8X8 INC /DE/
Form 10-K/A
October 03, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

(MARK ONE)

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

For the fiscal year ended March 31, 2005

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 000-21783

8X8, INC.

(Exact name of Registrant as Specified in its Charter)

Delaware	**77-0142404**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

3151 Jay Street
Santa Clara, CA 95054

(Address of Principal Executive Offices including Zip Code)

(408) 727-1885

(Registrant's Telephone Number, Including Area Code)

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

Securities registered pursuant to Section 12(g) of the Act: COMMON STOCK, PAR VALUE $.001 PER SHARE

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 [X] No [ ]

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 121(b)2 of the Securities Exchange Act of 1934). YES [X] NO [ ]

Based on the closing sale price of the Registrant's common stock on the NASDAQ SmallCap Market System on September 30, 2004, the aggregate market value of the voting stock held by non-affiliates of the Registrant was $159,961,000.

The number of shares of the Registrant's common stock outstanding as of May 20, 2005 was 53,816,989.

DOCUMENTS INCORPORATED BY REFERENCE

Items 10, 11, 12, 13 and 14 of Part III incorporate information by reference from the Proxy Statement to be filed for the 2005 Annual Meeting of Stockholders.

EXPLANATORY NOTE

8x8, Inc. ("8x8" or "the Company") is filing this amendment to its Annual Report on Form 10-K for the year ended March 31, 2005 (the "Amendment") to amend exhibits 31.1 and 31.2, which represent the certifications required by Rules13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934 (the "Exchange Act") as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. The Company is re-filing Exhibits 31.1 and 31.2 because the certifications as originally filed were not fully compliant with the requirements of the Exchange Act. This Amendment does not reflect any changes to the Annual Report on Form 10-K for the year ended March 31, 2005 other than those made to the exhibits, nor does it reflect events that have occurred after the original filing date of the Annual Report on Form 10-K that was originally filed. Information with respect to those events has been or will be set forth, as appropriate, in the Company's subsequent periodic filings, including its Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. Any reference to facts and circumstances at a "current" date refer to such facts and circumstances as of such original filing date.

8X8, INC.

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ANNUAL REPORT ON FORM 10-K/A
FOR YEAR ENDED MARCH 31, 2005

PART I

ITEM 1. BUSINESS

Forward-Looking Statements and Risk Factors

Statements contained in this annual report on Form 10-K, or Annual Report, regarding our expectations, beliefs, estimates, intentions or strategies are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act and include statements regarding our expectation concerning the adequacy of our facilities; our estimates of litigation exposure and our beliefs about the sufficiency of our supplier arrangements. All forward-looking statements included in this Report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. You should not place undue reliance on these forward-looking statements. Actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including a shifting of internal research and development focus based on changes in the market or adequacy of funding; a failure of customers to adopt voice and video over internet protocol technology or advances in competing systems and services; our business may grow in an unanticipated manner causing us to require different types of facilities; ordinary course litigation may cause a greater than anticipated impact due to factual matters or issues beyond our control; and our ability to source our products may be interrupted if our manufacturers cease operations or no longer desire to do business with us. Please also see the section entitled "Factors That May Affect Future Results" for additional risks that may impact our business. We undertake no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this Annual Report. Readers are urged to carefully review and consider the various disclosures made in this Annual Report, which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects.

Our fiscal year ends on March 31 of each calendar year. Each reference to a fiscal year in this Annual Report, refers to the fiscal year ending March 31 of the calendar year indicated (for example, fiscal 2005 refers to the fiscal year ended March 31, 2005). Unless the context requires otherwise, references to "we," "us," "our," "8x8" and the "Company" refer to 8x8, Inc. and its consolidated subsidiaries.

Overview

We develop, market and sell telecommunication services and technology for Internet protocol, or IP, telephony and video applications. We offer the Packet8 broadband voice over Internet protocol, or VoIP, phone service, Packet8 Virtual Office service and Packet8 videophone equipment and service. We shipped our first VoIP product in 1998, launched our Packet8 service in November 2002, launched the Packet8 Virtual Office business service in March 2004 and launched the Packet8 videophone service in June 2004. As of March 31, 2005, we had approximately 57,000 Packet8 lines in service.

The Packet8 voice and video broadband phone service (Packet8) enables broadband Internet users to add digital voice and video communications services to their high-speed Internet connection. Customers can choose a direct-dial phone number from any of the rate centers offered by the service, and then use an 8x8-supplied terminal adapter to connect any telephone to a broadband Internet connection and make or receive calls from a regular telephone number. All Packet8 telephone accounts come with voice mail, caller ID, call waiting, call waiting caller ID, call forwarding, hold, line-alternate, 3-way conferencing, web and voice-prompt access to account controls, and online billing. In addition, we offer a videophone in conjunction with our video service plans that connects to a customer's high-speed Internet connection to deliver all of the voice features above, as well as unlimited video calls to any other Packet8 videophone customer in the world. We also sell pre-programmed analog telephones with speakerphones and a display screen, in conjunction with our Virtual Office service plans, which enable our business customers to access additional features of Virtual Office through on-screen menus on the phone.

Substantially all of our revenues are generated from the sale, license and provisioning of VoIP products, services and technology. Prior to fiscal 2004, we were focused on our VoIP semiconductor business (through our subsidiary Netergy Microelectronics, Inc.) and hosted iPBX solutions business (through our subsidiary Centile, Inc.). In late fiscal 2003, we began to devote more of our resources to the promotion, distribution and development of the Packet8 service than to our existing semiconductor or hosted iPBX solutions businesses. We completed several transactions during fiscal 2004 to license and sell technology and assets of these former businesses, including the sale of our hosted iPBX research and development center in France, the sale and license of our next generation video semiconductor development effort, and the license of technology and manufacturing rights for our VoIP semiconductor products to other semiconductor companies. In addition, in January 2004, we announced the end of life of our VoIP semiconductor products, and began accepting last time buy orders from customers. We continue to own the voice and video technology related to the semiconductor and iPBX businesses, and utilize this technology in the Packet8 service offering, and continue to sell or license this technology to third parties.

During fiscal 2005, we completed three equity financing transactions for gross proceeds of approximately $38.5 million. As of March 31, 2005, we had cash, cash equivalents, restricted cash and investments of approximately $31.8 million as compared to $14 million at March 31, 2004.

Available Information

We maintain a corporate Internet website with the address http://www.8x8.com. The contents of this website are not incorporated in or otherwise to be regarded as part of this report. We file reports with the Securities and Exchange Commission, or SEC, which are available on our website free of charge. These reports include annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports, each of which is provided on our website as soon as reasonably practicable after we electronically file such materials with or furnish them to the SEC. You can also read and copy any materials we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. You can obtain additional information about the operation of the Public Reference Room by calling the SEC at 1.800.SEC.0330. In addition, the SEC maintains a website (www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including us.

Industry Background

VoIP is a technology that enables communications over the Internet through the compression of voice, video and/or other media into data packets that can be efficiently transmitted over data networks and then converted back into the original media at the other end. Data networks, such as the Internet or local area networks, or LANs, have always utilized packet-switched technology to transmit information between two communicating terminals (for example, a

PC downloading a page from a web server, or one computer sending an e-mail message to another computer). The most common protocol used for communicating on these packet switched networks is IP. VoIP allows for the transmission of voice along with other data over these same packet switched networks, and provides an alternative to traditional telephone networks, which use a fixed electrical path to carry voice signals through a series of switches to a destination.

As a result of the potential cost savings and added features of VoIP, consumers, enterprises, traditional telecommunication service providers and cable television providers are viewing VoIP as the future of telecommunications.

VoIP has experienced significant growth in recent years due to:

- Demand for lower cost telephone service;
- I
mproved quality and reliability of VoIP calls due to technological advances, increased network development and greater bandwidth capacity; and
- New product innovations that allow VoIP providers to offer services not currently offered by traditional telephone companies.

Technology research firms and analysts predict that VoIP telephony services will grow from less than 1,000,000 U.S. households at the end of 2004 to up to 20 million U.S. households by 2009.

The traditional telephone networks maintained by many local and long distance telephone companies were designed solely to carry low-fidelity audio signals with a high level of reliability. Although these traditional telephone networks are very reliable for voice communications, these networks are not well suited to service the explosive growth of digital communication applications for the following reasons:

- They are expensive to build because each subscriber's telephone must be individually connected to the central office switch, which is usually several miles away from a typical subscriber's location;

- They transmit data at very low rates and resolutions, making them poorly suited for delivering high-fidelity audio, entertainment-quality video or other rich multimedia content;

- They use dedicated circuits for each telephone call, which allot fixed bandwidth throughout the duration of each call, whether or not voice is actually being transmitted; and

- They may experience difficulty in providing new or differentiated services or functions, such as video communications, that the network was not originally designed to accommodate.

Until recently, traditional telephone companies have avoided the use of packet switched networks for transmitting voice calls due to the potential for poor sound quality attributable to latency issues (delays) and lost packets which can prevent real-time transmission. Recent improvements in packet switch technology, compression and broadband access technologies, as well as improved hardware and provisioning techniques, have significantly improved the quality and usability of packet-switched voice calls.

Packet-switched networks have been built mainly for carrying non real-time data. The advantages of such networks are their efficiency, flexibility and scalability. Bandwidth is only consumed when needed. Networks can be built in a variety of configurations to suit the number of users, client/server application requirements and desired availability of bandwidth, and many terminals can share the same connection to the network. As a result, significantly more traffic can be transmitted over a packet switched network, such as a home network or the Internet, than a circuit-switched telephony network. Packet switching technology allows service providers to converge their traditionally separate voice and data networks and more efficiently utilize their networks by carrying voice, video, fax and data traffic over the same network. The improved efficiency of packet switching technology creates network cost savings that can be passed on to the consumer in the form of lower telephony rates.

The growth of the Internet in recent years has proven the scalability of these underlying packet switched networks. As broadband connectivity, including cable modem and digital subscriber line, or DSL, has become more available and less expensive, it is now possible for service providers like us to offer voice and video services that run over these IP networks to businesses and residential consumers. Providing such services has the potential to both substantially lower the cost of telephone service and equipment costs to these customers and to increase the breadth of features available to our subscribers. Services like full-motion, two-way video are now supported by the bandwidth spectrum commonly available to broadband customers, whether business or residential.

Our Strategy

Our objective is to provide reliable, scalable, and profitable worldwide broadband communication services with unmatched quality. Our goal is to achieve this objective by delivering innovative technologies and services and balancing the needs of our customers with the needs of our business. We foster an environment that empowers our employees to provide the best service to our customers and partners in every way that they interact with us. We intend to bring the best possible voice and video products and services, at an affordable price, to residential consumers and businesses and enhance the ways in which these customers communicate with each other, and with the world.

Specific strategies to accomplish this objective include:

- *Capitalize on our technological expertise to introduce new products and features.*
  Over the past ten years, we have developed or acquired several core technologies that form the backbone of our video and voice over IP service and which we intend to use to develop product enhancements and future products. We developed the endpoint technologies used to provide video and voice service at the customer premise, and control the embedded software that run these endpoint devices. As a result, we are able to update the software functionality of our customers' endpoints without any third party assistance.
- *Offer the best possible service and support to our customers with a world class customer support organization.*
  We have established a call center and customer support group at our headquarters in Santa Clara, California and have outsourced call center operations in Syracuse, New York and Phoenix, Arizona. We are also investing in significant upgrades to our existing back office infrastructure to enhance the support we can provide to new and existing subscribers, as well as our distribution partners. In an emerging industry with world-changing technologies, we are focused on our customers and their experience with Packet8.
- *Develop additional distribution channels.*

We have established relationships with resellers, retailers and other distributors of telecommunications products. To further accelerate growth of our Packet8 residential and business offerings, we intend to build upon our existing relationships and establish new relationships with distributors, value added resellers and system integrators, other service providers, equipment manufacturers and retailers to make our products more readily available and accessible to potential customers of our service.

Our Packet8 Solution

Packet8 is an Internet-based communication service that works over virtually any high-speed Internet connection in the world, and allows calls to or from any phone in the world, whether that phone is an IP phone or a regular public switched telephone network, or PSTN, phone. Packet8 utilizes IP communication endpoints (i.e., a desktop adapter) which, when used in conjunction with the Packet8 network software and any standard telephone, enable plug and play installation and a familiar dialtone user interface. The Packet8 service also uses web-based technologies to enable account setup, account management, billing and customer support. We have developed a significant amount of the technology underlying our Packet8 service, which works with third party carriers to terminate VoIP calls on the PSTN network. As part of the Packet8 service, we currently resell private-branded telephone IP terminal adapters, which allow a regular analog telephone to be connected to an IP network, IP videophones, and preprogrammed business telephones. These devices, some of which are manufactured by certain of our former semiconductor customers, utilize our licensed semiconductor technology and certain unique software modifications to the protocol and application code that enable them to connect to 8x8's Packet8 IP services platform. The designs of these devices are based on our former semiconductor reference designs. We continue to enhance and develop new functionality in the software code that is embedded in these devices.

Products and Services

PACKET8 VoIP & VIDEO TELEPHONE SERVICE

Our Packet8 VoIP telephone service was introduced in November 2002. Customers enter into a service agreement with us, and select a calling plan based on their anticipated use of the service. Service plans provide various minutes of usage, up to unlimited, for calls in North America and Canada that are made to non-Packet8 customers. Subscribers are charged at a per-minute rate for international calls to non-Packet8 customers, and, depending on the level of plan selected, may be charged for calls to the PSTN if they exceed the minutes allowed under their plan. Depending on the service plan selected, 8x8 will either sell or provide at no cost to the user an 8x8 Desktop Terminal Adapter or Desktop Videophone to use with the Packet8 service. Each subscriber is assigned a telephone number in any of the area codes and underlying rate centers currently offered by the service. We currently offer area codes in forty-five U.S. states and the ability for a subscriber to port a number from another service provider. All Packet8 customers receive access to a variety of telephone features, including voice mail, caller ID, call forwarding, call waiting, 3-way calling, online account management and billing, international call blocking and caller ID blocking. We are also offering video over IP service using our DV326 videophone product which includes all of the voice features described above plus unlimited video calls to any other Packet8 videophone subscriber anywhere in the world. We currently offer enhanced 911, or E911, service in over 2,000 rate centers as an optional feature on all Packet8 calling plans. A Packet8 E911 call is routed as 911 emergency traffic and is accompanied by caller information, which enables emergency personnel to ensure that callers receive the exact same response that they receive from 911 services provided by landline incumbent telephone carriers. The Packet8 E911 implementation routes a subscriber's call directly to a 911 operator and eliminates unnecessary dialog about callers' whereabouts, which is vital in cases where a caller may not be able to verbally communicate due to an emergency condition.

PACKET8 VIRTUAL OFFICE BUSINESS TELEPHONE SERVICE

Our Packet8 Virtual Office business class telephone service was launched in March 2004 and is targeted at the small office, home office (SOHO) business market. Packet8 Virtual Office is an easy-to-use alternative to traditional PBX systems or Centrex class services from legacy telecommunications providers, and provides features and services that neither can provide. Packet8 Virtual Office allows users with a high-speed Internet connection anywhere in the world to be part of a virtual PBX that includes automated attendants to assist callers, conference bridges, extension-to-extension dialing and ring groups, in addition to a rich variety of other business class PBX features normally found on dedicated PBX equipment.

Packet8 Virtual Office subscribers have the ability to choose any phone number available to Packet8 subscribers or regardless of a user's geographic location. Subscribers can also port numbers from other service providers. Each extension in the virtual PBX can be located anywhere in the world where there is access to the Internet. Packet8 Virtual Office extension-to-extension calls and transfers are accomplished over the Internet, anywhere in the world, free of extra charges. Packet8 Virtual Office offers the services small businesses need most, including:

- Auto-attendant providing dial by extension, name or by group;
- Unlimited calling to the US, Canada and other Packet8 subscribers, as well as low international rates;
- Unlimited Packet8 extension-to-extension dialing anywhere in the world;
- Direct Inward Dial (DID) phone number with any desired area code for each extension;
- Conference bridge, 3-Way conferencing, music on hold, call park/pick-up, call transfer, hunt groups, and do not disturb;
- Business-class voice mail including email alerts, and direct transfer to mailbox;
- Call waiting / Caller-ID;
- Distinctive ringing; and
- Optional receptionist console application offering:
    - Multiple call viewing and handling;
    - Direct transfer to extension's voicemail;
    - Supervised transfers; and
    - View of extension status.

Packet8 Virtual Office extensions can be provisioned without requiring dedicated communications infrastructure to be installed in an office or remote location. The service is installed and run over an office's existing Internet connection, so no dedicated phone lines or digital subscriber lines (like a T1) need to be installed, as is the case with traditional Centrex or PBX products.

WHOLESALE VOICE AND VIDEO SERVICES

Our wholesale voice and video services include a complete suite of VoIP platforms with a Session Initiation Protocol, or SIP, IP switching infrastructure at its core, and voice, video and wireless endpoint devices to form a complete, end-to-end solution. Our technology delivers differentiating features for residential, business and video value-added services with co-branding and private branding options available to enable our partners to offer a differently labeled service similar to Packet8. Our network address traversal, or NAT, firewall traversal technologies, and quality of service, or QOS, techniques are also integrated into the wholesale solution. A wholesale billing interface is also included, enabling service providers to deploy a private-branded offering that integrates into existing broadband billing platforms.

DESKTOP TERMINAL ADAPTER

Our desktop terminal adapter, or DTA, product line is a set of telephone handset-to-Ethernet adapters that interface regular analog phones with IP-based telephony networks. The DTA is installed by the subscriber at their premises and supports a single voice port with its own direct dial phone number. This adapter runs a variety of communication and network protocols, including SIP.

DESKTOP IP VIDEOPHONE

Our desktop videophone product, the DV326, is an IP videophone that contains all of the voice features of a regular Packet8 service. In addition, when a Packet8 videophone subscriber calls another Packet8 videophone subscriber, the videophones connect with instant-on high-speed video sent over the Internet. The videophones can be configured by the user to use a maximum total data bandwidth between 84 kilobits per second and 640 kilobits per second. The video quality of the call varies with the data bandwidth selected and other network conditions. The Packet8 videophone is designed to be compatible with other SIP protocol devices.

PACKET8 ENABLED HANDSETS

In March 2005, Uniden America Corporation introduced a fully integrated, service-ready whole house VoIP phone system, the Uniden UIP1868. The Packet8-enabled UIP1868 is a 5.8GHz digital expandable corded/cordless phone that is expandable with up to ten handsets, deploying VoIP capability to each handset using a single high-speed Internet connection. Incorporating 8x8's Internet telephony software, the UIP1868 offers plug-and-play access to Packet8's feature-rich broadband telephone service, and includes a built-in 1-port router. The UIP1868 also includes one phone port to interface external analog phone devices, such as an answering machine or facsimile machine, to the Packet8-enabled base station.

Sales, Marketing and Promotional Activities

We currently sell and market our Packet8 and Packet8 Virtual Office services to end users through our direct sales force, website, retail channels, online channels, network marketing firms and third party resellers. We launched the retail channel in fiscal 2005 and entered into arrangements with numerous brick and mortar retailers, such as CompUSA, Fry's and J&R Music World, and on-line retailers including Amazon.com and TigerDirect. During fiscal 2005, we developed a network marketing channel and entered into agreements with 5Linx, Cognigen, Escape International and TJF Associates (dba Trapeze Communications), among others. These network marketing firms have networks of agents who resell the service in exchange for payment of bounties and commissions by us.

We are marketing the wholesale voice and video service offering to Internet service providers, cable television companies and digital subscriber line, or DSL, providers. Packet8 is offered to these third parties through reseller agreements, hosted and prepaid service agreements or OEM technology license agreements.

We offer individuals and businesses the opportunity to become resellers of our Packet8 services through our affiliate and reseller programs. Resellers are able to purchase bulk Packet8 accounts and hardware at reseller specific rates and they are then able to resell these accounts to private individuals under the Packet8 brand.

Competition

Competitors for the Packet8 service include AT&T Callvantage, iConnectHere, Lingo, Net2Phone, Voicepulse and Vonage, as well as cable television companies, such as Cablevision, Cox and Time Warner, incumbent telephone carriers, such as AT&T, SBC and Verizon and other providers of traditional and legacy telephone service. Our videophone service competes with other providers of videophone services and videoconferencing systems, including Polycom, Sony, Tandberg, Worldgate and various software offerings that implement videophone functionality on a personal computer.

Operations

We have a centrally managed platform consisting of data management, monitoring, control and billing systems, which support all of our products and services. We have invested substantial resources to develop and implement our real-time call management information system. Key elements of this system include: customer provisioning, customer access, fraud control, network security, call routing, call monitoring, media processing and normalization, call reliability and detailed call records. Our platform monitors our process of digitizing and compressing voice and video into packets and transmitting these packets over data networks around the world. We maintain a call switching platform, which is a software-based product that manages call admission, call control, call rating and routes calls to an appropriate destination or endpoint. Unless the recipient is using an Internet telephony device, the packets (representing a voice and/or video call initiated by a Packet8 subscriber) are sent to a gateway belonging to one of our partner telecommunications carriers where the packets are reassembled and the call is transferred to the PSTN and directed to a regular telephone anywhere in the world. Our billing and back office systems manage and enroll customers and bill calls as they originate and terminate on the service.

Network Operations Center

We maintain a Network Operations Center at our headquarters in Santa Clara, California and employ a staff of individuals with experience in both voice and data operations to provide twenty-four hour operations support We use various tools to monitor and manage all elements of our network in real-time. Additionally, our Network Operations Center provides technical support to troubleshoot equipment and network problems. We also rely upon the network operations centers and resources of our telecommunications carrier partners to augment our monitoring and response efforts.

Customer and Technical Support

We maintain a call center at our headquarters in Santa Clara, California and have a staff of employees and contractors that provide customer service and technical support to customers. In addition, we have outsourced certain customer support activities to third parties. We also provide customer service and technical support directly to our resellers, and certain resellers provide their own support directly to their sub-resellers and end users. Customers who access our services directly through the web site receive customer service and technical support through multilingual telephone communication, web-based customer service and e-mail support.

Interconnection Agreements

We are party to telecommunications interconnect and service agreements with VoIP providers and PSTN telecommunications carriers. Pursuant to these agreements, VoIP calls originating on our network can be terminated on other VoIP networks or the PSTN. Correspondingly, calls originating on other VoIP networks and the PSTN can be terminated on our network.

Suppliers

We outsource the manufacturing of the videophones, desktop terminal adapters, business telephones and cordless handsets to third-party manufacturers. We do not have long-term purchase agreements with our contract manufacturers. We rely on one telecommunications provider to originate and terminate substantially all of our PSTN telephone calls. While we believe that relations with our suppliers are good, there can be no assurance that our suppliers will be able or willing to supply products and services to us in the future. While we believe that we could replace our suppliers if necessary, our ability to provide service to our subscribers would be impacted during this timeframe, and this could have an adverse effect on our business, financial condition and results of operations.

Research and Development

The VoIP market is characterized by rapid technological changes and advances. Accordingly, we make substantial investments in the design and development of new products and services and enhancements and features to existing products and services. Our current and future research and development efforts relate to our Packet8 service offerings and the development of new endpoints for subscribers of our service. Future development will also focus on emerging audio and video telephony standards and protocols, quality and performance enhancements to multimedia compression algorithms, and 802.11b standard and other wireless applications. The development of new products and the enhancement of existing products are essential to our success.

We currently employ twenty-seven individuals in research and development and engineering activities in our facilities in Santa Clara, California and Sophia Antipolis, France. Research and development expenses in each of the fiscal years ended March 31, 2005, 2004 and 2003 were $3.1 million, $2.7 million and $7.8 million, respectively.

Regulatory

The use of the Internet and private IP networks to provide voice, video and other forms of real-time, two-way communications services is a relatively recent development. Although the provisioning of such services is currently permitted by United States law and largely unregulated within the United States, several foreign governments have adopted laws and/or regulations that could restrict or prohibit the provisioning of voice communications services over the Internet or private IP networks. More aggressive domestic or international regulation of the Internet in general, and Internet telephony providers and services specifically, may materially and adversely affect our business, financial condition, operating results and future prospects, particularly if increased numbers of governments impose regulations restricting the use and sale of IP telephony services.

On April 10, 1998, the Federal Communications Commission, or FCC, issued a Universal Service Report to Congress, commonly known as the Stevens Report. At that time, there was a petition pending before the FCC asking the FCC to impose common telecommunications carrier regulation on every entity enabling the transmission of real-time voice communication over the Internet. While the petition was being evaluated, Congress instructed the FCC to study the impact of unregulated Internet access and related services on the federal universal service fund, which is a program designed to provide subsidies to providers of telephone service in rural and high cost areas. The FCC issued the Stevens Report in response to Congress

' request, and in that report declined to assert regulatory authority over IP telephony. The FCC did not conclude that IP telephony services constitute telecommunications services, and indicated that it would undertake a subsequent examination of the question whether certain forms of Internet telephony constitute information services or telecommunications services.

The FCC indicated that, in the future, it would consider the extent to which telephony providers could be considered "telecommunications carriers" such that they could be subject to the regulations governing traditional telephone companies such as the imposition of access charges. The FCC stated that, although it did not have a sufficient record upon which to make a definitive ruling, the record suggested that, to the extent that certain forms of IP telephony appear to possess the same characteristics as traditional telecommunications services and to the extent the providers of those services obtain the same circuit-switched access as obtained by interexchange carriers, the FCC may find it reasonable that they pay similar access charges. The FCC also recognized, however, that it would consider whether it should forbear from imposing any of the rules that would apply to Internet telephony providers as "telecommunications carriers." To date, the FCC has not imposed regulatory surcharges or traditional common carrier regulation upon providers of Internet communications services such as ours. Although the FCC treats providers of Internet telephony services no differently from providers of other information and enhanced services that are exempt from payment of interstate access charges, this decision may be reconsidered in the future. On February 12, 2004 the FCC began a Notice of Proposed Rulemaking (NPRM) process to institute a new examination of regulatory policy and how VoIP services should be classified. The FCC has indicated that this rulemaking may address, among other things, 911 requirements, disability access requirements, access charges, and universal service requirements. The FCC has further indicated that it will begin a separate rulemaking proceeding to consider the obligations of IP-based voice services providers and network providers under the Communications Assistance to Law Enforcement Act, which establishes federal requirements for wiretapping and other electronic surveillance capabilities. This NPRM process is currently underway (the latest information on this process is available from the FCC

's VoIP website at http://www.fcc.gov/voip). We are unable to predict the outcome of this process at this time.

In addition to the NPRM process, several recent decisions by, and the outcome of the various proceedings pending before, the FCC may affect the regulatory status of Internet telephony. On October 18, 2002, AT&T filed a petition with the FCC seeking a declaratory ruling that would prevent incumbent local exchange carriers, or ILECs, from imposing traditional circuit-switched access charges on phone-to-phone IP services. This petition was denied on April 14, 2004. On February 5, 2003, pulver.com filed a petition with the FCC seeking a declaratory ruling that its "Free World Dialup," which facilitates point-to-point broadband Internet protocol voice communications, is neither telecommunications nor a telecommunications service as these terms are defined in the Telecommunications Act of 1996. This petition was granted on February 12, 2004. In September 2003, Vonage filed a petition for declaratory ruling requesting that the FCC find an Order of the Minnesota Public Utilities Commission, MPUC, requiring Vonage to comply with state laws governing providers of traditional telephone service to be pre-empted because Vonage's broadband Internet telephony service is an information service. On November 9, 2004, the FCC adopted an order granting Vonage's request for pre-emption. In that order, the FCC ruled that Vonage's service was inherently interstate and subject to exclusive federal jurisdiction, but declined to rule on the issue of whether it is a telecommunications service or an information service. Judicial appeals from the FCC's Vonage order are pending. On February 5, 2004, SBC Communications Inc. filed two petitions with the FCC relating to IP communications. The first requests a declaratory ruling that all services offered on an IP platform are interstate information services, not telecommunications services, and that they are immune from state regulation as a result. The FCC has incorporated this petition into its generic IP-enabled services rulemaking, where it will consider the regulatory status of Internet protocol voice communications. The second SBC petition requests that the FCC forbear from applying certain common carrier regulation to services offered on IP platforms. On May 5, 2005, the FCC issued an opinion and order denying SBC

's forbearance petition, and concluding that the petition was procedurally defective.

Several states have also demonstrated an interest in regulating VoIP services at a state public utility level, as they do for providers of traditional telephone service from regulated carriers.

In certain cases, these state governments and their regulatory authorities have moved to assert jurisdiction over the provision of intrastate IP communications services (calls that begin in that state and end in that state) where they believe that their telecommunications regulations are broad enough to cover regulation of IP services. If this trend continues, and if state regulation is not preempted by action by the FCC we may become subject to a "patchwork quilt" of state regulations and taxes, which would increase our costs of doing business, and adversely affect our operating results and future prospects.

We have been contacted by several state regulatory authorities regarding our Packet8 service. By letter dated August 13, 2003, the Public Service Commission of Wisconsin (the WPSC) notified us that the WPSC believes that we, via our Packet8 voice and video communications service, are offering intrastate telecommunications services in the state of Wisconsin without certification from the WPSC. According to the WPSC's letter, it believes that we cannot legally provide Packet8-based resold intrastate services in Wisconsin without certification from the WPSC. In addition, the WPSC believes that Packet8 bills for intrastate services to Wisconsin customers are void and not collectible. The letter also states that if we do not obtain certification to offer intrastate telecommunications services, the matter will be referred to the State of Wisconsin Attorney General for enforcement action. The letter also states that even if we were certified by the WPSC, the previous operation without certification may still subject us to referral to the State of Wisconsin Attorney General for enforcement action and possible forfeitures. On October 15, 2003, we responded to the WPSC and disputed its assertions by asserting that we are an information services provider and not a telecommunications provider. While we do not believe that the potential amounts of any forfeitures would be material to us, if we are subject to an enforcement action, we may become subject to liabilities and may incur expenses that adversely affect our results of operations.

On September 17, 2003, we were contacted by the Ohio Public Utilities Commission (OPUC) and asked to respond to a questionnaire on Voice over IP technologies that the OPUC is conducting. The OPUC inquired as to the nature of our service, how it is provided, and to what Ohio residents the service is made available. The questionnaire did not contain any assertions regarding the legality of the Packet8 service under Ohio law or any statements as to whether the OPUC believes we are subject to regulation by the state of Ohio. We responded to this questionnaire on October 20, 2003.

On September 22, 2003, the California Public Utilities Commission (CPUC) sent us a letter that alleged that we are offering intrastate telecommunications services for profit in California without having received formal certification from the CPUC to provide such service. The CPUC also requested that we file an application with the CPUC for authority to conduct business as a telecommunications utility no later than October 22, 2003. After consultation with regulatory counsel, we responded to the CPUC, disputed its assertions and did not file the requested application. In our October 22, 2003 response to the CPUC, we disagreed with the CPUC's classification of us as a telephone corporation under the California Public Utilities Code. We asserted that we are an information services provider and not a telecommunications provider. The letter from the CPUC did not indicate, and we cannot predict, what any potential penalties or consequences in failing to obtain certification might be. If we are subjected to penalties, or if we are required to comply with CPUC regulations affecting telecommunications service providers, our business may be adversely affected. On November 13, 2003, the CPUC held a hearing in San Francisco to hear testimony from CPUC staff and industry representatives regarding what course of action the CPUC should take with respect to Internet telephony. A representative from 8x8 testified at the hearing. On February 11, 2004, the CPUC stated that, as a tentative conclusion of law, they believe that VoIP providers are telecommunications providers and should be treated as such from a regulatory standpoint. The CPUC initiated an investigation into appropriate regulation of VoIP providers under state law, and acknowledged that it has not enforced the same regulatory regime over VoIP as applies to telecommunications services. The CPUC is considering a number of potential regulatory requirements, including contribution to state universal service programs, provision of 911 services, payment of access charges to interconnect with the PSTN and compliance with NANP protocols and basic consumer protection laws. The CPUC is also considering whether exempting VoIP providers from requirements applicable to traditional providers of voice telephony creates unfair competitive advantages, if the regulatory framework governing the provision of VoIP should vary based on the market served and whether VoIP providers should be subject to the current system of intercompany compensation arrangements. The CPUC has indicated that this process could last up to 18 months, but there is no way for us to predict the timetable or outcome of this process. On April 7, 2005, the CPUC instituted a rulemaking to assess and revise the regulation of all telecommunications utilities in California except for small incumbent local exchange carriers, or ILECs. The primary goal of this proceeding is to develop a uniform regulatory framework for all telecommunications utilities, except small ILECs, to the extent that it is feasible and in the public interest to do so. While not specifically directed at VoIP, it is unclear at this time what impact this new rulemaking will have on the CPUC's classification or treatment of VoIP services.

In May 2004, in response to a 2003 complaint case brought by Frontier Telephone of Rochester against Vonage, the New York State Public Service Commission, or NYPSC, concluded that Vonage is a telephone corporation as defined by New York law and must obtain a Certificate of Public Convenience and Necessity, which represents the authorization of the NYPSC to provide telephone service in New York. Under this ruling, Vonage would be required to provide 911 service in some form, and would be required to file a schedule of its rates. Vonage appealed this decision and, in June 2004, a federal judge issued a preliminary injunction enjoining the NYPSC from regulating Vonage as a telecommunications carrier. Vonage has asked the federal district court to make this a permanent injunction, and this request is being considered. While this ruling applies only to Vonage and not to us, if we are subject to regulation by the NYPSC, we may become subject to liabilities and may incur expenses that adversely affect our results of operations.

In July 2004, we received a letter from the Arizona Corporation Commission (ACC) stating that it was conducting a competitive analysis of the various telecommunications markets in Arizona. The letter requested that we provide answers to a listing of questions as well as certain data. On August 26, 2004, after executing the ACC's standard protective agreement governing the submission of commercially sensitive information, we sent to the ACC answers to some of the questions posed in the initial letter, together with information responsive to certain of the data requests. Inasmuch as the ACC proceeding is a generic docket opened for the purpose of gathering information regarding VoIP, additional information requests are possible, but none has been received to date.

In July 2004, the Internal Revenue Service issued an Advance Notice of Proposed Rulemaking to determine whether to propose regulations that would revise the existing Federal Excise Tax requirements to reflect changes in communications technologies. Additionally, there are several amendments to the Internet Tax Freedom Act, or ITFA, pending in the federal legislature that aim to expressly exclude VoIP from the tax freedom enjoyed by Internet services under the ITFA.

In August 2004, the FCC released a NPRM to examine the applicability of CALEA on VoIP and broadband services. In the CALEA NPRM, the FCC made certain tentative conclusions that if adopted could impose CALEA obligations on VoIP and broadband services and providers such as us. Complying with CALEA requirements may impose additional substantial costs on us.

In November 2004, the FCC ruled that the VoIP service of a competitor and "similar" services are jurisdictionally interstate and not subject to state certification, tariffing and other legacy telecommunication carrier regulations. The FCC ruling has been appealed by several states and the outcome of these appeals cannot be determined at this time.

In late 2004 and early 2005, we received notices from multiple municipalities in California that the Packet8 service is subject to utility user taxes, as defined in the respective municipal codes. The notices require that we begin collecting and remitting utility user taxes no later than January 1, 2005. We have responded to these municipalities and disputed their assertions.

In January 2005, we received a letter from the Municipal Association of South Carolina, or MASC, an association representing multiple municipalities in South Carolina. The MASC asserts that we are subject to a business license tax applied to telecommunications companies doing business within the participating municipalities' corporate limits. We have responded to the MASC and disputed their assertion.

In May 2005, we received a notice from the City of Chicago that we were being investigated for non-compliance with Chicago tax laws as we are not collecting and remitting Chicago's Telecommunications Tax. We are working with counsel to formulate a response to dispute the applicability of this tax to the Packet8 service.

Most recently, on May 19, 2005, the FCC unanimously adopted an Order and NPRM that requires VoIP providers to provide emergency 911, or E911, service. On June 3, 2005, the FCC released the text of the First Report and Order and Notice of Proposed Rulemaking in the VoIP E911 proceeding, or the VoIP E911 Order. As a result of the VoIP E911 Order, VoIP service providers that interconnect to the PSTN, or interconnected VoIP providers, will be required to mimic the 911 emergency calling capabilities offered by traditional landline phone companies. All interconnected VoIP providers must deliver 911 calls to the appropriate local public safety answering point, or PSAP, along with call back number and location, where the PSAP is able to receive that information. E911 must be included in the basic service offering; it cannot be an optional or extra feature. The PSAP delivery obligation, along with call back number and location information must be provided regardless of whether the service is "fixed" or "nomadic." User registration of location is permissible initially, although the FCC is committed to an advanced form of E911 that will determine user location without user intervention, one of the topics of the further NPRM to be released eventually. The VoIP E911 Order mandates that existing and prospective customers must be notified of the capabilities and limitations of VoIP service with respect to emergency calling, and interconnected VoIP providers must obtain and maintain affirmative acknowledgement from each customer that the customer has read and understood the notice of limitations and distribute warning labels or stickers alerting consumers and other potential users of the limitations of VoIP 911 service to each new subscriber prior to the initiation of service. In addition, an interconnected VoIP provider must make it possible for customers to update their address (i.e., change their registered location) via at least one option that requires no equipment other than that needed to access the VoIP service. All interconnected VoIP providers must comply with the requirements of the VoIP E911 Order within one-hundred and twenty days of the publication of the VoIP E911 Order in the Federal Register, which is expected by late June, with the exception that the customer notification obligations must be complied with within thirty days of the publication. We currently do not offer this service to all of our customers, as it was not available in certain rate centers from which telephone numbers are provisioned for the Packet8 service. We have begun to address this issue with our telecommunication interconnection partners. However, we may not be able to offer E911 service to all of our customers, and, as a result, may need to cease from offering service in certain rate centers. The effect of this ruling could have a material adverse effect on our financial position, results of operations and cash flows.

We began to offer Packet8 E911 service in June 2004, but currently do not offer this service to all our customers, as it is not available in certain rate centers from which we provision telephone numbers. We have begun to address this issue with our telecommunication interconnection partners. We may not be able to offer E911 service to all of our customers, and, as a result, may need to cease from offering service in certain rate centers. The impact of not being able to offer E911 service to all of our customers could have an adverse effect on our business, financial condition and results of operations.

In May 2005, we began charging a Regulatory Recovery Fee, currently an additional $1.50 per month, on each telephone number that is used by our customers, including toll free and virtual numbers. The Regulatory Recovery Fee is charged monthly to offset costs incurred by us in complying with inquiries and obligations imposed by federal, state and municipal regulatory bodies/governments and the related legal and billing expenses. This fee is not a tax or charge required or assessed by any government. Many of our competitors charge similar fees.

Regulation of the Internet

In addition to regulations addressing Internet telephony and broadband services, other regulatory issues relating to the Internet in general could affect our ability to provide our services. Congress has adopted legislation that regulates certain aspects of the Internet, including online content, user privacy, taxation, liability for third-party activities and jurisdiction. In addition, a number of initiatives pending in Congress and state legislatures would prohibit or restrict advertising or sale of certain products and services on the Internet, which may have the effect of raising the cost of doing business on the Internet generally.

Federal, state, local and foreign governmental organizations are considering other legislative and regulatory proposals that would regulate the Internet. We cannot predict whether new taxes will be imposed on our services, and depending on the type of taxes imposed, whether and how our services would be affected thereafter. Increased regulation of the Internet may decrease its growth and hinder technological development, which may negatively impact the cost of doing business via the Internet or otherwise materially adversely affect our business, financial condition and results of operations.

Intellectual Property and Proprietary Rights

Our ability to compete depends, in part, on our ability to obtain and enforce intellectual property protection for our technology in the United States and internationally. We currently rely primarily on a combination of trade secrets, patents, copyrights, trademarks and licenses to protect our intellectually property. As of March 31, 2005, we had fifty-eight United States patents that have issued and a number of United States and foreign patent applications pending, none of which we consider critical to our business. Our patents expire on dates ranging from 2009 to 2018. We cannot predict whether our pending patent applications will result in issued patents.

To protect our trade secrets and other proprietary information, we require our employees to sign agreements providing for the maintenance of confidentiality and also the assignment of rights to inventions made by them while in our employ. There can be no assurance that our means of protecting our proprietary rights in the United States or abroad will be adequate or that competition will not independently develop technologies that are similar or superior to our technology, duplicate our technology or design around any of our patents. We are also subject to the risks of adverse claims and litigation alleging infringement of the intellectual property rights of others. The communications and software industries are subject to frequent litigation regarding patent and other intellectual property rights. In addition, the laws of foreign countries in which our products are or may be sold do not protect our intellectual property rights to the same extent as do the laws of the United States. Our failure to protect our proprietary information could cause our business and operating results to suffer.

We rely upon certain technology, including hardware and software, licensed from third parties. There can be no assurance that the technology licensed by us will continue to provide competitive features and functionality or that licenses for technology currently utilized by us or other technology which we may seek to license in the future will be available to us on commercially reasonable terms or at all. The loss of, or inability to maintain existing licenses could result in shipment delays or reductions until equivalent technology or suitable alternative products could be developed, identified, licensed and integrated, and could harm our business. These licenses are on standard commercial terms made generally available by the companies providing the licenses. The cost and terms of these licenses individually are not material to our business.

Licensing and Development Arrangements

Historically, we entered into licensing and development arrangements with our semiconductor and IP PBX customers to promote the design, development, manufacture and sale of our products. We have licensed portions of our systems technology and software object code for our semiconductors to virtually all of our semiconductor customers. Such arrangements may enable these companies to use our technology to produce products that compete with our Packet8 telephony and video products. We have also licensed the right to manufacture certain of our video and VoIP telephony semiconductor products to several original equipment manufacturers, or OEMs. These licenses generally provide for the payment of royalties. Only certain of these OEM licensees may sell semiconductors based on the licensed technology to third parties, while other licensees are limited to sales of such semiconductors as part of multimedia communication systems or sub-systems. We expect to continue licensing our technology to others, many of whom may be located outside of the United States. In addition to licensing our technology to others, we, from time to time, may take a license to technology owned by third parties and currently rely upon certain technology, including hardware and software, licensed from third parties.

Information about Segments and Geographic Areas

We have only one reportable segment. Financial information relating to our product lines and information on revenues generated in different geographic areas are set forth in Note 12 to our consolidated financial statements contained in Part II, Item 8 of this Report.

Employees

As of March 31, 2005, our workforce consisted of ninety-three employees and sixty-five contractors. These employees and contractors include ninety-six in operations, thirty-four in research and development, seventeen in sales and marketing and eleven in general and administrative capacities. None of our employees are represented by a labor union or are subject to a collective bargaining arrangement.

ITEM 2. PROPERTIES

Our principal operations are located in an approximately 47,000 square foot facility in Santa Clara, California that is leased through August 2009. Design, testing, research and development, sales and marketing, shipping, customer service and administrative activities are performed in this facility. We also lease office space for our research and development operation in Sophia-Antipolis, France. We believe that our existing facilities are adequate to meet our current and foreseeable future needs. For additional information regarding our obligations under leases see Note 9 to the consolidated financial statements contained in Part II, Item 8 of this Report.

ITEM 3. LEGAL PROCEEDINGS

On January 21, 2004, we filed and served a complaint against Sony Ericsson Mobile Communications AB (Sony Ericsson) in the United States District Court for the Eastern District of Texas, Marshall Division. The complaint alleged that certain Sony Ericsson products infringe two 8x8 patents, U.S. Patent Numbers 6,441,842, issued on August 27, 2002, and 6,119,178, issued on September 12, 2000. In March 2005, we and Sony Ericsson agreed to terminate the lawsuit.

We are involved in various other legal claims and litigation that have arisen in the normal course of our operations. While the results of such claims and litigation cannot be predicted with certainty, we believe that the final outcome of such matters will not have a significantly adverse effect on our financial position, results of operations or cash flows. However, should we not prevail in any such litigation, our operating results, financial condition or cash flows could be adversely impacted.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2005.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED SECURITY HOLDER MATTERS

We completed our initial public offering on July 2, 1997 under the name 8x8, Inc. From that date through April 3, 2000, our common stock was traded on the NASDAQ National Market (the NASDAQ) under the symbol "EGHT." From April 4, 2000 through July 18, 2001, our common stock was traded on the NASDAQ under the symbol "NTRG." Since July 19, 2001 our common stock has traded under the symbol "EGHT." In July 2002, our listing was transferred to the Nasdaq SmallCap Market. We have never paid cash dividends on our common stock and have no plans to do so in the foreseeable future. We did not repurchase any of our equity securities during the fourth quarter of fiscal 2005. As of May 20, 2005, there were 303 holders of record of our common stock.

The following table sets forth the range of high and low closing prices for each period indicated:

Period		High	Low
Fiscal 2005:			
	First quarter	$ 3.54	$ 2.25
	Second quarter	$ 3.84	$ 1.38
	Third quarter	$ 4.49	$ 2.52
	Fourth quarter	$ 4.08	$ 1.61
Fiscal 2004:			
	First quarter	$ 0.64	$ 0.23
	Second quarter	$ 1.90	$ 0.41
	Third quarter	$ 7.52	$ 1.33
	Fourth quarter	$ 5.47	$ 2.75

ITEM 6. SELECTED FINANCIAL DATA

	Years Ended March 31, (1) (6)				
	2005	2004	2003 (5)	2002 (2)	2001
	(in thousands, except per share amounts)				
Total revenues	$ 11,475	$ 9,308	$ 11,003	$ 14,691	$ 18
Net loss	$ (19,148)	$ (3,039)	$ (11,403)	$ (9,105)	$ (74
Net loss per share:					
Basic	$ (0.43)	$ (0.09)	$ (0.40)	$ (0.33)	$ (
Diluted	$ (0.43)	$ (0.09)	$ (0.40)	$ (0.33)	$ (
Total assets	$ 39,080	$ 15,571	$ 6,705	$ 19,653	$ 39
Convertible subordinated debentures	$ --	$ --	$ --	$ --	$ 6
Contingently redeemable common stock	$ --	$ --	$ 669	$ 813	$
Accumulated deficit	$ (170,866)	$ (151,718)	$ (148,679)	$ (137,276)	$ (128
Total stockholders' equity	$ 29,744	$ 12,786	$ 2,164	$ 13,234	$ 21

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1. Fiscal 2001 was a 52 week and 2 day fiscal year. Fiscal 2005, 2004, 2003 and 2002 were 52-week fiscal years.
2. Net loss and net loss per share include an extraordinary gain of $779,000 resulting from the early extinguishment of our convertible subordinated debentures.

3. Net loss and net loss per share include a restructuring charge of $33.3 million, an in-process research and development charge of $4.6 million, and a $1.1 million charge for the cumulative effect of a change in accounting principle.

4. The convertible subordinated debentures, which had a face value of $7.5 million, are presented net of the related debt discount, which was amortized over the initial three-year term of the debentures. The debentures were redeemed in December 2001.

5. Net loss and net loss per share include restructuring and other charges of $3.4 million.

6. Beginning fiscal 2003, Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," was adopted, and we ceased to amortize approximately $1.5 million of goodwill, net of amortization, including intangibles that were classified as goodwill upon adoption of SFAS No. 142. The 2001 and 2002 consolidated financial data includes amortization of goodwill and intangibles totaling $0.7 million for 2002 and $11 million for 2001.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We were founded in 1987 and completed an initial public offering of common stock in 1997. We develop and market telecommunication technology for Internet protocol, or IP, telephony and video applications. We offer the Packet8 broadband voice over Internet protocol, or VoIP, and video communications service, Packet8 Virtual Office service and videophone equipment and services. We shipped our first VoIP product in 1998, launched our Packet8 service in November 2002, and launched the Packet8 Virtual Office business service offering in March 2004. As of March 31, 2005, we had approximately 57,000 Packet8 lines in service. In fiscal 2005 and 2004 substantially all of the Company's revenues were generated from the sale, license and provision of VoIP products, services and technology. Prior to fiscal 2003, our focus was on our VoIP semiconductor business.

In late fiscal 2003, we began to devote more of our resources to the promotion, distribution and development of the Packet8 voice and video communications service than to our existing semiconductor business or hosted iPBX solutions business. We completed several transactions during fiscal 2004 to license and sell technology and assets of these businesses, including the sale of our IP PBX research and development center in France, the sale of our next generation video semiconductor development effort, and the license of technology and manufacturing rights for our VoIP semiconductor products to other semiconductor companies. In addition, during January 2004, we announced the end of life of our VoIP semiconductor products, and began accepting last time buy orders from customers. This change in our business has resulted in a reduction of revenues, but has enabled us to reduce costs and generate cash from the related license and sale transactions related to the semiconductor and IP PBX businesses. We continue to own the voice and video technology related to the semiconductor and IP PBX businesses, and utilize this technology in the Packet8 service offering and continue to sell or license this technology when the opportunity is in our best interest.

During fiscal 2005, we completed equity financings for gross proceeds of approximately $38.5 million. As of March 31, 2005, we had cash, cash equivalents, restricted cash and investments of approximately $31.8 million as compared to $14 million at March 31, 2004.

CRITICAL ACCOUNTING POLICIES & ESTIMATES

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. Note 1 to the consolidated financial statements in Part II, Item 8 of this Report describes the significant accounting policies and methods used in the preparation of our consolidated financial statements.

We have identified the policies below as some of the more critical to our business and the understanding of our results of operations. These policies may involve a higher degree of judgment and complexity in their application and represent the critical accounting policies used in the preparation of our financial statements. Although we believe our judgments and estimates are appropriate and correct, actual future results may differ from our estimates. If different assumptions or conditions were to prevail, the results could be materially different from our reported results. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results.

Use of Estimates

The preparation of the consolidated financial statements, in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and equity and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates, including, but not limited to, those related to bad debts, valuation of inventories, and litigation and other contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions.

In addition to evaluating estimates relating to the items discussed above, we also consider other estimates, including, but not limited to, those related to bad debts, the valuation of inventories, income taxes, and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets, liabilities and equity that are not readily apparent from other sources. Actual results could differ from those estimates under different assumptions or conditions. Additional information regarding risk factors that may impact our estimates is included below under "Factors that May Affect Future Results."

Revenue Recognition

Our revenue recognition policies are described in Note 1 to the consolidated financial statements in Part II, Item 8 of this Report. As described below, significant management judgments and estimates must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of our revenue for any period if our management made different judgments or utilized different estimates.

We defer recognition of new subscriber revenue from our Packet8 service offerings until the acceptance period has expired. New customers may terminate their service within thirty days of order placement and receive a full refund of fees previously paid. As we have been providing our Packet8 service for a limited period of time, we have not developed sufficient history to apply a return rate and reserve against new order revenue. Accordingly, we defer new subscriber revenue for thirty days to ensure that the thirty day acceptance period has expired.

Emerging Issues Task Force (EITF) consensus No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" requires that revenue arrangements with multiple deliverables be divided into separate units of accounting if the deliverables in the arrangement meet specific criteria. In addition, arrangement consideration must be allocated among the separate units of accounting based on their relative fair values, with certain limitations. The provisioning of the Packet8 service with the accompanying desktop terminal adapter or other customer premise equipment constitutes a revenue arrangement with multiple deliverables. In accordance with the guidance of EITF No. 00-21, we allocate Packet8 revenues, including activation fees, among the customer premise equipment and subscriber services. Revenues allocated to the customer premise equipment are recognized as product revenues at the end of thirty days after order placement, provided the customer does not cancel their Packet8 service. All other revenues are recognized as license and service revenues when the related services are provided. We defer the cost of goods sold of products sold for which the end customer or distributor has a right of return. The cost of the products sold is recognized, contemporaneously with the recognition of revenue, when the subscriber has accepted the service.

At the time of each revenue transaction we assess whether the revenue amount is fixed and determinable and whether or not collection is reasonably assured. We assess whether the fee is fixed and determinable based on the payment terms associated with the transaction. If a significant portion of a fee is due after our normal payment terms, which are thirty to ninety days from invoice date, we account for the fee as not being fixed and determinable. In these cases, we recognize revenue as the fees become due. We assess collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We generally do not request collateral from our customers. If we determine that collection of a fee is not reasonably assured, we defer the fee and recognize revenue at the time collection becomes reasonably assured, which is generally upon receipt of payment.

For arrangements with multiple obligations (for example, undelivered maintenance and support), we allocate revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements, which is specific to us. This means that we defer revenue from the arranged fee that is equivalent to the fair value of the undelivered elements. Fair values for the ongoing maintenance and support obligations for our technology licenses are based upon separate sales of renewals to other customers or upon renewal rates quoted in the contracts. We base the fair value of services, such as training or consulting, on separate sales of these services to other customers. We recognize revenue for maintenance services ratably over the contract term. Our training and consulting services are billed based on hourly rates and we generally recognize revenue as these services are performed.

If a software license arrangement includes acceptance criteria, revenue is not recognized until we can objectively demonstrate that the software or service can meet the acceptance criteria or when the customer has signed formal acceptance documentation. If a software license arrangement obligates us to deliver unspecified future products, revenue is recognized on a subscription basis, ratably over the term of the contract.

For all sales, except those completed via the Internet, we use either a binding purchase order or other signed agreement as evidence of an arrangement. For sales over the Internet, we use a credit card authorization as evidence of an arrangement, and recognize revenue upon settlement of the transaction, if there are no customer acceptance conditions. We do not settle credit card transactions until equipment related to the transaction, if any, is shipped to a customer.

Our ability to enter into revenue generating transactions and recognize revenue in the future is subject to a number of business and economic risks discussed below under "Factors that May Affect Future Results."

Collectibility of Accounts Receivable

We must make estimates of the collectibility of our accounts receivable. Management specifically analyzes accounts receivable, including historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. The accounts receivable balance approximated $1.1 million, net of an allowance for doubtful accounts of $68,000 as of March 31, 2005, including a reserve for disputed credit card charges. If the financial condition of our customers were to deteriorate, our actual losses may exceed our estimates, and additional allowances would be required.

Valuation of Inventories

We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand, market conditions and replacement costs. If actual future demand or market conditions are less favorable than those projected by us, additional inventory write-downs may be required.

Income Taxes

As part of the process of preparing our consolidated financial statements we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves us estimating our actual current tax expense together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. In the event that we determine that we would be able to realize deferred tax assets in the future in excess of the net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made.

Significant management judgment is required in determining the valuation allowance recorded against our net deferred tax assets, which primarily consist of net operating loss and tax credit carry forwards. We have recorded a valuation allowance of $60.9 million as of March 31, 2005, due to uncertainties related to our ability to utilize most of our deferred tax assets before they expire. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable.

Litigation

From time to time, we receive notices that our products or manufacturing processes may be infringing the patent or intellectual property rights of others. Management's current estimated range of liability related to pending intellectual property and other litigation involving the Company is based on claims and exposures for which our management can estimate the amount and range of loss. We have recorded the minimum estimated liability related to those claims, where there is a range of loss. At March 31, 2005, liabilities related to litigation matters were not significant. Because of the uncertainties related to both the amount and range of loss on pending litigation, management is unable to make a reasonable estimate of the liability that could result from an unfavorable outcome. As additional information becomes available, we will assess the potential liability, if any, related to our pending litigation and revise our estimates. Such revisions in our estimates of the potential liability could materially impact our results of operations, financial position or cash flows.

RESULTS OF OPERATIONS

The following table sets forth consolidated statement of operations data for each of the years ended March 31, 2005, 2004 and 2003, expressed as the percentage of our total revenues represented by each item. Cost of product revenues is presented as a percentage of product revenues and cost of license and other revenues is presented as a percentage of license and service revenues. You should read this information in conjunction with our Consolidated Financial Statements and related notes included elsewhere in this Report.

	Year Ended March 31,		
	2005	2004	2003
Product revenues	21 %	29 %	52 %
License and service revenues	79 %	71 %	48 %

Total revenues	100 %	100 %	100 %
Operating expenses:			
Cost of product revenues	40 %	19 %	25 %
Cost of license and service revenues	45 %	28 %	14 %
Research and development	27 %	30 %	71 %
Selling, general and administrative	161 %	65 %	68 %
Restructuring and other charges	-- %	-- %	31 %
Total operating expenses	273 %	142 %	209 %
Loss from operations	(173)%	(42)%	(109)%
Other income, net	4 %	9 %	5 %
Loss before benefit for income taxes	(169)%	(33)%	(104)%
Benefit for income taxes	(2)%	-- %	-- %
Net loss	(167)%	(33)%	(104)%

REVENUES

Product revenues

consist of revenues from sales of VoIP terminal adapters, telephones and videophones, primarily attributable to our Packet8 service, as well as sales of VoIP semiconductors and other system products. Product revenues were $2.4 million, $2.7 million and $5.7 million for fiscal 2005, 2004 and 2003, respectively. The $0.3 million decrease in fiscal 2005 compared to fiscal 2004 million was primarily attributable to a $1.4 million increase in Packet8 product revenues attributable to the growth in the subscriber base compared to the prior year, partially offset by a $1.7 million decrease in sales of video and VoIP semiconductors. During fiscal 2005, our Packet8 lines in service increased from approximately 11,000 at March 31, 2004 to approximately 57,000 at March 31, 2005.

The $3 million decrease in product revenues in fiscal 2004 compared to fiscal 2003 was due primarily to a $2.8 million decline in sales of our semiconductor products, consisting of a $2.5 million decrease in videoconferencing semiconductor sales combined with a $300,000 decrease in VoIP semiconductor sales. The decrease in videoconferencing semiconductor sales was attributable to a decrease in unit shipments due to the end of life of those products and completion of final shipments of such products in the first quarter of fiscal 2004. Total videoconferencing semiconductor product revenues were $530,000 and $3.1 million for the fiscal years ended March 31, 2004 and 2003, respectively. The decrease in VoIP semiconductor revenue was attributable to a decrease in unit shipments combined with a decrease in average selling prices (ASPs). Revenues from system products decreased approximately $264,000 in fiscal 2004 as compared to fiscal 2003 due to decreases in sales of media hubs used with our hosted iPBX product and videophone sales offset by an increase in product revenues attributable to the Packet8 service due to the growth in subscribers.

License and service revenues

consist primarily of revenues attributable to our Packet8 service and technology licenses and related maintenance revenues, as well as the royalties earned under such licenses. We expect that Packet8 service revenues will continue to comprise substantially all of our license and service revenues on a going forward basis. Prior to fiscal 2004, our license and service revenues were primarily generated by nonrecurring transactions. License and services revenues were $9.1 million, $6.6 million and $5.3 million for fiscal 2005, 2004 and 2003, respectively. The $2.5 million increase in fiscal 2005 was primarily attributable to a $7.3 million increase in Packet8 service revenues attributable to the growth in the subscriber base, which was partially offset by a decrease of $4.8 million in license and maintenance revenues associated with our hosted iPBX product and IP semiconductor telephony technology.

The increase in license and service revenues of approximately $1.3 million for fiscal 2004 as compared to fiscal 2003 was primarily due to the following:

- A $1.2 million increase in revenues in fiscal 2004 related to the license and sale of the technology related to our next generation video semiconductor product to Leadtek as compared to revenues recognized related to the development effort with Leadtek in fiscal 2003, which effort was terminated in fiscal 2004 in connection with the license and sale transaction;

- A $1.7 million increase in revenues attributable to our IP semiconductor telephony technology, primarily attributable to a July 2003 license of the Audacity T2 and T2U semiconductor products and Veracity software to a single customer; and

- A $1.0 million increase in recurring service revenues attributable to our Packet8 service.

These increases in license and service revenues were offset by:

- A $1.4 million reduction in revenues from the June 2000 sale of our video monitoring business;

- A $750,000 decrease in royalties earned from a single customer under a license agreement for our MPEG video compression technology; the final royalty revenues under this license agreement were received in the first quarter of fiscal 2003; and

- A decrease of $386,000 in license and maintenance revenues associated with our hosted iPBX product.

Revenues from our ten largest customers in the fiscal years ended March 31, 2005, 2004 and 2003 accounted for approximately 11%, 73% and 63%, respectively, of our total revenues. No single customer represented more than 10% of our total revenues during fiscal 2005. Two customers represented 26% and 16% of our total revenues in fiscal 2004. We expect customer concentration to decrease in the future as revenues from our Packet8 service increase as a percentage of overall revenues.

Sales to customers outside the United States represented 9%, 71% and 62% of total revenues in the fiscal years ended March 31, 2005, 2004 and 2003, respectively. The following table illustrates our net revenues by geographic area. Revenues are attributed to countries based on the destination of shipment (in thousands):

	Year Ended March 31,		
	2005	2004	2003
United States	$ 10,472	$ 2,728	$ 4,218
Europe	646	1,309	2,657
Taiwan	157	4,163	1,569
Japan	--	568	919
Other	200	540	1,640
	$ 11,475	$ 9,308	$ 11,003

Cost of Product Revenues

The cost of product revenues consists of costs associated with systems, components, system and semiconductor assembly and testing performed by third-party vendors, estimated warranty obligations and direct and indirect costs associated with product purchasing, scheduling, quality assurance, shipping and handling. The cost of product revenues was $4.5 million, $1.8 million and $2.8 million for fiscal 2005, 2004 and 2003, respectively. We generally do not charge Packet8 subscribers for the terminal adapters used to provide our service when they subscribe on our website. We have also offered incentives to customers who purchase terminal adapters in our retail channels to offset the cost of the equipment purchased from a retailer. In accordance with Emerging Issues Task Force Issue No. 00-21, a portion of Packet8 revenues is allocated to product revenues, but these revenues are less than the cost of the terminal adapters. Accordingly, cost of product revenues exceeds product revenues, and we expect this trend to continue.

The $2.7 million increase in the cost of product revenues in fiscal 2005 was primarily due to an approximately $3.3 million increase attributable to equipment provided and sold to Packet8 subscribers upon commencement of service and related manufacturing, personnel, handling, overhead and shipping costs. The increase in Packet8 expenses was partially offset by a decrease in cost of revenues for semiconductor products due to the decrease in sales of such products during fiscal 2005 due to the end of life of these products initiated in fiscal 2004. For the year ended March 31, 2005, we reversed $74,000 of write-downs related to semiconductor product inventory that had been previously written down or for which we had recorded purchase commitment reserves due to the sale of the inventory. In addition, we reversed approximately $120,000 of royalty and $103,000 of warranty reserves related to our former video semiconductor and PSTN videophone products as a result of changes in estimates.

The $1 million decrease in the cost of product revenues in fiscal 2004 as compared to fiscal 2003 was primarily attributable to a $1.3 million decrease in cost of goods sold for semiconductor products, partially offset by a $0.3 million increase for equipment provided and sold to Packet8 subscribers upon commencement of service and related manufacturing, personnel, handling, overhead and shipping costs. For the year ended March 31, 2004, we reversed $116,000 of write-downs related to semiconductor product inventory due to the sale of the inventory, and recorded $70,000 of reserves against our non-IP videophone product inventory. We also reversed approximately $220,000 of warranty reserves related to our video monitoring business as a result of a change in estimate of our warranty exposure.

Cost of License and Service Revenues

The cost of license and service revenues consists of costs primarily associated with network operations and related personnel, telephony origination and termination services provided by third party carriers, and royalty expenses. The cost of license and service revenues was $5.2 million, $2.6 million and $1.5 million for fiscal 2005, 2004 and 2003, respectively. The $2.6 million increase in cost of license and service revenues in fiscal 2005 as compared to fiscal 2004 was primarily due to a $4.1 million increase in Packet8 network operations, third party carrier service and other costs due to the year over year growth in the Packet8 lines in service. This increase was offset by a $1.5 million decrease in license and royalty costs attributable to our IP semiconductor technology, primarily attributable to video semiconductor product development efforts during fiscal 2004. As the costs of developing this video semiconductor product related to a revenue generating contract, they were included in cost of license and service revenue in fiscal 2004 and fiscal 2003. In the third quarter of fiscal 2004, we terminated this video semiconductor development effort in connection with the license and sale of the technology.

The $1.1 million increase in cost of license and service revenues in fiscal 2004 as compared to fiscal 2003 was primarily due to a $1 million increase in Packet8 network operations, third party carrier service and other costs due to the year over year growth in the Packet8 subscriber base and a $0.1 million increase attributable to our IP semiconductor technology.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses have historically consisted primarily of personnel, system prototype design and fabrication, mask, prototype wafer, and equipment costs necessary for us to conduct our development and engineering efforts. Research and development costs, including software development costs, are expensed as incurred. Research and development expenses were $3.1 million, $2.7 million and $7.8 million for fiscal 2005, 2004 and 2003, respectively. The $0.4 million increase in research and development expenses for fiscal 2005 as compared to fiscal 2004 was primarily due to a $0.9 million increase in personnel costs due to additional employee and contractor headcount. These increases were offset by decreases in depreciation, tooling and maintenance expenses.

The $5.1 million decrease in research and development expenses in fiscal 2004 as compared to fiscal 2003 was primarily due to a $2.7 million reduction in compensation expense for personnel primarily attributable to headcount reductions arising from the sale of Centile Europe SA during fiscal 2004, closure of our United Kingdom (UK) office in late fiscal 2003, and the transfer of employees to Leadtek Research, Inc. in connection with the sale and license of our next generation video chip technology, a $0.6 million reduction in depreciation and amortization expense due to the end of life of certain assets and the asset write-offs recorded in fiscal 2003; and a $1.7 million reduction in expenditures attributable to the closure of our UK office in late fiscal 2003 and the sale of Centile Europe SA in the second quarter of fiscal 2004. The reduction in Centile Europe SA expenses in France was partially offset by expenses attributable to 8x8 Europe SARL, our new French subsidiary formed in the third quarter of fiscal 2004.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses consist primarily of personnel and related overhead costs for sales, marketing, customer support, finance, human resources and general management. Such costs also include sales commissions, trade show, advertising and other marketing and promotional expenses. Selling, general, and administrative expenses were $18.5 million, $6.1 million and $7.4 million in fiscal 2005, 2004, and 2003, respectively. The $12.4 million increase in selling, general and administrative expenses for fiscal 2005, as compared to fiscal 2004 was primarily attributable to a $1.4 million increase in compensation expense for personnel due to headcount additions, a $4.9 million increase in advertising, public relations and other marketing and promotional expenses, a $1.8 million increase in contractor expenses to the increase in staffing of our telemarketing and customer service organizations, a $1 million increase in sales agent and retailer commissions, a $0.8 million increase in consultant and auditor expenses related to compliance with Sarbanes Oxley Section 404, a $0.5 million increase in legal fees and a $0.4 million increase in credit card transaction processing fees.

The $1.3 million decrease in selling, general, and administrative expenses in fiscal 2004 as compared to fiscal 2003 was due primarily to a $1 million reduction in compensation expense for personnel due to headcount reductions, a $0.7 million reduction in facility related expenses for our headquarters due to a reduction of rent and operating expenses in the fist quarter of fiscal 2004 in connection with a lease extension and a $0.3 million reduction in depreciation and amortization expense due to the end of life of certain assets. The decreases were partially offset by a $0.7 million increase in various other sales, general and administrative expenses including: advertising, promotion and trade show expenses, legal expenditures, primarily related to intellectual property, regulatory and financing matters, and reseller commissions and credit card processing fees.

RESTRUCTURING AND OTHER CHARGES

2003 Restructuring Actions

As a result of restructuring activities in fiscal 2003, we recorded restructuring and other asset impairment charges of approximately $3.4 million. These charges included severance and benefits of approximately $1.2 million, as we reduced our workforce, under voluntary and involuntary separation plans, by thirty-two employees or thirty percent. The majority of the affected employees were Netergy employees based in Santa Clara, California and Marlow, United Kingdom and included employees from sales and marketing and research and development, as well as four executives of Netergy. Severance of approximately $325,000 attributable to involuntary terminations was paid during the year ended March 31, 2003.

We closed our facility in Marlow, United Kingdom, and recorded $434,000 of charges related to the termination of the operating leases for the facility and related services. In addition, we recorded asset impairment charges of $212,000 related to assets in the United Kingdom that were abandoned or disposed of.

We also recorded a charge of approximately $74,000 for our remaining lease liability for office space in Tempe, Arizona that was vacated as a result of the restructuring actions during the fourth quarter.

In the fourth quarter of fiscal 2003, we also implemented a plan to reduce the workforce at our Sophia Antipolis, France office by ten employees or seventy percent. This downsizing and its potential impact on our iPBX business prompted an assessment of the key assumptions underlying our goodwill valuation judgments. As a result of the analysis, we determined that an impairment charge of $1.5 million was required because the estimated fair value of the goodwill was less than the book value of the goodwill that arose from the acquisition of Odisei S.A. in fiscal 2000.

The following table illustrates the charges, credits and balances of the restructuring reserves for the years ended March 31, 2005, 2004 and 2003, and summarizes asset impairment charges (in thousands):

	Total Charges	Cash Payments	Non-Cash Charges	Liability at March 31, 2003	Cash Payments	Liability at March 3 2004
Restructuring Charges:						
Severance....................	$ 1,177	$ (1,002)	$ --	$ 175	$ (175)	$ --
Facility related............	508	(161)	(273)	74	(33)	41
Total restructuring charges	1,685	(1,163)	(273)	249	(208)	41
Asset Impairments:						
Fixed Assets.................	212	--	(212)	--	--	--
Goodwill.....................	1,539	--	(1,539)	--	--	--
Total impairment charges...	1,751	--	(1,751)	--	--	--
Total restructuring and impairment charges.......	$ 3,436	$ (1,163)	$ (2,024)	$ 249	$ (208)	$ 41

OTHER INCOME, NET

In fiscal 2005, 2004 and 2003, other income, net, was $558,000, $822,000 and $597,000, respectively. In fiscal 2005, other income, net was primarily comprised of interest income earned on our cash, cash equivalents and investment balances. The $264,000 decrease in fiscal 2005 was primarily attributable to a $790,000 one time gain recorded in fiscal 2004 in connection with the sale of Centile Europe SA, partially offset by an increase in interest income of $276,000 due to higher cash balances maintained during the year and the receipt of escrow funds of $180,000 from a cost basis common stock investment in an entity acquired in 1999 by a third party.

The $225,000 increase in other income, net, in fiscal 2004 was primarily attributable to a $790,000 gain recorded in fiscal 2004 in connection with the sale of Centile Europe SA, which was offset by a decrease of $560,000 related to the Canadian tax credits that we collected in fiscal 2003 and recorded as other income.

BENEFIT FOR INCOME TAXES

We had no provisions for the fiscal years ended March 31, 2005, 2004 and 2003. We recorded a $203,000 benefit in fiscal 2005, which was primarily attributable to the release of income tax reserves recorded in prior years and $20,000 attributable to an income tax refund received by one of our foreign subsidiaries.

At March 31, 2005, we had net operating loss carryforwards for federal and state income tax purposes of approximately $106 million and $57.3 million, respectively, which expire at various dates beginning in 2006 and continuing through 2025. In addition, at March 31, 2005, we had research and development credit carryforwards for federal and state tax reporting purposes of approximately $3.2 million and $2.4 million, respectively. The federal credit carryforwards will begin expiring in 2010 continuing through 2017, while the California credit will carryforward indefinitely. Under the ownership change limitations of the Internal Revenue Code of 1986, as amended, the amount and benefit from the net operating losses and credit carryforwards may be impaired or limited in certain circumstances.

At March 31, 2005 and 2004, we had gross deferred tax assets of approximately $60.9 million and $54.2 million. We believe that, based on a number of factors, the weight of objective available evidence indicates that it is more likely than not that we will not be able to realize our deferred tax assets, and a full valuation allowance was recorded at March 31, 2005 and 2004.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2005, we had $22.5 million of cash and cash equivalents, $0.3 million in restricted cash, and $9 million in investments in marketable securities for a combined total of $31.8 million. In comparison, at March 31, 2004, we had $13.2 million in cash and cash equivalents, $0.8 million in restricted cash and no investments for a combined total of $14 million. We currently have no borrowing arrangements. Our cash and cash equivalents balance increased $9.3 million and the combined balance increased by $17.8 million during fiscal 2005. The increase was primarily attributable to $35.7 million of net proceeds from financing activities, partially offset by $16.5 million used for operating activities, as discussed below. Our restricted cash balance decreased by $0.3 million, as adjusted for $0.3 million of restricted cash recorded on other assets on our consolidated balance sheet, due to termination of agreements requiring letters of credit. The remaining amount is pledged as collateral for a stand-by letter of credit issued by our primary bank.

Cash used in operations of $16.5 million in fiscal 2005 was primarily attributable to the net loss of $19.1 million, adjusted for $0.2 million of non-cash depreciation and amortization, a $0.5 million increase in accounts receivable, a $1.5 million increase in inventory and a $1.9 million increase in deferred cost of goods sold. Cash used in operations was partially offset by a $2.1 million increase in deferred revenue, a $3.6 million increase in accounts payable and a $0.5 million increase in accrued compensation and other accrued liabilities. The increase in accounts receivable was primarily attributable to our development of the retail and distributor channels in fiscal 2005 combined with an increase in subscribers in fiscal 2005, and the increase in inventory was primarily attributable to the growth of the Packet8 service and ramping of production for desktop terminal adapters. The increases in deferred cost of goods sold and deferred revenue were primarily attributable to the growth in subscribers in fiscal 2005 and the retail and distributor channels that we did not have in fiscal 2004. The increase in accounts payable was attributable to timing and an increase in payables for inventory and service provider costs.

Cash used in investing activities of $10.3 million for fiscal 2005 was primarily attributable to $1.6 million of purchases of fixed assets and purchases of investments of $9.7 million, partially offset by a net $0.3 million decrease in cash classified as restricted cash due to the termination of agreements requiring letters of credit and $0.6 million of proceeds received from maturities of investments. The purchases of fixed assets were primarily attributable to equipment required by the growth of the Packet8 subscriber base and expenditures for financial application and customer relationship management software and implementation fees.

Cash provided by financing activities of approximately $36.2 million in fiscal 2005 consisted primarily of $35.7 million of net proceeds received from common stock offerings completed in June and October 2004 and March 2005, and $0.4 million of proceeds received from the sale of our common stock to employees through our employee stock purchase and stock option plans.

Cash used in operations of $1.6 million in fiscal 2004 was primarily attributable to the net loss of $3 million, adjusted for $1.3 million of stock compensation expense, the $790,000 gain o