

J2 GLOBAL COMMUNICATIONS INC
Form 10-K
February 28, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2010

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: 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, (323) 860-9200
(Address and telephone number of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, \$0.01 par value
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of the last business day of the registrant's most recently completed second fiscal quarter, the approximate aggregate market value of the common stock held by non-affiliates, based upon the closing price of the common stock as quoted by the NASDAQ Global Select Market was \$644,602,730. Shares of common stock held by executive officers, directors and holders of more than 5% of the outstanding common stock have been excluded. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 22, 2011, the registrant had 45,884,180 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held May 12, 2011 are incorporated by reference into Part III of this Form 10-K.

This Annual Report on Form 10-K includes 73 pages with the Index to Exhibits located on page 64.

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PART I

Item 1. Business

j2 Global Communications, Inc. (“j2 Global”, “our”, “us” or “we”) is a Delaware corporation founded in 1995. We provide cloud-based, value-added communication, messaging and data backup services to businesses of all sizes, from individuals to enterprises. Our hosted solutions deliver our customers greater efficiency, flexibility, mobility, business continuity and security. We offer online fax, virtual phone systems, hosted email, email marketing, online backup and bundled suites of these services. We market our services principally under the brand names eFax®, eVoice®, Electric Mail®, Campaigner®, KeepItSafe™ and Onebox®.

We deliver many of our services in more than 4,300 cities in 49 countries across six continents. We provide these services through equipment we co-locate at various locations worldwide, telephone numbers (referred to herein as Direct Inward-Dial numbers or “DIDs”) obtained from third-party telecommunications providers and Internet bandwidth typically obtained from third-party co-location providers. Most of the DIDs we obtain for our services are “local” (as opposed to toll-free), which enables us to provide our paying subscribers DIDs with a geographic identity.

Our services make our customers more efficient, more mobile, more cost-effective and more secure than traditional alternatives. We generate substantially all of our revenues from subscribers that pay subscription and usage fees. Subscription fees are referred to as “fixed” revenues, while usage fees are referred to as “variable” revenues. We also generate revenues from patent licensing and sales, advertising and revenue share from our customers’ use of premium rate DIDs. Of the 13.1 million DIDs deployed as of December 31, 2010, approximately 1.9 million were serving paying subscribers, with the balance deployed to free subscribers, including those with premium rate DIDs. We operate in one reportable segment: cloud-based, value-added communication, messaging and data backup services.

During the past three years, we have derived a substantial portion of our revenues from our DID-based services, including eFax®, eVoice® and Onebox®. 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 seek to increase revenues through a combination of stimulating use by our customers of usage-based services and introducing new services.

We market our services to a broad spectrum of prospective business customers including individuals, small to medium-sized businesses and large enterprises and government organizations. Our marketing efforts include enhancing brand awareness; utilizing online advertising, search engines and affiliate programs; and selling through both a telesales and direct sales force. We continuously seek to extend the number of distribution channels through which we acquire paying customers and improve the cost and volume of customers obtained through our current channels.

In addition to growing our business organically, we have used acquisitions to grow our customer base, enhance our technology, expand service offerings and acquire skilled personnel. Since fiscal year 2000, we have completed 31 acquisitions in the cloud-based, value-added communication, messaging and data backup services segment.

Through a combination of internal technology development and acquisitions, we have built a portfolio of numerous U.S. and foreign patents and multiple pending U.S. and foreign patent applications. We generate licensing revenues from some of these patents. We intend to continue to invest in patents, to aggressively protect our patent assets from unauthorized use and to continue to generate patent licensing revenues from authorized users. For more information on our patents and other intellectual property, please refer to the section entitled Patents and Proprietary Rights contained in Item 1 of this Annual Report on Form 10-K.

Our Solutions

We believe that businesses of all sizes are increasingly outsourcing their communication, messaging and data backup needs. Their goal is to reduce or eliminate costs while also enhancing productivity, mobility, business continuity and security. Our core eFax® and MyFax® solution enable users to receive faxes into their email inboxes and to send faxes via the Internet. Our core eVoice® and Onebox® solutions provide customers a virtual phone system with various available enhancements. These services represent more efficient and less expensive solutions than many existing alternatives, and provide for increased security, privacy and message handling flexibility (e.g., the ability to store messages electronically and forward them by simply forwarding an email).

We currently offer integrated solutions designed to replace or augment individual and corporate communication, messaging and data backup functions. We tailor our solutions to satisfy the differing needs of our customers. Our paid DID-based services allow a subscriber to select a local DID from among more than 4,300 cities around the world. Toll-free U.S. and Canadian DIDs are also available, as are premium rate numbers in various countries. In addition, our services enhance the ability of businesses to provide communication and messaging services to their remote workforces, increase their level of information security and control and allocate costs more effectively.

We offer the following services and solutions:

Fax

We market a variety of brands in the global online fax space. The online fax space has three basic components: desktop, production and broadcast. These brands have various tiers of services and features catering to differing components of the fax space. Our leading fax brands are eFax® and MyFax®.

Desktop fax

eFax® is the leading brand in the global online fax market. Various tiers of service provide increasing levels of features and functionality to individuals, small and medium-sized businesses, and enterprises around the world.

eFax Plus® and eFax Pro™ serve individuals and small work groups. Subscribers choose either a toll-free fax number that covers both the U.S. and Canada or a local fax number from among more than 4,300 cities worldwide. Users can receive inbound fax messages in their email inboxes, access these messages via a full-featured online Message Center and send digital documents to any fax number in the world directly from their computer or smartphone. This service is localized in many international currencies and languages including Dutch, French, German, Italian, Japanese, Polish, Portuguese and Spanish.

eFax Corporate™ offers capabilities similar to eFax Plus® and eFax Pro™, but with added features geared to the broader needs of enterprises and their users. These include online account administration tools which enable customers to manually or automatically self-provision fax numbers to employees as needed. eFax Corporate also offers the option of enhanced security features, which are particularly attractive to law firms and companies in regulated industries such as banking, brokerage and healthcare.

MyFax® is our number two online fax brand. The service supports individuals and small business customers that value core features and price over breadth and depth of functionality. MyFax focuses on the North American market with a selection of fax numbers across the United States and Canada. The service has won a number of awards for its comprehensive customer support program.

In addition to eFax® and MyFax®, we offer desktop online fax services under a variety of alternative brands. We acquired these brands in business purchases and, rather than being merged into existing brands, continue to offer them on a standalone basis to serve legacy customer bases, target specific market segments or address unique price points. These brands include Fax.com™ and SmartFax™, among others.

Production fax

eFax Developer™ offers high-volume production fax solutions. Designed for easy integration with application environments through simple software development kits or universal web protocols, eFax Developer provides inbound and outbound faxing through a secure XML interface. Enhanced features include bar-code recognition, dynamic retries and high speed processing.

Broadcast fax

eFax Broadcast™ and jBlast® offer cost-effective solutions for high-volume outbound broadcast faxing. These services enable users to send important documents simultaneously to hundreds or thousands of recipients anywhere in the world, accurately monitor the status of their faxes and update their database of “Do Not Fax” names and undeliverable fax numbers.

Voice

eVoice® is a virtual phone system that provides small and medium-sized businesses on-demand voice communications services, featuring a toll-free or local company DID, a professionally-produced auto-attendant and menu tree. With these services, a subscriber can assign departmental and individual extensions that can connect to multiple U.S. or Canadian DIDs, including traditional land-line telephones as well as mobile and IP networks, and can enhance reachability through “find me/follow me” capabilities. These services also include advanced integrated voicemail for each extension, effectively unifying mobile, office and other separate voicemail services and improving efficiency by delivering voicemails in both native audio format and as transcribed text.

Hosted Email

Electric Mail® and FuseMail® offer hosted email, email hygiene and email archival services to businesses. These solutions are hosted offsite and seamlessly integrated into a customer’s existing email system. The services include Electric WebMail™ and FuseMail® hosted email, VirusSMART™ virus scanning, CypherSMART™ encryption services, SpamSMART™ SPAM filtering and VaultSMART™ / PolicySMART™ archiving which delivers a secure, scalable email archiving and customizable compliance tool to correspond with a company’s retention policy.

Email Marketing

Campaigner® is an email marketing service that enables businesses to easily create and send highly personalized one-to-one email communications to subscribers and customers to build better relationships. Campaigner® also helps businesses increase the size of their mailing lists, comply with email regulations like CAN-SPAM and get more emails to more inboxes.

Online Backup

KeepItSafe™ provides fully managed and monitored online backup solutions for businesses, using its ISO-certified platform. By securing critical digital assets via the Internet to highly secure data vaults, customers enjoy peace of mind knowing they have reliable and cost effective backups, and equally importantly rapid restores of the data that keeps their business operating. The software installs simply and provides full server imaging and proven off-site data recovery capabilities without costly investments. Company data is protected from human error, file corruption and other harmful factors.

Unified Communications

Onebox® is a full-featured unified communications suite. It combines the features of many of our other branded services, as well as additional features to provide full virtual office functionality. Onebox includes a virtual phone system, hosted email, online fax, audio conferencing and web conferencing.

Global Network and Operations

We have multiple physical Points of Presence (“POPs”) worldwide, a central data center in Los Angeles and a remote disaster recovery facility. We connect our POPs to our central data centers via redundant, and often times diverse, Virtual Private Networks (“VPNs”) using the Internet. Our network is designed to deliver value-added user applications, customer support, billing and a local presence for our customers from among more than 4,300 cities in 49 countries on six continents. Our network covers all major metropolitan areas in the U.S., U.K. and Canada, and such other major cities as Berlin, Hong Kong, Madrid, Manila, Mexico City, Milan, Paris, Rome, Singapore, Sydney, Taipei, Tokyo and Zurich. For financial information about geographic areas, see Note 14 of the Notes to Consolidated Financial Statements included elsewhere in this Annual Report on Form 10-K.

We obtain DIDs from various local carriers throughout the U.S. and internationally. Our ability to continue to acquire additional DIDs in desired locations in the future will depend on our relationships with our local carriers, our ability to pay market prices for such DIDs, our ability to secure DIDs from among growing number of alternate providers and the regulatory environment. Please refer to the sections entitled Government Regulation and Risk Factors contained in Item 1 and 1A, respectively, of this Annual Report on Form 10-K.

Customer Support Services

Our Customer Service organization provides support to our customers through a combination of online self-help, email messages, interactive chat sessions and telephone calls. Our Internet-based online self-help tools enable customers to resolve simple issues on their own, eliminating the need to speak or write to our customer service representatives. We use internal personnel and contracted third parties (on a dedicated personnel basis) to answer our customer emails and telephone calls and to participate in interactive chat sessions.

We provide email support seven days per week, 24 hours per day to all subscribers. Paying subscribers have access to live-operator telephone support seven days per week, 24 hours per day. Dedicated telephone support is provided for Corporate customers 24 hours per day, seven days per week.

Competition

Competition in the cloud-based, value-added communication, messaging and data backup space is fierce and continues to intensify. We face competition from, among others, online fax-providers, broadcast fax companies, traditional fax machine or multi-function printer companies, unified messaging/communications providers, telephone companies, voicemail providers, companies offering PBX systems and outsourced PBX solutions, email providers and various data backup solutions. We believe that the primary competitive factors determining success in the market for our services include financial strength and stability, pricing, reputation for reliability and security of service, intellectual property ownership, effectiveness of customer support, service and software ease-of-use, service scalability, customer messaging and branding, geographic coverage, scope of services and local language sales, messaging and support.

Our most popular solutions relate to online faxing, including the ability of our customers to access faxes via email and our outbound desktop faxing capabilities. These solutions compete primarily against traditional fax machine manufacturers, which are generally large and well-established companies, providers of fax servers and related software, such as Open Text Corporation as well

as publicly traded and privately-held application service providers, such as Easylink Services International Corporation. Some of these companies may have greater financial and other resources than we do. For more information regarding the competition that we face, please refer to the section entitled Risk Factors contained in Item 1A of this Annual Report on Form 10-K.

Patents and Proprietary Rights

We regard the protection of our intellectual property rights as important to our success. We aggressively protect these rights by relying on a combination of patents, trademarks, copyrights, trade dress and trade secret laws and by using the domain name dispute resolution system. We also enter into confidentiality and invention assignment agreements with employees and contractors, and nondisclosure agreements with parties with whom we conduct business in order to limit access to and disclosure of our proprietary information.

We have a portfolio of numerous U.S. and foreign patents and have multiple pending U.S. and foreign patent applications, all covering components of our technology and in some cases technologies beyond those that we currently offer. Three of our core U.S. patents have been reaffirmed through reexamination proceedings with the United States Patent and Trademark Office (the "USPTO"). We seek patents for inventions that contribute to our business and technology strategy. We have obtained patent licenses for certain technologies where such licenses are necessary or advantageous. Unless and until patents are issued on the pending applications, no patent rights on those applications can be enforced.

Over the past five years we have generated royalties from licensing certain of our patents and have enforced these patents against companies using our patented technology without our permission. We have pending patent infringement lawsuits against several companies. In each case, we are seeking at least a reasonable royalty for the infringement of the patent(s) in suit, a permanent injunction against continued infringement and attorneys' fees, interest and costs.

We own and use a number of trademarks in connection with our products and services, including eFax and the eFax logo, MyFax and the MyFax logo, eFax Corporate and the eFax Corporate logo, eVoice and the eVoice logo, Electric Mail and the Electric Mail logo, KeepItSafe™ and the KeepItSafe™ logo and Onebox and the Onebox logo, among others. Many of these trademarks are registered in the U.S. and other countries, and numerous trademark applications are pending in the U.S. and several non-U.S. jurisdictions. We hold numerous Internet domain names, including "efax.com", "efaxcorporate.com", "myfax.com", "fax.com", "evoice.com", "electricmail.com", "campaigner.com", "fusem.com", "keepitsafe.com" and "onebox.com", among others. We have in place an active program to continue securing "eFax" and other domain names in non-U.S. jurisdictions. We have filed to protect our rights to the "eFax" and other names in certain alternative top-level domains such as ".org", ".net", ".biz", ".info" and ".us", among others.

Like other technology-based businesses, we face the risk that we will be unable to protect our intellectual property and other proprietary rights, and the risk that we will be found to have infringed the proprietary rights of others. For more information regarding these risks, please refer to the section entitled Risk Factors contained in Item 1A of this Annual Report on Form 10-K.

Government Regulation

We are subject to a number of foreign and domestic laws and regulations that affect companies conducting business over the Internet and, in some cases, using services of third-party telecommunications providers, including, among others, those addressing privacy, data storage, retention and security, freedom of expression, content, taxation, DIDs, advertising and intellectual property. We are not a regulated telecommunications provider in the U.S. For information about the risks we face with respect to governmental regulation, please see Item 1A of this Annual Report on Form 10-K entitled Risk Factors.

Seasonality and Backlog

Our subscriber revenues are impacted by the number of effective business days in a given period. We experience no material backlog in sales orders or the provisioning of customer orders. We traditionally experience lower than average usage and customer sign-ups in the fourth quarter.

Research and Development

The markets for our services are evolving rapidly, requiring ongoing expenditures for research and development and timely introduction of new services and service enhancements. Our future success will depend, in part, on our ability to enhance our current services, to respond effectively to technological changes, to sell additional services to our existing customer base and to introduce new services and technologies that address the increasingly sophisticated needs of our customers.

We devote significant resources to develop new services and service enhancements. Our research, development and engineering expenditures were \$12.8 million, \$11.7 million and \$12.0 million for the fiscal years ended December 31, 2010, 2009 and 2008, respectively. For more information regarding the technological risks that we face, please refer to the section entitled Risk

Factors contained in Item 1A of this Annual Report on Form 10-K.

Employees

As of December 31, 2010, we had approximately 600 employees, the majority of whom are in the U.S.

Our future success will depend, in part, on our ability to continue to attract, retain and motivate highly qualified technical, marketing and management personnel. Our employees are not represented by any collective bargaining unit or agreement. We have never experienced a work stoppage. We believe our relationship with our employees is good.

Web Availability of Reports

Our corporate information Website is www.j2global.com. The information on our Website is not part of this Annual Report on Form 10-K. However, on the Investor Relations portion of this Website the public can access free of charge our annual, quarterly and current reports, changes in the stock ownership of our directors and executive officers and other documents filed with the Securities and Exchange Commission ("SEC") as soon as reasonably practicable after the filing dates. Further, the SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov.

Item 1A. Risk Factors

Before deciding to invest in j2 Global or to maintain or increase your investment, you should carefully consider the risks described below in addition to the other cautionary statements and risks described elsewhere in this Annual Report on Form 10-K and our other filings with the SEC, including our subsequent reports on Forms 10-Q and 8-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may affect our business. If any of these known or unknown risks or uncertainties actually occurs, our business, prospects, financial condition, operating results and cash flows could be materially adversely affected. In that event, the market price of our common stock will likely decline and you may lose part or all of your investment.

Risks Related To Our Business

Weakness in the economy has adversely affected and may continue to adversely affect segments of our customers, which has resulted and may continue to result in decreased usage levels, customer acquisitions and customer retention rates and, in turn, could lead to a decrease in our revenues or rate of revenue growth.

Certain segments of our customers have been and may continue to be adversely affected by the current weakness in the general economy. To the extent these customers' businesses have been adversely affected by the economic downturn and their usage levels of our services decline, we may experience a decrease in our average usage per subscriber and, therefore, a decrease in our average variable revenue per subscriber. In addition, continued weakness in the economy may adversely affect our customer retention rates for certain customer segments and the number of our new customer acquisitions in general. These factors may adversely impact our revenues and profitability.

Increased numbers of credit and debit card declines as a result of decreased availability of credit and/or a weak economy which continues to experience heightened levels of unemployment could lead to a decrease in our revenues or rate of revenue growth.

A significant number of our paid subscribers pay for their services through credit and debit cards. Weakness in certain segments of the credit markets and in the U.S. and global economies, which continue to experience heightened levels of unemployment, has resulted in and may continue to result in increased numbers of rejected credit and debit card

payments. We believe this has resulted in and may continue to result in increased customer cancellations and decreased customer signups. This also has required and may continue to require us to increase our reserves for doubtful accounts and write-offs of accounts receivables. The foregoing may adversely impact our revenues and profitability.

Our financial results may be adversely impacted by higher-than-expected income tax rates or exposure to additional income tax liabilities.

We are a U.S.-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. Our provision for income taxes is based on a jurisdictional mix of earnings, statutory rates and enacted tax rules, including transfer pricing. Significant judgment is required in determining our provision for income taxes and in evaluating our tax positions on a worldwide basis. It is possible that these positions may be challenged or we may find tax-beneficial intercompany transactions to be uneconomical, either of which may have a significant impact on our effective tax rate.

A number of factors affect our income tax rate and the combined effect of these factors could result in an increase in our effective income tax rate. An increase in future effective income tax rates would adversely affect net income in future periods. We operate in different countries that have different income tax rates. Effective tax rates could be adversely affected by earnings being

lower than anticipated in countries having lower statutory rates and higher than anticipated in countries having higher statutory rates, by changes in the valuation of deferred tax assets or liabilities or by changes in tax laws or interpretations thereof.

A substantial portion of our cash and investments are invested outside of the U.S. We may be subject to incremental taxes upon repatriation of such funds to the U.S.

We may be subject to examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. We are currently under audit by the California Franchise Tax Board for tax years 2005 through 2007 and by other state taxing authorities for various periods. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our income tax reserves and expense. If our reserves are not sufficient to cover these contingencies, such inadequacy could materially adversely affect our business, prospects, financial condition, operating results and cash flows.

Our business and users may be subject to telecommunications and sales taxes.

As a provider of cloud-based, value-added communication, messaging and data backup, we do not provide telecommunications services. Thus, we believe that our business and our users (by using our services) are not subject to various telecommunication taxes. However, state taxing authorities may challenge this belief and have and may continue to audit our business and operations with respect to telecommunications taxes.

In addition, the application of other indirect taxes (such as sales and use tax, value added tax (“VAT”), goods and services tax, business tax and gross receipt tax) to e-commerce businesses such as j2 Global and our users is a complex and evolving issue. In November 2007, the U.S. federal government enacted legislation extending the moratorium on states and other local authorities imposing access or discriminatory taxes on the Internet through November 2014. This moratorium does not prohibit federal, state or local authorities from collecting taxes on our income or from collecting taxes that are due under existing tax rules. The application of existing, new or future laws could have adverse effects on our business, prospects and operating results. There have been, and will continue to be, substantial ongoing costs associated with complying with the various indirect tax requirements in the numerous markets in which we conduct or will conduct business.

Our growth will depend on our ability to develop our brands and market new brands, and these efforts may be costly.

We believe that continuing to strengthen our current brands and effectively launch new brands will be critical to achieving widespread acceptance of our services, and will require continued focus on active marketing efforts. The demand for and cost of online and traditional advertising have been increasing and may continue to increase. Accordingly, we may need to spend increasing amounts of money on, and devote greater resources to, advertising, marketing and other efforts to create and maintain brand loyalty among users. In addition, we are supporting an increasing number of brands, each of which requires its own resources. Brand promotion activities may not yield increased revenues, and even if they do, any increased revenues may not offset the expenses incurred in building our brands. If we fail to promote and maintain our brands, or if we incur substantial expense in an unsuccessful attempt to promote and maintain our brands, our business could be harmed.

If our trademarks are not adequately protected or we are unable to protect our domain names, our reputation and brand could be adversely affected.

Our success depends, in part, on our ability to protect our trademarks. We rely on some brands that use the letter “e” before a word, such as “eFax” and “eVoice”. Some regulators and competitors have taken the view that the “e” is descriptive. Others have claimed that these brands are generic when applied to the products and services we offer. If we are unable to secure and protect trademark rights to these or other brands, the value of these brands may be

diminished, competitors may be able to more effectively mimic our service and methods of operations, the perception of our business and service to subscribers and potential subscribers may become confused in the marketplace and our ability to attract subscribers may be adversely affected.

We currently hold various domain names relating to our brands, both in the U.S. and internationally, including efax.com and various other international extensions, evoice.com, fax.com, onebox.com and others. The acquisition and maintenance of domain names generally are regulated by governmental agencies and their designees. The regulation of domain names in the U.S. may change. Governing bodies may establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names in the U.S. Furthermore, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights in the U.S. is unclear. Similarly, international rules governing the acquisition and maintenance of domain names in foreign jurisdictions are sometimes different from U.S. rules, and we may not be able to obtain all of our domains internationally. As a result of these factors, we may be unable to prevent third parties from acquiring domain names that are similar to, infringe upon or otherwise decrease the value of our trademarks and other proprietary rights. In addition, failure to protect our domain names domestically or internationally could adversely affect our reputation and brands, and make it more difficult for users to find our Websites and our services.

We may be subject to risks from international operations.

As we continue to expand our business operations in countries outside the U.S., our future results could be materially adversely affected by a variety of uncontrollable and changing factors including, among others, foreign currency exchange rates; political or

social unrest or economic instability in a specific country or region; trade protection measures and other regulatory requirements which may affect our ability to provide our services; difficulties in staffing and managing international operations; and adverse tax consequences, including imposition of withholding or other taxes on payments by subsidiaries and affiliates. Any or all of these factors could have a material adverse impact on our future business, prospects, financial condition, operating results and cash flows.

We have only limited experience in marketing and operating our services in certain international markets. Moreover, we have in some cases experienced and expect to continue to experience in some cases higher costs as a percentage of revenues in connection with establishing and providing services in international markets versus the U.S. In addition, certain international markets may be slower than the U.S. in adopting the Internet and/or outsourced messaging and communications solutions and so our operations in international markets may not develop at a rate that supports our level of investments.

We rely heavily on the revenue generated by our fax services.

Currently, a substantial portion of the overall traffic on our network is fax related. Our success is therefore dependent upon the continued use of fax as a messaging medium and/or our ability to diversify our service offerings and derive more revenue from other services, such as voice, email and unified messaging solutions. If the demand for fax as a messaging medium decreases, and we are unable to replace lost revenues from decreased usage of our fax services with a proportional increase in our customer base or with revenues from our other services, our business, financial condition, operating results and cash flows could be materially and adversely affected.

We believe that one of the attractions to fax versus alternatives, such as email, is that fax signatures are a generally accepted method of executing contracts. There are on-going efforts by governmental and non-governmental entities, many of which possess greater resources than we do, to create a universally accepted method for electronically signing documents. Widespread adoption of so-called “digital signatures” could reduce demand for our fax services and, as a result, could have a material adverse effect on our business, prospects, financial condition, operating results and cash flows.

If we experience excessive fraudulent activity or cannot meet evolving credit card company merchant standards, we could incur substantial costs and lose the right to accept credit cards for payment and our subscriber base could decrease significantly.

A significant number of our paid subscribers authorize us to bill their credit card accounts directly for all service fees charged by us. If people use our services using stolen credit cards, we could incur substantial third-party vendor costs for which we may not be reimbursed. We also incur losses from claims that the customer did not authorize the credit card transaction to purchase our service. If the numbers of unauthorized credit card transactions become excessive, we could be assessed substantial fines for excess chargebacks and we could lose the right to accept credit cards for payment. In addition, credit card companies may change the merchant standards required to utilize their services from time to time. If we are unable to meet these new standards, we could be unable to accept credit cards. Substantial losses due to fraud or our inability to accept credit card payments, which could cause our paid subscriber base to significantly decrease, could have a material adverse effect on our business, prospects, financial condition, operating results and cash flows.

A system failure or security breach could delay or interrupt service to our customers, harm our reputation or subject us to significant liability.

Our operations are dependent on our ability to protect our network from interruption by damage from fire, earthquake, power loss, telecommunications failure, unauthorized entry, computer viruses or other events beyond our control. There can be no assurance that our existing and planned precautions of backup systems, regular data backups, security

protocols and other procedures will be adequate to prevent significant damage, system failure or data loss. Also, many of our services are web-based, and the amount of data we store for our users on our servers has been increasing. Despite the implementation of security measures, our infrastructure may be vulnerable to computer viruses, hackers or similar disruptive problems caused by our subscribers, employees or other Internet users who attempt to invade public and private data networks. Further, in some cases we do not have in place disaster recovery facilities for certain ancillary services. Currently, a significant number of our users authorize us to bill their credit or debit card accounts directly for all transaction fees charged by us. We rely on encryption and authentication technology to effect secure transmission of confidential information, including customer credit and debit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or breach of the technology used by us to protect transaction data. Any system failure or security breach that causes interruptions or data loss in our operations or in the computer systems of our customers or leads to the misappropriation of our or our customers' confidential information could result in significant liability to us (including in the form of judicial decisions and/or settlements, regulatory findings and/or forfeitures, and other means), cause considerable harm to us and our reputation (including requiring notification to customers, regulators, and/or the media) and deter current and potential customers from using our services. Any of these events could have a material adverse effect on our business, prospects, financial condition, operating results and cash flows.

Our business is dependent on a small number of telecommunications carriers in each region and our inability to maintain agreements at attractive rates with such carriers may negatively impact our business.

Our business substantially depends on the capacity, affordability, reliability and security of our network and services provided to us by our telecommunications suppliers. Only a small number of carriers in each region, and in some cases only one carrier, offer

the DID and network services we require. We purchase certain telecommunications services pursuant to short-term agreements that the providers can terminate or elect not to renew. As a result, any or all of our current carriers could discontinue providing us with service at rates acceptable to us, or at all, and we may not be able to obtain adequate replacements, which could materially and adversely affect our business, prospects, financial condition, operating results and cash flows.

The successful operation of our business depends upon the supply of critical elements and marketing relationships from other companies.

We depend upon third parties for several critical elements of our business, including various technology, infrastructure, customer service and marketing components. We rely on private third-party providers for our Internet and other connections and for co-location of a significant portion of our servers. Any disruption in the services provided by any of these suppliers, or any failure by them to handle current or higher volumes of activity could have a material adverse effect on our business, prospects, financial condition, operating results and cash flows. To obtain new customers, we have marketing agreements with operators of leading search engines and Websites. These arrangements typically are not exclusive and do not extend over a significant period of time. Failure to continue these relationships on terms that are acceptable to us or to continue to create additional relationships could have a material adverse effect on our business, prospects, financial condition, operating results and cash flows.

Inadequate intellectual property protections could prevent us from enforcing or defending our proprietary technology.

Our success depends in part upon our proprietary technology. We rely on a combination of patents, trademarks, trade secrets, copyrights and contractual restrictions to protect our proprietary technology. However, these measures provide only limited protection, and we may not be able to detect unauthorized use or take appropriate steps to enforce our intellectual property rights, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the U.S. While we have been issued a number of patents and other patent applications are currently pending, there can be no assurance that any of these patents will not be challenged, invalidated or circumvented, or that any rights granted under these patents will in fact provide competitive advantages to us.

In addition, effective protection of patents, copyrights, trademarks, trade secrets and other intellectual property may be unavailable or limited in some foreign countries. As a result, we may not be able to effectively prevent competitors in these regions from infringing our intellectual property rights, which could reduce our competitive advantage and ability to compete in those regions and negatively impact our business.

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