to buy PCs equipped with video conferencing capabilities, which are currently available. As a result, the Company faces or may face competition from Intel; PC system manufacturers such as Apple, Compaq, IBM and Sony; PC software suppliers such as Microsoft and Netscape; and PC add-on component suppliers.

Existing manufacturers of video conferencing equipment. Manufacturers of more expensive corporate video conferencing systems may enter the market for lower cost consumer video conferencing products. Potential competitors include C-Phone (which is shipping to consumer electronics stores a product that is competitive with the Company's ViaTV), PictureTel, Sony and Vtel.

Emerging suppliers of "Internet appliances." Potential customers for the Company's VideoCommunicators may elect instead to buy standalone Internet access terminals which may provide some or all of the functionality of the Company's products. Consumer products for television-based Internet access have been announced or introduced by companies such as Microsoft, Philips and Sony.

C-Phone, Leadtek, and 3Com are shipping products to consumer electronics stores and other resellers that are competitive with the Company's ViaTV product line. Leadtek and 3Com are currently licensees of certain of the Company's technology; they have also purchased ViaTV products and/or the Company's video compression semiconductors. The Company expects that others have introduced or will introduce products that compete with the Company's VideoCommunicators in the future.

The principal competitive factors in the market for video compression semiconductors include product definition, product design, system integration, chip size, functionality, time-to-market, adherence to industry standards, price and reliability. The Company has a number of competitors in this market including Analog Devices, Chromatic Research, Lucent Technologies, Philips, Texas Instruments and Winbond Electronics. Certain of the Company's

competitors for video compression semiconductors maintain their own semiconductor foundries and may therefore benefit from certain capacity, cost and technical advantages.

Many of the Company's current and potential competitors have longer operating histories, are substantially larger, and have greater financial, manufacturing, marketing, technical and other resources. A number also have greater name recognition and a larger installed base of products than the Company. Competition in the Company's markets may result in significant price reductions. As a result of their greater resources, many current and potential competitors may be better able than the Company to initiate and withstand significant price competition or downturns in the economy. There can be no assurance that the Company will be able to continue to compete effectively, and any failure to do so would have a material adverse effect on the Company's business and operating results.

#### Uncertainty of Market Acceptance; Limits of Existing Technology

Previous efforts to sell consumer video phones have been unsuccessful and there can be no assurance that the market for such products will develop. The Company has no reliable data to suggest that there will be significant customer demand for such products, including the Company's VideoCommunicators. The Company's current ViaTV product line is not capable of delivering video data at rates of 24 frames per second. Below this data rate, the human eye can detect degradation of video quality. Further, POTS infrastructure varies widely in configuration and integrity, which can result in decreased rates of transmission and difficulties in establishing and maintaining connections. Actual or perceived technical difficulties related to video conferencing on POTS could impede market acceptance and have a material adverse effect on the Company's business and results of operations.

#### Rapid Technological Change; Dependence on New Product Introduction

The video compression semiconductor and video conferencing markets are characterized by rapid changes in customer requirements, frequent introductions of new and enhanced products, and continuing and rapid technological advancement. To compete successfully, the Company must continue to design, develop, manufacture and sell new and enhanced products that provide increasingly higher levels of performance and reliability, take advantage of technological advancements and changes and respond to new customer requirements. The Company's success in designing, developing, manufacturing and selling such products will depend on a variety of factors, including the identification of market demand for new products, product selection, timely implementation of product design and development, product performance, cost-effectiveness of products under development, effective manufacturing processes and the success of promotional efforts.

The Company plans to introduce additional VideoCommunicators and video compression semiconductors. The development of new products or enhancements to existing products involves technical and other risks, which the Company may not fully understand. In addition, new product introductions or enhancements to products may decrease demand for existing products resulting in higher than expected product returns and/or excess inventory of existing products. The Company has in the past experienced delays in the development of new products and the enhancement of existing products, and such delays may occur in the future. If the Company is 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, it would have a material adverse effect on the Company's business and operating results.

### Dependence on Proprietary Technology; Reliance on Third Party Licenses

The Company relies in part on trademark, copyright and trade secret law to protect its intellectual property in the United States and abroad. The Company seeks to protect its software, documentation and other written materials under trade secret and copyright law, which afford only limited protection. The Company also relies in part on patent law to protect its intellectual property in the United States and abroad. The Company currently holds four United States patents, including patents relating to video compression and memory architecture technology, and has a number of United States and foreign patent applications pending. There can be no assurance that any such patent applications will result in an issued patent. There can be no assurance that the Company's means of protecting its proprietary rights in the United States or abroad (where effective intellectual property protection may be unavailable or limited) will be adequate or that competitors will not independently develop technologies that are similar or superior to the Company's technology, duplicate the Company's technology or design around any patent of the Company. Moreover, litigation may be necessary in the future to enforce the Company's 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 the Company's business and operating results.

There has been substantial litigation in the semiconductor, electronics and related industries regarding intellectual property rights, and there can be no assurance that third parties will not claim infringement by the Company of their intellectual property rights. If the Company were found to be infringing on the intellectual property rights of any third party, the Company could be subject to liabilities for such infringement, which could be material, and the Company could 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 the Company's business and operating results.

The Company relies upon certain technology, including hardware and software, licensed from third parties. The loss of, or inability to maintain, existing licenses could have a material adverse effect on the Company's business and operating results.

### Dependence on Third Party Manufacturers and Component Suppliers

The Company outsources the manufacture of its VideoCommunicators and semiconductors to subcontract manufacturers and independent foundries. The Company does not have long term purchase agreements with its subcontract manufacturers or its component suppliers. There can be no assurance that the Company's contract manufacturers will be able or willing to reliably manufacture the Company's products, or that the Company's component suppliers will be able or willing to reliably supply components for the Company's products, in volumes, on a cost effective basis or in a timely manner. The Company may experience difficulties due to its reliance on independent subcontract manufacturers, semiconductor foundries and component suppliers which could have a material adverse effect on the Company's business and operating results.

In addition, from time to time the Company may issue non-cancelable purchase orders to its third-party manufacturers for raw materials used in its VideoCommunicator products to ensure availability for long lead-time items or to take advantage of favorable pricing terms. If the Company should experience decreased demand for its VideoCommunicator products, the Company would still be required to take delivery of and make payment for such raw materials. In the event of a significant decrease in VideoCommunicator product demand, such purchase commitments could have a material adverse effect on the Company's business and operating results.

## Compliance with Regulations and Industry Standards

The Company must comply with certain rules and regulations of the Federal Communications Commission ("FCC") regarding electromagnetic radiation and standards established by Underwriters Laboratories, Inc., as well as similar regulations and standards applicable in other countries. The failure of the Company's products to comply, or delays in compliance, with the various existing and evolving government regulations and industry standards could delay or interrupt volume production of VideoCommunicators, which would have a material adverse effect on the Company's business and operating results.

## International Operations

Sales to customers outside of the United States represented 40% of the Company's total revenues for both the third quarter and the nine months ended December 31, 1997 and 54%, 49% and 40% of total revenues in the fiscal years ended March 31, 1997, 1996 and 1995, respectively. Specifically, sales to customers in the Asia Pacific region represented 22% and 26% of the Company's total revenues for the third quarter and the nine months ended December 31, 1997, respectively.

International sales of the Company's semiconductors will continue to represent a substantial portion of the Company's product revenues for the foreseeable future. In addition, substantially all of the Company's current products are, and substantially all of the Company's 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 telecommunications standards, export license requirements, tariffs and taxes, other trade barriers, fluctuations in currency exchange rates, difficulty in collecting accounts receivable and difficulty in staffing and managing foreign operations. The Company is also subject to geopolitical risks, such as political, social and economic instability, potential hostilities and changes in diplomatic and trade relationships, in connection with its international operations. A significant decline in demand from foreign markets, such as may result from the current economic conditions in the Asia Pacific region, could have a material adverse effect on the Company's business and operating results.

## Management of Growth and Change; Dependence on Key Personnel

The development and marketing of the Company's VideoCommunicators will continue to place a significant strain on the Company's limited personnel, management and other resources, particularly in light of the Company's limited experience in developing, manufacturing, marketing and selling consumer products. The Company's ability to manage any future growth effectively will require it to successfully attract, train, motivate, retain and manage employees, particularly key engineering and managerial personnel, to effectively integrate new employees into its operations and to continue to improve its operational, financial and management systems. The Company's failure to manage its growth and changes in its business effectively and to attract and retain key personnel could have a material adverse effect on the Company's business and operating results.

Further, the Company is highly dependent on the continued service of, and on its ability to attract and retain, qualified technical, marketing, sales and managerial personnel. The competition for such personnel is intense, and the loss of any of such persons, as well as the failure to recruit additional key technical and sales personnel in a timely manner, would have a material adverse effect on the Company's business and operating results. There can be no assurance that the Company will be able to continue to attract and retain the qualified personnel necessary for the development of its business. The Company currently does not have employment contracts with any of its employees and does not maintain key person life insurance policies on any of its employees.

### Product Concentration; Potential Loss of Semiconductor Sales; Dependence on Video Conferencing Industry

Sales of video compression semiconductors and reference design boards accounted for approximately 41% and 39% of the Company's total revenues for the third quarter and the nine months ended December 31, 1997 and 76%, 59%, 38% of total revenues in the fiscal years ended March 31, 1997, 1996 and 1995, respectively. Pending widespread market acceptance of its VideoCommunicators, sales of video compression semiconductors will continue to account for a substantial portion of total revenues. Moreover, successful introduction of VideoCommunicators may adversely affect sales of semiconductors to the Company's existing customers that currently, or may in the future, sell products that compete with the Company's VideoCommunicators.

Sales of the Company's existing compression semiconductors and VideoCommunicators are also dependent on the video conferencing industry. Any reduction in the demand for the Company's video compression semiconductors, particularly prior to substantial VideoCommunicator revenues, or any general decline in the market for video conferencing products could have a material adverse effect on the Company's business and operating results.

### Potential Volatility of Stock Price

The market price of the shares of common stock has been and is likely to be highly volatile and may be significantly affected by factors such as actual or anticipated fluctuations in the Company's operating results, announcements of technical innovations, new products or new contracts by the Company, its competitors or their customers, governmental regulatory action, developments with respect to patents or proprietary rights, general market conditions, changes in financial estimates by securities analysts and other factors, certain of which could be unrelated to, or outside the control of, the Company. 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 the Company's common stock. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has been initiated against the issuing company. There can be no assurance that such litigation will not occur in the future with respect to the Company. Such litigation could result in substantial costs and a diversion of management's attention and resources, which would have a material adverse effect on the Company's business and operating results. Any settlement or adverse determination in such litigation would also subject the Company to significant liability, which would have a material adverse effect on the Company's business and financial condition.

### Shares Eligible for Future Sale

After the Company's public initial public offering in July 1997, the majority of the outstanding shares of the Company's common stock were subject to lock-up agreements under which the holders of such shares agreed not to sell or otherwise dispose of such shares without the consent of Montgomery Securities, the lead managing underwriter for the Company's initial public offering. On October 27, 1997, one third of the shares subject to lock-up agreements were released from such agreements. On November 6, 1997, substantially all remaining shares of the Company's common stock subject to lock-up agreements became eligible for sale into the public market. The continuing sale of part or all of such shares in the public market could have an adverse effect on the trading price of the Company's common stock.

## PART II -- OTHER INFORMATION

## ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Net offering proceeds:	\$24,699,163
Use of net offering proceeds:	
Purchase of machinery and equipment (1)	\$ 512,000
Product development (1)(2)	5,826,000
Sales, marketing and administration (1)(2)	7,089,000
Officer compensation	1,611,000
Working capital (1)(2)	9,661,163
	-----
	\$24,699,163

(1) Does not include any direct or indirect payments to directors, officers, general partners of the issuer or their associates; to persons owning ten (10) percent or more of any class of equity securities of the issuer; or to affiliates of the issuer.

(2) This amount represents a reasonable estimate.

## ITEM 5. OTHER INFORMATION

The Company's 1998 Annual Meeting of Stockholders will be held at 2 p.m. Pacific Standard Time on June 15, 1998 at the Company's principal executive offices at 2445 Mission College Blvd., Santa Clara, California.

The Company announced on January 19, 1997 that Joe Parkinson resigned as Chairman, Chief Executive Officer and Director. On the same date, Paul Voois, formerly the Company's Executive Vice President and Director, was appointed Chairman and CEO, and each of Bryan Martin, Vice President of Engineering and Chief Technical Officer, and Chris McNiffe, Vice President of Sales and Marketing, were appointed to the Company's Board of Directors. Mr. Parkinson will remain with the Company on a temporary basis as a part-time employee to assist with the transition.

## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) See Exhibit Index.
- (b) No reports on Form 8-K were filed during the three month period ended December 31, 1997.

## SIGNATURE

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

Date: January 23, 1998

8X8, INC.

By: /s/ SANDRA L. ABBOTT

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Sandra L. Abbott

Chief Financial Officer and  
Vice President of Finance  
(Principal Financial and Accounting Officer)

## EXHIBIT INDEX

8X8, INC.

EXHIBIT  
NUMBER

EXHIBIT TITLE

11.1	Calculation of Historical and Pro forma Earnings (Loss) Per Share
27.1	Financial Data Schedule

All other schedules are omitted because they are not required, are not applicable or the information is included in the Condensed Consolidated Financial Statements or notes thereto.



## EXHIBIT 11.1

CALCULATION OF HISTORICAL AND PRO FORMA EARNINGS (LOSS) PER SHARE  
(In thousands, except per share amounts)  
(unaudited)

	Three months ended December 31,		Nine months ended December 31,	
	----- 1997 -----	----- 1996 -----	----- 1997 -----	----- 1996 -----
Net income (loss) .....	\$ 132	\$(1,580)	\$ 3,645	\$(10,769)
	=====	=====	=====	=====
Basic earnings per share.....	\$ 0.01			
	=====			
Historical weighted average number of common shares:				
Common stock.....	14,985			
	=====			
Pro forma basic earnings(loss) per share.....		\$ (0.15)	\$ 0.27	\$ (1.12)
		=====	=====	=====
Pro forma weighted average number of common shares:				
Preferred stock.....		3,681	1,298	3,355
Common stock.....		6,972	12,144	6,228
		-----	-----	-----
		10,653	13,442	9,583
		=====	=====	=====
Diluted earnings per share.....	\$0.01			
	=====			
Historical weighted average number of common and common equivalent shares:				
Common stock.....	14,985			
Common stock options.....	1,865			
	-----			
	16,850			
	=====			
Pro forma diluted earnings (loss) per share.....		\$ (0.13)	\$ 0.24	\$ (0.91)
		=====	=====	=====
Pro forma weighted average number of common and common equivalent shares:				
Preferred stock.....		3,681	1,297	3,355
Common stock.....		6,972	12,144	6,228
Common stock options.....		1,593	1,652	2,280
		-----	-----	-----
		12,246	15,093	11,863
		=====	=====	=====

THIS SCHEDULE CONTAINS SUMMARY INFORMATION EXTRACTED FROM 8X8, INC.'S CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND CONDENSED CONSOLIDATED BALANCE SHEETS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000

9-MOS		
	MAR-31-1998	
	APR-01-1997	
	DEC-31-1997	
		33,187
		0
		4,569
		0
		8,766
	47,529	
		7,195
	(5,818)	
	49,067	
13,118		0
	0	
		0
		15
		35,831
49,067		
		37,647
	37,647	
		13,960
		13,960
	22,137	
		0
	0	
		2,645
	(1,000)	
3,645		
		0
		0
		0
		3,645
		0.27
		0.24

ITEM SHOWN NET OF ALLOWANCE, CONSISTENT WITH THE BALANCE SHEET PRESENTATION.