Crexendo, Inc.
Form 10-Q
August 04, 2015

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from ________ to ________.

Commission file number 001-32277

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

Delaware (State or other jurisdiction of incorporation or organization)	87-0591719 (I.R.S. Employer Identification No.)

1615 South 52nd Street, Tempe, AZ (Address of Principal Executive	85281 (Zip Code)

Offices)

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

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

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

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 "smaller reporting company" in Rule 12b-2 of the Exchange Act. (check one).

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

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

The number of shares outstanding of the registrant's common stock as of July 31, 2015 was 13,200,624.

INDEX

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$1,782	$2,906
Restricted cash	129	133
Trade receivables, net of allowance for doubtful accounts of $22		
as of June 30, 2015 and $49 as of December 31, 2014	345	543
Inventories	79	72
Equipment financing receivables	153	171
Prepaid expenses and other	1,194	1,032
Total current assets	3,682	4,857
Certificate of deposit	251	251
Long-term trade receivables, net of allowance for doubtful accounts		
of $28 as of June 30, 2015 and $19 as of December 31, 2014	95	64
Long-term equipment financing receivables	397	455
Property and equipment, net	56	68
Deferred income tax assets, net	381	381
Intangible assets, net	552	676
Goodwill	272	272
Long-term prepaid rent	215	376
Other long-term assets	228	114
Total Assets	$6,129	$7,514
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$95	$47
Accrued expenses	1,008	1,331
Income tax payable	24	7
Contingent consideration	110	211
Deferred income tax liability	381	381
Deferred revenue, current portion	634	726
Total current liabilities	2,252	2,703
Deferred revenue, net of current portion	95	64
Other long-term liabilities	156	203
Total liabilities	2,503	2,970

Stockholders' equity:		
Preferred stock, par value $0.001 per share - authorized 5,000,000 shares; none issued	—	—
Common stock, par value $0.001 per share - authorized 25,000,000 shares, 13,200,624 shares outstanding as of June 30, 2015 and 12,681,617 shares outstanding as of December 31, 2014	13	13
Additional paid-in capital	56,725	55,413
Accumulated deficit	(53,112)	(50,882)
Total stockholders' equity	3,626	4,544
Total Liabilities and Stockholders' Equity	$6,129	$7,514

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

3

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenue	$1,890	$1,808	$3,742	$3,880
Operating expenses:				
Cost of revenue	855	884	1,716	1,814
Selling and marketing	580	504	1,183	1,157
General and administrative	1,375	1,548	2,935	3,298
Research and development	165	435	368	849
Total operating expenses	2,975	3,371	6,202	7,118
Loss from operations	(1,085)	(1,563)	(2,460)	(3,238)
Other income (expense):				
Interest income	7	37	13	85
Interest expense	(3)	-	(13)	-
Other income, net	29	45	248	74
Total other income, net	33	82	248	159
Loss before income tax	(1,052)	(1,481)	(2,212)	(3,079)
Income tax provision	(8)	(13)	(18)	(47)
Net loss	$(1,060)	$(1,494)	$(2,230)	$(3,126)
Net loss per common share:				
Basic	$(0.08)	$(0.13)	$(0.18)	$(0.28)
Diluted	$(0.08)	$(0.13)	$(0.18)	$(0.28)
Weighted-average common shares outstanding:				
Basic	12,700,624	11,173,762	12,699,784	11,043,770
Diluted	12,700,624	11,173,762	12,699,784	11,043,770

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

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Stockholders' Equity
For the Six Months Ended June 30, 2015
(In thousands, except share data)
(unaudited)

	Common Stock Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity
Balance, January 1, 2015	12,681,617	$13	$55,413	$ (50,882)	$ 4,544
Expense for stock options granted to employees			582		582
Issuance of common stock from contingent consideration	19,007		40		40
Issuance of common stock in connection with exercise of warrants	500,000		690		690
Net loss				(2,230)	(2,230)
Balance, June 30, 2015	13,200,624	$13	$56,725	$ (53,112)	$ 3,626

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

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

	Six Months Ended June 30,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$(2,230)	$(3,126)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of prepaid rent	161	107
Depreciation and amortization	160	393
Expense for stock options issued to employees	582	429
Gain on disposal of property and equipment	-	(1)
Amortization of deferred gain	(47)	(32)
Change in fair value of contingent consideration	-	3
Changes in assets and liabilities, net of effects of acquisitions:		
Trade receivables	167	461
Equipment financing receivables	76	(121)
Inventories	(7)	102
Income tax receivable	-	12
Prepaid expenses and other	(162)	(108)
Other long-term assets	(114)	76
Accounts payable, accrued expenses and other	(275)	38
Income tax payable	17	-
Deferred revenue	(61)	(445)
Net cash used for operating activities	(1,733)	(2,212)
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of property and equipment	(24)	(3)
Proceeds from sale of property and equipment	-	2,002
Acquisition of One Stop Voice	-	(195)
Purchase of long-term investment	-	(1)
Change in restricted cash	4	5
Net cash (used for)/provided by investing activities	(20)	1,808
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of options	-	42
Proceeds from exercise of warrants	690	-
Payments of contingent consideration	(61)	(37)
Net cash provided by financing activities	629	5
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,124)	(399)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	2,906	3,076
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	$1,782	$2,677

Supplemental disclosure of cash flow information:		
Cash received/(paid) during the period for:		
Income taxes, net	$(1)	$11
Supplemental disclosure of non-cash investing and financing information:		
Business acquisition with stock (Note 3)	$-	$134
Contingent conideration related to acquisition (Note 3)	$-	$211
Prepayment of rent with common stock	$-	$966
Issuance of common stock from contingent consideration related to business acquisition	$40	$-

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

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

1. Significant Accounting Policies

Description of Business - Crexendo, Inc. is incorporated in the state of Delaware. As used hereafter in the notes to consolidated financial statements, we refer to Crexendo, Inc. and its wholly owned subsidiaries, as “we,” “us,” or “our Company”. We are a hosted services company that provides hosted telecommunications services, web hosting, e-commerce software, website development software, and broadband internet services for small, medium and enterprise level businesses. Our services are designed to make enterprise-class hosting services available to small, medium-sized and enterprise-sized businesses at affordable monthly rates. The Company has two operating segments, which consist of Hosted Telecommunications Services and Web Services.

The Company has transformed into a start-up company with the inherent risks and uncertainties of funding operations until profitability is achieved. We currently plan to fund our operations during the next twelve months using our cash and cash equivalents of $1,782,000. However, after considering the Company’s historical negative cash flows from operating activities as well as internal forecasts, such amount does not appear adequate to fund our anticipated cash needs for the next twelve months. Accordingly, the Company will be required to obtain additional debt or equity financing such as that available from its CEO to sustain operations. The Company received a commitment from the CEO, and major shareholder, in July 2015 that, if needed, he would provide up to $2,000,000 of financial support to enable the Company to fund its operations through September 30, 2016. As such, the Company believes it will have sufficient funds to sustain its operations during the next twelve months as a result of the sources of funding detailed above.

Basis of Presentation – The consolidated financial statements include the accounts and operations of Crexendo, Inc. and its wholly owned subsidiaries, which include Crexendo Telecom, Crexendo Business Solutions, Inc., StoresOnline Inc., StoresOnline International Canada ULC, StoresOnline International, Inc., StoresOnline International Ltd., Avail 24/7 Inc., Internet Training Group, Inc., Crexendo International, Inc., and Crexendo Property Management, LLC. All intercompany account balances and transactions have been eliminated in consolidation. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles, consistent in all material respects with those applied in our financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014. Because these financial statements address interim periods, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Such interim financial information is unaudited but reflects all adjustments that in the opinion of management are necessary for the fair presentation of the interim periods presented. The results of operations presented in this Quarterly Report on Form 10-Q are not necessarily indicative of the results that may be expected for the year ending December 31, 2015 or for any future periods. This Quarterly Report on Form 10-Q should be read in conjunction with the Company’s audited financial statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

Cash and Cash Equivalents - We consider all highly liquid, short-term investments with maturities of three months or less at the time of purchase to be cash equivalents. As of June 30, 2015 and December 31, 2014, we had cash and cash equivalents in financial institutions in excess of federally insured limits in the amount of $1,401,000 and $2,487,000, respectively.

Restricted Cash – We classified $129,000 and $133,000 as restricted cash as of June 30, 2015 and December 31, 2014, respectively. Cash is restricted for state licensing letters of credit and compensating balance requirements on merchant accounts, and purchasing card agreements. As of June 30, 2015, we had restricted cash in financial institutions in excess of federally insured limits in the amount of $129,000.

Trade Receivables – We have historically offered to our web site development software customers the option to finance, typically through 24 and 36-month extended payment term arrangements (“EPTAs”), purchases made at our suspended Internet Training Workshops through our Web Services segment. EPTAs are reflected as short-term and long-term trade receivables, as applicable, as we have the intent and ability to hold the receivables for the foreseeable future, until maturity or payoff. EPTAs are recorded on a nonaccrual cash basis beginning on the contract date. Trade receivables from our hosted telecommunications and web services segments are recorded at invoiced amounts.

Allowance for Doubtful Accounts – For sales made through EPTA contracts, we record an allowance for doubtful accounts each reporting period based on the Company’s ongoing assessment of collectability. The allowance represents estimated losses resulting from customers’ failure to make required payments. The allowance for doubtful accounts for EPTAs is netted against the current and long-term trade receivables balances. The allowance estimate is based on historical collection experience, specific identification of probable bad debts based on collection efforts, aging of trade receivables, customer payment history, and other known factors, including current economic conditions. We believe that the allowance for doubtful accounts is adequate based on our assessment to date, however, actual collection results may differ materially from our expectations. Because revenue generated from customers financing through EPTAs is deferred and not recognized prior to the collection of cash, adjustments to the allowance for doubtful accounts related to our EPTA contracts increase or decrease deferred revenue. Trade receivables are written off against the allowance when the related customers are no longer making required payments and the trade receivables are determined to be uncollectible, typically 90 days past their original due date. For sales made in our Hosted Telecommunications Services and Web Services segments, the allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. We determine the allowance based on known troubled accounts, historical experience, and other currently available evidence.

Interest Income - Interest income is primarily earned from EPTA contracts. EPTA contract terms generally contain an 18% simple interest rate. Interest income is recognized on these accounts only to the extent cash is received as the receivables are generally 24 and 36-months in length and collection of the full amount of the receivable is not probable. We recognized $7,000 and $37,000 in interest income for the three months ended June 30, 2015 and 2014, respectively. We recognized $13,000 and $85,000 for the six months ended June 30, 2015 and 2014, respectively.

Inventory - Telecommunications equipment inventory is stated at the lower of cost (first-in, first-out method) or market. In accordance with applicable accounting guidance, we regularly evaluate whether inventory is stated at the lower of cost or market.

Certificate of Deposit - We hold a $251,000 certificate of deposit as collateral for merchant accounts, which automatically renews every 12 months. The certificate of deposit is classified as long-term in the consolidated balance sheets.

Property and Equipment - Depreciation expense is computed using the straight-line method in amounts sufficient to allocate the cost of depreciable assets over their estimated useful lives ranging from two to five years. The cost of leasehold improvements is amortized using the straight-line method over the shorter of the estimated useful life of the asset or the term of the related lease. Depreciation expense is included in general and administrative expenses and totaled $15,000 and $112,000 for the three months ended June 30, 2015 and 2014, respectively and $36,000 and $289,000 for the six months ended June 30, 2015 and 2014, respectively. Depreciable lives by asset group are as follows:

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

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

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

Intangible Assets - Our intangible assets consist primarily of assets acquired in the acquisition of PBX Central and OSV, which include customer relationships and developed technology. The fair value of identifiable intangible assets is based upon the lower of discounted future cash flow projections or the amount paid in an arm’s length transaction. The intangible assets are amortized following the patterns in which the economic benefits are consumed. Amortization expense is included in general and administrative expenses and totaled $58,000 and $56,000 for the three months ended June 30, 2015 and 2014, respectively, and $124,000 and $104,000 for the six months ended June 30, 2015 and 2014, respectively.

We periodically review the estimated useful lives of our intangible assets and review these assets for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The determination of impairment is based on estimates of future undiscounted cash flows. If an intangible asset is considered to be impaired, the amount of the impairment will be equal to the excess of the carrying value over the fair value of the asset.

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

Revenue Recognition - In general, we recognize revenue when all of the following conditions are satisfied: (1) there is persuasive evidence of an arrangement; (2) the product or service has been provided to the customer; (3) the amount of fees to be paid by the customer is fixed or determinable; and (4) the collection of our fees is probable. We recognize revenue from our Hosted Telecommunications Services and Web Services segments on an accrual basis, with the exception of our EPTA cash receipts which are recognized on a cash basis. Specifics to revenue category are as follows:

Software licenses and DVD training courses sold under EPTAs are recognized as revenue upon receipt of cash from customers and not at the time of sale. Accounting standards require revenue to be deferred until customer payments are received if collection of the original principal balance is not probable.

We enter into agreements where revenue is derived from multiple deliverables including any mix of products and/or services. For these arrangements, we determine whether the delivered item(s) has value to the customer on a stand-alone basis, and in the event the arrangement includes a general right of return relative to the delivered item(s), whether the delivery or performance of the undelivered item(s) is considered probable and substantially in our control. If these criteria are met, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative selling price. If these criteria are not met, the arrangement is accounted for as a single unit of accounting which would result in revenue being recognized ratably over the contract term or deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. The amount of product and services revenue recognized for arrangements with multiple deliverables is impacted by the allocation of arrangement consideration to the deliverables in the arrangement based on the relative selling prices. In determining our selling prices, we apply the selling price hierarchy using vendor specific objective evidence ("VSOE") when available, third-party evidence of selling price ("TPE") if VSOE does not exist, and best estimated selling price ("BESP") if neither VSOE nor TPE is available.

VSOE of fair value for elements of an arrangement is based upon the normal pricing and discounting practices for a deliverable when sold separately. In determining VSOE, we require that a substantial majority of the selling prices fall within a reasonably narrow pricing range, generally evidenced by a substantial majority of such historical stand-alone transactions falling within a reasonably narrow range of the median rate. In addition, we consider major service groups, geographies, customer classifications, and other variables in determining VSOE.

We are typically not able to determine TPE for our products or services. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our offerings contain a significant level of differentiation such that the comparable pricing of products with similar functionality is difficult to obtain. Furthermore, we are unable to reliably determine what similar competitor products' selling prices are on a stand-alone basis.

When we are unable to establish the selling price using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. We determine BESP for a product or service by considering multiple factors including, but not limited to, cost of products, gross margin objectives, pricing practices, geographies, customer classes and distribution channels.

We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the timing of revenue recognized but does not change the total revenue recognized on any agreement.

Professional Services Revenue - Fees collected for professional services, including website design and development, search engine optimization services, link-building, paid search management services, and telecom installation services are recognized as revenue, net of expected customer refunds, over the period during which the services are performed, based upon the value for such services.

Telecommunications Services Hosting and Web Hosting Revenue - Fees collected for hosting revenue are recognized ratably as services are provided. Customers are billed for these services on a monthly or annual basis at the customer's option. We recognize revenue ratably over the applicable service period. When we provide a free trial period, we do not begin to recognize subscription revenue until the trial period has ended and the customer has been billed for the services.

Equipment Sales and Financing Revenue - Fees generated from the sale of telecommunications equipment are recognized when the devices are installed and hosted telecommunications services begin.

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

Commission Revenue - We have affiliate agreements with third-party entities that are resellers of satellite television services and internet service provider bandwidth. We receive commissions when the services are bundled with our hosted service offerings.

Cost of Revenue – Cost of Hosted Telecommunications Service revenue primarily consists of fees we pay to third-party telecommunications and business internet providers, personnel costs related to system implementation, customer service and travel costs related to system implementation, and the costs associated with the purchase of phones and other third party equipment. Cost of Web Services revenue consists primarily of salaries and outsourcing fees related to fulfillment of our web services and customer service costs.

Prepaid Sales Commissions - For arrangements where we recognize revenue over the relevant contract period, we defer related commission payments to our direct sales force and amortize these amounts over the same period that the related revenues are recognized. This is done to match commissions with the related revenues. Commission payments are nonrefundable unless amounts due from a customer are determined to be uncollectible or if the customer subsequently changes or terminates the level of service, in which case commissions which were paid are recoverable by us. Prepaid sales commissions as of June 30, 2015 and December 31, 2014 were $394,000 and $308,000, respectively, and are included in prepaid expenses and other on the condensed consolidated balance sheets.

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

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

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

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

Quoted prices for similar assets or liabilities in active markets;

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

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

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

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

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

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

We do not intend to indefinitely reinvest the undistributed earnings of our United Kingdom subsidiary, therefore, we have provided for U.S. deferred income taxes on such undistributed foreign earnings. All other foreign subsidiaries are considered disregarded foreign entities for US tax purposes.

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

Comprehensive Loss – There were no other components of comprehensive loss other than net loss for the three and six months ended June 30, 2015 and 2014.

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

Significant Customers – No customer accounted for 10% or more of our total revenue or total accounts receivable as of and for the three and six months ended June 30, 2015 and 2014.

Recently Adopted Accounting Guidance - In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 that introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This standard is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the new guidance to determine the impact it will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This ASU requires that a performance target that affects vesting and could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, Compensation-Stock Compensation, as it relates to such awards. ASU 2014-12 is effective for us in our first quarter of fiscal 2017 with early adoption permitted using either of two methods: (i) prospective to all awards granted or modified after the effective date; or (ii) retrospective to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter, with the cumulative effect of applying ASU 2014-12 as an adjustment to the opening retained earnings balance as of the beginning of the earliest annual period presented in the financial statements. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15. This ASU requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the ASU (1) provides a definition of the term substantial doubt, (2) requires an evaluation every reporting period including interim periods, (3) provides principles for considering the mitigating effect of management's plans, (4) requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (5) requires an express statement and other disclosures when substantial doubt is not alleviated, and (6) requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). This standard is effective for the fiscal years ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company is currently evaluating the new guidance to determine the impact it will have on its consolidated financial statements.

2. Net Loss Per Common Share

Basic net loss per common share is computed by dividing the net loss for the period by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is computed giving effect to all dilutive common stock equivalents, consisting of common stock options and warrants. Diluted net loss per common share for the three and six months ended June 30, 2015 and 2014 is the same as basic net loss per common share because the common share equivalents were anti-dilutive due to the net loss. The following table sets forth the computation of basic and diluted net loss per common share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net loss (in thousands)	$(1,060)	$(1,494)	$(2,230)	$(3,126)
Weighted-average share reconciliation:				
Weighted-average basic shares outstanding	12,700,624	11,173,762	12,699,784	11,043,770
Diluted shares outstanding	12,700,624	11,173,762	12,699,784	11,043,770
Net loss per common share:				
Basic	$(0.08)	$(0.13)	$(0.18)	$(0.28)
Diluted	$(0.08)	$(0.13)	$(0.18)	$(0.28)

Common stock equivalent shares are not included in the computation of diluted loss per share, because the Company has a net loss and the inclusion of such shares would be anti-dilutive due to the net loss. At June 30, 2015 and 2014, the common stock equivalent shares were, as follows:

	June 30, 2015	June 30, 2014
Shares of common stock issuable under equity incentive plans outstanding	3,175,961	2,310,890
Common stock equivalent shares excluded from diluted net loss per share	3,175,961	2,310,890

3. Acquisitions

One Stop Tech Solutions, LLC Acquisition

On June 1, 2014, we acquired certain assets from One Stop Tech Solutions, LLC, dba One Stop Voice (OSV), a privately-held provider of IP Telecom and Cloud communications located in Scottsdale, Arizona. The aggregate purchase price of approximately $540,000 consisted of $195,000 of cash paid at closing and 40,521 shares of our common stock with an estimated fair value of approximately $134,000. The fair value of the issuance of common stock issued as consideration for OSV was determined on the basis of the closing market price of the Company's common stock on the acquisition date. In addition, the Company recorded as part of the purchase price approximately $211,000 of contingent consideration it estimates will be paid during the earn-out period. The contingent consideration of $211,000 will be paid out in cash and stock at a split of 60% cash and 40% stock. The Company's consolidated financial statements include the results of operations of OSV from the date of acquisition. The historical results of operations of OSV were not significant to the Company's consolidated results of operations for the periods presented. The total purchase consideration was allocated to the assets acquired and liabilities assumed at their estimated fair values as of the date of acquisition, as determined by management based on a valuation performed by an independent third party valuation firm. The excess of the purchase price over the amounts allocated to assets acquired and liabilities assumed has been recorded as goodwill. The goodwill arising from the acquisitions discussed above consists largely of the synergies and economies of scale we hope to achieve from combining the acquired assets and operations with our historical operations. In accordance with current accounting standards, goodwill associated with the OSV acquisition will not be amortized and will be tested for impairment at least annually.

The following table presents the purchase price allocation of OSV (in thousands):

Consideration (including estimated unpaid contingent consideration):	
Cash	$195
Common stock	134
Contingent consideration	211
Total consideration	$540
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Identifiable intangible assets	$353
Commission liability	(10)
Total identifiable net assets	343
Goodwill	197
Total consideration	$540

The following were the identified intangible assets acquired and the respective estimated periods over which such assets will be amortized (in thousands):

Intangible Assets:	Amount	Weighted Average useful life (in years)
Customer relationships	$335	7
Technology	18	3
Total intangible assets	$353	

In determining the purchase price allocation, the Company considered, among other factors, its intention to use the acquired assets and the historical and estimated future demand for One Stop Voice services. The estimated fair value of customer relationships was based upon the income approach. The income approach relies on an estimation of the present value of the future monetary benefits expected to flow to the owner of an asset during its remaining economic life. This approach requires a projection of the cash flow that the asset is expected to generate in the future. The projected cash flow is discounted to its present value using a rate of return, or discount rate that accounts for the time value of money and the degree of risk inherent in the asset. The income approach may take the form of a “relief from royalty” methodology, a cost savings methodology, a “with and without” methodology, or excess earnings methodology, depending on the specific asset under consideration.

The relief from royalty approach was used to determine the fair value of the technology license acquired from One Stop Voice. The relief from royalty approach estimates the value of the intangible asset by quantifying the aggregate expenditures that would be required to replace the intangible asset. The customer relationships were valued using a form of the income approach known as the multi-period excess earnings method. Inherent in the multi-period excess earnings method is the recognition that, in most cases, all of the assets of the business, both tangible and intangible, contribute to the generation of the cash flow of the business and the net cash flows attributable to the subject asset must recognize the support of the other assets which contribute to the realization of the cash flows. This future cash flow was then discounted using an estimated required rate of return for the asset to determine the present value of the future cash flows attributable to the asset. The key assumptions used in valuing the customer relationships acquired are as follows: discount rate of 12.5%, tax rate of 39.3%, contributory asset charges for technology license and tangible assets used to deliver services, assembled workforce, and estimated economic life of 7 years.

The total weighted average amortization period for the identified intangible assets acquired from One Stop Voice is 7 years. The goodwill resulting from the One Stop Voice acquisition is not currently deductible for income tax purposes.

4. Trade Receivables, net

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

	June 30, 2015	December 31, 2014
Trade receivables	$338	$433
Conforming EPTAs	127	192
Non-Conforming EPTAs:		
1 - 30 days	17	19
31 - 60 days	6	28
61 - 90 days	2	3
Gross trade receivables	490	675
Less: allowance for doubtful accounts	(50)	(68)
Trade receivables, net	$440	$607
Current trade receivables, net	$345	$543
Long-term trade receivables, net	95	64
Trade receivables, net	$440	$607

All current and long-term EPTAs in the table above had original contract terms of greater than one year. The Company wrote off $53,000 of EPTAs during the six months ended June 30, 2015 and $158,000 during the year ended December 31, 2014, of which, all had original contract terms of greater than one year.

5. Equipment Financing Receivables

We rent certain hosted telecommunication equipment (IP telephone devices) through leasing contracts that we classify as either operating leases or sale-type leases. Equipment finance receivables arising from the rental of our hosted telecommunication equipment through sales-type leases, were as follows (in thousands):

	June 30, 2015	December 31, 2014
Gross financing receivables	$1,329	$1,610
Less unearned income	(779)	(984)
Financing receivables, net	550	626
Less: Current portion of finance receivables, net	(153)	(171)
Finance receivables due after one year	$397	$455

Equipment finance receivables are expected to be collected over the next thirty-six to sixty months.

6. Intangible Assets

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

	June 30, 2015	December 31, 2014
Customer relationships	$941	$941
Technical know-how	60	60
Non-compete	60	60
Developed technology	198	198
Less accumulated amortization		
Customer relationships	(399)	(316)
Technical know-how	(60)	(60)
Non-compete	(60)	(60)
Developed technology	(188)	(147)
Total	$552	$676

7. Fair Value Measurements

We have financial instruments as of June 30, 2015 and December 31, 2014 for which the fair value is summarized below (in thousands):

	June 30, 2015		December 31, 2014	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets:				
Trade receivables, net	$440	$440	$607	$607
Equipment financing receivables	550	550	626	626
Certificate of deposit	251	251	251	251
Liabilities:				
Acquisition related contingent consideration	$110	$110	$211	$211

Assets and liabilities for which fair value is recognized in the balance sheet on a recurring basis are summarized below as of June 30, 2015 and December 31, 2014 (in thousands):

Description	June 30, 2015	Fair value measurement at reporting date Level 1	Level 2	Level 3
Assets:				
Certificate of deposit	$251	$-	$251	$-
Liabilities:				
Acquisition related contingent consideration	110	-	-	110

Description	December 31, 2014	Level 1	Level 2	Level 3
Assets:				
Certificate of deposit	$251	$-	$251	$-
Liabilities:				
Acquisition related contingent consideration	211	-	-	211

The carrying amount of certificates of deposit approximates fair value, as determined by certificates of deposit with similar terms and conditions.

The recurring Level 3 measurement of our contingent consideration liability includes the following significant unobservable inputs at June 30, 2015 and December 31, 2014, respectively (in thousands):

Contingent consideration liability	Fair Value at June 30, 2015	Valuation technique	Unobservable inputs	Range
Revenue - based payments	$110	Discounted cash flow	Discount Rate	12.5%
			Probability of milestone payment	90%
			Projected year of payments	2015

Contingent consideration liability	Fair Value at December 31, 2014	Valuation technique	Unobservable inputs	Range
Revenue - based payments	$211	Discounted cash flow	Discount Rate	12.5%
			Probability of milestone payment	90%
			Projected year of payments	2015

Level 3 instruments are valued based on unobservable inputs that are supported by little or no market activity and reflect the Company's own assumptions in measuring fair value. Future changes in fair value of the contingent financial milestone consideration, as a result of changes in significant inputs such as the discount rate and estimated probabilities of financial milestone achievements, could have a material effect on the statement of operations and balance sheet in the period of the change.

The progression of the Company's Level 3 instruments fair valued on a recurring basis for the six months ended June 30, 2015 and the year ended December 31, 2014 are shown in the table below (in thousands):

	Acquisition Related Contingent Consideration
Balance at January 1, 2014	$ 51
Change in fair value	3
Cash payments	(54)
Additions	211
Balance at December 31, 2014	$ 211
Cash payments	(61)
Issuance of common stock from contingent consideration	(40)
Balance at June 30, 2015	$ 110

8. Income Taxes

Our effective tax rate for the three and six months ended June 30, 2015 was (0.8)% and (0.8)%, respectively, which resulted in an income tax provision of $8,000 and $18,000, respectively. The tax provision for the six months ended June 30, 2015 was due to state tax payments made with extensions filed.

Our effective tax rate for the three and six months ended June 30, 2014 was (0.9)% and (1.5)%, respectively, which resulted in an income tax provision of $13,000 and $47,000, respectively. The tax provision for the six months ended June 30, 2015 was due to state tax payments made with extensions filed.

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

9. Prepaid Expenses and Other

Prepaid expenses consisted of the following (in thousands):

	June 30, 2015	December 31, 2014
Current prepaid rent	$322	$322
Prepaid commissions	394	308
Other	478	402
Total current prepaids	$1,194	$1,032
Long-term prepaid rent	215	376
Total prepaid and other	$1,409	$1,408

10. Accrued Expenses

Accrued expenses consisted of the following (in thousands):

	June 30, 2015	December 31, 2014
Accrued wages and benefits	$310	$345
Accrued accounts payable	155	318
Accrued legal costs	-	231
Accrued sales taxes	216	209
Other	327	228
Total accrued expenses	$1,008	$1,331

17

11. Commitments and Contingencies

Operating Leases

We lease certain of our equipment and corporate offices under non-cancelable operating lease agreements expiring at various dates through 2016. The operating leases for our Reno, NV and Draper, UT offices contain customary escalation clauses.

Rental expense for the three months ended June 30, 2015 and 2014 was approximately $30,000 and $30,000, respectively. Rental expense for the six months ended June 30, 2015 and 2014 was approximately $60,000 and $60,000, respectively.

Sale-Leaseback

On February 28, 2014, the Company sold and leased back the land, building and furniture associated with the corporate headquarters in Tempe, Arizona to a Company that is owned by the major shareholder and CEO of the Company for $2.0 million in cash. The Company recognized a deferred gain of $281,000 on sale-leaseback, which will be amortized over the initial lease term of 36 months to offset rent expense. The net deferred gain is included in other long-term liabilities in the condensed consolidated balance sheets as of June 30, 2015 and December 31, 2014.

The lease agreement called for rent payments for the initial three-year term to be made in advance in the form of 300,000 shares of common stock of Crexendo, Inc. The fair value price per share at the time of the lease was $3.22 per share, resulting in rent expense of $322,000 per year for three years. Prepaid rent included in the condensed consolidated balance sheets as of June 30, 2015 and December 31, 2014, is as follows:

	June 30, 2015	December 31, 2014
Current prepaid rent	$322,000	$322,000
Long-term prepaid rent	215,000	376,000
Total prepaid rent, net	$537,000	$698,000

Rent expense incurred on the sale-leaseback during the three months ended June 30, 2015 and 2014, net of deferred gain amortization of $23,000 and $23,000, respectively, was $57,000 and $57,000, respectively. Rent expense incurred on the sale-leaseback during the six months ended June 30, 2015 and 2014, net of deferred gain amortization of $47,000 and $31,000, respectively, was $114,000 and $76,000, respectively.

12. Segments

Management has chosen to organize the Company around differences based on its products and services. Hosted Telecommunications Services segment generates revenue from selling hosted telecommunication services and broadband internet services. Web Services segment generates revenue from website hosting, managing e-commerce or lead generation offerings, websites, search engine optimization/management and online promotional needs for small, medium, and enterprise sized businesses. The Company has two operating segments, which consist of Hosted Telecommunications Services and Web Services. Effective April 1, 2014, the Company changed its reporting segments to reflect changes in how the Chief Operating Decision Maker (CODM) internally measures performance and allocates resources. Segment operating results for the prior year have been revised to conform to current year segment operating results presentation. Segment revenue and income (loss) before income tax provision was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenue:				
Hosted telecommunications services	$1,421	$963	$2,745	$1,918
Web services	469	845	997	1,962
Consolidated revenue	1,890	1,808	3,742	3,880
Income/(loss) from operations:				
Hosted telecommunications services	(1,091)	(1,376)	(2,441)	(2,887)
Web services	6	(187)	(19)	(351)
Total operating loss	(1,085)	(1,563)	(2,460)	(3,238)
Other income, net:				
Hosted telecommunications services	18	21	39	41
Web services	15	61	209	118
Total other income	33	82	248	159
Income/(loss) before income tax provision				
Hosted telecommunications services	(1,073)	(1,355)	(2,402)	(2,846)
Web services	21	(126)	190	(233)
Loss before income tax provision	$(1,052)	$(1,481)	$(2,212)	$(3,079)

Depreciation and amortization was $56,000 and $98,000 for the Hosted Telecommunications Services segment for the three months ended June 30, 2015 and 2014, respectively. Depreciation and amortization was $121,000 and $220,000 for the Hosted Telecommunications Services segment for the six months ended June 30, 2015 and 2014, respectively. Depreciation and amortization was $17,000 and $70,000 for the Web Services segment for the three months ended June 30, 2015 and 2014, respectively. Depreciation and amortization was $39,000 and $174,000 for the Web Services segment for the six months ended June 30, 2015 and 2014, respectively.

Interest income was $7,000 and $39,000 for the Web Services segment for the three months ended June 30, 2015 and 2014, respectively. Interest income was $13,000 and $86,000 for the Web Services segment for the six months ended June 30, 2015 and 2014, respectively.

Interest expense was $1,000 and $1,000 for the Web Services segment for the three months ended June 30, 2015 and 2014, respectively. Interest expense was $9,000 and $1,000 for the Web Services segment for the six months ended June 30, 2015 and 2014, respectively. Interest expense was $4,000 and $0 for the Hosted Telecommunications Services segment for the three months ended June 30, 2015 and 2014, respectively. Interest expense was $4,000 and $0 for the Hosted Telecommunications Services segment for the six months ended June 30, 2015 and 2014, respectively.

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

This section and other parts of this Form 10-Q contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can be identified by words such as "anticipates," "expects," "believes," "plans," "predicts," a similar terms. Forward-looking statements are not guarantees of future performance and our Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Part II, Item 1A, "Risk Factors," which are incorporated herein by reference. The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2014 (the "2014 Form 10-K") filed with the SEC and the Condensed Consolidated Financial Statements and notes thereto included in the 2014 Form 10-Qs and elsewhere in this Form 10-Q. We assume no obligation to revise or update any forward-looking statements for any reason, except as required by law.

OVERVIEW

We are a hosted services company that provides website hosting, hosted telecommunications services, e-commerce software, website development software, and broadband internet services for small, medium and enterprise level businesses. Our services are designed to make enterprise-class hosting services available to small, medium-sized and enterprise-sized businesses at affordable monthly rates. The Company has two operating segments, which consist of Hosted Telecommunications Services and Web Services.

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

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

Web Services segment –We generate website hosting revenue and professional services revenue primarily from search engine optimization services, link building, paid search management services, conversion rate optimization services, and website design and development. These services are typically billed on a fixed price basis or on a monthly recurring basis with an initial term of six to twelve months. During the quarter ended September 30, 2013, the Company made a strategic decision to limit our provision of web services to our enterprise sized customers.

OUR SERVICES AND PRODUCTS

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

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

Crexendo's hosted telecommunication service offers a wide variety of essential and advanced features for small and medium-size businesses. Many of these features included in the service offering are:

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

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

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

Call Center Features such as Automated Call Distribution (ACD), Call Monitor, Whisper and Barge, Automatic Call Recording

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

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

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

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

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

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

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

Hosted Website Services - Our website hosting services allows businesses and entrepreneurs to host their websites in our data center for a monthly fee.

Search Engine Optimization (SEO) - There are two general aspects to Search Engine Optimization (“SEO”). First, the tactical level, that includes conditioning a website and/or its pages to be relevant and search-engine friendly. Second, we help businesses strategically select keywords and keyword phrases. The popularity of a site plays a role in what keyword phrases a business can compete on versus what keyword phrases might be “out of their league”. We focus on the strategic selection of keywords and prioritize keywords that have healthy search volumes and high ‘win’ capability. Our experience coupled with our software allow us to strategically select the best choices for keyword phrases to target which provide the highest probability of getting high search engine positions and draws maximum traffic to the website. Our SEO packages include a keyword interview, strategic keyword research, baseline ranking report, search engine optimization plan, and comparison ranking report.

Link Building - Link building is a critical component of off-page SEO. To be effective, a link building campaign must be done manually. Search engines can detect links obtained via automated submission. Also, links need to come from many different types of sites, not just one or two. Link building is closely related to search engine optimization, as such; we carefully synchronize all our link building efforts and anchor text with our search engine optimization efforts.

An effective link building effort is labor intensive, with no real shortcuts. We use a broad based approach for link building that follows search engine webmaster guidelines. We use strategies that include, but aren't limited to: Web 2.0 sites, social media and social bookmarking sites, vertical portals, local directories, live directories, and others.

Paid Search Management - We offer paid search management services, such as management of Google® AdWords™, Yahoo and Microsoft Advertising adCenter™ accounts for our customers.

Modern paid search networks are incredibly sophisticated and require a tremendous amount of experience and expertise to avoid the many potential pitfalls of paid search. We assist customers by taking a conservative approach to paid search management. By using a combination of proprietary automation tools, split test dedicated landing pages, as well as the practiced eye of an expert monitoring our customer accounts on a daily basis, we are able to consistently raise conversion rates and lower the cost of pay-per-click (PPC) acquisition.

Website Design and Development - Using our proprietary software and processes we design and develop websites with "conversion" in mind. The term conversion means different things to different websites. To a lead-generation website, it means getting prospects to submit their contact information so the sales team can contact them. For an e-commerce website, conversion means getting an online customer to complete an order.

Our website design packages range from a semi-custom template based design package to a completely custom design package. We incorporate analytics into every website we build. Proper analytics allow identification of weak spots in the conversion process. Once weak spots are identified, the site can be adjusted to smooth out the process and help turn more prospects into customers.

Once the site is complete, we provide tutorials and tools to allow customers to make changes to their sites as often as necessary without having to pay additional programming fees. Alternatively, customers can elect to have us manage the changes to their websites for an additional fee.

USE OF NON-GAAP FINANCIAL MEASURES

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

In our May 5, 2015 earnings press release, as furnished on Form 8-K, we included Non-GAAP net loss, EBITDA and Adjusted EBITDA. The terms Non-GAAP net loss, EBITDA, and Adjusted EBITDA are not defined under U.S. GAAP, and are not measures of operating income, operating performance or liquidity presented in analytical tools, and when assessing our operating performance, Non-GAAP net loss, EBITDA, and Adjusted EBITDA should not be considered in isolation, or as a substitute for net loss or other consolidated income statement data prepared in accordance with U.S. GAAP. Some of these limitations include, but are not limited to:

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

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

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

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

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

while share-based compensation is a component of operating expense, the impact on our financial statements compared to other companies can vary significantly due to such factors as the assumed life of the options and the assumed volatility of our common stock; and other companies may calculate EBITDA and Adjusted EBITDA differently than we do, limiting their usefulness as comparative measures.

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

RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(In thousands)		(In thousands)	
U.S. GAAP net loss	$(1,060)	$(1,494)	$(2,230)	$(3,126)
Share-based compensation	211	265	582	429
Amortization of rent expense paid in stock, net of deferred gain	57	57	114	76
Amortization of intangible assets	58	56	123	104
Non-GAAP net loss	$(734)	$(1,116)	$(1,411)	$(2,517)

Reconciliation of U.S. GAAP Net Loss to EBITDA to Adjusted EBITDA
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(In thousands)		(In thousands)	
U.S. GAAP net loss	$(1,060)	$(1,494)	$(2,230)	$(3,126)
Depreciation and amortization	73	167	160	393
Interest expense	3	-	13	-
Interest and other income	(36)	(82)	(261)	(159)
Income tax provision	8	13	18	47
EBITDA	$(1,012)	$(1,396)	$(2,300)	$(2,845)
Share-based compensation	211	265	582	429
Amortization of rent expense paid in stock, net of deferred gain	57	57	114	76
Adjusted EBITDA	$(744)	$(1,074)	$(1,604)	$(2,340)

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our financial statements, we make estimates, assumptions and judgments that can have a significant impact on our revenue, operating income or loss and net income or loss, as well as on the value of certain assets and liabilities on our balance sheet. We believe that the estimates, assumptions and judgments involved in our accounting policies described in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2014 have the greatest potential impact on our financial statements, so we consider them to be our critical accounting policies and estimates. Our senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-Q with the Audit Committee of our Board of Directors.

RESULTS OF OPERATIONS

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

Results of Consolidated Operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenue	$1,890	$1,808	$3,742	$3,880
Loss before income taxes	(1,052)	(1,481)	(2,212)	(3,079)
Income tax provision	(8)	(13)	(18)	(47)
Net loss	(1,060)	(1,494)	(2,230)	(3,126)
Basic net loss per share	$(0.08)	$(0.13)	$(0.18)	$(0.28)
Diluted net loss per share	$(0.08)	$(0.13)	$(0.18)	$(0.28)

Three months ended June 30, 2015 compared to three months ended June 30, 2014

Revenue

Total revenue increased 5% or $82,000, to $1,890,000 for the three months ended June 30, 2015 as compared to $1,808,000 for the three months ended June 30, 2014. Hosted Telecommunications Services segment revenue increased 48% or $458,000, to $1,421,000 for the three months ended June 30, 2015 as compared to $963,000 for the three months ended June 30, 2014. Web Services segment revenue decreased 44% or $376,000, to $469,000 for the three months ended June 30, 2015 as compared to $845,000 for the three months ended June 30, 2014. The decline in Web Services segment revenue is related to $106,000 decrease in EPTA revenue, $145,000 decrease in web management service revenue due to shift in focus, and $125,000 decrease in website hosting revenue.

Loss Before Income Taxes

Loss before income tax decreased 29% or $429,000, to $1,052,000 for the three months ended June 30, 2015 as compared to loss before income tax of $1,481,000 for the three months ended June 30, 2014. The decrease in loss before income tax is primarily due to the decrease in operating expenses of 12% or $396,000, to $2,975,000 for the three months ended June 30, 2015 as compared to $3,371,000 for the three months ended June 30, 2014.

Income Tax Provision

Our effective tax rate for the three months ended June 30, 2015 and 2014 was (0.08)% and (0.9)%, respectively, which resulted in a provision for income taxes of $(8,000) and $(13,000), respectively. The provision for income taxes relates to minimum state tax requirements.

Six months ended June 30, 2015 compared to six months ended June 30, 2014

Revenue

Total revenue decreased 4% or $138,000, to $3,742,000 for the six months ended June 30, 2015 as compared to $3,880,000 for the six months ended June 30, 2014. Hosted Telecommunications Services segment revenue increased 43% or $827,000, to $2,745,000 for the six months ended June 30, 2015 as compared to $1,918,000 for the six months ended June 30, 2014. Web Services segment revenue decreased 49% or $965,000, to $997,000 for the six months ended June 30, 2015 as compared to $1,962,000 for the six months ended June 30, 2014. The decline in Web Services segment revenue is related to $360,000 decrease in EPTA revenue, $358,000 decrease in web management service revenue due to shift in focus, and $247,000 decrease in website hosting revenue.

Loss Before Income Taxes

Loss before income tax decreased 28% or $867,000, to $2,212,000 for the six months ended June 30, 2015 as compared to loss before income tax of $3,079,000 for the six months ended June 30, 2014. The decrease in loss before income tax is primarily due to the decrease in operating expenses of 13% or $916,000, to $6,202,000 for the six months ended June 30, 2015 as compared to $7,118,000 for the six months ended June 30, 2014.

Income Tax Provision

Our effective tax rate for the six months ended June 30, 2015 and 2014 was (0.08)% and (1.5)%, respectively, which resulted in a provision for income taxes of $(18,000) and $(47,000), respectively. The provision for income taxes relates to minimum state tax requirements.

Segment Operating Results

The Company has two operating segments, which consist of Hosted Telecommunications Services and Web Services. Effective April 1, 2014, the Company changed its reporting segments to reflect changes in how the Chief Operating Decision Maker (CODM) internally measures performance and allocates resources. Segment operating results for the prior periods have been modified to conform to current year segment operating results presentations. The information below is organized in accordance with our two reportable segments. Segment operating income (loss) is equal to segment net revenue less segment cost of revenue, sales and marketing, research and development, and general and administrative expenses.

Operating Results of our Hosted Telecommunications Services Segment (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
Hosted Telecommunications Services	2015	2014	2015	2014
Revenue	$1,421	$963	$2,745	$1,918
Operating expenses:				
Cost of revenue	745	708	1,489	1,371
Research and development	155	258	341	506
Selling and marketing	569	488	1,169	1,106
General and administrative	1,043	885	2,187	1,822
Total operating expenses	2,512	2,339	5,186	4,805
Operating loss	(1,091)	(1,376)	(2,441)	(2,887)
Other income	18	21	39	41
Loss before tax provision	$(1,073)	$(1,355)	$(2,402)	$(2,846)

Three months ended June 30, 2015 compared to three months ended June 30, 2014

Revenue

Hosted Telecommunications Services segment revenue increased 48% or $458,000, to $1,421,000 for the three months ended June 30, 2015 as compared to $963,000 for the three months ended June 30, 2014. Equipment sales, including sales of equipment under sales-type leases, increased 53% or $95,000, to $273,000 for the three months ended June 30, 2015 as compared to $178,000 for the three months ended June 30, 2014. Interest revenue associated with the sales-type leases increased 1% or $1,000, to $110,000 for the three months ended June 30, 2015 as compared to $109,000 for the three months ended June 30, 2014. Revenue from recurring and one-time services increased 54% or $362,000 to $1,037,000 for the three months ended June 30, 2015 as compared to $675,000 for the three months ended June 30, 2014. A substantial portion of Hosted Telecommunications Services segment revenue is generated through thirty-six to sixty month service contracts. As such, we believe growth in Hosted Telecommunications Services segment will initially be seen through increases in our backlog. Backlog represents contracts signed with no service or payment provided at June 30, 2015 and 2014.

Below is a table which displays the Hosted Telecommunications Services segment revenue backlog as of April 1, 2015 and 2014, and June 30, 2015 and 2014, which we expect to recognize as revenue within the next thirty-six to sixty months (in thousands):

Hosted Telecommunications Services backlog as of April 1, 2015	$10,987
Hosted Telecommunications Services backlog as of June 30, 2015	$11,283

Hosted Telecommunications Services backlog as of April 1, 2014	$7,152
Hosted Telecommunications Services backlog as of June 30, 2014	$8,402

Cost of Revenue

Cost of revenue consists primarily of fees we pay to third-party telecommunications and business internet providers, personnel costs related to system implementation, customer service, travel costs related to system implementation, and the costs associated with the purchase of phones and other third party equipment. Cost of revenue increased 5% or $37,000, to $745,000 for the three months ended June 30, 2015 as compared to $708,000 for the three months ended June 30, 2014. The increase in cost of revenue was primarily due to an increase in bandwidth costs of $94,000, and an increase in salary and benefit expenses of $5,000 related to our customer service department, which was offset by a decrease in product costs of $62,000.

Research and Development

Research and development expenses primarily consist of salaries and benefits, and related expenses, related to the development of new hosted telecommunications products. Research and development expenses decreased 40% or $103,000, to $155,000 for the three months ended June 30, 2015 as compared to $258,000 for the three months ended June 30, 2014. The decrease was primarily due to changes in staffing which resulted in lower salaries and benefits for the engineering department and an allocation of costs to general and administrative salaries and benefits.

Selling and Marketing

Selling and marketing expenses consist primarily of direct sales representative salaries and benefits, dealer channel commissions, and the production of marketing materials. Selling and marketing expenses increased 17% or $81,000, to $569,000 for the three months ended June 30, 2015 as compared to $488,000 for the three months ended June 30, 2014. The increase was primarily due to an increase in commissions of $106,000 and an increase of $20,000 in other sales and marketing, which was offset by a decrease in salaries and benefits of $34,000 and a decrease in business development costs of $11,000.

General and Administrative

General and administrative expenses consist of salaries and benefits, and related expenses for executives, administrative personnel, legal, rent, accounting and other professional services, and other general corporate expenses. General and administrative expenses increased 18% or $158,000, to $1,043,000 for the three months ended June 30, 2015 as compared to $885,000 for the three months ended June 30, 2014. General and administrative expenses for the three months ended June 30, 2015 were higher than the three months ended June 30, 2014, primarily due to an increased allocation of corporate expenses being allocated at a higher rate resulting from increased revenue in the Hosted Telecommunications Services segment along with an increase in rent expense of $22,000 related to the sale-leaseback of the building on February 28, 2014, an increase in general and administrative salaries and benefits of $96,000, and legal and accounting services increased $40,000. As Web Services revenue decreased significantly for three months ended June 30, 2015, we allocated less of the general and administrative expenses to the Web Services segment and more expenses to the Hosted Telecommunications Services segment. Consolidated general and administrative expenses decreased 11%, or $173,000 to $1,375,000 for the three months ended June 30, 2015 compared to $1,548,000 for the three months ended June 30, 2014.

Other Income

Other income primarily relates to the allocated portion of sublease rental income. Other income decreased $3,000, to $18,000 for the three months ended June 30, 2015 as compared to $21,000 for the three months ended June 30, 2014.

Six months ended June 30, 2015 compared to six months ended June 30, 2014

Revenue

Hosted Telecommunications Services segment revenue increased 43% or $827,000, to $2,745,000 for the six months ended June 30, 2015 as compared to $1,918,000 for the six months ended June 30, 2014. Equipment sales, including sales of equipment under sales-type leases, increased 31% or $131,000, to $557,000 for the six months ended June 30, 2015 as compared to $426,000 for the six months ended June 30, 2014. Interest revenue associated with the sales-type leases increased 10% or $20,000, to $226,000 for the six months ended June 30, 2015 as compared to $206,000 for the six months ended June 30, 2014. Revenue from recurring and one-time services increased 53% or

$676,000 to $1,962,000 for the six months ended June 30, 2015 as compared to $1,286,000 for the six months ended June 30, 2014. A substantial portion of Hosted Telecommunications Services segment revenue is generated through thirty-six to sixty month service contracts. As such, we believe growth in Hosted Telecommunications Services segment will initially be seen through increases in our backlog. Backlog represents contracts signed with no service or payment provided at June 30, 2015 and 2014.

Below is a table which displays the Hosted Telecommunications Services segment revenue backlog as of January 1, 2015 and 2014, and June 30, 2015 and 2014, which we expect to recognize as revenue within the next thirty-six to sixty months (in thousands):

Hosted Telecommunications Services backlog as of January 1, 2015	$9,763
Hosted Telecommunications Services backlog as of June 30, 2015	$11,283
Hosted Telecommunications Services backlog as of January 1, 2014	$7,019
Hosted Telecommunications Services backlog as of June 30, 2014	$8,402

Cost of Revenue

Cost of revenue consists primarily of fees we pay to third-party telecommunications and business internet providers, personnel costs related to system implementation, customer service, travel costs related to system implementation, and the costs associated with the purchase of phones and other third party equipment. Cost of revenue increased 9% or $118,000, to $1,489,000 for the six months ended June 30, 2015 as compared to $1,371,000 for the six months ended June 30, 2014. The increase in cost of revenue was primarily due to an increase in bandwidth costs of $175,000 and an increase in salary and benefit expenses of $13,000 related to our customer service department, offset by a decrease in products costs of $70,000.

Research and Development

Research and development expenses primarily consist of salaries and benefits, and related expenses, related to the development of new hosted telecommunications products. Research and development expenses decreased 33% or $165,000, to $341,000 for the six months ended June 30, 2015 as compared to $506,000 for the six months ended June 30, 2014. The decrease was primarily due to changes in staffing which resulted in lower salaries and benefits for the engineering department and an allocation of costs to general and administrative salaries and benefits.

Selling and Marketing

Selling and marketing expenses consist primarily of direct sales representative salaries and benefits, dealer channel commissions, and the production of marketing materials. Selling and marketing expenses increased 6% or $63,000, to $1,169,000 for the six months ended June 30, 2015 as compared to $1,106,000 for the six months ended June 30, 2014. The increase was primarily due to an increase in commissions of $222,000, an increase in business development costs of $34,000 and other sales and marketing costs of $43,000, which was offset by a decrease in salaries and benefits of $236,000.

General and Administrative

General and administrative expenses consist of salaries and benefits, and related expenses for executives, administrative personnel, legal, rent, accounting and other professional services, and other general corporate expenses. General and administrative expenses increased 20% or $365,000, to $2,187,000 for the six months ended June 30, 2015 as compared to $1,822,000 for the six months ended June 30, 2014. General and administrative expenses for the six months ended June 30, 2015 were higher than the six months ended June 30, 2014, primarily due to an increased allocation of corporate expenses being allocated at a higher rate resulting from increased revenue in the Hosted Telecommunications Services segment along with an increase in rent expense of $61,000 related to the sale-leaseback of the building on February 28, 2014, an increase of salaries and benefits of $189,000, and an increase in corporate options expense of $115,000. As Web Services revenue decreased significantly for six months ended June 30, 2015, we allocated less of the general and administrative expenses to the Web Services segment and more expenses to the Hosted Telecommunications Services segment. Consolidated general and administrative expenses decreased 11%, or $363,000 to $2,935,000 for the six months ended June 30, 2015 compared to $3,298,000 for the six months ended June 30, 2014.

Other Income

Other income primarily relates to the allocated portion of sublease rental income. Other income decreased $2,000, to $39,000 for the six months ended June 30, 2015 as compared to $41,000 for the six months ended June 30, 2014.

Operating Results of Web Services segment (in thousands):

Web Services	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Revenue	$469	$845	$997	$1,962
Operating expenses:				
Cost of revenue	110	176	227	443
Research and development	10	177	27	343
Selling and marketing	11	16	14	51
General and administrative	332	663	748	1,476
Total operating expenses	463	1,032	1,016	2,313
Operating income/(loss)	6	(187)	(19)	(351)
Other income	15	61	209	118
Income/(loss) before tax provision	$21	$(126)	$190	$(233)

Three months ended June 30, 2015 compared to three months ended June 30, 2014

Revenue

Web Services segment revenue decreased 44% or $376,000, to $469,000 for the three months ended June 30, 2015 as compared to $845,000 for the three months ended June 30, 2014. The decrease in revenue from the prior year is primarily related to the decrease in cash collected on EPTAs of $106,000 and our shift in focus to only providing web services to enterprise-sized customers, resulting in a decrease of $145,000, and a decrease in hosting revenue of $125,000. Revenue from Web Services is generated primarily through website hosting and Search Engine Optimization ("SEO") services, link building, search engine management services, conversion rate optimization services, and website design and development services. A portion of Web Services revenue is generated through three to twelve month service contracts. Our typical EPTA agreement has a term of two to three years. As such, while we no longer offer EPTAs to our customers as a result of the suspension of our direct mail seminar sales, we will continue to recognize revenue from those EPTA contracts executed prior to July 2011 as cash is collected from those contracts.

Revenue related to cash collected under EPTA agreements decreased 66% or $106,000 to $54,000 for the three months ended June 30, 2015, compared to $160,000 for the three months ended June 30, 2014. Our typical EPTA agreement has a term of two to three years. As such, while we no longer offer EPTAs to our customers as a result of the suspension of our direct mail seminar sales, we will continue to recognize revenue from those EPTA contracts executed prior to July 2011 as cash is collected from those contracts. EPTAs were originally recognized in our balance sheet, net of an allowance for doubtful accounts, through our deferred revenue balance. The remaining deferred revenue balance is expected to be recognized as revenue, however, at a decreasing rate over the next twelve months. The following table summarizes the activity within deferred revenue for the three months ended June 30, 2015 and 2014 (in thousands):

EPTA deferred revenue as of March 31, 2015	$165
Cash collected on Principal of EPTA Contracts	(59)
Adjustments of EPTA deferred revenue	11
EPTA deferred revenue as of June 30, 2015	$117
EPTA deferred revenue as of March 31, 2014	$374
Cash collected on Principal of EPTA Contracts	(166)
Adjustments of EPTA deferred revenue	76

EPTA deferred revenue as of June 30, 2014	$284

28

Revenue related to cash collected on previously written off bad debt decreased 12% or $8,000, to $60,000 for the three months ended June 30, 2015 as compared to $68,000 for the three months ended June 30, 2014.

Cost of Revenue

Cost of revenue consists primarily of salaries and outsourcing fees related to collections of our EPTA agreements, fulfillment of our web services and customer service costs. Cost of revenue decreased 38% or $66,000, to $110,000 for the three months ended June 30, 2015 as compared to $176,000 for the three months ended June 30, 2014. The decrease is primarily related to a decrease in pay per click advertising costs of $48,000 and a reduction in salaries and benefits associated with the fulfillment of website management services of $18,000.

Research and Development

Research and development expenses primarily consist of salaries and benefits, and related expenses which are attributable to the development of our website development software products. Research and development expenses decreased 94% or $167,000, to $10,000 for the three months ended June 30, 2015 as compared to $177,000 for the three months ended June 30, 2014. The decrease was due to decreased salaries and benefits related to the discontinued development of our website development software and an allocation of costs to general and administrative salaries and benefits.

Selling and Marketing

Selling and marketing expenses consist primarily of salaries and benefits, commissions as well as advertising expenses. Selling and marketing expense decreased 31% or $5,000, to $11,000 for the three months ended June 30, 2015 as compared to $16,000 for the three months ended June 30, 2014. The decrease was primarily attributable to our shift in focus to only providing web services to enterprise-sized customers, thus there was no allocation of salaries and expenses during the three months ended June 30, 2015 and a reduction in web commissions during the three months ended June 30, 2015 to a minimal amount.

General and Administrative

General and administrative expenses consist of salaries and benefits, and related expenses for executives, administrative personnel, legal, rent, accounting and other professional services, and other general corporate expenses. General and administrative expenses decreased 50% or $331,000, to $332,000 for the three months ended June 30, 2015 as compared to $663,000 for the three months ended June 30, 2014. The decrease in general and administrative expenses is primarily due to less of an allocation of corporate general and administrative expenses resulting from the 44% decrease in revenue for the three months ended June 30, 2015 compared to the three months ended June 30, 2014, and a company-wide reduction in general and administrative expenses as we continue to cut unnecessary expenses. Consolidated general and administrative expenses decreased 11%, or $173,000 to $1,375,000 for the three months ended June 30, 2015 compared to $1,548,000 for the three months ended June 30, 2014.

Other Income

Other income decreased 75% or $46,000, to $15,000 for the three months ended June 30, 2015 as compared to $61,000 for the three months ended June 30, 2014. This decrease is primarily related to the interest earned on the principal collections of EPTAs, which decreased to $12,000 for the three months ended June 30, 2015 compared to $166,000.

Six months ended June 30, 2015 compared to six months ended June 30, 2014

Revenue

Web Services segment revenue decreased 49% or $965,000, to $997,000 for the six months ended June 30, 2015 as compared to $1,962,000 for the six months ended June 30, 2014. The decrease in revenue from the prior year is primarily related to the decrease in cash collected on EPTAs of $360,000 and our shift in focus to only providing web services to enterprise-sized customers, resulting in a decrease of $358,000, and a decrease in hosting revenue of $247,000. Revenue from Web Services is generated primarily through website hosting and Search Engine Optimization ("SEO") services, link building, search engine management services, conversion rate optimization services, and website design and development services. A portion of Web Services revenue is generated through three to twelve month service contracts. Our typical EPTA agreement has a term of two to three years. As such, while we no longer offer EPTAs to our customers as a result of the suspension of our direct mail seminar sales, we will continue to recognize revenue from those EPTA contracts executed prior to July 2011 as cash is collected from those contracts.

Revenue related to cash collected under EPTA agreements decreased 73% or $360,000 to $136,000 for the six months ended June 30, 2015, compared to $496,000 for the six months ended June 30, 2014. Our typical EPTA agreement has a term of two to three years. As such, while we no longer offer EPTAs to our customers as a result of the suspension of our direct mail seminar sales, we will continue to recognize revenue from those EPTA contracts executed prior to July 2011 as cash is collected from those contracts. EPTAs were originally recognized in our balance sheet, net of an allowance for doubtful accounts, through our deferred revenue balance. The remaining deferred revenue balance is expected to be recognized as revenue, however, at a decreasing rate over the next twelve months. The following table summarizes the activity within deferred revenue for the six months ended June 30, 2015 and 2014 (in thousands):

EPTA deferred revenue as of January 1, 2015	$186	
Cash collected on Principal of EPTA Contracts	(142	)
Adjustments of EPTA deferred revenue	73	
EPTA deferred revenue as of June 30, 2015	$117	
EPTA deferred revenue as of January 1, 2014	$545	
Cash collected on Principal of EPTA Contracts	(486	)
Adjustments of EPTA deferred revenue	225	
EPTA deferred revenue as of June 30, 2014	$284	

Revenue related to cash collected on previously written off bad debt decreased 40% or $71,000, to $106,000 for the six months ended June 30, 2015 as compared to $177,000 for the six months ended June 30, 2014.

Cost of Revenue

Cost of revenue consists primarily of salaries and outsourcing fees related to fulfillment of our web services and customer service costs. Cost of revenue decreased 49% or $216,000, to $227,000 for the six months ended June 30, 2015 as compared to $443,000 for the six months ended June 30, 2014. The decrease is primarily related to a decrease in pay per click advertising costs of $143,000, a reduction in salaries and benefits associated with the fulfillment of website management services of $56,000, and a decrease in other cost of revenue of $17,000.

Research and Development

Research and development expenses primarily consist of salaries and benefits, and related expenses which are attributable to the development of our website development software products. Research and development expenses decreased 92% or $316,000, to $27,000 for the six months ended June 30, 2015 as compared to $343,000 for the six months ended June 30, 2014. The decrease was due to decreased salaries and benefits related to the discontinued development of our website development software and an allocation of costs to general and administrative salaries and benefits.

Selling and Marketing

Selling and marketing expenses consist primarily of salaries and benefits, commissions as well as advertising expenses. Selling and marketing expense decreased 73% or $37,000, to $14,000 for the six months ended June 30, 2015 as compared to $51,000 for the six months ended June 30, 2014. The decrease was primarily attributable to our shift in focus to only providing web services to enterprise-sized customers, thus there was no allocation of salaries and expenses during the six months ended June 30, 2015 and a reduction in commissions during the six months ended June 30, 2015.

General and Administrative

General and administrative expenses consist of salaries and benefits, and related expenses for executives, administrative personnel, legal, rent, accounting and other professional services, and other general corporate expenses. General and administrative expenses decreased 49% or $728,000, to $748,000 for the six months ended June 30, 2015 as compared to $1,476,000 for the six months ended June 30, 2014. The decrease in general and administrative expenses is primarily due to less of an allocation of corporate general and administrative expenses resulting from the 49% decrease in revenue for the six months ended June 30, 2015 compared to the six months ended June 30, 2014, and a company-wide reduction in general and administrative expenses as we continue to cut unnecessary expenses. Consolidated general and administrative expenses decreased 11%, or $363,000 to $2,935,000 for the six months ended June 30, 2015 compared to $3,298,000 for the six months ended June 30, 2014.

Other Income

Other income increased 77% or $91,000, to $209,000 for the six months ended June 30, 2015 as compared to $118,000 for the six months ended June 30, 2014. This increase is primarily related to the reversal of certain legal accruals totaling $193,000 during the six months ended June 30, 2015 that were determined to no longer have a reasonable possibility of being paid out, which was offset by a decrease of $102,000 in the interest earned on the principal collections of EPTAs.

Liquidity and Capital Resources

The Company has transformed into a start-up company with the inherent risks and uncertainties of funding operations until profitability is achieved. We currently plan to fund our operations during the next twelve months using our cash and cash equivalents of $1,782,000. However, after considering the Company's historical negative cash flows from operating activities as well as internal forecasts, such amount does not appear adequate to fund our anticipated cash needs for the next twelve months. Accordingly, the Company will be required to obtain additional debt or equity financing such as that available from its CEO to sustain operations. The Company received a commitment from the CEO, and major shareholder, in July 2015 that, if needed, he would provide up to $2,000,000 of financial support to enable the Company to fund its operations through September 30, 2016. As such, the Company believes it will have sufficient funds to sustain its operations during the next twelve months as a result of the sources of funding detailed above.

Working Capital

Working capital decreased 34% or $724,000, to $1,430,000 as of June 30, 2015 as compared to $2,154,000 for the year ended December 31, 2014. The decrease in working capital was primarily related to the decrease in cash and cash equivalents of $1,124,000 during the six months ended June 30, 2015, which was offset by a decrease in accrued expenses of $323,000 and a decrease in deferred revenue of $92,000 for the six months ended June 30, 2015.

Cash and Cash Equivalents

Cash and cash equivalents decreased 39% or $1,124,000, to $1,782,000 at June 30, 2015 as compared to $2,906,000 as of December 31, 2014. During the six months ended June 30, 2015, we used $1,733,000 in cash for operating activities, we used $20,000 in cash for investing activities, and financing activities provided $629,000.

Trade Receivables

Current and long-term trade receivables, net of allowance for doubtful accounts, decreased 28% or $167,000, to $440,000 at June 30, 2015 as compared to $607,000 at December 31, 2014. Long-term trade receivables, net of allowance for doubtful accounts, increased 48% or $31,000, to $95,000 at June 30, 2015 as compared to $64,000 at December 31, 2014. Historically, we offered our customers a contract with payment terms between 24 and 36 months, as one of several payment options. The payments that become due more than 12 months after the end of the fiscal period are classified as long-term trade receivables. The decrease in our accounts receivable balance is primarily related to a decrease in our Hosted Telecommunications Services trade receivables of $80,000 and cash collections and write-offs of EPTA agreements during the six months ended June 30, 2015 of $87,000.

Accounts Payable

Accounts payable increased 102% or $48,000, to $95,000 at June 30, 2015 as compared to $47,000 at December 31, 2014. Our accounts payable as of June 30, 2015 were generally within our vendors' terms of payment. The increase is primarily related to the timing of vendor payments.

Capital

Total stockholders’ equity decreased 20% or $918,000, to $3,626,000 at June 30, 2015 as compared to $4,544,000 at December 31, 2014. The significant changes in stockholders’ equity during the six months ended June 30, 2015 included an increase of additional paid-in capital of $582,000 for options granted, an increase of additional paid-in capital of $690,000 for the exercise of stock warrants, and issuance of common stock in connection with a business acquisition of $40,000, offset by a net loss of $2,230,000 for the six month period ending June 30, 2015.

Off Balance Sheet Arrangements

As of June 30, 2015, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Impact of Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 that introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. This standard is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. The Company is currently evaluating the new guidance to determine the impact it will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This ASU requires that a performance target that affects vesting and could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, Compensation-Stock Compensation, as it relates to such awards. ASU 2014-12 is effective for us in our first quarter of fiscal 2017 with early adoption permitted using either of two methods: (i) prospective to all awards granted or modified after the effective date; or (ii) retrospective to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter, with the cumulative effect of applying ASU 2014-12 as an adjustment to the opening retained earnings balance as of the beginning of the earliest annual period presented in the financial statements. The Company is currently assessing the impact of this pronouncement to its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15. This ASU requires management to assess an entity’s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the ASU (1) provides a definition of the term substantial doubt, (2) requires an evaluation every reporting period including interim periods, (3) provides principles for considering the mitigating effect of management’s plans, (4) requires certain disclosures when substantial doubt is alleviated as a result of consideration of management’s plans, (5) requires an express statement and other disclosures when substantial doubt is not alleviated, and (6) requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). This standard is effective for the fiscal years ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The Company is currently evaluating the new guidance to determine the impact it will have on its consolidated financial statements.

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

With the exception of historical facts, the statements contained in Management’s Discussion and Analysis of Financial Condition and Results of Operations are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, which reflect our current expectations and beliefs regarding our future results of operations, performance and achievements. These statements are subject to risks and uncertainties and are based upon assumptions and beliefs that may or may not materialize. These forward-looking statements include, but are not limited to, statements concerning:

our belief that our target market will increasingly look to Internet solutions providers who leverage industry and customer practices, increase predictability of success of their Internet initiatives and decrease implementation risks by providing low-cost, scalable solutions with minimal lead time;

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

our belief that we can continue our success by periodic review and revision of our methods of doing business and by continuing our expansion into domestic and international markets;

our belief that a key component of our success comes from a number of new, recently developed proprietary technologies and that these technologies and advances distinguish our services and products from our competitors and further help to substantially reduce our operating costs and expenses;

our contention that we do not offer our customers a "business opportunity" or a "franchise" as those terms are defined in applicable statutes of the states in which we operate;

our belief that there is a large, fragmented and under-served population of small businesses and entrepreneurs searching for professional services firms that offer business-to-consumer e-commerce solutions coupled with support and continuing education;

our expectation that our offering of products and services will evolve as some products are replaced by new and enhanced products intended to help our customers achieve success with their Internet-related businesses; and

our expectation that the costs and expenses we incur will be insignificant as deferred revenue amounts are recognized as product and other revenues when cash is collected.

We caution readers that our operating results are subject to various risks and uncertainties that could cause our actual results and outcomes to differ materially from those discussed or anticipated, including changes in economic conditions and internet technologies, interest rate fluctuations, and the factors set forth in the section entitled, “Risk Factors,” under Part I, Item 1A of the 2014 Form 10-K. We also advise readers not to place any undue reliance on the forward-looking statements contained in this Form 10-Q, which reflect our beliefs and expectations only as of the date of this Report. We assume no obligation to update or revise these forward-looking statements to reflect new events or circumstances or any changes in our beliefs or expectations, other than as required by law.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not required

Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the six months ended June 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

There are many risk factors that may affect our business and the results of our operations, many of which are beyond our control. Information on certain risks that we believe are material to our business is set forth in "Part I – Item 1A. Risk Factors" of the 2014 Form 10-K.

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

None

Item 6. Exhibits

Exhibits

Exhibit No.	Description
31.1	Certification of Chief Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as amended
31.2	Certification of Chief Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities and Exchange Act of 1934, as amended
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350
101.INS*	XBRL INSTANCE DOCUMENT
101.SCH*	XBRL TAXONOMY EXTENSION SCHEMA DOCUMENT
101.CAL*	XBRL TAXONOMY EXTENSION CALCULATION LINKBASE DOCUMENT
101.DEF*	XBRL TAXONOMY EXTENSION DEFINITION LINKBASE DOCUMENT
101.LAB*	XBRL TAXONOMY EXTENSION LABEL LINKBASE DOCUMENT
101.PRE*	XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE DOCUMENT

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

SIGNATURES

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

Crexendo, Inc.

August 4, 2015	By:	/s/ Steven G. Mihaylo Steven G. Mihaylo Chief Executive Officer
August 4, 2015	By:	/s/ Ronald Vincent Ronald Vincent Chief Financial Officer