Crexendo, Inc.
Form 10-Q
November 06, 2018

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

FORM 10-Q

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from ________ to ________.

Commission file number 001-32277

Crexendo, Inc.
(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	87-0591719 (I.R.S. Employer Identification No.)
1615 South 52nd Street, Tempe, AZ (Address of Principal Executive Offices)	85281 (Zip Code)

(602) 714-8500
(Registrant’s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of the registrant's common stock as of October 31, 2018 was 14,394,113.

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PART I - FINANCIAL INFORMATION

Item 1.
Financial Statements.

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited, in thousands, except par value and share data)

	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$1,796	$1,282
Restricted cash	100	100
Trade receivables, net of allowance for doubtful accounts of $7 as of September 30, 2018 and $19 as of December 31, 2017	363	372
Contract assets	9	3
Inventories	293	131
Equipment financing receivables	70	116
Contract costs	374	379
Prepaid expenses	253	251
Income tax receivable	2	-
Other current assets	-	10
Total current assets	3,260	2,644
Long-term trade receivables, net of allowance for doubtful accounts of $9 as of September 30, 2018 and $10 as of December 31, 2017	29	31
Long-term equipment financing receivables, net	128	58
Property and equipment, net	132	8
Intangible assets, net	185	239
Goodwill	272	272
Contract costs, net of current portion	351	364
Other long-term assets	107	121
Total assets	$4,464	$3,737
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$77	$79
Accrued expenses	1,254	961
Capital lease obligations	27	-
Notes payable	74	69
Contract liabilities	585	614
Total current liabilities	2,017	1,723

Contract liabilities, net of current portion	410	374
Capital lease obligations, net of current portion	123	-
Notes payable, net of current portion	-	10
Total liabilities	2,550	2,107
Stockholders' equity:		
Preferred stock, par value $0.001 per share - authorized 5,000,000 shares; none issued	—	—
Common stock, par value $0.001 per share - authorized 25,000,000 shares, 14,394,113 shares issued and outstanding as of September 30, 2018 and 14,287,556 shares issued and outstanding as of December 31, 2017	14	14
Additional paid-in capital	61,059	60,560
Accumulated deficit	(59,159)	(58,944)
Total stockholders' equity	1,914	1,630
Total Liabilities and Stockholders' Equity	$4,464	$3,737

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

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CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited, in thousands, except per share and share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Service revenue	$2,712	$2,259	$7,694	$6,407
Product revenue	314	385	1,117	967
Total revenue	3,026	2,644	8,811	7,374
Operating expenses:				
Cost of service revenue	833	664	2,293	1,962
Cost of product revenue	161	151	549	383
Selling and marketing	910	735	2,506	2,081
General and administrative	1,101	954	3,080	3,134
Research and development	214	194	589	569
Total operating expenses	3,219	2,698	9,017	8,129
Loss from operations	(193)	(54)	(206)	(755)
Other income/(expense):				
Interest income	1	3	5	8
Interest expense	(5)	(135)	(8)	(205)
Other income, net	6	4	9	7
Total other income/(expense), net	2	(128)	6	(190)
Loss before income tax	(191)	(182)	(200)	(945)
Income tax provision	(8)	(8)	(15)	(16)
Net loss	$(199)	$(190)	$(215)	$(961)
Net loss per common share:				
Basic	$(0.01)	$(0.01)	$(0.02)	$(0.07)
Diluted	$(0.01)	$(0.01)	$(0.02)	$(0.07)
Weighted-average common shares outstanding:				
Basic	14,346,092	13,951,480	14,311,190	13,824,307
Diluted	14,346,092	13,951,480	14,311,190	13,824,307

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

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Stockholders' Equity
Nine Months Ended September 30, 2018
(Unaudited, in thousands, except share data)

	Common Stock		Additional Paid-in	Accumulated	Total Stockholders'
	Shares	Amount	Capital	Deficit	Equity
Balance, January 1, 2018	14,287,556	$14	$60,560	$(58,944)	$1,630
Share-based compensation	-	-	344	-	344
Issuance of common stock for exercise of stock options	106,557	-	155	-	155
Net loss	-	-	-	(215)	(215)
Balance, September 30, 2018	14,394,113	$14	$61,059	$(59,159)	$1,914

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

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited, in thousands)

	Nine Months Ended September 30,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(215)	$(961)
Adjustments to reconcile net loss to net cash used for operating activities:		
Amortization of prepaid rent	-	54
Depreciation and amortization	66	81
Non-cash interest expense	-	198
Share-based compensation	344	481
Amortization of deferred gain	-	(16)
Changes in assets and liabilities:		
Trade receivables	11	(30)
Contract assets	(6)	(1)
Equipment financing receivables	(24)	93
Inventories	(162)	17
Contract costs	18	1
Prepaid expenses	(2)	191
Income tax payable	(2)	4
Other assets	24	14
Accounts payable and accrued expenses	291	(114)
Contract liabilities	7	165
Net cash provided by operating activities	350	177
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(136)	-
Sale of long-term investment	-	252
Net cash provided by/(used for) investing activities	(136)	252
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from capital lease obligations	154	-
Repayments made on capital lease obligations	(4)	-
Proceeds from notes payable	113	111
Repayments made on notes payable	(118)	(1,092)
Proceeds from exercise of options	155	1,140
Net cash provided by financing activities	300	159
NET INCREASE IN CASH, CASH EQUIVALENTS, AND RESTRICTED CASH	514	588

CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT THE BEGINNING OF THE PERIOD	1,382	719
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT THE END OF THE PERIOD	$1,896	$1,307
Supplemental disclosure of cash flow information:		
Cash used during the period for:		
Income taxes, net	$(17)	$(12)
Supplemental disclosure of non-cash investing and financing information:		
Issuance of common stock for prepayment of interest on related-party note payable	-	109
Prepaid assets financed through notes payable	122	111
Property and equipment financed through capital lease obligations	129	-

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

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CREXENDO, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (unaudited)

1.
Significant Accounting Policies

Description of Business - Crexendo, Inc. is incorporated in the state of Nevada. As used hereafter in the notes to condensed consolidated financial statements, we refer to Crexendo, Inc. and its wholly owned subsidiaries, as “we,” “us,” or “our Company.” Crexendo is a next-generation CLEC and an award-winning leader and provider of unified communications cloud telecom services, broadband Internet services, and other cloud business services that are designed to provide enterprise-class cloud services to any size business at affordable monthly rates. The Company has two operating segments, which consist of Cloud Telecommunications and Web Services.

Basis of Presentation – The condensed consolidated financial statements include the accounts and operations of Crexendo, Inc. and its wholly owned subsidiaries, which include Crexendo Business Solutions, Inc. and Crexendo International, Inc. All intercompany account balances and transactions have been eliminated in consolidation. The condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“US GAAP”) and pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). These condensed consolidated financial statements reflect the results of operations, financial position, changes in stockholders’ equity, and cash flows of our Company.

Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations.

Cash and Cash Equivalents - We consider all highly liquid, short-term investments with maturities of three months or less at the time of purchase to be cash equivalents. As of September 30, 2018 and December 31, 2017, we had cash and cash equivalents in financial institutions in excess of federally insured limits in the amount of $1,546,000 and $1,032,000, respectively.

Restricted Cash – We classified $100,000 and $100,000 as restricted cash as of September 30, 2018 and December 31, 2017, respectively. Cash is restricted for compensating balance requirements on purchasing card agreements. As of September 30, 2018 and December 31, 2017, we had restricted cash in financial institutions in excess of federally insured limits in the amount of $100,000 and $100,000, respectively.

The following table provides a reconciliation of cash and cash equivalents and restricted cash reported on the balance sheet to the cash, cash equivalents, and restricted cash shown in the condensed consolidated statement of cash flows (in thousands):

	September 30, 2018	December 31, 2017
Cash and cash equivalents	$1,796,000	$1,282,000
Restricted cash	100,000	100,000
Total cash, cash equivalents, and restricted cash shown in the condensed consolidated statement of cash flows	$1,896,000	$1,382,000

Trade Receivables – Trade receivables from our cloud telecommunications and web services segments are recorded at invoiced amounts. We have historically offered to our web site development software customers the option to finance, typically through twenty-four and thirty-six month extended payment term agreements (“EPTAs”). EPTAs are reflected as short-term and long-term trade receivables, as applicable, as we have the intent and ability to hold the receivables for the foreseeable future, until maturity or payoff. EPTAs are recorded on a nonaccrual cash basis beginning on the contract date.

Allowance for Doubtful Accounts –The allowance represents estimated losses resulting from customers’ failure to make required payments. The allowance estimate is based on historical collection experience, specific identification of probable bad debts based on collection efforts, aging of trade receivables, customer payment history, and other known factors, including current economic conditions. We believe that the allowance for doubtful accounts is adequate based on our assessment to date, however, actual collection results may differ materially from our expectations.

Contract Assets – Contract assets primarily relate to the Company’s rights to consideration for work completed but not billed as of the reporting date. The contract assets are transferred to receivables when the rights become unconditional.

Contract Costs - Contract costs primarily relate to incremental commission costs paid to sales representatives and sales leadership as a result of obtaining telecommunications contracts which are recoverable. The Company capitalized contract costs in the amount of $725,000 and $743,000 at September 30, 2018 and December 31, 2017, respectively. Capitalized commission costs are amortized based on the transfer of goods or services to which the assets relate which typically range from thirty-six to sixty months, and are included in selling and marketing expenses. During the three months ended September 30, 2018 and 2017, the Company amortized $125,000 and $105,000, respectively, and there was no impairment loss in relation to the costs capitalized. During the nine months ended September 30, 2018 and 2017, the Company amortized $352,000 and $303,000, respectively, and there was no impairment loss in relation to the costs capitalized.

Inventory – Finished goods telecommunications equipment inventory is stated at the lower of cost or net realizable value (first-in, first-out method). In accordance with applicable accounting guidance, we regularly evaluate whether inventory is stated at the lower of cost or net realizable value. If net realizable value is less than cost, the write-down is recognized as a loss in earnings in the period in which the excess occurs.

Property and Equipment - Depreciation and amortization expense is computed using the straight-line method in amounts sufficient to allocate the cost of depreciable assets over their estimated useful lives ranging from two to five years. The cost of leasehold improvements is amortized using the straight-line method over the shorter of the estimated useful life of the asset or the term of the related lease. Depreciation expense is included in general and administrative expenses and totaled $8,000 and $2,000 for the three months ended September 30, 2018 and 2017, respectively and $12,000 and $8,000 for the nine months ended September 30, 2018 and 2017, respectively. Depreciable lives by asset group are as follows:

Computer and office equipment	2 to 5 years
Computer software	3 years
Furniture and fixtures	4 years
Leasehold improvements	2 to 5 years

Maintenance and repairs are expensed as incurred. The cost and accumulated depreciation of property and equipment sold or otherwise retired are removed from the accounts and any related gain or loss on disposition is reflected in the statement of operations.

Goodwill – Goodwill is tested for impairment using a fair-value-based approach on an annual basis (December 31) and between annual tests if indicators of potential impairment exist.

Intangible Assets - Our intangible assets consist primarily of customer relationships and developed technology. The intangible assets are amortized following the patterns in which the economic benefits are consumed. We periodically review the estimated useful lives of our intangible assets and review these assets for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The determination of impairment is based on estimates of future undiscounted cash flows. If an intangible asset is considered to be impaired, the amount of the impairment will be equal to the excess of the carrying value over the fair value of the asset.

Contract Liabilities – Our contract liabilities consist primarily of advance consideration received from customers for telecommunications contracts. The product and monthly service revenue is recognized on completion of the implementation and the remaining activation fees are reclassified as deferred revenue.

Use of Estimates - In preparing the condensed consolidated financial statements, management makes assumptions, estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the condensed consolidated financial statements and the reported amounts of net sales and expenses during the reported periods. Specific estimates and judgments include valuation of goodwill and intangible assets in connection with business acquisitions, allowances for doubtful accounts, uncertainties related to certain income tax benefits, valuation of deferred income tax assets, valuations of share-based payments and recoverability of long-lived assets. Management's estimates are based on historical experience and on our expectations that are believed to be reasonable. The combination of these factors forms the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from our current estimates and those differences may be material.

Product and Service Revenue Recognition - Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services and excludes any amounts collected on behalf of third parties. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the timing of revenue recognized but does not change the total revenue recognized on any agreement. Revenue is recognized net of any taxes collected from customers, which are subsequently remitted to governmental authorities. For more detailed information about revenue, see Note 3.

Cost of Service Revenue – Cost of service includes Cloud Telecommunications and Web Services cost of service revenue. Cloud Telecommunications cost of service revenue primarily consists of fees we pay to third-party telecommunications and broadband Internet providers, costs of other third party services we resell, personnel and travel expenses related to system implementation, and customer service. Web Services cost of service revenue consists primarily of customer service costs and outsourcing fees related to fulfillment of our professional web management services.

Cost of Product Revenue – Cost of product revenue primarily consists of the costs associated with the purchase of desktop devices and other third party equipment we purchase for resale.

Research and Development - Research and development costs are expensed as incurred. Costs related to internally developed software are expensed as research and development expense until technological feasibility has been achieved, after which the costs are capitalized.

Fair Value Measurements - The fair value of our financial assets and liabilities was determined based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 — Unadjusted quoted prices that are available in active markets for the identical assets or liabilities at the measurement date.

Level 2 — Other observable inputs available at the measurement date, other than quoted prices included in Level 1, either directly or indirectly, including:

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets in non-active markets;

Inputs other than quoted prices that are observable for the asset or liability; and

Inputs that are derived principally from or corroborated by other observable market data.

Level 3 — Unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

Lease Obligations - At the inception of each lease, we evaluate the lease terms to determine whether the lease will be accounted for as an operating or capital lease. A lease that transfers substantially all of the benefits and risks incidental to ownership of property is accounted for as a capital lease. At the inception of a capital lease, an asset and payment obligation is recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property’s fair market value. Capital lease obligations are classified as either short or long-term based on the due dates of future minimum lease payments, net of interest. All other leases are accounted for as operating leases and the related lease payments are charged to expenses as incurred.

Notes Payable – We record notes payable net of any discounts or premiums. Discounts and premiums are amortized as interest expense or income over the life of the note in such a way as to result in a constant rate of interest when applied to the amount outstanding at the beginning of any given period.

Income Taxes - We recognize a liability or asset for the deferred tax consequences of all temporary differences between the tax basis of assets and liabilities and their reported amounts in the condensed consolidated financial statements that will result in taxable or deductible amounts in future years when the reported amounts of the assets and liabilities are recovered or settled. Accruals for uncertain tax positions are provided for in accordance with accounting guidance. Accordingly, we may recognize the tax benefits from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting guidance is also provided on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in the financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our financial position, results of operations, and cash flows. In assessing the need for a valuation allowance, we evaluate all significant available positive and negative evidence, including historical operating results, estimates of future taxable income and the existence of prudent and feasible tax planning strategies. We have placed a full valuation allowance on net deferred tax assets.

Interest and penalties associated with income taxes are classified as income tax expense in the condensed consolidated statements of operations.

Stock-Based Compensation - For equity-classified awards, compensation expense is recognized over the requisite service period based on the computed fair value on the grant date of the award. Equity classified awards include the issuance of stock options.

Comprehensive Income/(Loss) – There were no other components of comprehensive income/(loss) other than net income/(loss) for the three and nine months ended September 30, 2018 and 2017.

Operating Segments - Accounting guidance establishes standards for the way public business enterprises are to report information about operating segments in annual financial statements and requires enterprises to report selected information about operating segments in financial reports issued to stockholders. The Company has two operating segments, which consist of Cloud Telecommunications and Web Services. Research and development expenses are allocated to Cloud Telecommunications and Web Services segments based on the level of effort, measured primarily by wages and benefits attributed to our engineering department. Indirect sales and marketing expenses are allocated to the Cloud Telecommunications and Web Services segments based on level of effort, measured by month-to-date contract bookings. General and administrative expenses are allocated to both segments based on revenue recognized for each segment. Accounting guidance also establishes standards for related disclosure about products and services, geographic areas and major customers. We generate over 90% of our total revenue from customers within North America (United States and Canada) and less than 10% of our total revenues from customers in other parts of the world.

Significant Customers – No customer accounted for 10% or more of our total revenue for the three and nine months ended September 30, 2018 and 2017. No customer accounted for 10% or more of our total trade accounts receivable as of September 30, 2018 and one Cloud Telecommunications services customer accounted for 10% of total trade accounts receivable as of September 30, 2017.

Recently Adopted Accounting Pronouncements - In July 2015, the Financial Accounting Standards Board issued ASU 2015-11, Inventory, which will require an entity to measure in scope inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. We adopted this guidance effective January 1, 2017. The adoption of this guidance did not have an impact on our condensed consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805) Clarifying the Definition of a Business, that provides guidance to assist entities with evaluating when a set of transferred assets and activities (set) is a business. Under the new guidance, an entity first determines whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If this threshold is met, the set is not a business. If it's not met, the entity then evaluates whether the set meets the requirement that a business include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. Under today's guidance, it doesn't matter whether all the value relates primarily to one asset. Under ASU 2017-01, a set is not a business when substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. The ASU includes guidance on which types of assets can and cannot be combined into a single identifiable asset or a group of similar identifiable assets for the purpose of applying the threshold. The ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those years. We adopted this guidance effective January 1, 2018. The adoption of this guidance did not have an impact on our condensed consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. We adopted the new accounting standards effective January 1, 2018. Amounts generally described as restricted cash are now presented with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. As a result of adoption, there was no impact to cash flows from operating, investing or financing activities for the nine months ended September 30, 2018 and 2017. A reconciliation of cash and cash equivalents and restricted cash presented on the balance sheet to the totals presented in the statement of cash flows as cash, cash equivalents, and restricted cash has been added to the footnote disclosures, see Note 1.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which amends ASC 230, to clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows. The changes to the classification of how certain cash receipts and payments are presented within the statement of cash flows had no impact on our condensed consolidated financial statements.

The adoption of these new ASUs required us to restate the previously reported cash and cash equivalent amounts reported in prior periods to include restricted cash, see Note 2-Changes in Accounting Principles.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation, which requires that a performance target that affects vesting and could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, Compensation-Stock Compensation, as it relates to such awards. ASU 2014-12 is effective for us in our first quarter of fiscal 2017 with early adoption permitted using either of two methods: (i) prospective to all awards granted or modified after the effective date; or (ii) retrospective to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter, with the cumulative effect of applying ASU 2014-12 as an adjustment to the opening retained earnings balance as of the beginning of the earliest annual period presented in the financial statements. The Company adopted ASU 2014-12 effective January 1, 2017. The adoption of this ASU did not impact our condensed consolidated financial statements, as there are no performance targets associated with outstanding awards.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. The objective of ASU 2014-09 is to establish a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The Company adopted this guidance on January 1, 2018 utilizing the full retrospective method of adoption allowed by the standard, in order to provide for comparative results in all periods presented. Under the standard, revenue is recognized when a customer obtains control of promised goods or services in an amount that reflects the consideration the entity expects to receive in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. We elected to adopt the standard effective January 1, 2018, using the full retrospective method, which required us to restate each prior reporting period presented, see Note 2-Changes in Accounting Principles. The most significant impact of the standard relates to our accounting for incremental costs to obtain a contract and principal versus agent considerations. Specifically, incremental sales leadership commissions were expensed immediately rather than ratably over the term of the related contracts. Revenue from the resell of broadband Internet services and professional website management services were recognized on a gross basis as a principal rather than on net basis as an agent. The new standard focuses on control of the specified goods and service as the overarching principle and the Company does not control the delivery of the goods and services. Revenue recognition related to our hardware, telecommunications services and website hosting services remains substantially unchanged. See Note 2 for disclosures related to changes in accounting policies.

In May 2017, the FASB issued ASU 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, the amendments provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. Effective for all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. The Company adopted ASU 2017-09 effective January 1, 2018. The adoption of this ASU did not impact our condensed consolidated financial statements.

Recently Issued Accounting Pronouncements - In August 2018, the FASB issued ASU 2018-13, which changes the fair value measurement disclosure requirements of ASC 820. The amendments in this ASU are the result of a broader disclosure project called FASB Concepts Statement, Conceptual Framework for Financial Reporting — Chapter 8: Notes to Financial Statements, which the Board finalized in August 2018. The Board used the guidance in the Concepts Statement to improve the effectiveness of ASC 820’s disclosure requirements. The ASU is effective for all entities for fiscal years beginning after December 15, 2019, including interim periods therein. Early adoption is permitted. The Company is in the process of evaluating the impact of this new ASU on our condensed consolidated financial statements.

In August 2018, the FASB issued Accounting Standards Update (ASU) 2018-07, to simplify the accounting for share-based payments to nonemployees by aligning it with the accounting for share-based payments to employees, with certain exceptions. The new guidance expands the scope of Accounting Standards Codification (ASC) 718 to include share-based payments granted to nonemployees in exchange for goods or services used or consumed in an entity’s own operations and supersedes the guidance in ASC 505-50. The guidance also applies to awards granted by an investor to employees and nonemployees of an equity method investee for goods or services used or consumed in the investee’s operations. The guidance in ASC 718 does not apply to instruments issued to a lender or an investor in a financing (e.g., in a capital raising) transaction. It also does not apply to equity instruments granted when selling goods or services to customers in the scope of ASC 606. However, the guidance states that share-based payments granted to a customer in exchange for a distinct good or service to be used or consumed in the grantor’s own operations are accounted for under ASC 718. The guidance is effective for public business entities (PBEs) in annual periods beginning after December 15 2018, and interim periods within those annual periods. The Company is in the process of evaluating the impact of this new ASU on our condensed consolidated financial statements.

In July 2018, the FASB issued ASU 2018-11 to provide entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU 2016-02 (codified as ASC 842). Specifically, under the amendments in ASU 2018-11:

Entities may elect not to recast the comparative periods presented when transitioning to ASC 842 (Issue 1).

Lessors may elect not to separate lease and non-lease components when certain conditions are met (Issue 2).

These amendments are consistent with the tentative decisions that the Board made at its November 29, 2017, meeting and further refined at its March 7, 2018, and March 28, 2018, meetings. In addition, on July 19, 2018, the FASB issued ASU 2018-10, which made 16 separate amendments to ASC 842. The Company is in the process of evaluating the impact of this new ASU on our condensed consolidated financial statements.

In July 2018, the FASB has issued Accounting Standards Update (ASU) 2018-10, “Codification Improvements to Topic 842, Leases.” The clarifications address the rate implicit in the lease, impairment of the net investment in the lease, lessee reassessment of lease classification, lessor reassessment of lease term and purchase options, variable payments that depend on an index or rate and certain transition adjustments. The amendments have the same effective date and transition requirements as the new leases standard. The Company is in the process of evaluating the impact of this new ASU on our condensed consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which eliminates Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. This guidance is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted. ASU 2017-04 should be adopted on a prospective basis. The Company is in the process of evaluating the potential impact of this new ASU on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous Generally Accepted Accounting Principles ("GAAP"). The ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. The Company is in the process of evaluating the impact of this new ASU on our condensed consolidated financial statements.

2.
Changes in Accounting Principles

Except for the changes below, the Company has consistently applied the accounting principles to all periods presented in these condensed consolidated financial statements. The Company adopted Topic 606 Revenue from Contracts with Customers with a date of the initial application of January 1, 2018. As a result, the Company has changed its accounting policies for revenue recognition as detailed below.

The Company applied Topic 606 retrospectively using the practical expedient in paragraph 606-10-65-1(f)(3), under which the Company does not disclose the amount of consideration allocated to the remaining performance obligations or an explanation of when the Company expects to recognize that amount as revenue for all reporting periods presented before the date of the initial application – i.e. January 1, 2018. The details of the significant changes and quantitative impact of the changes are disclosed below.

A.
Commission fees payable

The Company previously recognized management level indirect sales commission expense related to contracts as selling expenses when they were incurred. Under Topic 606, the Company capitalizes those commission fees as costs of obtaining a contract, when they are incremental and, if they are expected to be recovered, it amortizes them consistently with the pattern of transfer of the good or service over the specific contract life or the average contract life for the group of contracts that resulted in the achievement of the sales commissions. If the expected amortization period is one year or less, the commission fee is expensed when incurred. The adoption of this new accounting policy resulted in a cumulative adjustment to the accumulated deficit related to the incremental contract acquisition cost that was previously expensed being capitalized. Refer to Impacts to Previously Reported Results below for the impact of adoption of the standard on our condensed consolidated financial statements.

B.
Principal versus agent considerations

For the majority of our contracts, we expect no changes. We have certain contracts where we recognize revenue from reselling third party products and services, such as broadband Internet access and professional website management services as a principal on a gross basis. Under Topic 606, the Company recognizes revenue on a net basis as an agent. The new standard focuses on control of the specified goods and service as the overarching principle and the Company does not control the delivery of the goods and services. The adoption of this new accounting policy required us to restate certain previously reported results, including the reduction of service revenue and related cost of service revenue. There was no impact on the accumulated deficit as a result of any changes to our current policy. Refer to Impacts to Previously Reported Results below for the impact of adoption of the standard on our condensed consolidated financial statements.

The Company adopted ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash. As a result, amounts generally described as restricted cash are included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. Refer to Impacts of Previously Reported Results below for the impact of the standard on our condensed consolidated financial statements.

Impacts to Previously Reported Results

Adoption of the standards related to revenue recognition and statement of cash flows impacted our previously reported results as follows:

		(Topic 606)	
Condensed Consolidated Balance Sheet		New Revenue	
December 31, 2017	As Previously	Standard	As
(In thousands)	Reported	Adjustment	Adjusted
Trade receivables, net of allowance for doubtful accounts	$375	$(3)	$372
Contract assets	-	3	3
Contract costs	-	379	379
Prepaid expenses	530	(279)	251
Total current assets	2,544	100	2,644
Long-term prepaid expenses	173	(173)	-
Contract costs, net of current portion	-	364	364
Total assets	3,446	291	3,737
Deferred revenue, current portion	957	(957)	-
Contract liabilities	-	614	614
Total current liabilities	2,066	(343)	1,723
Deferred revenue, net of current portion	31	(31)	-
Contract liabilities, net of current portion	-	374	374
Accumulated deficit	(59,235)	291	(58,944)
Total stockholders' equity	1,339	291	1,630
Total Liabilities and Stockholders' Equity	3,446	291	3,737

		(Topic 606)	
Condensed Consolidated Statement of Operations		New Revenue	
Three Months Ended September 30, 2017	As Previously	Standard	As
(In thousands, except per share amounts)	Reported	Adjustment	Adjusted
Service revenue	$2,305	$(46)	$2,259
Total revenue	2,690	(46)	2,644

Cost of service revenue	709	(45)	664
Selling and marketing	734	1	735
Total operating expenses	2,744	(46)	2,698
Loss before income tax	(181)	(1)	(182)
Net loss	(189)	(1)	(190)
Diluted loss per share	$(0.01)	$-	$(0.01)

		(Topic 606)	
Condensed Consolidated Statement of Operations		New Revenue	
Nine Months Ended September 30, 2017	As Previously	Standard	As
(In thousands, except per share amounts)	Reported	Adjustment	Adjusted
Service revenue	$6,552	$(145)	$6,407
Total revenue	7,519	(145)	7,374
Cost of service revenue	2,106	(144)	1,962
Selling and marketing	2,133	(52)	2,081
Total operating expenses	8,327	(198)	8,129
Loss from operations	(808)	53	(755)
Loss before income tax	(997)	52	(945)
Net loss	(1,013)	52	(961)
Diluted loss per share	$(0.07)	$-	$(0.07)

Condensed Consolidated Statements of Stockholders' Equity			Additional		Total
(In thousands)	Common Stock		Paid-in	Accumulated	Stockholders'
	Shares	Amount	Capital	Deficit	Equity
Balance at January 1, 2017, as previously reported	13,578,556	$14	$58,716	$(58,215)	$515
Impact of change in accounting principle	-	-	-	200	200
As adjusted balance at January 1, 2017	13,578,556	14	58,716	(58,015)	715
As adjusted net loss	709,000	-	1,844	(929)	915
As adjusted balance as of December 31, 2017	14,287,556	$14	$60,560	$(58,944)	$1,630

		(Topic 606)	(Topic 230)	
Condensed Consolidated Statement of Cash Flows		New Revenue	Statement of	
Nine Months Ended September 30, 2017	As Previously	Standard	Cash Flows	As
(In thousands)	Reported	Adjustment	Adjustments	Adjusted
Net loss	$(1,013)	$52	$-	$(961)
Trade receivables	(31)	1	-	(30)
Contract assets	-	(1)	-	(1)
Contract costs	-	1	-	1
Prepaid expenses	244	(53)	-	191
Contract liabilities	-	165	-	165
Deferred revenue	165	(165)	-	-
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	619	-	(619)	-
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT THE BEGINNING OF THE PERIOD	-	-	719	719
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	1,207	-	(1,207)	-
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT THE END OF THE PERIOD	-	-	1,307	1,307

Adoption of the standards related to revenue recognition (Topic 606) and statement of cash flows presentation of restricted cash (Topic 230) had no impact to cash provided by or used for financing, or investing on our condensed consolidated statement of cash flows.

3.
Revenue

Revenue is measured based on a consideration specified in a contract with a customer, and excludes any sales incentives and amounts collected on behalf of third parties. The Company recognizes revenue when it satisfies a performance obligation by transferring control over a product or service to a customer. Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by the Company from a customer, are excluded from revenue. The following is a description of principal activities – separated by reportable segments – from which the Company generates its revenue. For more detailed information about reportable segments, see Note 14.

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Telecommunications Segment

Products and services may be sold separately or in bundled packages. The typical length of a contract for service is thirty-six to sixty months. Customers are billed for these services on a monthly basis. For bundled packages, the Company accounts for individual products and services separately if they are distinct – i.e. if a product or service is separately identifiable from other items in the bundled package and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The consideration (including any discounts) is allocated between separate products and services in a bundle based on their relative stand-alone selling prices. The stand-alone selling prices are determined based on the prices at which the Company separately sells the desktop devices and telecommunication services. For items that are not sold separately (e.g. additional features) the Company estimates stand-alone selling prices using the adjusted market assessment approach. When we provide a free trial period, we do not begin to recognize recurring revenue until the trial period has ended and the customer has been billed for the services.

Desktop Devices - Revenue generated from the sale of telecommunications equipment (desktop devices) is recognized when the customer takes possession of the devices and the cloud telecommunications services begin. The Company typically bills and collects the fees for the equipment upon entering into a contract with a customer. Cash receipts are recorded as a contract liability until implementation is complete and the services begin.

Equipment Financing Revenue - Fees generated from renting our cloud telecommunication equipment (IP or cloud telephone desktop devices) through leasing contracts are recognized as revenue based on whether the lease qualifies as an operating lease or sales-type lease. The two primary accounting provisions which we use to classify transactions as sales-type or operating leases are: 1) lease term to determine if it is equal to or greater than 75% of the economic life of the equipment and 2) the present value of the minimum lease payments to determine if they are equal to or greater than 90% of the fair market value of the equipment at the inception of the lease. The economic life of most of our products is estimated to be three years, since this represents the most frequent contractual lease term for our products, and there is no residual value for used equipment. Residual values, if any, are established at the lease inception using estimates of fair value at the end of the lease term. The vast majority of our leases that qualify as sales-type leases are non-cancelable and include cancellation penalties approximately equal to the full value of the lease receivables. Leases that do not meet the criteria for sales-type lease accounting are accounted for as operating leases. Revenue from sales-type leases is recognized upon installation and the interest portion is deferred and recognized as earned. Revenue from operating leases in recognized ratably over the applicable service period.

Cloud Telecommunications Services - Telecommunication services include voice, data, and collaboration software. The Company recognizes revenue as services are provided in service revenue. Telecommunications services are billed and paid on a monthly basis.

Broadband Internet Access – Fees generated from reselling broadband Internet access are recognized as revenue net of the costs charged by the third party service providers. Broadband Internet access services are billed and paid on a monthly basis.

Professional Services Revenue – Professional services revenue includes activation fees and any professional installation services. Installation services are recognized as revenue when the services are completed. The Company generally allocates a portion of the activation fees to the desktop devices, which is recognized at the time of the installation or customer acceptance, and a portion to the service, which is recognized over the contract term using the straight-line method. Our telecommunications services contracts typically have a term of thirty-six to sixty months.

Commission Revenue - We have affiliate agreements with third-party entities that are resellers of satellite television services and Internet service providers. We receive commissions when the services are bundled with our offerings and we recognize commission revenue when received.

Web Services Segment

Website Hosting Service – Fees generated from hosting customer websites are recognized as revenue as the services are provided in service revenue. Website hosting services are billed and collected on a monthly basis.

Professional Website Management Service and Other– Fees generated from reselling professional website management services are recognized as revenue net of the costs charged by the third party service providers. Professional website management services are billed and paid on a monthly basis.

Disaggregation of Revenue

In the following table, revenue is disaggregated by primary major product line, and timing of revenue recognition. The table also includes a reconciliation of the disaggregated revenue with the reportable segments.

Three Months Ended September 30, 2018	Cloud		Total
(In thousands)	Telecommunications	Web Services	Reportable
	Segment	Segment	Segments
Major products/services lines			
Desktop devices	$314	$-	$314
Equipment financing revenue	24	-	24
Telecommunications services	2,305	-	2,305
Fees, commissions, and other, recognized over time	162	-	162
One time fees, commissions and other	18	-	18
Website hosting services	-	167	167
Website management services and other	-	36	36
	$2,823	$203	$3,026
Timing of revenue recognition			
Products and fees recognized at a point in time	$332	$-	$332
Services and fees transferred over time	2,491	203	2,694
	$2,823	$203	$3,026

Three Months Ended September 30, 2017	Cloud		Total
(In thousands)	Telecommunications	Web Services	Reportable
	Segment	Segment	Segments
	As Adjusted	As Adjusted	As Adjusted
Major products/services lines			
Desktop devices	$385	$-	$385
Equipment financing revenue	44	-	44
Telecommunications services	1,807	-	1,807
Fees, commissions, and other, recognized over time	106	-	106

One time fees, commissions and other	42	-	42
Website hosting services	-	237	237
Website management services and other	-	23	23
	$2,384	$260	$2,644
Timing of revenue recognition			
Products and fees recognized at a point in time	$427	$-	$427
Services and fees transferred over time	1,957	260	2,217
	$2,384	$260	$2,644

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Nine Months Ended September 30, 2018	Cloud		Total
(In thousands)	Telecommunications	Web Services	Reportable
	Segment	Segment	Segments
Major products/services lines			
Desktop devices	$1,117	$-	$1,117
Equipment financing revenue	83	-	83
Telecommunications services	6,474	-	6,474
Fees, commissions, and other, recognized over time	448	-	448
One time fees, commissions and other	53	-	53
Website hosting services	-	552	552
Website management services and other	-	84	84
	$8,175	$636	$8,811
Timing of revenue recognition			
Products and fees recognized at a point in time	$1,170	$-	$1,170
Services and fees transferred over time	7,005	636	7,641
	$8,175	$636	$8,811

Nine Months Ended September 30, 2017	Cloud		Total
(In thousands)	Telecommunications	Web Services	Reportable
	Segment	Segment	Segments
	As Adjusted	As Adjusted	As Adjusted
Major products/services lines			
Desktop devices	$967	$-	$967
Equipment financing revenue	149	-	149
Telecommunications services	5,063	-	5,063
Fees, commissions, and other, recognized over time	312	-	312
One time fees, commissions and other	77	-	77
Website hosting services	-	728	728
Website management services and other	-	78	78
	$6,568	$806	$7,374
Timing of revenue recognition			

Products and fees recognized at a point in time	$1,044	$-	$1,044
Services and fees transferred over time	5,524	806	6,330
	$6,568	$806	$7,374

Contract balances

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers.

(In thousands)	September 30, 2018	December 31, 2017 As Adjusted
Receivables, which are included in Trade receivables, net of allowance for doubtful accounts	$392	$403
Contract assets	9	3
Contract liabilities	995	988

Significant changes in the contract assets and the contract liabilities balances during the period are as follows:

(In thousands)	Nine Months Ended September 30, 2018		For the Year Ended December 31, 2017 As Adjusted	
	Contract assets	Contract Liabilities	Contract assets	Contract Liabilities
Revenue recognized that was included in the contract liability balance at the beginning of the period	$-	$(833)	$-	$(642)
Increase due to cash received, excluding amounts recognized as revenue during the period	-	840	-	778
Transferred to receivables from contract assets recognized at the beginning of the period	(1)	-	(1)	-
Increase due to additional unamortized discounts	7	-	2	-

Transaction price allocated to the remaining performance obligations

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) at the end of the reporting period (in thousands):

	2018	2019	2020	2021	2022	2023	Total
Desktop devices	$230	-	-	-	-	-	$230
Telecommunications service	$2,287	7,651	5,554	3,756	1,902	354	$21,504
All consideration from contracts with customers is included in the amounts presented above							

The Company applies the transition practical expedient in paragraph 606-10-65-1(f)(3) and does not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the Company expects to recognize that amount as revenue for the year ended December 31, 2017.

4.
Net Loss Per Common Share

Basic net loss per common share is computed by dividing the net loss for the period by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is computed giving effect to all dilutive common stock equivalents, consisting of common stock options and warrants. Diluted net loss per common share for the three and nine months ended September 30, 2018 and 2017 is the same as basic net loss per common share because the common share equivalents were anti-dilutive due to the net loss. The following table sets forth the computation of basic and diluted net loss per common share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
		As Adjusted		As Adjusted
Net loss (in thousands)	$(199)	$(190)	$(215)	$(961)
Weighted-average share reconciliation:				
Weighted-average basic shares outstanding	14,346,092	13,951,480	14,311,190	13,824,307
Diluted shares outstanding	14,346,092	13,951,480	14,311,190	13,824,307
Net loss per common share:				
Basic	$(0.01)	$(0.01)	$(0.02)	$(0.07)
Diluted	$(0.01)	$(0.01)	$(0.02)	$(0.07)

Common stock equivalent shares are not included in the computation of diluted loss per share, as the Company has a net loss and the inclusion of such shares would be anti-dilutive due to the net loss. At September 30, 2018 and 2017, the common stock equivalent shares were, as follows:

	September 30,	September 30,
	2018	2017
Shares of common stock issuable under equity incentive plans outstanding	3,699,695	3,598,710
Common stock equivalent shares excluded from diluted net loss per share	3,699,695	3,598,710

5.
Trade Receivables, net

Our trade receivables balance consists of traditional trade receivables and residual Extended Payment Term Agreements (“EPTAs”) sold prior to July 2011. Below is an analysis of the days outstanding of our trade receivables as shown on our balance sheet (in thousands):

	September 30, 2018	December 31, 2017
Trade receivables	$368	$386
Conforming EPTAs	36	41
Non-Conforming EPTAs:		
1 - 30 days	4	4
31 - 60 days	-	-
61 - 90 days	-	1
Gross trade receivables	408	432
Less: allowance for doubtful accounts	(16)	(29)
Trade receivables, net	$392	$403
Current trade receivables, net	$363	$372
Long-term trade receivables, net	29	31
Trade receivables, net	$392	$403

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All current and long-term EPTAs in the table above had original contract terms of greater than one year. The Company wrote off $1,000 of EPTAs during the nine months ended September 30, 2018 and $13,000 during the year ended December 31, 2017, of which, all had original contract terms of greater than one year.

6.
Equipment Financing Receivables

We rent certain cloud telecommunication equipment (IP telephone devices) through leasing contracts that we classify as either operating leases or sale-type leases. Equipment finance receivables are expected to be collected over the next thirty-six to sixty months. Equipment finance receivables arising from the rental of our cloud telecommunication equipment through sales-type leases, are as follows (in thousands):

	September 30, 2018	December 31, 2017
Gross equipment financing receivables	$321	$264
Less: unearned income	(123)	(90)
Equipment financing receivables, net	198	174
Less: Current portion of equipment finance receivables, net	(70)	(116)
Long-term equipment finance receivables, net	$128	$58

7.
Prepaid Expenses

Prepaid expenses consisted of the following (in thousands):

	September 30, 2018	December 31, 2017 As Adjusted
Prepaid corporate insurance	$70	$44
Prepaid software services	40	17
Prepaid tax liability deposit	34	-
Prepaid inventory deposits	26	117
Other prepaid expenses	83	73
Total prepaid expenses	$253	$251

8.
Intangible Assets

The net carrying amount of intangible assets is as follows (in thousands):

	September 30, 2018	December 31, 2017
Customer relationships	$941	$941
Less: accumulated amortization	(756)	(702)
Total	$185	$239

Amortization expense is included in general and administrative expenses and totaled $18,000 and $24,000 for the three months ended September 30, 2018 and 2017, respectively, and $54,000 and $73,000 for the nine months ended September 30, 2018 and 2017, respectively.

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9.
Accrued Expenses

Accrued expenses consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Accrued wages and benefits	$457	$303
Accrued accounts payable	223	242
Accrued sales and telecommunication taxes	422	343
Other	152	73
Total accrued expenses	$1,254	$961

10.
Notes Payable

Related-Party Note Payable

On December 30, 2015, Crexendo, Inc. (the "Company") entered into a Term Loan Agreement (the "Loan Agreement"), with Steven G. Mihaylo, as Trustee of The Steven G. Mihaylo Trust dated August 19, 1999 (the "Lender"). Mr. Mihaylo is the principal shareholder and Chief Executive Officer of the Company. The term of the Loan is five years, with simple interest paid at 9% per annum until a balloon payment is due December 30, 2020. The Loan Agreement provides for interest to be paid in shares of common stock of the Company (the “Common Stock”) at a stock price of $1.20. For the first two years of the Loan term, interest will be paid in advance at the beginning of each year; for the last three years of the Loan term, interest will be paid at the end of each year. After the second year of the Loan term, there is no pre-payment penalty for early repayment of the outstanding principal amount of the Loan. If the Loan is repaid within the first two years of the Loan term, the Company will forfeit prepaid interest as a pre-payment penalty.

In February 2017, the Company entered into a second amendment to our Loan Agreement with Steven G. Mihaylo. The amendment extends the ability of the Board of Directors to request the remaining $1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018. All other terms remain the same as initial loan agreement.

In September 2017, Steven G. Mihaylo exercised 444,999 options for a total strike price of $974,000. In December 2017, Steven G. Mihaylo exercised 12,001 options for a total strike price of $22,000. The Company used the proceeds from the stock options exercise to repay $996,000 of the $1.0 million outstanding related party note payable. During the year ended December 31, 2017, the Company accelerated the amortization of the debt discount in the amount of $77,000 as a result of the repayment.

In September 2018, the Company repaid the remaining $4,000 of the $1.0 million related party note payable.

Other Notes Payable

Other notes payable consists of short and long-term financing arrangements for software licenses, subscriptions, support and corporate insurance policies.

The Company's outstanding balances under its note payable agreements were as follows (in thousands):

	September 30, 2018	December 31, 2017
Related-party note payable	$-	$4
Other notes payable	74	75
Total notes payable	74	79
Less: notes payable, current portion	(74)	(69)
Notes payable, net of current portion	$-	$10

As of September 30, 2018, future principal payments are scheduled as follows (in thousands):

Year ending December 31,	
2018	$33
2019	41
Total	$74

11.
Fair Value Measurements

We have financial instruments as of September 30, 2018 and December 31, 2017 for which the fair value is summarized below (in thousands):

	September 30, 2018		December 31, 2017	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets:				
Trade receivables, net	$392	$392	$403	$403
Equipment financing receivables	198	198	174	174
Liabilities:				
Capital lease obligations	150	150	-	-
Notes payable	74	74	79	79

12.
Income Taxes

Our effective tax rate for the three and nine months ended September 30, 2018 was (4.3)% and (7.6)%, respectively, which resulted in an income tax provision of $(8,000) and $(15,000), respectively. The tax provision is due to state tax payments made with extensions filed.

Our effective tax rate for the three and nine months ended September 30, 2017 was (4.4)% and (1.7)%, respectively, which resulted in an income tax provision of $(8,000) and $(16,000), respectively. The tax provision is due to state tax payments made with extensions filed.

Significant management judgment is required in determining our provision for income taxes and in determining whether deferred tax assets will be realized in full or in part. In assessing the recovery of the deferred tax assets, we considered whether it is more likely than not that some portion or all of our deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in the periods in which those temporary differences become deductible. We considered the scheduled reversals of future deferred tax assets, projected future taxable income, the suspension of the sale of product and services through the seminar sales channel, and tax planning strategies in making this assessment. As a result, we determined it was more likely than not that the deferred tax assets would not be realized; accordingly, we recorded a full valuation allowance. Subsequent to placing a full valuation allowance on our net deferred tax assets, adjustments impacting our tax rate have been and are expected to continue to be insignificant.

13.
Commitments and Contingencies

Capital Lease Obligations

The Company leases equipment and support under a capital lease agreement which extends through 2023. The outstanding balance for capital leases was $150,000 and $0 as of September 30, 2018 and December 31, 2017, respectively. The Company recorded assets under capital lease obligations of $129,000 and $0 as of September 30, 2018 and December 31, 2017, respectively. Related accumulated depreciation totaled $9,000 and $0 as of September 30, 2018 and December 31, 2017, respectively. The $25,000 support contract has been classified as a prepaid expense that will be amortized over the service period of 3 years. Amortization expense is included in general and administrative expenses and totaled $2,000 and $0 for the three months ended September 30, 2018 and 2017, respectively, and $6,000 and $0 for the nine months ended September 30, 2018 and 2017, respectively. The interest rate on the capital lease obligation is 6.7% and interest expense was $2,000 and $0 for the three months ended September 30, 2018 and 2017, respectively. Interest expense was $2,000 and $0 for the nine months ended September 30, 2018 and 2017, respectively. Future minimum capital lease payments at September 30, 2018 were as follows (in thousands):

Year ending September 30,	
2018	$9
2019	36
2020	37
2021	36
2022	37
2023	21
Total minimum lease payments	176
Less: amount representing interest	26
Present value of minimum lease payments	$150

Operating Leases

We lease office space under non-cancelable operating lease agreements. We had one lease agreement in Reno, NV, which expired at the end of the third quarter of 2018. The operating lease for our Reno, NV office contained customary escalation clauses. Rental expense incurred on operating leases for the three months ended September 30, 2018 and 2017 was approximately $5,000 and $5,000, respectively. Rental expense incurred on operating leases for the nine months ended September 30, 2018 and 2017 was approximately $15,000 and $15,000, respectively.

Sale-Leaseback

On February 28, 2014, the Company sold and leased back the land, building and furniture associated with the corporate headquarters in Tempe, Arizona to a Company that is owned by the major shareholder and CEO of the Company for $2.0 million in cash. The Company recognized a deferred gain of $281,000 on sale-leaseback, which was amortized over the initial lease term of thirty-six months to offset rent expense. Deferred gain amortization for the three months ended September 30, 2018 and 2017 was $0 and $0, respectively. Deferred gain amortization for the nine months ended September 30, 2018 and 2017 was $0 and $16,000, respectively.

Effective March 1, 2017 the rent agreement was renewed for a three year term with rent payable in cash. Rent expense incurred on the sale-leaseback during the three months ended September 30, 2018 and 2017 was $75,000 and $75,000, respectively. Rent expense incurred on the sale-leaseback during the nine months ended September 30, 2018 and 2017 was $225,000 and $213,000, respectively.

Future aggregate minimum lease obligations under the operating lease as of September 30, 2018, exclusive of taxes and insurance, are as follows (in thousands):

Year ending December 31,	
2018	$75
2019	300
2020	50
Total	$425

14.
Segments

Management has chosen to organize the Company around differences based on its products and services. Cloud Telecommunications segment generates revenue from selling cloud telecommunication products and services and broadband Internet services. Web Services segment generates revenue from website hosting and other professional services. The Company has two operating segments, which consist of Cloud Telecommunications and Web Services. Segment revenue and loss before income tax provision are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
		As Adjusted		As Adjusted
Revenue:				
Cloud telecommunications	$2,823	$2,384	$8,175	$6,568
Web services	203	260	636	806
Consolidated revenue	3,026	2,644	8,811	7,374
Income/(loss) from operations:				
Cloud telecommunications	(284)	(196)	(528)	(1,132)
Web services	91	142	322	377
Total operating loss	(193)	(54)	(206)	(755)
Other income/(expense), net:				
Cloud telecommunications	-	(122)	7	(184)
Web services	2	(6)	(1)	(6)
Total other income/(expense), net	2	(128)	6	(190)
Income/(loss) before income tax provision:				
Cloud telecommunications	(284)	(318)	(521)	(1,316)
Web services	93	136	321	371

Loss before income tax provision	$(191)	$(182)	$(200)	$(945)

Depreciation and amortization was $24,000 and $23,000 for the Cloud Telecommunications segment for the three months ended September 30, 2018 and 2017, respectively. Depreciation and amortization was $61,000 and $73,000 for the Cloud Telecommunications segment for the nine months ended September 30, 2018 and 2017, respectively. Depreciation and amortization was $2,000 and $3,000 for the Web Services segment for the three months ended September 30, 2018 and 2017, respectively. Depreciation and amortization was $5,000 and $8,000 for the Web Services segment for the nine months ended September 30, 2018 and 2017, respectively.

Interest income was $1,000 and $3,000 for the Web Services segment for the three months ended September 30, 2018 and 2017, respectively. Interest income was $5,000 and $8,000 for the Web Services segment for the nine months ended September 30, 2018 and 2017, respectively.

Interest expense was $5,000 and $123,000 for the Cloud Telecommunications segment for the three months ended September 30, 2018 and 2017, respectively. Interest expense was $8,000 and $186,000 for the Cloud Telecommunications segment for the nine months ended September 30, 2018 and 2017, respectively. Interest expense was $0 and $12,000 for the Web Services segment for the three months ended September 30, 2018 and 2017, respectively. Interest expense was $0 and $20,000 for the Web Services segment for the nine months ended September 30, 2018 and 2017, respectively.

Item 2.
Management's Discussion and Analysis of Financial Condition and Results of Operations

This section and other parts of this Form 10-Q contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," and similar terms. Forward-looking statements are not guarantees of future performance and our Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A, "Risk Factors," which are incorporated herein by reference. The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K") filed with the SEC and the Condensed Consolidated Financial Statements and notes thereto included in the 2018 Form 10-Qs and elsewhere in this Form 10-Q. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

OVERVIEW

Crexendo, Inc. is a next-generation CLEC and an award-winning leader and provider of unified communications cloud telecom services, broadband Internet services, and other cloud business services that are designed to provide enterprise-class cloud services to any size business at affordable monthly rates. The Company has two operating segments, which consist of Cloud Telecommunications and Web Services.

Cloud Telecommunications - Our cloud telecommunications services transmit calls using IP or cloud technology, which converts voice signals into digital data packets for transmission over the Internet or cloud. Each of our calling plans provides a number of basic features typically offered by traditional telephone service providers, plus a wide range of enhanced features that we believe offer an attractive value proposition to our customers. This platform enables a user, via a single "identity" or telephone number, to access and utilize services and features regardless of how the user is connected to the Internet or cloud, whether it's from a desktop device or an application on a mobile device.

We generate recurring revenue from our cloud telecommunications and broadband Internet services. Our cloud telecommunications contracts typically have a thirty-six to sixty month term. We generate product revenue and equipment financing revenue from the sale and lease of our cloud telecommunications equipment. Revenues from the sale of equipment, including those from sales-type leases, are recognized at the time of sale or at the inception of the lease, as appropriate.

Our Cloud Telecommunications service revenue increased 26% or $510,000 to $2,509,000 for the three months ended September 30, 2018 as compared to $1,999,000 for the three months ended September 30, 2017. Cloud Telecommunications service revenue increased 26% or $1,457,000 to $7,058,000 for the nine months ended September 30, 2018 as compared to $5,601,000 for the nine months ended September 30, 2017. Our Cloud Telecommunications product revenue decreased 18% or $71,000 to $314,000 for the three months ended September 30, 2018 as compared to $385,000 for the three months ended September 30, 2017. Cloud Telecommunications product revenue increased 16% or $150,000 to $1,117,000 for the nine months ended September 30, 2018 as compared to $967,000 for the nine months ended September 30, 2017. As of September 30, 2018 and 2017, our backlog was $21,734,000 and $18,264,000, respectively.

Web Services - We generate recurring revenue from website hosting and other professional services.

Our Web Services revenue decreased 22% or $57,000 to $203,000 for the three months ended September 30, 2018 as compared to $260,000 for the three months ended September 30, 2017. Our Web Services revenue decreased 21% or $170,000 to $636,000 for the nine months ended September 30, 2018 as compared to $806,000 for the nine months ended September 30, 2017.

OUR SERVICES AND PRODUCTS

Our goal is to provide a broad range of cloud-based products and services that nearly eliminate the cost of a businesses' technology infrastructure and enable businesses of any size to more efficiently run their business. By providing a variety of comprehensive and scalable solutions, we are able to cater to businesses of all sizes on a monthly subscription basis without the need for expensive capital investments, regardless of where their business is in its lifecycle. Our products and services can be categorized in the following offerings:

Cloud Telecommunications - Our cloud telecommunications service offering includes hardware, software, and unified communication solutions for businesses using IP or cloud technology over any high-speed Internet connection. These services are rendered through a variety of devices and user interfaces such as a Crexendo branded desktop phones and/or mobile and desktop applications. Some examples of mobile devices are Android cell phones, iPhones, iPads or Android tablets. These services enable our customers to seamlessly communicate with others through phone calls that originate/terminate on our network or PSTN networks. Our cloud telecommunications services are powered by our proprietary implementation of standards based Web and VoIP cloud technologies. Our services use our highly scalable complex infrastructure that we build and manage based on industry standard best practices to achieve greater efficiencies, better quality of service (QoS) and customer satisfaction. Our infrastructure comprises of compute, storage, network technologies, 3rd party products and vendor relationships. We also develop end user portals for account management, license management, billing and customer support and adopt other cloud technologies through our partnerships.

Crexendo's cloud telecommunication service offers a wide variety of essential and advanced features for businesses of all sizes. Many of these features included in the service offering are:

Business Productivity Features such as dial-by extension and name, transfer, conference, call recording, Unlimited calling to anywhere in the US and Canada, International calling, Toll free (Inbound and Outbound)

Individual Productivity Features such as Caller ID, Call Waiting, Last Call Return, Call Recording, Music/Message-On-Hold, Voicemail, Unified Messaging, Hot-Desking

Group Productivity Features such as Call Park, Call Pickup, Interactive Voice Response (IVR), Individual and Universal Paging, Corporate Directory, Multi-Party Conferencing, Group Mailboxes, Web and mobile devices based collaboration applications

Call Center Features such as Automated Call Distribution (ACD), Call Monitor, Whisper and Barge, Automatic Call Recording, One way call recording, Analytics

Advanced Unified Communication Features such as Find-Me-Follow-Me, Sequential Ring and Simultaneous Ring, Voicemail transcription

Mobile Features such as extension dialing, transfer and conference and seamless hand-off from WiFi to/from 3G and 4G, LTE, as well as other data services. These features are also available on CrexMo, an intelligent mobile application for iPhones and Android smartphones, as well as iPads and Android tablets

Traditional PBX Features such as Busy Lamp Fields, System Hold. 16-48 Port density Analog Devices

Expanded Desktop Device Selection such as Entry Level Phone, Executive Desktop, DECT Phone for roaming users

Advanced Faxing solution such as Cloud Fax (cFax) allowing customers to send and receive Faxes from their Email Clients, Mobile Phones and Desktops without having to use a Fax Machine simply by attaching a file

Web based online portal to administer, manage and provision the system.

Asynchronous communication tools like SMS/MMS, chat and document sharing to keep in pace with emerging communication trends.

Many of these services are included in our basic offering to our customers for a monthly recurring fee and do not require a capital expense. Some of the advanced features such as Automatic Call Recording and Call Center Features require additional monthly fees. Crexendo continues to invest and develop its technology and CPaaS offerings to make them more competitive and profitable.

Website Services - Our website services segment allows businesses to host their websites in our data center for a recurring monthly fee.

RESULTS OF OPERATIONS

The following discussion of financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and notes thereto and other financial information included elsewhere in this Form 10-Q.

Results of Consolidated Operations (in thousands, except for per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Service revenue	$2,712	$2,259	$7,694	$6,407
Product revenue	$314	$385	$1,117	$967
Total revenue	$3,026	$2,644	$8,811	$7,374
Loss before income taxes	(191)	(182)	(200)	(945)
Income tax provision	(8)	(8)	(15)	(16)
Net loss	(199)	(190)	(215)	(961)
Basic net loss per share	$(0.01)	$(0.01)	$(0.02)	$(0.07)
Diluted net loss per share	$(0.01)	$(0.01)	$(0.02)	$(0.07)

Three months ended September 30, 2018 compared to three months ended September 30, 2017

Service revenue

Service revenue consists primarily of fees collected for cloud telecommunications services, professional services, interest from sales-type leases, broadband Internet services, administrative fees, website hosting, and web management services. Service revenue increased 20% or $453,000, to $2,712,000 for the three months ended September 30, 2018 as compared to $2,259,000 for the three months ended September 30, 2017. Cloud Telecommunications service revenue increased 26% or $510,000, to $2,509,000 for the three months ended September 30, 2018 as compared to $1,999,000 for the three months ended September 30, 2017. Web service revenue decreased 22% or $57,000, to $203,000 for the three months ended September 30, 2018 as compared to $260,000 for the three months ended September 30, 2017.

Product Revenue

Product revenue consists primarily of fees collected for the sale of desktop phone devices and third party equipment. Product revenue decreased by 18% or $71,000, to $314,000 for the three months ended September 30, 2018 as compared to $385,000 for the three months ended September 30, 2017. Product revenue fluctuates from one period to the next based on timing of installations. Our typical customer installation is complete within 30 days. However, larger enterprise customers can take multiple months, depending on size and the number of locations. Product revenue is recognized when products have been installed and services commence. We believe growth will initially be seen through increase in our backlog.

Loss Before Income Taxes

Loss before income tax increased 5% or $9,000, to $191,000 for the three months ended September 30, 2018 as compared to $182,000 for the three months ended September 30, 2017. The increase in loss before income tax is primarily due to the increase in revenue of $382,000 and a decrease in interest expense of $130,000, offset by an increase in operating expenses of $521,000.

Income Tax Provision

We had an income tax provision of $8,000 for the three months ended September 30, 2018 compared to an income tax provision of $8,000 for the three months ended September 30, 2017. We had pre-tax loss for the three months ended September 30, 2018 and 2017 of $191,000 and $182,000, respectively, and a full valuation allowance on all of our deferred tax assets for the three months ended September 30, 2018 and 2017.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017

Service revenue

Service revenue consists primarily of fees collected for cloud telecommunications services, professional services, interest from sales-type leases, broadband Internet services, administrative fees, website hosting, and web management services. Service revenue increased 20% or $1,287,000, to $7,694,000 for the nine months ended September 30, 2018 as compared to $6,407,000 for the nine months ended September 30, 2017. Cloud Telecommunications service revenue increased 26% or $1,457,000, to $7,058,000 for the nine months ended September 30, 2018 as compared to $5,601,000 for the nine months ended September 30, 2017. Web service revenue decreased 21% or $170,000, to $636,000 for the nine months ended September 30, 2018 as compared to $806,000 for the nine months ended September 30, 2017.

Product Revenue

Product revenue consists primarily of fees collected for the sale of desktop phone devices and third party equipment. Product revenue increased by 16% or $150,000, to $1,117,000 for the nine months ended September 30, 2018 as compared to $967,000 for the nine months ended September 30, 2017. Product revenue fluctuates from one period to the next based on timing of installations. Our typical customer installation is complete within 30 days. However, larger enterprise customers can take multiple months, depending on size and the number of locations. Product revenue is recognized when products have been installed and services commence. We believe growth will initially be seen through increase in our backlog.

Loss Before Income Taxes

Loss before income tax decreased 79% or $745,000, to $200,000 for the nine months ended September 30, 2018 as compared to loss before income tax of $945,000 for the nine months ended September 30, 2017. The decrease in loss before income tax is primarily due to the increase in revenue of $1,437,000 and an increase in other income of $196,000 due to a decrease in interest expense, offset by an increase in operating expenses of $888,000.

Income Tax Provision

We had an income tax provision of $15,000 for the nine months ended September 30, 2018 compared to an income tax provision of $16,000 for the nine months ended September 30, 2017. We had a pre-tax loss for the nine months ended September 30, 2018 and 2017 of $200,000 and $945,000, respectively, and a full valuation allowance on all of our deferred tax assets for the nine months ended September 30, 2018 and 2017.

USE OF NON-GAAP FINANCIAL MEASURES

To evaluate our business, we consider and use non-generally accepted accounting principles (“Non-GAAP”) net income (loss) and Adjusted EBITDA as a supplemental measure of operating performance. These measures include the same adjustments that management takes into account when it reviews and assesses operating performance on a period-to-period basis. We consider Non-GAAP net income (loss) to be an important indicator of overall business performance because it allows us to evaluate results without the effects of share-based compensation, rent expense paid with common stock, interest expense paid with common stock, and amortization of intangibles. We define EBITDA as U.S. GAAP net income (loss) before interest income, interest expense, other income and expense, provision for income taxes, and depreciation and amortization. We believe EBITDA provides a useful metric to investors to compare us with other companies within our industry and across industries. We define Adjusted EBITDA as EBITDA adjusted for share-based compensation, and rent expense paid with stock. We use Adjusted EBITDA as a supplemental measure to review and assess operating performance. We also believe use of Adjusted EBITDA facilitates investors' use of operating performance comparisons from period to period, as well as across companies.

In our November 6, 2018 earnings press release, as furnished on Form 8-K, we included Non-GAAP net income (loss), EBITDA and Adjusted EBITDA. The terms Non-GAAP net income (loss), EBITDA, and Adjusted EBITDA are not defined under U.S. GAAP, and are not measures of operating income, operating performance or liquidity presented in analytical tools, and when assessing our operating performance, Non-GAAP net income (loss), EBITDA, and Adjusted EBITDA should not be considered in isolation, or as a substitute for net loss or other consolidated income statement data prepared in accordance with U.S. GAAP. Some of these limitations include, but are not limited to:

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EBITDA and Adjusted EBITDA do not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;

they do not reflect changes in, or cash requirements for, our working capital needs;

they do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt that we may incur;

they do not reflect income taxes or the cash requirements for any tax payments;

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will be replaced sometime in the future, and EBITDA and Adjusted EBITDA do not reflect any cash requirements for such replacements;

while share-based compensation is a component of operating expense, the impact on our financial statements compared to other companies can vary significantly due to such factors as the assumed life of the options and the assumed volatility of our common stock; and

other companies may calculate EBITDA and Adjusted EBITDA differently than we do, limiting their usefulness as comparative measures.

We compensate for these limitations by relying primarily on our U.S. GAAP results and using Non-GAAP net income (loss), EBITDA, and Adjusted EBITDA only as supplemental support for management's analysis of business performance. Non-GAAP net income (loss), EBITDA and Adjusted EBITDA are calculated as follows for the periods presented.

RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

In accordance with the requirements of Regulation G issued by the SEC, we are presenting the most directly comparable U.S. GAAP financial measures and reconciling the unaudited Non-GAAP financial metrics to the comparable U.S. GAAP measures.

Reconciliation of U.S. GAAP Net Loss to Non-GAAP Net Income/(Loss)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
		As Adjusted		As Adjusted

	(In thousands)		(In thousands)	
U.S. GAAP net loss	$(199)	$(190)	$(215)	$(961)
Share-based compensation	169	89	344	481
Amortization of rent expense paid in stock, net of deferred gain	-	-	-	38
Amortization of intangible assets	18	24	54	73
Non-cash interest expense	-	132	-	198
Non-GAAP net income/(loss)	$(12)	$55	$183	$(171)
Non-GAAP net income/(loss) per common share:				
Basic	$(0.00)	$0.00	$0.01	$(0.01)
Diluted	$(0.00)	$0.00	$0.01	$(0.01)
Weighted-average common shares outstanding:				
Basic	14,346,092	13,951,480	14,311,190	13,824,307
Diluted	14,346,092	14,278,141	15,130,602	13,824,307

Reconciliation of U.S. GAAP Net Loss to EBITDA to Adjusted EBITDA

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
		As Adjusted		As Adjusted
	(In thousands)		(In thousands)	
U.S. GAAP net loss	$(199)	$(190)	$(215)	$(961)
Depreciation and amortization	26	26	66	81
Interest expense	5	135	8	205
Interest and other income	(7)	(7)	(14)	(15)
Income tax provision	8	8	15	16
EBITDA	(167)	(28)	(140)	(674)
Share-based compensation	169	89	344	481
Amortization of rent expense paid in stock, net of deferred gain	-	-	-	38
Adjusted EBITDA	$2	$61	$204	$(155)

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our financial statements, we make estimates, assumptions and judgments that can have a significant impact on our revenue, operating income or loss and net income or loss, as well as on the value of certain assets and liabilities on our balance sheet. We believe that the estimates, assumptions and judgments involved in our accounting policies described in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2017 have the greatest potential impact on our financial statements, so we consider them to be our critical accounting policies and estimates. Our senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-Q with the Audit Committee of our Board of Directors.

Segment Operating Results

The Company has two operating segments, which consist of Cloud Telecommunications and Web Services. The information below is organized in accordance with our two reportable segments. Segment operating income (loss) is equal to segment net revenue less segment cost of service revenue, cost of product revenue, sales and marketing, research and development, and general and administrative expenses.

Operating Results of our Cloud Telecommunications Segment (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cloud Telecommunications		As Adjusted		As Adjusted
Service revenue	$2,509	$1,999	$7,058	$5,601
Product revenue	314	385	1,117	967
Total revenue	2,823	2,384	8,175	6,568
Operating expenses:				
Cost of service revenue	797	641	2,209	1,884
Cost of product revenue	161	151	549	383
Research and development	207	187	570	550
Selling and marketing	910	735	2,506	2,081
General and administrative	1,032	866	2,869	2,802
Total operating expenses	3,107	2,580	8,703	7,700
Operating loss	(284)	(196)	(528)	(1,132)
Other income/(expense)	-	(122)	7	(184)
Loss before tax provision	$(284)	$(318)	$(521)	$(1,316)

Three months ended September 30, 2018 compared to three months ended September 30, 2017

Service Revenue

Cloud Telecommunications service revenue consists primarily of fees collected for cloud telecommunications services, professional services, interest from sales-type leases, administrative fees, and broadband Internet services. Service revenue increased 26% or $510,000, to $2,509,000 for the three months ended September 30, 2018 as compared to $1,999,000 for the three months ended September 30, 2017. The increase in service revenue is due to an increase in contracted service revenue, usage charges, and professional services revenue of $530,000, offset by a decrease in sales-type lease interest of $20,000. A substantial portion of Cloud Telecommunications service revenue is generated through thirty-six to sixty month service contracts. As such, we believe growth in Cloud Telecommunications segment will initially be seen through increases in our backlog.

Product Revenue

Product revenue consists primarily of fees collected for the sale of desktop phone devices and third party equipment. Product revenue decreased 18% or $71,000, to $314,000 for the three months ended September 30, 2018 as compared to $385,000 for the three months ended September 30, 2017. Product revenue fluctuates from one period to the next based on timing of installations. Our typical customer installation is complete within 30 days. However, larger enterprise customers can take multiple months, depending on size and the number of locations. Product revenue is recognized when products have been installed and services commence. We believe growth will initially be seen through increases in our backlog.

Backlog

Backlog represents the total contract value of all contracts signed, less revenue recognized from those contracts as of September 30, 2018 and 2017. Below is a table which displays the Cloud Telecommunications segment revenue backlog as of July 1, 2018 and 2017, and September 30, 2018 and 2017, which we expect to recognize as revenue within the next thirty-six to sixty months (in thousands):

Cloud Telecommunications backlog as of July 1, 2018	$20,774
Cloud Telecommunications backlog as of September 30, 2018	$21,734
Cloud Telecommunications backlog as of July 1, 2017	$18,045
Cloud Telecommunications backlog as of September 30, 2017	$18,264

Cost of Service Revenue

Cost of service revenue consists primarily of fees we pay to third-party telecommunications carriers and software providers, broadband Internet fees, and costs related to installations and customer support salaries and benefits. Cost of service revenue increased 24% or $156,000, to $797,000 for the three months ended September 30, 2018 as compared to $641,000 for the three months ended September 30, 2017. The increase in cost of service revenue was primarily due to an increase in stock options expense of $62,000, an increase in salary and benefits of $55,000 due to an increase in headcount, an increase in bandwidth costs of $28,000, and an increase in credit card processing fees of $11,000.

Cost of Product Revenue

Cost of product revenue consists of the costs associated with the purchase of desktop phone devices and third party equipment. Cost of product revenue increased 7% or $10,000, to $161,000 for the three months ended September 30, 2018 as compared to $151,000 for the three months ended September 30, 2017. The increase is primarily due to a higher volume of replacement phones being sent out to customers and lower quality phones being replaced with higher quality phones.

Research and Development

Research and development expenses primarily consist of payroll and related expenses, related to the development of new cloud telecommunications features and products. Research and development salary expenses increased 11% or $20,000, to $207,000 for the three months ended September 30, 2018 as compared to $187,000 for the three months ended September 30, 2017 due to fluctuations in salary and benefits.

Selling and Marketing

Selling and marketing expenses consist primarily of direct and channel sales representative salaries and benefits, partner channel commissions, amortization of costs to acquire contracts, tradeshows, the production of marketing materials, and sales support software. Selling and marketing expenses increased 24% or $175,000, to $910,000 for the three months ended September 30, 2018 as compared to $735,000 for the three months ended September 30, 2017. The increase in selling and marketing expense was due to an increase in salaries and benefits of $112,000, an increase in commission expenses of $48,000 directly related to an increase in revenue, an increase in business development costs of $10,000, which includes trade shows and other marketing materials, and an increase of $9,000 for travel, offset by a decrease in stock options expense of $4,000.

General and Administrative

General and administrative expenses consist of salaries and benefits for executives, administrative personnel, legal, rent, accounting and other professional services, and other administrative corporate expenses. General and administrative expenses increased 19% or $166,000, to $1,032,000 for the three months ended September 30, 2018 as compared to $866,000 for the three months ended September 30, 2017. Consolidated general and administrative expenses increased 15%, or $147,000 to $1,101,000 for the three months ended September 30, 2018 as compared to $954,000 for the three months ended September 30, 2017. As Web Services segment revenue continues to decrease and Cloud Telecommunications segment revenue continues to increase, a higher percentage of general and administrative costs are being allocated to the Cloud Telecommunications segment. The increase in consolidated general and administrative expenses is primarily due to an increase in administrative salaries and benefits of $42,000, an increase in accounting and other professional services of $32,000, an increase in office equipment and software of $43,000, an increase in repairs and maintenance of $25,000, an increase in stock options expense of $21,000, and an increase in other administrative corporate expenses of $2,000, offset by a decrease in shareholder and investor relations expense of $18,000.

Other Expense

Other expense primarily relates to the allocated portions of interest expense, offset by sublease rental income. Net other expense decreased 100% or $122,000, to $0 for the three months ended September 30, 2018 as compared to $122,000 for the three months ended September 30, 2017. The decrease is due to a decrease in interest expense of $117,000 related to the related party note payable, which was substantially paid off in September 2017, and an increase in sublease income of $5,000 resulting from a sub-lease signed in the fourth quarter of 2017.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017

Service Revenue

Cloud Telecommunications service revenue consists primarily of fees collected for cloud telecommunications services, professional services, interest from sales-type leases, administrative fees, and broadband Internet services. Service revenue increased 26% or $1,457,000, to $7,058,000 for the nine months ended September 30, 2018 as compared to $5,601,000 for the nine months ended September 30, 2017. The increase in service revenue is due to an increase in contracted service revenue, usage charges, and professional services revenue of $1,523,000, offset by a decrease in sales-type lease interest of $66,000. A substantial portion of Cloud Telecommunications service revenue is generated through thirty-six to sixty month service contracts. As such, we believe growth in Cloud Telecommunications segment will initially be seen through increases in our backlog.

Product Revenue

Product revenue consists primarily of fees collected for the sale of desktop phone devices and third party equipment. Product revenue increased 16% or $150,000, to $1,117,000 for the nine months ended September 30, 2018 as compared to $967,000 for the nine months ended September 30, 2017. Product revenue fluctuates from one period to the next based on timing of installations. Our typical customer installation is complete within 30 days. However, larger enterprise customers can take multiple months, depending on size and the number of locations. Product revenue is recognized when products have been installed and services commence. We believe growth will initially be seen through increases in our backlog.

Backlog

Backlog represents the total contract value of all contracts signed, less revenue recognized from those contracts as of September 30, 2018 and 2017. Below is a table which displays the Cloud Telecommunications segment revenue backlog as of January 1, 2018 and 2017, and September 30, 2018 and 2017, which we expect to recognize as revenue within the next thirty-six to sixty months (in thousands):

Cloud Telecommunications backlog as of January 1, 2018	$19,871
Cloud Telecommunications backlog as of September 30, 2018	$21,734
Cloud Telecommunications backlog as of January 1, 2017	$15,921
Cloud Telecommunications backlog as of September 30, 2017	$18,264

Cost of Service Revenue

Cost of service revenue consists primarily of fees we pay to third-party telecommunications carriers and software providers, broadband Internet fees, and costs related to installations and customer support. Cost of service revenue increased 17% or $325,000, to $2,209,000 for the nine months ended September 30, 2018 as compared to $1,884,000 for the nine months ended September 30, 2017. The increase in cost of service revenue was primarily due to an increase in salaries and benefits of $156,000 as a result of an increase in headcount, an increase in bandwidth costs of $84,000, an increase in stock options expense of $49,000, an increase in credit card processing fees of $31,000, and a $5,000 increase in freight and other installation costs. These increases are directly related to the growth in monthly recurring revenue.

Cost of Product Revenue

Cost of product revenue consists of the costs associated with the purchase of desktop phone devices and third party equipment. Cost of product revenue increased 43% or $166,000, to $549,000 for the nine months ended September 30, 2018 as compared to $383,000 for the nine months ended September 30, 2017. The increase is primarily due to the increase in product sales and an increase in shipping costs.

Research and Development

Research and development expenses primarily consist of payroll and related expenses, related to the development of new cloud telecommunications features and products. Research and development salary expenses increased 4% or $20,000, to $570,000 for the nine months ended September 30, 2018 as compared to $550,000 for the nine months ended September 30, 2017 due to fluctuations in salary and benefits.

Selling and Marketing

Selling and marketing expenses consist primarily of direct and channel sales representative salaries and benefits, partner channel commissions, amortization of costs to acquire contracts, tradeshows, the production of marketing materials, and sales support software. Selling and marketing expenses increased 20% or $425,000, to $2,506,000 for the nine months ended September 30, 2018 as compared to $2,081,000 for the nine months ended September 30, 2017. The increase in selling and marketing expense was due to an increase in commission expenses of $239,000 directly related to an increase in revenue, an increase in salaries and benefits of $160,000, an increase in travel expenses of $24,000, an increase in bad debt of $6,000, and an increase in stock options expense of $5,000, offset by a decrease in business development costs of $9,000, which includes trade shows and other marketing materials.

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General and Administrative

General and administrative expenses consist of salaries and benefits for executives, administrative personnel, legal, rent, accounting and other professional services, and other administrative corporate expenses. General and administrative expenses increased 2% or $67,000, to $2,869,000 for the nine months ended September 30, 2018 as compared to $2,802,000 for the nine months ended September 30, 2017. Consolidated general and administrative expenses decreased 2%, or $54,000 to $3,080,000 for the nine months ended September 30, 2018 as compared to $3,134,000 for the nine months ended September 30, 2017. As Web Services segment revenue continues to decrease and Cloud Telecommunications segment revenue continues to increase, a higher percentage of general and administrative costs are being allocated to the Cloud Telecommunications segment. The decrease in consolidated general and administrative expenses is primarily due to a decrease in stock options expense of $179,000, a decrease in shareholder and investor relations expense of $7,000, and a decrease in office equipment and software of $47,000, offset by an increase in administrative salaries and benefits of $37,000, an increase in accounting and other professional services of $104,000, an increase in rent expense of $9,000, an increase in repairs and maintenance of $23,000, and an increase in other administrative corporate expenses of $6,000.

Other Income/(Expense)

Other income/(expense) primarily relates to the allocated portions of interest expense, offset by sublease rental income. Net other expense decreased 104% or $191,000, to $7,000 of net other income for the nine months ended September 30, 2018 as compared to net other expense of $(184,000) for the nine months ended September 30, 2017. The decrease is due to a decrease in interest expense of $179,000 related to the related party note payable, which was substantially paid off in September 2017, and an increase in sublease income of $12,000 resulting from a sub-lease signed in the fourth quarter of 2017.

Operating Results of Web Services segment (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Web Services		As Adjusted		As Adjusted
Service revenue	$203	$260	$636	$806
Operating expenses:				
Cost of service revenue	36	23	84	78
Research and development	7	7	19	19
General and administrative	69	88	211	332
Total operating expenses	112	118	314	429
Operating income	91	142	322	377
Other income/(expense)	2	(6)	(1)	(6)
Income before tax provision	$93	$136	$321	$371

Three months ended September 30, 2018 compared to three months ended September 30, 2017

Service Revenue

Service revenue is generated primarily through website hosting, professional web management services, and extended payment term agreements (EPTAs). Web Services segment revenue decreased 22% or $57,000, to $203,000 for the three months ended September 30, 2018 as compared to $260,000 for the three months ended September 30, 2017. The decrease in service revenue is primarily due to a decrease in hosting revenue of $47,000 and a $10,000 decrease in EPTA revenue due to a decrease in outstanding receivables.

Cost of Service Revenue

Cost of service revenue consists primarily of bandwidth, customer service costs, and credit card processing fees. Cost of service revenue increased 57% or $13,000, to $36,000 for the three months ended September 30, 2018 as compared to $23,000 for the three months ended September 30, 2017. The increase in cost of revenue is primarily related to an increase in customer service salaries and wages costs of $11,000 from an increase in web support requests for SSL certificates, an increase in stock option expense of $3,000, offset by a decrease in credit card fees of $1,000 directly related to decrease in revenue.

Research and Development

Research and development expenses primarily consist of salaries and benefits, and related expenses which are attributable to the development of our website development software products. Research and development expenses were $7,000 for the three months ended September 30, 2018 and September 30, 2017.

General and Administrative

General and administrative expenses consist of salaries and benefits for executives, administrative personnel, legal, rent, accounting and other professional services, and other administrative corporate expenses. General and administrative expenses decreased 22% or $19,000, to $69,000 for the three months ended September 30, 2018 as compared to $88,000 for the three months ended September 30, 2017. The decrease in general and administrative expenses is primarily due to less of an allocation of corporate general and administrative expenses resulting from the 22% decrease in revenue for the period. Consolidated general and administrative expenses increased 15%, or $147,000 to $1,101,000 for the three months ended September 30, 2018 compared to $954,000 for the three months ended September 30, 2017. As Web Services segment revenue continues to decrease and Cloud Telecommunications segment revenue continues to increase, a higher percentage of general and administrative costs are being allocated to the Cloud Telecommunications segment. The increase in consolidated general and administrative expenses is primarily due to an increase in administrative salaries and benefits of $42,000, an increase in accounting and other professional services of $32,000, an increase in office equipment and software of $43,000, an increase in repairs and maintenance of $25,000, an increase in stock options expense of $21,000, and an increase in other administrative corporate expenses of $2,000, offset by a decrease in shareholder and investor relations expense of $18,000.

Other Income/(Expense)

Other income/(expense) primarily relates to interest income from the collection of EPTA receivables, foreign exchange gains or losses, and the allocated portions of interest expense and sublease rental income. Net other expense decreased 133%, or $8,000, to $2,000 of net other income for the three months ended September 30, 2018 as compared to net other expense of $(6,000) for the three months ended September 30, 2017. The decrease is due to a decrease in interest expense of $12,000 related to the related party note payable, which was substantially paid off in September 2017, offset by a net foreign exchange gain of $3,000, and a $1,000 decrease in interest income from the collection of EPTAs.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017

Service Revenue

Service revenue is generated primarily through website hosting, professional web management services, and extended payment term agreements (EPTAs). Web Services segment revenue decreased 21% or $170,000, to $636,000 for the nine months ended September 30, 2018 as compared to $806,000 for the nine months ended September 30, 2017. The decrease in service revenue is primarily due to a decrease in hosting revenue of $148,000 and a $22,000 decrease in EPTA revenue due to a decrease in outstanding receivables.

Cost of Service Revenue

Cost of service revenue consists primarily of bandwidth, customer service costs, and credit card processing fees. Cost of service revenue increased 8% or $6,000, to $84,000 for the nine months ended September 30, 2018 as compared to $78,000 for the nine months ended September 30, 2017. The cost of revenue increase is primarily related to a $10,000 increase in customer service salaries and wages from an increase in web support requests for SSL certificates, offset by a $4,000 decrease in credit card processing fees directly related to the reduction in revenue.

Research and Development

Research and development expenses primarily consist of salaries and benefits, and related expenses which are attributable to the development of our website development software products. Research and development expenses were $19,000 for the nine months ended September 30, 2018 and September 30, 2017.

General and Administrative

General and administrative expenses consist of salaries and benefits for executives, administrative personnel, legal, rent, accounting and other professional services, and other administrative corporate expenses. General and administrative expenses decreased 36% or $121,000, to $211,000 for the nine months ended September 30, 2018 as compared to $332,000 for the nine months ended September 30, 2017. The decrease in general and administrative expenses is primarily due to less of an allocation of corporate general and administrative expenses resulting from the 21% decrease in revenue for the period. Consolidated general and administrative expenses decreased 2%, or $54,000 to $3,080,000 for the nine months ended September 30, 2018 compared to $3,134,000 for the nine months ended September 30, 2017. As Web Services segment revenue continues to decrease and Cloud Telecommunications segment revenue continues to increase, a higher percentage of general and administrative costs are being allocated to the Cloud Telecommunications segment. The decrease in consolidated general and administrative expenses is primarily due to a decrease in stock options expense of $179,000, a decrease in shareholder and investor relations expense of $7,000, and a decrease in office equipment and software of $47,000, offset by an increase in administrative salaries and benefits of $37,000, an increase in accounting and other professional services of $104,000, an increase in rent expense of $9,000, an increase in repairs and maintenance of $23,000, and an increase in other administrative corporate expenses of $6,000.

Other Expense

Other expense primarily relates to interest income from the collection of EPTA receivables, foreign exchange gains or losses, and the allocated portions of interest expense and sublease rental income. Other expense decreased 83% or $5,000 to $1,000 for the nine months ended September 30, 2018 as compared to $6,000 for the nine months ended September 30, 2017. The decrease is due to a decrease in interest expense of $18,000 related to the related party note payable, which was substantially paid off in September 2017, offset by a net foreign exchange gain of $11,000, and a $2,000 decrease in interest income from the collection of EPTAs.

Liquidity and Capital Resources

As of September 30, 2018 and 2017, we had cash and cash equivalents of $1,796,000 and $1,207,000, respectively. Changes in cash and cash equivalents are dependent upon changes in, among other things, working capital items such as contract liabilities, contract costs, accounts payable, accounts receivable, prepaid expenses, and various accrued expenses, as well as purchases of property and equipment and changes in our capital and financial structure due to debt repayments and issuances, stock option exercises, sales of equity investments and similar events. We believe that our operations along with existing liquidity sources will satisfy our cash requirements for at least the next 12 months. If the assumptions underlying our business plan regarding future revenue and expenses change or if unexpected opportunities or needs arise, we may seek to raise additional cash by selling equity or debt securities.

Working Capital

Working capital increased 35% or $322,000 to $1,243,000 as of September 30, 2018 as compared to $921,000 at December 31, 2017. The increase in working capital was related to an increase in cash and cash equivalents of $514,000, an increase in contract assets of $6,000, an increase in inventories of $162,000, an increase in prepaid expenses of $2,000, an increase in income tax receivable of $2,000, a decrease in accounts payable of $2,000, and a decrease in contract liabilities, current portion, of $29,000, offset by a decrease in trade receivables, net of allowance for doubtful accounts of $9,000, a decrease in equipment financing receivables of $46,000, a decrease in contract costs of $5,000, a decrease in other current assets of $10,000, an increase accrued expenses of $293,000, an increase in capital lease obligations, current portion of $27,000, and an increase in notes payable, current portion, of $5,000.

Cash, Cash Equivalents, and Restricted Cash

Cash, cash equivalents, and restricted cash increased 37% or $514,000 to $1,896,000 at September 30, 2018 as compared to $1,382,000 at December 31, 2017. During the nine months ended September 30, 2018, operating activities provided $350,000, financing activities provided $300,000, and $136,000 was used for investing activities.

Inventories

Inventories increased 124% or $162,000 to $293,000 at September 30, 2018 as compared to $131,000 at December 31, 2017. The increase is due to the receipt of a large inventory shipment at the end of June to replenish inventory from shipments made during the quarter.

Prepaid Expenses

Prepaid expenses increased 1% or $2,000 to $253,000 at September 30, 2018 as compared to $251,000 at December 31, 2017.

Accounts Payable and Accrued Expenses

Accounts payable decreased 3% or $2,000 to $77,000 at September 30, 2018 as compared to $79,000 at December 31, 2017. Our accounts payable as of September 30, 2018 were generally within our vendors' terms of payment. The increase is primarily related to the timing of check processing schedule.

Accrued expenses increased 30% or $293,000 to $1,254,000 at September 30, 2018 as compared to $961,000 at December 31, 2017. Salaries and benefits accrual increased $189,000, sales tax accrual increased $78,000, accrued audit and tax preparation fees increased $54,000, accrued expenses for building repairs increased $14,000, and other accrued expenses increased $13,000, offset by a $55,000 decrease in accrued accounts payable.

Notes Payable

Notes payables decreased 6% or $5,000 to $74,000 at September 30, 2018 as compared to $79,000 at December 31, 2017. The decrease is related to payments made on financing contracts.

Contract Liabilities

Contract liabilities increased 1% or $7,000 to $995,000 at September 30, 2018 as compared to $988,000 at December 31, 2017. The increase is primarily due to one customer paying their entire 60 month agreement upfront, offset by a reclassification to revenue for installations completed during the period.

Capital

Total stockholders' equity increased 17% or $284,000, to $1,914,000 at September 30, 2018 as compared to $1,630,000 at December 31, 2017. The increase in total stockholders' equity was attributable to an increase in additional paid-in capital of $344,000 for stock options issued to employees and $155,000 for proceeds from the exercise of stock options, offset by a net loss of $215,000.

Off Balance Sheet Arrangements

As of September 30, 2018, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Impact of Recent Accounting Pronouncements

The information set forth under Note 1 to the condensed consolidated financial statements under the caption "Recent Accounting Pronouncements" is incorporated herein by reference.

Forward-Looking Statements and Factors That May Affect Future Results and Financial Condition

With the exception of historical facts, the statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations are "forward-looking statements" within the meaning of the Private Securities

Litigation Reform Act of 1995, which provides a "safe harbor" for such forward-looking statements. The words "believe," "expect," "anticipate," "estimate," "will" and other similar statements of expectation identify forward-looking statements. The statements reflect our current expectations and beliefs regarding our future results of operations, performance and achievements. These statements are subject to risks and uncertainties and are based upon assumptions and beliefs that may or may not materialize. These forward-looking statements include, but are not limited to, statements concerning:

market acceptance of new or existing services and features; customer acceptance and demand for our cloud communication and services; our ability to increase sales.

our belief that we can compete successfully by relying on our infrastructure and marketing strategies as well as techniques, systems and procedures, and by adding additional products and services in the future;

changes in both our competitors and the markets in which we compete; the quality and reliability of our services; customer cancellations and churn rate; our ability to scale our business; customer acquisition costs; our reliance on infrastructure of third-party network services providers; risk of failure in our physical infrastructure; risk of failure of our software; firmware, hardware or any other products;

our continued compliance with industry standards and regulatory requirements in the United States and foreign countries in which we make our solutions available the costs of such compliance; risks relating to our strategies and objectives for future operations including managing our systems, sales and channel partners, as well as acquisitions. Managing our cost structure, margins and achieve profitability; and

risk of cybersecurity breaches; general economic conditions that could adversely affect our business and operating results; implementation and effects of new accounting standards and policies in our reported financial results; and; potential future intellectual property infringement claims and other claims that could adversely affect our business and operating results.

We caution readers that our operating results are subject to various risks and uncertainties that could cause our actual results and outcomes to differ materially from those discussed or anticipated, including changes in economic conditions and Internet technologies, interest rate fluctuations, and the factors set forth in the section entitled, "Risk Factors," under Part I, Item 1A of the 2017 Form 10-K. We also advise readers not to place any undue reliance on the forward-looking statements contained in this Form 10-Q, which reflect our beliefs and expectations only as of the date of this Report. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances or any changes in our beliefs or expectations, other than as required by law.

Item 3.
Quantitative and Qualitative Disclosures about Market Risk

Not required

Item 4.
Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this Report, have concluded that, based on the evaluation of these controls and procedures, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the nine months ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1.
Legal Proceedings

From time to time, we are involved in lawsuits, claims, investigations and proceedings that arise in the ordinary course of business. There are no matters pending or threatened that we expect to have a material adverse impact on our business, results of operations, financial condition or cash flows.

Item 1A.
Risk Factors

There are many risk factors that may affect our business and the results of our operations, many of which are beyond our control. Information on certain risks that we believe are material to our business is set forth in "Part I – Item 1A. Risk Factors" of the 2017 Form 10-K.

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

None

Item 6.
Exhibits

Exhibits

31.1	Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as amended
31.2	Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as amended
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

101.INS*	XBRL INSTANCE DOCUMENT
101.SCH*	XBRL TAXONOMY EXTENSION SCHEMA DOCUMENT
101.CAL*	XBRL TAXONOMY EXTENSION CALCULATION LINKBASE DOCUMENT
101.DEF*	XBRL TAXONOMY EXTENSION DEFINITION LINKBASE DOCUMENT
101.LAB*	XBRL TAXONOMY EXTENSION LABEL LINKBASE DOCUMENT
101.PRE*	XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE DOCUMENT

* In accordance with Rule 406T of Regulation S-T, these XBRL (eXtensible Business Reporting Language) documents are furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability under these sections.

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, thereunto duly authorized.

	Crexendo, Inc.	
November 6, 2018	By:	/s/ Steven G. Mihaylo Steven G. Mihaylo Chief Executive Officer
November 6, 2018	By:	/s/ Ronald Vincent Ronald Vincent Chief Financial Officer