

J2 GLOBAL COMMUNICATIONS INC  
Form 10-Q  
November 09, 2007

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

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2007**

OR

**o 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: 0-25965**

**j2 GLOBAL COMMUNICATIONS, INC.**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**51-0371142**  
(I.R.S. Employer  
Identification No.)

**6922 Hollywood Boulevard, Suite 500**  
**Los Angeles, California 90028**  
(Address of principal executive offices)

**(323) 860-9200**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required 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 x No o

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

As of October 31, 2007, the registrant had 49,331,644 shares of common stock outstanding.

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**j2 GLOBAL COMMUNICATIONS, INC.  
FOR THE QUARTER ENDED SEPTEMBER 30, 2007**

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**j2 Global Communications, Inc.**  
**Condensed Consolidated Balance Sheets**  
**(Unaudited, in thousands)**

	September 30, 2007	December 31, 2006
<b>ASSETS</b>		
Cash and cash equivalents	\$ 132,096	\$ 95,605
Short-term investments	97,672	83,498
Accounts receivable, net of allowances of \$1,183 and \$1,105, respectively	16,049	11,989
Prepaid expenses and other current assets	5,536	4,779
Deferred income taxes	2,643	2,643
Total current assets	253,996	198,514
Long-term investments	10,019	12,493
Property and equipment, net	21,289	18,951
Goodwill	36,891	30,954
Other purchased intangibles, net	27,349	21,400
Deferred income taxes	5,833	5,406
Other assets	278	442
Total assets	\$ 355,655	\$ 288,160
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Accounts payable and accrued expenses	\$ 20,069	\$ 17,117
Income taxes payable	167	4,511
Deferred revenue	14,626	11,530
Current portion of long-term debt	—	149
Total current liabilities	34,862	33,307
Accrued income taxes	28,569	—
Other	73	112
Total liabilities	63,504	33,419
Commitments and contingencies	—	—
Total stockholders' equity	292,151	254,741
Total liabilities and stockholders' equity	\$ 355,655	\$ 288,160

**See Notes to Condensed Consolidated Financial Statements**

**j2 Global Communications, Inc.**  
**Condensed Consolidated Statements of Operations**  
(Unaudited, in thousands except share and per share data)

	<b>Three Months Ended September</b>		<b>Nine Months Ended September 30,</b>	
	<b>30,</b>		<b>2007</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenues:				
Subscriber	\$ 54,029	\$ 44,491	\$ 156,935	\$ 127,724
Other	1,717	1,400	6,932	4,451
	55,746	45,891	163,867	132,175
Cost of revenues (including stock-based compensation of \$169 and \$491 for the three and nine months of 2007, respectively, and \$97 and \$303 for the three and nine months of 2006, respectively)	11,168	9,648	32,390	27,947
Gross profit	44,578	36,243	131,477	104,228
Operating expenses:				
Sales and marketing (including stock-based compensation of \$304 and \$846 for the three and nine months of 2007, respectively, and \$266 and \$807 for the three and nine months of 2006, respectively)	10,218	8,141	28,670	22,498
Research, development and engineering (including stock-based compensation of \$186 and \$543 for the three and nine months of 2007, respectively, and \$149 and \$413 for the three and nine months of 2006, respectively)	3,045	2,129	8,734	5,965
General and administrative (including stock-based compensation of \$1,209 and \$3,420 for the three and nine months of 2007, respectively, and \$995 and \$3,073 for the three and nine months of 2006, respectively)	10,042	10,204	28,817	26,454
Total operating expenses	23,305	20,474	66,221	54,917
Operating earnings	21,273	15,769	65,256	49,311
Interest and other income, net	2,598	1,586	6,721	3,922
Earnings before income taxes	23,871	17,355	71,977	53,233
Income tax expense	5,783	4,565	20,372	14,933
Net earnings	\$ 18,088	\$ 12,790	\$ 51,605	\$ 38,300

Net earnings per common share:								
Basic	\$	0.37	\$	0.26	\$	1.05	\$	0.78
Diluted	\$	0.35	\$	0.25	\$	1.01	\$	0.75
Weighted average shares outstanding:								
Basic		49,215,250		49,218,918		49,050,697		49,272,631
Diluted		51,075,957		51,107,362		50,923,136		51,072,988

**See Notes to Condensed Consolidated Financial Statements**

**j2 Global Communications, Inc.**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited, in thousands)**

	<b>Nine Months Ended September</b>	
	<b>30,</b>	
	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Net earnings	\$ 51,605	\$ 38,300
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	7,188	5,996
Stock-based compensation	5,417	4,596
Tax benefit of vested restricted stock	363	24
Tax benefit of stock option exercises	4,843	1,381
Excess tax benefits on stock option exercises	(3,460)	(1,290)
Deferred income taxes	(426)	(1,214)
Loss on disposal of fixed assets	194	—
Changes in assets and liabilities, net of effects of business combinations:		
Decrease (increase) in:		
Accounts receivable	(3,794)	(1,725)
Prepaid expenses and other current assets	(740)	(2,064)
Other assets	160	(177)
(Decrease) increase in:		
Accounts payable and accrued expenses	(1,541)	3,018
Income taxes payable	(4,350)	(2,970)
Deferred revenue	3,036	3,135
Accrued income taxes	9,971	—
Other	(38)	92
Net cash provided by operating activities	68,428	47,102
Cash flows from investing activities:		
Net purchases of available-for-sale investments	(23,740)	(18,655)
Net redemptions of held-to-maturity investments	12,040	29,354
Purchases of property and equipment	(5,975)	(5,226)
Acquisition of businesses, net of cash received	(6,814)	(7,194)
Purchases of intangible assets	(3,802)	(2,950)
Proceeds from sale of property and equipment	—	10
Proceeds from sale of investment	—	822
Net cash used in investing activities	(28,291)	(3,839)
Cash flows from financing activities:		
Repurchases of common stock	(14,950)	(9,727)
Repurchases of restricted stock	(295)	—
Issuance of common stock under employee stock purchase plan	193	381
Exercise of stock options	6,791	800
Excess tax benefits on stock option exercises	3,460	1,290
Repayment of long-term debt	(151)	(460)
Net cash used in financing activities	(4,952)	(7,716)



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Effect of exchange rate changes on cash and cash equivalents	1,306	1,595
Net increase in cash and cash equivalents	36,491	37,142
Cash and cash equivalents at beginning of period	95,605	36,301
Cash and cash equivalents at end of period	\$ 132,096	\$ 73,443

**See Notes to Condensed Consolidated Financial Statements**

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**SEPTEMBER 30, 2007**  
**(UNAUDITED)**

**1. Basis of Presentation**

j2 Global Communications, Inc. (“j2 Global” or the “Company”) is a Delaware corporation founded in 1995. By leveraging the power of the Internet, the Company provides outsourced, value-added messaging and communications services to individuals and businesses throughout the world. j2 Global offers fax, voicemail, email and call handling services and bundled suites of certain of these services. j2 Global markets its services principally under the brand names eFax<sup>®</sup>, eFax Corporate<sup>®</sup>, Fax.com<sup>™</sup>, Send2Fax<sup>®</sup>, eFax Broadcast<sup>™</sup>, jBlast<sup>®</sup>, jConnect<sup>®</sup>, Onebox<sup>®</sup>, Onebox Receptionist<sup>™</sup>, eVoice<sup>®</sup>, eVoice Receptionist<sup>™</sup>, YAC<sup>®</sup> and Electric Mail<sup>®</sup>.

The accompanying interim condensed consolidated financial statements include the accounts of j2 Global and its direct and indirect wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) including those for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X issued by the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and note disclosures required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been reflected in these interim financial statements. These financial statements should be read in conjunction with the audited financial statements and related notes for the year ended December 31, 2006 included in the Company’s Annual Report on Form 10-K filed with the SEC on March 12, 2007.

The results of operations for these interim periods are not necessarily indicative of the operating results for the full year or for any future period.

*Income Taxes*

In July 2006, the Financial Accounting Standard Board (“FASB”) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted the provisions of FIN 48 effective January 1, 2007. As a result of the adoption, the Company recorded an approximately \$18.6 million increase in accrued income taxes in the condensed consolidated balance sheet for unrecognized tax benefits, which was accounted for as a cumulative effect adjustment to the January 1, 2007 balance of retained earnings. See Note 6 for further information regarding the effects of adopting FIN 48.

**2. Use of Estimates**

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenue and expenses during the reporting period. On an ongoing basis, management evaluates its estimates, including those related to revenue recognition, allowances for doubtful accounts and the valuation of deferred income taxes, tax contingencies, stock-based compensation expense, long-lived and intangible assets and goodwill. These estimates are based on historical experience and on various other factors that the

Company believes to be reasonable under the circumstances. Actual results could differ from those estimates.

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### 3. Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (“SFAS 157”), which defines fair value, provides a framework for measuring fair value, and expands the disclosures required for fair value measurements. SFAS 157 applies to all accounting pronouncements that require fair value measurements. It does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. Accordingly, the Company will adopt SFAS 157 commencing in the first quarter of 2008. The Company is currently assessing the potential impact of SFAS 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Liabilities – Including an amendment of FASB Statement No. 115* (“SFAS 159”). SFAS 159 permits entities to choose to measure certain financial assets and liabilities at fair value. Unrealized gains and losses, arising subsequent to adoption, are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is required to adopt SFAS 159 in the first quarter of 2008. The Company is currently assessing the impact of SFAS 159 on its consolidated financial statements.

### 4. Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. Intangible assets resulting from the acquisitions of entities accounted for using the purchase method of accounting are estimated by management based on the fair value of assets acquired. Identifiable intangible assets subject to amortization are being amortized using the straight-line method over estimated useful lives ranging from two to twenty years.

The changes in carrying amounts of goodwill and other intangible assets for the nine months ended September 30, 2007 are as follows (in thousands):

	Balance as of January 1, 2007	Additions	Amortization	Foreign Exchange Translation	Balance as of September 30, 2007
Goodwill	\$ 30,954	\$ 5,456	\$ —	481	\$ 36,891
Intangible assets with indefinite lives	2,063	267	—	—	2,330
Intangible assets subject to amortization	19,337	8,250	(2,724)	156	25,019
	\$ 52,354	\$ 13,973	\$ (2,724)	\$ 637	\$ 64,240

Intangible assets with indefinite lives relate primarily to a trade name. As of September 30, 2007, intangible assets subject to amortization relate primarily to the following (in thousands):

	Weighted-Average Amortization Period	Historical Cost	Accumulated Amortization	Net
Patents	10.7 years	\$ 19,429	\$ 4,756	\$ 14,673
Technology	3.0 years	4,096	3,106	990
Customer relationships	4.5 years	4,665	2,290	2,375
Trade name	16.1 years	7,789	808	6,981
Total		\$ 35,979	\$ 10,960	\$ 25,019

Amortization expense, included in general and administrative expense, during the three-month periods ended September 30, 2007 and 2006 approximated \$1.1 million and \$0.7 million, respectively. Amortization expense, included in general and administrative expense, during the nine-month periods ended September 30, 2007 and 2006 approximated \$2.7 million and \$1.9 million, respectively. Amortization expense is estimated to approximate \$3.7 million, \$3.7 million, \$3.4 million, \$3.0 million and \$2.3 million for fiscal years 2007 through 2011, respectively, and \$11.7 million thereafter through the duration of the amortization period.

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## 5. Litigation

In February 2004 and July 2005, the Company filed two lawsuits against Venali in the United States District Court for the Central District of California for infringement of several of its U.S. patents. On June 21, 2006, Venali filed suit against the Company and its affiliate in the United States District Court for the Southern District of Florida, alleging violations of antitrust law and various related claims arising out of the Company's procurement and enforcement of its patents. In lieu of any response to Venali's complaint, the parties reached an agreement whereby Venali dismissed its complaint without prejudice and re-filed certain of its claims as counterclaims in the patent infringement actions in California. On December 27, 2006, Venali filed amended counterclaims in the July 2005 action alleging several violations of antitrust law (fraudulent procurement of patents, fraudulent enforcement of patents, tying and attempted monopolization) as well as tortious interference with business relationships, trademark infringement and unfair and deceptive trade practices. Venali is seeking damages, including treble damages for the antitrust claims, injunctive relief, attorneys' fees and costs. Venali's claims relate in substantial part to the patent infringement claims by the Company against Venali. On April 13, 2007, the court granted in part the Company's motion to dismiss Venali's counterclaims, dismissing the tying claim with leave to amend. Venali has agreed that it will not replead the tying counterclaim and has also stipulated to the dismissal of its Lanham Act and tortious interference counterclaims.

On December 12, 2006, Venali filed suit against the Company in the United States District Court for the Southern District of Florida, alleging infringement of U.S. Patent Number 7,114,004 (the "'004 Patent"). Venali is seeking damages in the amount of lost profits or a reasonable royalty, a permanent injunction against continued infringement, treble damages, attorneys' fees, interest and costs. On March 6, 2007, the Company filed an answer to the complaint denying liability. On May 17, 2007, the Company filed a request with the U.S. Patent & Trademark Office for reexamination of the '004 Patent, which request was granted on July 27, 2007. On August 13, 2007, the Company moved to stay the action pending the reexamination. On August 20, 2007, the court granted the motion and stayed the action pending reexamination of the patent.

On May 9, 2007, Bear Creek Technologies, Inc. ("Bear Creek") filed suit against the Company in the United States District Court for the Eastern District of Texas, alleging infringement of U.S. Patent Number 6,685,494. Bear Creek is seeking damages in, at least, the amount of a reasonable royalty, a permanent injunction against continued infringement, treble damages, attorneys' fees, interest and costs. On June 29, 2007, the Company filed an answer to the complaint denying liability, asserting affirmative defenses, and asserting counterclaims of non-infringement and invalidity. On September 21, 2007, Bear Creek filed its reply to the Company's counterclaims, denying each one. The claim construction hearing is set for April 28, 2008, and jury selection for trial in the matter is set for April 7, 2009.

On June 21, 2007, Integrated Global Concepts, Inc. ("IGC") filed a lawsuit against the Company, certain of the Company's current and former officers and/or directors, one of the Company's affiliates, and several other parties in the United States District Court for the Northern District of Illinois. The suit purports to allege violations of antitrust law, the Racketeer Influenced and Corrupt Organizations Act and various related statutory and common law claims arising out of the Company's procurement and enforcement of its patents and its acquisition of certain companies. IGC's claims relate in substantial part to a patent infringement action by an affiliate of the Company against IGC. The suit seeks damages, including treble and punitive damages, an injunction against further violations, divestiture of certain assets, attorneys' fees and costs. On October 31, 2007, the Court stayed this action pending resolution of the related case in the Northern District of Georgia described below.

On October 11, 2007, IGC filed substantially the same claims it previously filed in the Northern District of Illinois as counterclaims in a pending patent infringement case in the United States District Court for the Northern District of Georgia brought against IGC by an affiliate of the Company. Like the prior lawsuit, IGC's counterclaims name the Company, certain of the Company's current and former officers and/or directors, one of the Company's affiliates, and several other parties, and purport to allege violations of antitrust law, the Racketeer Influenced and Corrupt Organizations Act and various related statutory and common law claims arising out of the Company's procurement and enforcement of its patents and its acquisition of certain companies. The counterclaims seek damages, including treble

and punitive damages, an injunction against further violations, divestiture of certain assets, attorneys' fees and costs. The Company has not yet responded to the counterclaim.

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On June 29, 2007, a purported class action was filed by Justin Lynch as the named plaintiff in the United States District Court for the Central District of California alleging that the Company has attempted to monopolize and/or monopolized the market for Internet facsimile services to home and small offices in violation of Section 2 of the Sherman Act. The claims relate in substantial part to the patent infringement actions by the Company against various companies. The suit seeks treble damages, injunctive relief, attorneys' fees and costs. On August 24, 2007, the Company filed an answer to the complaint denying liability.

The Company does not believe, based on current knowledge, that any of the foregoing legal proceedings or claims is likely to have a material adverse effect on its financial position, results of operations or cash flows. However, depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect its business, financial position, results of operations or cash flows in a particular period.

## **6. Income Taxes**

The Company adopted the provisions of FIN 48 effective January 1, 2007. As a result of the implementation of FIN 48, the Company recognized an increase in the liability for unrecognized tax benefits of approximately \$18.6 million, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. Prior to the adoption of FIN 48, the Company recorded reserves related to uncertain tax positions as a current liability, whereas upon adoption of FIN 48, the Company reclassified tax reserves of approximately \$6.0 million related to uncertain tax positions for which a cash tax payment is not expected within the next twelve months to noncurrent liabilities. As of January 1, 2007, the total amount of unrecognized tax benefits was \$24.6 million, substantially all of which would have an impact on the Company's effective tax rate if subsequently recognized. The Company recognized an additional \$0.6 million and \$4.0 million of unrecognized tax benefits during the three and nine months ended September 30, 2007, respectively, relating to tax positions taken during those periods, in each case net of \$1.1 million of required reductions in the third quarter of 2007 due to the lapse of a statute of limitations.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. The Company has approximately \$1.2 million in interest and penalties related to unrecognized tax benefits accrued as of January 1, 2007. For the three and nine months ended September 30, 2007, the Company recognized an additional \$0.5 million and \$1.0 million, respectively, of interest and penalties, net of deferred income tax benefit, within income tax expense.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdictions. The Company is generally no longer subject to income tax examinations by U.S. federal, California state and foreign tax authorities for years before 2004, 2003 and 2000, respectively. Management believes that its accrual for tax liabilities is adequate for all open audit years based on its assessment of many factors including past experience and interpretation of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. Over the next twelve months, the Company's existing tax positions are expected to generate an increase in total unrecognized tax benefits.

The Company is currently under audit by the Internal Revenue Service for the 2005 tax year. While it is possible that the 2005 tax audit may conclude in the next 12 months and that the unrecognized tax benefits the Company has recorded in relation to this audit may change compared to the liabilities recorded for the period, it is not possible to estimate the effect, if any, of any amount of such change during the next 12 months to previously recorded uncertain tax positions.

## **7. Stockholders' Equity**

### *Common Stock Repurchase Program*



In March 2006, the Company's Board of Directors approved a common stock repurchase program authorizing the repurchase of up to 2,000,000 shares of the Company's common stock through December 2008. During the three months ended March 31, 2007, the Company repurchased 400,000 shares of common stock under this program at an aggregated cost of approximately \$10.2 million (including commission fees of \$12,000), representing an average price per share of \$25.43. The Company did not make any common stock repurchases during the three months

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ended June 30, 2007. During the three months ended September 30, 2007, the Company repurchased 142,278 shares at an aggregated cost of approximately \$4.8 million (including commission fees of \$4,300). As of September 30, 2007, there were 986,822 shares of common stock available for repurchase under this program.

## 8. Stock Options and Employee Stock Purchase Plan

The Company's stock-based compensation plans include the Second Amended and Restated 1997 Stock Option Plan, 2007 Stock Plan and the 2001 Employee Stock Purchase Plan (described below).

### (a) *Second Amended and Restated 1997 Stock Option Plan and 2007 Stock Plan*

The 1997 Stock Option Plan (the "1997 Plan") was adopted in November 1997 and has twice been amended and restated. This plan provides for the granting of incentive stock options, nonqualified stock options and restricted stock awards. Options under the 1997 Plan may be granted at exercise prices determined by the Board of Directors, provided that the exercise prices shall not be less than the fair market value of the Company's common stock on the date of grant for incentive stock options and not less than 85% of the fair value of the Company's common stock on the date of grant for non-statutory stock options. At September 30, 2007, there were 1,565,987 additional shares underlying options and shares of restricted stock available for grant under the original terms of the 1997 Plan and no additional shares available for grant outside of the 1997 Plan. On August 22, 2007, the Company's Board of Directors adopted resolutions limiting shares available for grant under the 1997 Plan to 356,000 for the period from June 30, 2007 until October 24, 2007, the date of the Special Meeting of Stockholders to approve the 2007 Stock Plan discussed below. The limitation reduced the number of shares available for grant under the 1997 Plan to 138,854 as of September 30, 2007.

The 2007 Stock Plan (the "2007 Plan") was adopted on October 24, 2007 (see Note 14) to replace the 1997 Plan, which expires in November 2007. The 2007 Plan provides for the granting of awards similar in nature and under terms comparable to awards provided for under the 1997 Plan. The total number of shares reserved for awards under the 2007 Plan is 4.5 million, none of which have been granted.

### Stock Options

The following table represents stock option activity for the nine months ended September 30, 2007:

	Number of Shares	Weighted- Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at January 1, 2007	4,639,614	\$ 8.58		
Granted	640,100	31.00		
Exercised	(684,681)	9.92		
Canceled	(131,200)	23.37		
Outstanding at September 30, 2007	4,463,833	11.18	6.0	\$ 96,414,975
Exercisable at September 30, 2007	2,898,853	4.83	4.7	80,881,512
Vested and expected to vest at September 30, 2007	4,150,353	10.29	5.8	93,308,283

For the nine months ended September 30, 2007, the Company granted 640,100 options to purchase shares of common stock pursuant to the 1997 Plan to newly hired and existing members of management. The stock options vest 20% per

year and expire 10 years from the date of grant.

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The per share weighted-average grant-date fair values of stock options granted during the nine months ended September 30, 2007 and 2006 were \$21.49 and \$18.81, respectively.

The aggregate intrinsic values of options exercised during the nine months ended September 30, 2007 and 2006 were \$13.5 million and \$4.3 million, respectively.

As of September 30, 2007, there was \$22.2 million of total unrecognized compensation expense related to non-vested stock-based compensation awards granted under the 1997 Plan. That expense is expected to be recognized ratably over a weighted-average period of 3.9 years (i.e., the remaining requisite service period).

#### Fair Value Disclosure

The Company uses the Black-Scholes option pricing model to calculate the fair-value of each option grant. The expected volatility for the nine months ended September 30, 2007 is based on historical volatility of the Company's common stock. The Company elected to use the simplified method for estimating the expected term as allowed by Staff Accounting Bulletin No. 107. Under the simplified method, the expected term is equal to the midpoint between the vesting period and the contractual term of the stock option. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a term equal to the expected term of the option assumed at the date of grant. Forfeitures are estimated at the date of grant based on historical experience. The weighted-average fair values of stock options granted have been estimated utilizing the following assumptions:

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
Risk-free interest rate	4.7%	4.8%
Expected term (in years)	6.5	6.5
Dividend yield	0%	0%
Expected volatility	72%	92%
Weighted-average volatility	72%	92%

#### Stock-Based Compensation Expense

The following table represents the stock-based compensation expense that was included in cost of revenues and operating expenses in the accompanying condensed consolidated statements of operations for the three and nine months ended September 30, 2007 and 2006 (in thousands):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Cost of revenues	\$ 169	\$ 97	\$ 491	\$ 303
Operating expenses:				
Sales and marketing	304	266	846	807
Research, development and engineering	186	149	543	413
General and administrative	1,209	995	3,420	3,073
	\$ 1,868	\$ 1,507	\$ 5,300	\$ 4,596

#### Restricted Stock

The Company has awarded restricted shares of common stock to members of its Board of Directors and to management pursuant to the 1997 Plan. Compensation expense resulting from restricted stock grants is measured at



fair value on the date of grant and is recognized as stock-based compensation expense over a five-year vesting period. The Company granted 112,800 shares of restricted stock to newly hired and existing members of management pursuant to the 1997 Plan during the nine months ended September 30, 2007 and recognized approximately \$0.9 million of related compensation expense in the nine months ended September 30, 2007 related to restricted stock awards. As of September 30, 2007, the Company has unrecognized stock-based compensation cost of approximately \$7.0 million associated with these awards. The cost is expected to be recognized over a weighted-average period of 3.8 years.

Restricted stock activity for the nine months ended September 30, 2007 is set forth below:

	<b>Shares</b>	<b>Weighted-Average Grant-Date Fair Value</b>
Nonvested at January 1, 2007	307,840	\$ 19.32
Granted	112,800	31.55
Vested	(46,834)	19.02
Canceled	(12,006)	22.10
Nonvested at September 30, 2007	361,800	23.08

(b) *Employee Stock Purchase Plan*

The 2001 Employee Stock Purchase Plan (the "Purchase Plan") provides for stock purchases by all eligible employees. Under the Purchase Plan, eligible employees can have up to 15% of their earnings withheld, up to certain maximums, to be used to purchase shares of the Company's common stock at certain plan-defined dates. The price of the common stock purchased under the Purchase Plan for the offering periods is equal to 90% of the lower of the fair market value of the common stock on the commencement date of each three-month offering period or the specified purchase date. Effective May 1, 2006, the Company's Board of Directors removed the compensatory features of the Purchase Plan by changing the purchase price of a share of common stock for each offering period to 95% of its fair market value at the end of the offering period. For the nine months ended September 30, 2007 and 2006, 7,003 and 17,333 shares were purchased under the plan, respectively. Cash received upon the issuance of common stock under the Purchase Plan was \$0.2 million and \$0.4 million for the nine months ended September 30, 2007 and 2006, respectively.

(c) *Section 409A Tax Compensation*

In connection with the restatements of the Company's 2005 and prior period financial statements, which are more fully described in Note 3 of the Notes to Consolidated Financial Statements included in the Company's 2006 Annual Report on Form 10-K, the Company modified the terms of certain stock options as discussed below.

In December 2006 the Company offered each named executive officer and director the option to increase the exercise price of certain of their stock options in order to avoid potential inadvertent taxation under Internal Revenue Code Section 409A ("Section 409A"). During the nine months ended September 30, 2007 the Company made an aggregate compensating payment to such option holders of \$0.5 million. For the same purpose, the Company increased the exercise price of certain options held by all other employees during the nine months ended September 30, 2007 and will make a compensating payment to these employees of approximately \$0.1 million no later than the first quarter of 2008. The Company has accrued \$0.1 million as of September 30, 2007 with respect to this compensating payment of which approximately \$32,000 was paid to employees during the nine months ended September 30, 2007 and the remaining amount remains accrued for payments to employees no later than the first quarter of 2008.

In addition, to the extent employees and directors have already incurred a tax liability under Section 409A, the Company plans to reimburse such individuals for that liability plus a gross-up for income taxes owed as a result of such reimbursement. The estimated impact of these reimbursements was included in general and administrative



expense in the condensed consolidated statement of operations for the fourth quarter of 2006 and amounted to \$0.7 million, net of tax.

## 9. Earnings Per Share

Basic earnings per share is computed on the basis of the weighted-average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted-average number of common shares outstanding plus the dilutive effect of common stock equivalents using the "treasury stock" method. The components of basic and diluted earnings per share are as follows (in thousands, except share and per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Numerator for basic and diluted net earnings per common share:				
Net earnings	\$ 18,088	\$ 12,790	\$ 51,605	\$ 38,300
Denominator:				
Weighted-average outstanding shares of common stock	49,215,250	49,218,918	49,050,697	49,272,631
Dilutive effect of:				
Employee stock options	1,734,217	1,795,721	1,752,336	1,716,251
Restricted stock	126,490	92,723	120,103	84,106
Common stock and common stock equivalents	51,075,957	51,107,362	50,923,136	51,072,988
Net earnings per share:				
Basic	\$ 0.37	\$ 0.26	\$ 1.05	\$ 0.78
Diluted	\$ 0.35	\$ 0.25	\$ 1.01	\$ 0.75

## 10. Comprehensive Income

The components of comprehensive income were net earnings and accumulated other comprehensive income. The change in accumulated other comprehensive income for all periods presented resulted from foreign translation gains and losses. Comprehensive income for the three and nine months ended September 30, 2007 and 2006 is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net earnings	\$ 18,088	\$ 12,790	\$ 51,605	\$ 38,300
Foreign currency translation adjustment	1,234	(73)	2,040	2,646
Comprehensive income	\$ 19,322	\$ 12,717	\$ 53,645	\$ 40,946



## 11. Geographic Information

The Company maintains operations in the United States, Canada, Ireland, the United Kingdom and other international territories. Geographic information about the United States and international territories for the reporting periods is presented below. Such information attributes revenues based on the location of a customer's Direct Inward Dial ("DID") number for services using such a number or a customer's residence for other services (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
<b>Revenue:</b>				
United States	\$ 48,287	\$ 40,833	\$ 143,758	\$ 117,882
All other countries	7,459	5,058	20,109	14,293
	\$ 55,746	\$ 45,891	\$ 163,867	\$ 132,175
	September 30,	December 31,		
	2007	2006		
<b>Long-lived assets:</b>				
United States	\$ 18,622	\$ 17,377		
All other countries	2,667	1,574		
	\$ 21,289	\$ 18,951		

## 12. Supplemental Cash Flow Information

Cash paid for interest during the nine months ended September 30, 2007 and 2006 approximated \$7,000 and \$22,000, respectively, substantially all of which related to long-term debt.

The Company paid approximately \$10.1 million and \$19.2 million for income taxes during the nine months ended September 30, 2007 and 2006, respectively.

During the nine months ended September 30, 2007, the Company acquired property and equipment and intangible assets for approximately \$648,000 and \$3.6 million, respectively, which have not yet been paid at September 30, 2007.

Through the nine months ended September 30, 2007 and 2006, the Company recorded the tax benefit from the exercise of non-qualified stock options and the vesting of restricted stock as a reduction of its income tax liability in the amount of approximately \$5.2 million and \$1.4 million, respectively.

As a result of the implementation of FIN 48, the Company recognized an increase in the liability for unrecognized tax benefits of approximately \$18.6 million, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings.

## 13. Acquisition

On July 13, 2007, the Company acquired YAC Limited ("YAC"), an Ireland-based provider of messaging services whose customers are predominantly located in the United Kingdom. In connection with the acquisition, the Company paid an immaterial amount of cash in exchange for all outstanding shares of capital stock. Pro forma information has not been presented as the historical results of operations of YAC are not material.

**14. Subsequent Event**

On October 24, 2007, at a Special Meeting of Stockholders, the Company's stockholders approved the Company's adoption of a new 2007 Stock Plan, which replaces the 1997 Plan that expires in November 2007. The 2007 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards, as defined, covering up to 4.5 million shares.

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

### **Overview**

j2 Global Communications, Inc. ("j2 Global", "the Company", "our", or "we") is a Delaware corporation founded in 1995. By leveraging the power of the Internet, we provide outsourced, value-added messaging and communications services to individuals and businesses throughout the world. We offer fax, voicemail, email and call handling services and bundled suites of certain of these services. We market our services principally under the brand names eFax<sup>®</sup>, eFax Corporate<sup>®</sup>, Fax.com<sup>™</sup>, Send2Fax<sup>®</sup>, eFax Broadcast<sup>™</sup>, jBlast<sup>®</sup>, jConnect<sup>®</sup>, Onebox<sup>®</sup>, Onebox Receptionist<sup>™</sup>, eVoice<sup>®</sup>, eVoice Receptionist<sup>™</sup>, YAC<sup>®</sup> and Electric Mail<sup>®</sup>.

We deliver many of our services through our global telephony/Internet Protocol ("IP") network, which spans more than 2,900 cities in 42 countries across five continents. We have created this network, and continuously seek to expand it, through negotiating with U.S. and foreign telecommunications and co-location providers for telephone numbers (also referred to as Direct Inward Dial numbers or "DIDs"), Internet bandwidth and co-location space for our equipment. We maintain and seek to grow an inventory of telephone numbers to be assigned to new customers. Most of these numbers are "local" (as opposed to toll-free), which enables us to provide our paying subscription customers telephone numbers with a geographic identity. In addition to growing our business internally, we have used small acquisitions to grow our customer base, enhance our technology and acquire skilled personnel.

Our core services include fax, voicemail, email and call handling, as well as bundled suites of certain of these services. These are business services that make our customers more efficient, more mobile, more cost-effective and more secure than traditional alternatives. We generate substantially all of our revenue from subscribers that pay activation, subscription and usage fees. Activation and subscription fees are referred to as "fixed" revenues, while usage fees are referred to as "variable" revenues. We also generate revenues from patent licensing fees, advertising and revenue share from our customers' use of premium rate telephone numbers. Of the 11.7 million telephone numbers deployed as of September 30, 2007, more than one million were serving paying subscribers, with the balance deployed to free subscribers, including those with premium rate telephone numbers. We operate in one reportable segment: value-added messaging and communications services, which provides for the delivery of fax, voice and email messages via the telephone and/or Internet networks.

During the past three years, we have derived a substantial portion of our revenues from the sale of our eFax and jConnect paid services, including eFax Corporate<sup>®</sup>, eFax Plus<sup>®</sup>, eFax Pro<sup>™</sup> and jConnect Premier<sup>®</sup>. These services are deployed through DIDs. As a result, we believe that paying DIDs and the revenues associated therewith are an important metric for understanding our business. It has been and continues to be our objective to increase the number of paying DIDs through a variety of distribution channels and marketing arrangements and by enhancing our brand awareness. In addition, we continuously seek to increase revenues through a combination of stimulating use by our customers of usage-based services, introducing new services and instituting appropriate price increases to our fixed monthly subscription and other fees.

For the past three years, 90% or more of our total revenues have been produced by our DID-based services. DID-based annual revenues have increased from \$100 million to \$168 million from fiscal 2004 through fiscal 2006. The primary reason for this increase was a 64% increase in the number of paid DIDs over this period. We expect that DID-based revenues will continue to be a dominant driver of total revenues.

The following table sets forth our key operating metrics for the three and nine months ended September 30, 2007 and 2006 (in thousands, except for percentages and average revenue per paying telephone number):

	September 30,					
	2007	2006				
Free service telephone numbers	10,706	10,619				
Paying telephone numbers	1,018	888				
Total active telephone numbers	11,724	11,507				
	Three Months Ended September 30,		Nine Months Ended September 30,			
	2007	2006	2007	2006		
Subscriber revenues:						
Fixed	\$ 41,362	\$ 32,179	\$ 118,779	\$ 90,572		
Variable	12,667	12,312	38,156	37,152		
Total subscriber revenues	\$ 54,029	\$ 44,491	\$ 156,935	\$ 127,724		
Percentage of total subscriber revenues:						
Fixed	76.6%	72.3%	75.7%	70.9%		
Variable	23.4%	27.7%	24.3%	29.1%		
Revenues:						
DID-based	\$ 51,209	\$ 42,832	\$ 149,423	\$ 122,233		
Non-DID-based	4,537	3,059	14,444	9,942		
Total revenues	\$ 55,746	\$ 45,891	\$ 163,867	\$ 132,175		
Average monthly revenue per paying telephone number <sup>(1)</sup>	\$ 16.47	\$ 15.98	\$ 16.66	\$ 16.14		

<sup>(1)</sup> See calculation of average monthly revenue per paying telephone number at the end of this section, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Critical Accounting Policies and Estimates

In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements. Actual results could differ significantly from those estimates under different assumptions and conditions. The Company's critical accounting policies are described in the Company's 2006 Annual Report on Form 10-K filed with the SEC on March 12, 2007. During the nine months ended September 30, 2007, we updated our critical accounting policies as follows:

#### Income Taxes

Effective January 1, 2007, we adopted Financial Accounting Standard Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, *Accounting for Income Taxes*. We utilize a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. See Note 6 to the accompanying financial statements for information regarding the effects of adopting FIN 48.



**Results of Operations for the Three and Nine Months Ended September 30, 2007****Revenues**

*Subscriber Revenues.* Subscriber revenues consist of both a fixed monthly recurring subscription component and a variable component which is driven by the actual usage of our service offerings. Over the past three years, the fixed portion of our subscriber revenues has consistently contributed approximately 70% to our subscriber revenues. Subscriber revenues were \$54.0 million and \$44.5 million for the three months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and 2006, subscriber revenues were \$156.9 million and \$127.7 million, respectively. The increase in subscriber revenues was due to an increase in our paying subscribers and a price increase discussed below, net of decreased usage discussed below. The increase in our base of paying subscribers was primarily the result of new sign-ups derived from subscribers coming directly to our websites, free-to-paid subscriber upgrades, small to mid-sized corporate and enterprise sales, direct large enterprise and government sales, direct marketing costs for acquisition of paying subscribers and international sales, net of cancellations.

During the third quarter of 2006, we began implementing a price increase to new and existing domestic eFax individual subscribers. The monthly subscription fee was increased from \$12.95 to \$16.95 and annual programs were increased as well. As of September 30, 2007, the price change implementation was substantially complete.

During the third quarter of 2007, our revenues were negatively impacted by lower usage of our service offerings among business customers affected by the deterioration in domestic credit markets. Although the majority of our customers have not been affected, softness in usage revenues from credit-sensitive customers may persist in future periods.

*Other Revenues.* Other revenues were \$1.7 million and \$1.4 million for the three months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and 2006, other revenues were \$6.9 million and \$4.5 million, respectively. Other revenues consist primarily of patent licensing revenues and advertising revenues generated by delivering email messages to our free customers on behalf of advertisers. Other revenues for the three months ended September 30, 2007 remained relatively consistent compared to the same period in the prior year. The increase in other revenues for the nine months ended September 30, 2007 resulted primarily from an increase in patent licensing revenues of approximately \$2 million from a license agreement with CallWave, Inc. entered into during the first quarter of 2007.

**Stock-Based Compensation**

The following table represents the stock-based compensation expense that was included in cost of revenues and operating expenses in the accompanying condensed consolidated statements of operations for the three and nine months ended September 30, 2007 and 2006 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Cost of revenues	\$ 169	\$ 97	\$ 491	\$ 303
Sales and marketing	304	266	846	807
Research, development and engineering	186	149	543	413
General and administrative	1,209	995	3,420	3,073
	\$ 1,868	\$ 1,507	\$ 5,300	\$ 4,596

**Cost of Revenues**

Cost of revenues is primarily comprised of costs associated with data and voice transmission, telephone numbers, network operations, customer service, on-line processing fees and equipment depreciation. Cost of revenues was \$11.2 million, or 20% of total revenues, and \$9.6 million, or 21% of total revenues, for the three

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months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and 2006, cost of revenues was \$32.4 million, or 20% of total revenues and \$27.9 million, or 21% of total revenues, respectively. The cost of revenues as a percentage of revenues for the three and nine months ended September 30, 2007 improved primarily due to the price increase as discussed above which has little or no cost associated with it as well as enhanced utilization of network capacity. In addition, the increase in other revenues for the nine months ended September 30, 2007 discussed above had minimal associated cost of revenues resulting in cost of revenues as a percentage of revenues declining period over period.

### *Operating Expenses*

*Sales and Marketing.* Our sales and marketing costs consist primarily of Internet-based advertising, sales and marketing personnel costs and other business development-related expenses. Sales and marketing expenses were \$10.2 million, or 18% of total revenues, and \$8.1 million, or 18% of total revenues, for the three months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and 2006, sales and marketing expenses were \$28.7 million, or 18% of total revenues, and \$22.5 million, or 17% of total revenues, respectively. The increase in sales and marketing expenses for the three and nine months ended September 30, 2007 was primarily due to international marketing and testing of new forms of domestic marketing.

*Research, Development and Engineering.* Our research, development and engineering costs consist primarily of personnel-related expenses. Research, development and engineering costs were \$3.0 million, or 5% of total revenues, and \$2.1 million, or 5% of total revenues, for the three months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007 and 2006, research, development and engineering costs were \$8.7 million, or 5% of total revenues, and \$6.0 million, or 5% of total revenues, respectively. The increase in research, development and engineering costs for the three and nine months ended September 30, 2007 compared to the same periods in the prior year was primarily due to an increase in personnel costs to maintain our existing services, accommodate our service enhancements, develop and implement additional service features and functionality and continue to bolster our infrastructure security.

*General and Administrative.* Our general and administrative costs consist primarily of personnel-related expenses, depreciation and amortization, stock-based compensation expense, bad debt expense and insurance costs. General and administrative costs were \$10.0 million, or 18% of total revenues, and \$10.2 million, inclusive of \$1.1 million in investigation costs associated with the prior year restatement of September 30, 2005 financial statements, or 22% of total revenues, for the three months ended September 30, 2007 and 2006, respectively. General and administrative costs were \$28.8 million, or 18% of total revenues, and \$26.5 million, inclusive of \$1.1 million in investigation costs, or 20% of total revenues, for the nine months ended September 30, 2007 and 2006, respectively. General and administrative expenses as a percentage of revenue for the three and nine months ended September 30, 2007 have decreased compared to the same period in the prior year primarily due to lower professional fees, including fees associated with the special investigation in the prior year.

*Interest and Other Income, Net.* Our interest and other income, net, is generated primarily from interest earned on cash, cash equivalents and short- and long-term investments. Interest and other income, net, was \$2.6 million and \$1.6 million for the three months ended September 30, 2007 and 2006, respectively, and \$6.7 million and \$3.9 million for the nine months ended September 30, 2007 and 2006, respectively. The increase in interest and other income, net, was primarily due to higher cash and investment balances and higher interest rates period over period.

*Income Taxes.* Our effective tax rate is based on pre-tax income, statutory tax rates, tax regulations and different tax rates in the various jurisdictions in which we operate. Income tax expense amounted to approximately \$5.8 million and \$4.6 million for the three months ended September 30, 2007 and 2006, respectively. Income tax expense for the nine months ended September 30, 2007 and 2006 was \$20.4 million and \$14.9 million, respectively. Income tax expense for the nine months ended September 30, 2007 is based on a worldwide estimated effective tax rate for 2007 of approximately 28% compared to our estimated effective tax rate of 28% for the nine months ended September 30,



2006. We expect our fiscal 2007 effective tax rate to be approximately 28% compared to an effective tax rate for fiscal 2006 of approximately 27%. This expected increase in our annual effective income tax rate is primarily attributable to an expected increase in the proportion of our taxable income being sourced in the U.S. with higher tax rates than in foreign jurisdictions, offset in part by the favorable impact of the lapse of a statute of

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limitations, which caused a reduction in our liability for unrecognized tax benefits of approximately \$1.1 million for the three and nine months ended September 30, 2007.

## **Liquidity and Capital Resources**

### ***Cash and Cash Equivalents and Investments***

At September 30, 2007, we had cash and investments of \$239.8 million, consisting of cash and cash equivalents of \$132.1 million, short-term investments of \$97.7 million and long-term investments of \$10.0 million. Our investments are comprised primarily of readily marketable corporate debt securities, U.S. government agency securities, auction rate debt and preferred securities. For financial statement presentation, we classify our investments primarily as held-to-maturity, and thus, they are reported as short-term and long-term based upon their maturity dates. Short-term investments primarily mature within one year of the date of the financial statements and long-term investments mature between one and five years from the date of the financial statements. We classify auction rate securities as short-term investments as the established interest rate reset periods are less than one year.

### ***Cash Flows***

Our primary sources of liquidity are cash flows generated from operations, together with cash and cash equivalents and short-term investments. Net cash provided by operating activities was \$68.4 million and \$47.1 million for the nine months ended September 30, 2007 and 2006, respectively. Our operating cash flows resulted primarily from cash received from our subscribers, offset by cash payments we made to third parties for their services, employee compensation and tax payments. Our cash and cash equivalents and short-term investments were \$229.8 million at September 30, 2007.

Net cash used in investing activities was approximately \$28.3 million and \$3.8 million for the nine months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007, net cash used in investing activities was primarily attributable to net purchases of investments, acquisitions of businesses, purchases of property and equipment, and purchases of intangible assets. For the nine months ended September 30, 2006, net cash used in investing activities was primarily attributable to acquisitions of businesses, purchases of property and equipment and purchases of intangible assets, offset by net purchases and redemption of investments.

Net cash used in financing activities was approximately \$5.0 million and \$7.7 million for the nine months ended September 30, 2007 and 2006, respectively. For the nine months ended September 30, 2007, net cash used in financing activities was primarily comprised of the repurchase of our common stock, repurchases of our restricted stock and repayment of long-term debt, offset by proceeds from the exercise of stock options and common shares issued under our employee stock purchase plan and excess tax benefits resulting from stock option exercises. For the nine months ended September 30, 2006, net cash used in financing activities was primarily comprised of the repurchase of our common stock, offset by excess tax benefits resulting from stock option exercises and proceeds from the exercise of stock options and common shares issued under our employee stock purchase plan.

### ***Stock Repurchase Program***

In March 2006, our Board of Directors approved a program authorizing the repurchase of up to 2,000,000 shares of our common stock through December 2008. During the three months ended March 31, 2007, we repurchased a total of 400,000 shares at an aggregated cost of approximately \$10.2 million (including commission fees of \$12,000), representing an average price per share of \$25.43. The Company did not make any common stock repurchases during the three months ended June 30, 2007. During the three months ended September 30, 2007, we repurchased a total of 142,278 shares at an aggregated cost of approximately \$4.8 million (including commission fees of \$4,300), representing an average price per share of \$33.47. As of September 30, 2007, there were 986,822 shares of our common stock available for repurchase under this program.

We currently anticipate that our existing cash and cash equivalents and short-term investment balances and cash generated from operations will be sufficient to meet our anticipated needs for working capital and capital expenditures, investment requirements, commitments and repurchases of our common stock for at least the next 12 months.

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## Forward-Looking Information

*In addition to historical information, the foregoing Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. These forward-looking statements involve risks, uncertainties and assumptions. The actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those discussed below, the risk factors discussed in Part II, Item 1A "Risk Factors" of this Quarterly Report on Form 10-Q and in Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006 (together, the "Risk Factors"), and the factors discussed in the section in this Quarterly Report on Form 10-Q entitled "Quantitative and Qualitative Disclosures About Market Risk". Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's opinions only as of the date hereof. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Readers should carefully review the Risk Factors and the risk factors set forth in other documents we file from time to time with the SEC.*

Some factors that could cause actual results to differ materially from those anticipated in these forward-looking statements include, but are not limited to, our ability to:

- o Sustain growth or profitability;
  - o Continue to maintain, expand and retain our customer base;
  - o Compete with other similar providers with regard to price, service and functionality;
  - o Cost-effectively procure and retain large quantities of telephone numbers in desired locations in the United States and abroad;
  - o Achieve business and financial objectives in light of burdensome telecommunications or Internet regulation or higher-than-expected tax rates or exposure to additional income tax liabilities;
  - o Successfully manage our cost structure, including but not limited to our telecommunication- and personnel-related expenses;
  - o Successfully adapt to technological changes in the messaging, communications and document management industries;
    - o Successfully protect our intellectual property and avoid infringing upon the proprietary rights of others;
    - o Adequately manage growth in terms of managerial and operational resources;
  - o Maintain and upgrade our systems and infrastructure to deliver acceptable levels of service quality and security of customer data and messages;
  - o Not incur unanticipated tax liabilities and accurately estimate the assumptions underlying our effective worldwide tax rate;
    - o Introduce new services and achieve acceptable levels of returns-on-investment for those new services;
- and
- o Recruit and retain key personnel.

In addition, our financial results could be materially impacted by risks associated with new accounting pronouncements.

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**Calculation of Average Monthly Revenue per Paying Telephone Number:**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	(In thousands except average monthly revenue per paying telephone number)			
DID-based revenues	\$ 51,209	\$ 42,832	\$ 149,423	\$ 122,233
Less other revenues	2,040	1,508	5,099	3,977
Total paying telephone number revenues	\$ 49,169	\$ 41,324	\$ 144,324	\$ 118,256
Average paying telephone number monthly revenue (total divided by number of months)	\$ 16,390	\$ 13,775	\$ 16,036	\$ 13,140
Number of paying telephone numbers				
Beginning of period	973	837	907	740
End of period	1,018	888	1,018	888
Average of period	995	862	962	814
Average monthly revenue per paying telephone number <sup>(1)</sup>	\$ 16.47	\$ 15.98	\$ 16.66	\$ 16.14

<sup>(1)</sup> Due to rounding, individual numbers may not add. In addition, for average monthly revenue per paying telephone number ("ARPU"), the average number of paid DIDs for the nine-month period will differ from the average of the first three quarterly average paid DIDs calculations resulting in a different ARPU for the nine months compared to the average of the ARPU for the first three quarterly periods.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*The following discussion of the market risks we face contains forward-looking statements. Forward-looking statements are subject to risks and uncertainties. Actual results could differ materially from those discussed in the forward-looking statements.*

#### **Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We maintain an investment portfolio of various holdings, types and maturities. The primary objectives of our investment activities are to preserve our principal while at the same time maximizing yields without significantly increasing risk. To achieve these objectives, we maintain our portfolio of cash equivalents and investments in a mix of tax-exempt and taxable instruments that meet high credit quality standards, as specified in our investment policy. Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of September 30, 2007, the carrying value of our cash and cash equivalents approximated fair value. Our return on these investments is subject to interest rate fluctuations. None of our investments is held for trading purposes.

Our short- and long-term investments are comprised primarily of readily marketable corporate debt securities, debt instruments of the U.S. government and its agencies, auction rate debt, preferred securities and certificates of deposits. Investments in fixed rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. Our interest income is sensitive to changes in the general level of U.S. and foreign countries' interest rates. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates. As of September 30, 2007, we had investments in debt securities with effective maturities between three months and one year of approximately \$97.7 million. Such investments had a weighted-average yield of approximately 4.6%. As of September 30, 2007, we had investments in debt securities with effective maturities between one and five years of approximately \$10.0 million. Such investments had a weighted average yield of approximately 5.2%. Based on our cash and cash equivalents and short-term and long-term investment holdings as of September 30, 2007, an immediate 100 basis point decline in interest rates would decrease our annual interest income by approximately \$2.4 million.

#### **Foreign Currency Risk**

We conduct business in certain foreign markets, primarily in Canada and the European Union. Our primary exposure to foreign currency risk relates to investment in foreign subsidiaries that transact business in a functional currency other than the U.S. Dollar, primarily the Canadian Dollar, Euro and British Pound Sterling. However, the exposure is mitigated by our practice of generally reinvesting profits from international operations in order to grow that business.

As we increase our operations in international markets we become increasingly exposed to changes in currency exchange rates. The economic impact of currency exchange rate movements is often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, could cause us to adjust our financing and operating strategies.

As currency exchange rates change, translation of the income statements of the international businesses into U.S. Dollars affects year-over-year comparability of operating results. Historically, we have not hedged translation risks because cash flows from international operations were generally reinvested locally.

Foreign exchange gains and losses were not material to our earnings for the nine months ended September 30, 2007. For the nine months ended September 30, 2007, translation adjustments amounted to approximately \$2.0 million. As of September 30, 2007, cumulative translation adjustments included in other comprehensive income amounted to approximately \$3.2 million. We periodically review our strategy for hedging transaction risks. Our objective in managing foreign exchange risk is to minimize the potential exposure to changes that exchange rates might have on

earnings, cash flows and financial position.

We do not have derivative financial instruments for hedging, speculative or trading purposes.

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**Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

j2 Global's management, with the participation of our principal executive officer and principal financial officer, performed an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 ("Exchange Act")) as of the end of the period covered by this report. Our principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed in reports we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (2) accumulated and communicated to our management to allow their timely decisions regarding required disclosure.

(b) Changes in Internal Controls

There were no changes in our internal control over financial reporting that occurred during the third quarter ended September 30, 2007 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**

#### **Overview of Patent Litigation**

As part of our continuing effort to prevent the unauthorized use of our intellectual property, we have initiated litigation against the following two companies, among others, for infringing our patents relating to Internet fax and other messaging technologies: Venali, Inc. (“Venali”) and Protus IP Solutions, Inc.

#### **Overview of Legal Proceedings Against Us**

From time to time, we are involved in litigation and other disputes or regulatory inquiries that arise in the ordinary course of our business. Many of these actions are filed in response to patent actions filed by us against the plaintiffs. The number and significance of these disputes and inquiries are increasing as our business expands and our company grows larger. Any claims or regulatory actions against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time, and result in the diversion of significant operational resources.

In February 2004 and July 2005, we filed two lawsuits against Venali in the United States District Court for the Central District of California for infringement of several of our U.S. patents. On June 21, 2006, Venali filed suit against us and our affiliate in the United States District Court for the Southern District of Florida, alleging violations of antitrust law and various related claims arising out of our procurement and enforcement of our patents. In lieu of any response to Venali’s complaint, the parties reached an agreement whereby Venali dismissed its complaint without prejudice and re-filed certain of its claims as counterclaims in the patent infringement actions in California. On December 27, 2006, Venali filed amended counterclaims in the July 2005 action alleging several violations of antitrust law (fraudulent procurement of patents, fraudulent enforcement of patents, tying and attempted monopolization) as well as tortious interference with business relationships, trademark infringement and unfair and deceptive trade practices. Venali is seeking damages, including treble damages for the antitrust claims, injunctive relief, attorneys’ fees and costs. Venali’s claims relate in substantial part to the patent infringement claims by us against Venali. On April 13, 2007, the court granted in part our motion to dismiss Venali’s counterclaims, dismissing the tying claim with leave to amend. Venali has agreed that it will not replead the tying counterclaim and has also stipulated to the dismissal of its Lanham Act and tortious interference counterclaims.

On December 12, 2006, Venali filed suit against us in the United States District Court for the Southern District of Florida, alleging infringement of U.S. Patent Number 7,114,004 (the “ ’004 Patent”). Venali is seeking damages in the amount of lost profits or a reasonable royalty, a permanent injunction against continued infringement, treble damages, attorneys’ fees, interest and costs. On March 6, 2007, we filed an answer to the complaint denying liability. On May 17, 2007, we filed a request with the U.S. Patent & Trademark Office for reexamination of the ’004 Patent, which request was granted on July 27, 2007. On August 13, 2007, we moved to stay the action pending the reexamination. On August 20, 2007, the court granted the motion and stayed the action pending reexamination of the patent.

On May 9, 2007, Bear Creek Technologies, Inc. (“Bear Creek”) filed suit against us in the United States District Court for the Eastern District of Texas, alleging infringement of U.S. Patent Number 6,685,494. Bear Creek is seeking damages in, at least, the amount of a reasonable royalty, a permanent injunction against continued infringement, treble damages, attorneys’ fees, interest and costs. On June 29, 2007, we filed an answer to the complaint denying liability, asserting affirmative defenses, and asserting counterclaims of non-infringement and invalidity. On September 21, 2007, Bear Creek filed its reply to our counterclaims, denying each one. The claim construction hearing is set for April 28, 2008, and jury selection for trial in the matter is set for April 7, 2009.

On June 21, 2007, Integrated Global Concepts, Inc. ("IGC") filed a lawsuit against us, certain of our current and former officers and/or directors, one of our affiliates, and several other parties in the United States District Court for the Northern District of Illinois. The suit purports to allege violations of antitrust law, the Racketeer Influenced and Corrupt Organizations Act and various related statutory and common law claims arising out of our procurement

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and enforcement of our patents and our acquisition of certain companies. IGC's claims relate in substantial part to a patent infringement action by our affiliate against IGC. The suit seeks damages, including treble and punitive damages, an injunction against further violations, divestiture of certain assets, attorneys' fees and costs. On October 31, 2007, the Court stayed this action pending resolution of the related case in the Northern District of Georgia described below.

On October 11, 2007, IGC filed substantially the same claims it previously filed in the Northern District of Illinois as counterclaims in a pending patent infringement case in the United States District Court for the Northern District of Georgia brought against IGC by our affiliate. Like the prior lawsuit, IGC's counterclaims name us, certain of our current and former officers and/or directors, one of our affiliates, and several other parties, and purport to allege violations of antitrust law, the Racketeer Influenced and Corrupt Organizations Act and various related statutory and common law claims arising out of our procurement and enforcement of our patents and our acquisition of certain companies. The counterclaims seek damages, including treble and punitive damages, an injunction against further violations, divestiture of certain assets, attorneys' fees and costs. We have not yet responded to the counterclaim.

On June 29, 2007, a purported class action was filed by Justin Lynch as the named plaintiff in the United States District Court for the Central District of California alleging that we have attempted to monopolize and/or monopolized the market for Internet facsimile services to home and small offices in violation of Section 2 of the Sherman Act. The claims relate in substantial part to the patent infringement actions by us against various companies. The suit seeks treble damages, injunctive relief, attorneys' fees and costs. On August 24, 2007, we filed an answer to the complaint denying liability.

We do not believe, based on current knowledge, that any of the foregoing legal proceedings or claims is likely to have a material adverse effect on our financial position, results of operations or cash flows. However, depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect our business, financial position, results of operations or cash flows in a particular period.

#### **Item 1A. Risk Factors**

In addition to the other information set forth in this report, before deciding to invest in our Company or to maintain or increase your investment, you should carefully consider the factors discussed in Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006 (the "10-K Risk Factors"). If any of these risks occur, our business, prospects, financial condition, operating results and cash flows could be materially adversely affected. The 10-K Risk Factors are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. Except as set forth below, there are no material changes from the 10-K Risk Factors.

**The current weakness in the financial markets has adversely affected segments of our customers, which has and could continue to result in a decrease in usage levels by these customers and, therefore, a decrease in our average variable revenue per subscriber and a resulting decrease in our rate of revenue growth.**

Certain segments of our customers - those whose business activity is tied to the health of the credit markets and the broader economy, such as banks, brokerage firms and those in the real estate industry - have been and may continue to be adversely affected by the current turmoil in the credit markets and weakness in the broader mortgage market and the general economy. To the extent our customers' businesses have been adversely affected by these economic factors and their usage levels of our services declined, we have experienced a decrease in our average usage per subscriber and, therefore, a decrease in our average variable revenue per subscriber. We may continue to experience this adverse impact in future periods. These factors have in turn led to, and may continue to cause, a decrease in our rate of revenue growth. Since the vast majority of our revenues are fixed (i.e., subscription fee based) versus variable (i.e., usage based), our exposure to this decrease in our rate of revenue growth has been, and we would expect it to continue to be limited.



**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****Issuer Purchases of Equity Securities**

In March 2006, our Board of Directors approved a common stock repurchase program whereby we were authorized to repurchase up to 2,000,000 shares of our common stock through December 2008. On April 26, 2006, we entered into a Rule 10b5-1 trading plan with a broker to facilitate the repurchase program.

The following table details the repurchases that were made under the program during the three months ended September 30, 2007:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share (1)</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Program</b>	<b>Maximum Number of Shares That May Yet Be Purchased Under the Program</b>
July 1, 2007 - July 31, 2007	—	—	870,900	1,129,100
August 1, 2007 - August 31, 2007	24,778	\$ 32.31	895,678	1,104,322
September 1, 2007 - September 30, 2007	117,500	\$ 33.71	1,013,178	986,822

(1) Average price per share excludes commissions.

**Item 6. Exhibits**

31.1 Rule 13a-14(a) Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Rule 13a-14(a) Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Section 1350 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Section 1350 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Items 3, 4 and 5 are not applicable and have been omitted.

**SIGNATURE**

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

j2 Global Communications, Inc.

Date: November 9, 2007

By: /s/ KATHLEEN M. GRIGGS  
Kathleen M. Griggs  
Chief Financial Officer



**INDEX TO EXHIBITS**

<u>Exhibit Number</u>	<u>Description</u>
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