

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

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

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2007**

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File Number: 0-25965**

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

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

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

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

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

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

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of April 30, 2007, the registrant had 49,366,224 shares of common stock outstanding.

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**j2 GLOBAL COMMUNICATIONS, INC.**

**FOR THE QUARTER ENDED MARCH 31, 2007**

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

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

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

|   | <b>March 31,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|---|---------------------------|----------------------------------|
| <b>ASSETS</b>   |                           |                                  |
| Cash and cash equivalents   | \$ 103,883                | \$ 95,605                        |
| Short-term investments  | 103,180                   | 83,498                           |
| Accounts receivable, net of allowances of \$938 and \$1,105, respectively | 11,755                    | 11,989                           |
| Prepaid expenses and other  | 3,025                     | 4,779                            |
| Deferred income taxes   | 2,643                     | 2,643                            |
| Total current assets  | 224,486                   | 198,514                          |
| Long-term investments   | 3,217                     | 12,493                           |
| Property and equipment, net   | 18,162                    | 18,951                           |
| Goodwill  | 31,002                    | 30,954                           |
| Other purchased intangibles, net  | 22,787                    | 21,400                           |
| Deferred income taxes   | 5,437                     | 5,406                            |
| Other assets  | 380                       | 442                              |
| Total assets  | \$ 305,471                | \$ 288,160                       |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                               |                           |                                  |
| Accounts payable and accrued expenses                                     | \$ 15,341                 | \$ 17,117                        |
| Income taxes payable  | —                         | 4,511                            |
| Deferred revenue  | 14,063                    | 11,530                           |
| Current portion of long-term debt   | 18                        | 149                              |
| Total current liabilities   | 29,422                    | 33,307                           |
| Accrued income taxes  | 26,265                    | —                                |
| Other   | 102                       | 112                              |
| Total liabilities   | 55,789                    | 33,419                           |
| Commitments and contingencies   |                           |                                  |
| Total stockholders' equity  | 249,682                   | 254,741                          |
| Total liabilities and stockholders' equity                                | \$ 305,471                | \$ 288,160                       |

**See Notes to Condensed Consolidated Financial Statements**



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

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2007</b>                         | <b>2006</b> |
| Revenues:   |                                     |             |
| Subscriber  | \$ 50,293                           | \$ 40,562   |
| Other   | 3,848                               | 1,456       |
|   | 54,141                              | 42,018      |
| Cost of revenues (including stock-based compensation of \$182 and \$109 for the three months of 2007 and 2006, respectively)                      | 10,990                              | 9,010       |
| Gross profit  | 43,151                              | 33,008      |
| Operating expenses:   |                                     |             |
| Sales and marketing (including stock-based compensation of \$278 and \$265 for the three months of 2007 and 2006, respectively)                   | 8,780                               | 6,864       |
| Research, development and engineering (including stock-based compensation of \$173 and \$110 for the three months of 2007 and 2006, respectively) | 2,713                               | 1,892       |
| General and administrative (including stock-based compensation of \$1,097 and \$940 for the three months of 2007 and 2006, respectively)          | 9,825                               | 7,900       |
| Total operating expenses  | 21,318                              | 16,656      |
| Operating earnings  | 21,833                              | 16,352      |
| Interest and other income, net  | 1,725                               | 1,256       |
| Earnings before income taxes  | 23,558                              | 17,608      |
| Income tax expense  | 7,119                               | 5,297       |
| Net earnings  | \$ 16,439                           | \$ 12,311   |
| Net earnings per common share:  |                                     |             |
| Basic   | \$ 0.34                             | \$ 0.25     |
| Diluted   | \$ 0.32                             | \$ 0.24     |
| Weighted average shares outstanding:  |                                     |             |
| Basic   | 48,822,735                          | 49,249,778  |
| Diluted   | 50,680,093                          | 51,037,378  |

**See Notes to Condensed Consolidated Financial Statements**

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

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2007</b>                         | <b>2006</b> |
| Cash flows from operating activities:   |                                     |             |
| Net earnings  | \$ 16,439                           | \$ 12,311   |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                                     |             |
| Depreciation and amortization   | 2,164                               | 1,989       |
| Stock-based compensation  | 1,698                               | 1,424       |
| Tax benefit of vested restricted stock  | 5                                   | —           |
| Tax benefit of stock option exercises   | 2,823                               | 506         |
| Excess tax benefits on stock option exercises                                       | (2,163)                             | (482)       |
| Deferred income taxes   | (31)                                | (343)       |
| Loss on disposal of fixed assets  | 104                                 | —           |
| Changes in assets and liabilities, net of effects of business combinations:         |                                     |             |
| Decrease (increase) in:   |                                     |             |
| Accounts receivable   | 257                                 | 79          |
| Prepaid expenses and other  | 1,756                               | 153         |
| Other assets  | 62                                  | (122)       |
| (Decrease) increase in:   |                                     |             |
| Accounts payable and accrued expenses   | (2,130)                             | (1,446)     |
| Income taxes payable  | 3,157                               | 3,880       |
| Deferred revenue  | 2,528                               | 1,183       |
| Other   | (10)                                | 113         |
| Net cash provided by operating activities   | 26,659                              | 19,245      |
| Cash flows from investing activities:   |                                     |             |
| Net purchases of available-for-sale investments                                     | (21,660)                            | (22,479)    |
| Net redemptions of held-to-maturity investments                                     | 11,254                              | 19,065      |
| Purchases of property and equipment   | (529)                               | (757)       |
| Acquisition of businesses, net of cash received                                     | (4)                                 | —           |
| Purchases of intangible assets  | (1,995)                             | (1,068)     |
| Net cash used in investing activities   | (12,934)                            | (5,239)     |
| Cash flows from financing activities:   |                                     |             |
| Repurchases of common stock   | (10,184)                            | —           |
| Issuance of common stock under employee stock purchase plan                         | 62                                  | 130         |
| Exercise of stock options   | 2,529                               | 183         |
| Excess tax benefits on stock option exercises                                       | 2,163                               | 482         |
| Repayment of long-term debt   | (132)                               | (170)       |
| Net cash (used in) provided by financing activities                                 | (5,562)                             | 625         |
| Effect of exchange rate changes on cash and cash equivalents                        | 115                                 | (201)       |
| Net increase in cash and cash equivalents   | 8,278                               | 14,430      |



|  |            |           |
|--|------------|-----------|
| Cash and cash equivalents at beginning of period | 95,605     | 36,301    |
| Cash and cash equivalents at end of period       | \$ 103,883 | \$ 50,731 |

**See Notes to Condensed Consolidated Financial Statements**

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**MARCH 31, 2007**  
**(UNAUDITED)**

**1. Basis of Presentation**

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

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

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

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

On May 25, 2006, the Company effected a two-for-one stock split of its common stock in the form of a stock dividend to each shareholder of record at the close of business on May 15, 2006. All share and per share data included in this Form 10-Q have been restated to reflect the stock split.

*Income Taxes*

In July 2006, the Financial Accounting Standard Board (“FASB”) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company adopted the provisions of FIN 48 effective January 1, 2007. As a result of the adoption, the Company recorded an approximately \$18.6 million increase in accrued income taxes in the condensed consolidated balance sheet for unrecognized tax benefits, which was accounted for as a cumulative effect adjustment to the January 1, 2007 balance of retained earnings. See Note 7 for further information regarding the effects of adopting FIN 48.

**2. Use of Estimates**

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial

statements and the reported amounts of net revenue and expenses during the reporting period. On an ongoing basis, management evaluates its estimates, including those related to revenue recognition, allowances for doubtful accounts and the valuation of deferred income taxes, tax contingencies, stock-based compensation expense, long-

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lived and intangible assets and goodwill. These estimates are based on historical experience and on various other factors that the Company believes to be reasonable under the circumstances. Actual results could differ from those estimates.

### 3. Recent Accounting Pronouncements

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

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

### 4. Business Acquisitions

In July 2006, the Company purchased substantially all of the assets and operations of Send2Fax, LLC, a South Carolina provider of Internet fax services. The purchase price, including acquisition costs, was approximately \$7.2 million of which \$800,000 was a contingent holdback on the date of acquisition. The contingent holdback amount has release features in 2007 and 2008. A revenue based contingent earn-out of \$850,000 was paid in January 2007.

### 5. Goodwill and Intangible Assets

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

The changes in carrying amounts of goodwill and other intangible assets for the three months ended March 31, 2007 are as follows (in thousands):

|   | Balance as of<br>January 1,<br>2007 | Additions | Amortization | Foreign<br>Exchange<br>Translation | Balance as of<br>March 31,<br>2007 |
|---|-------------------------------------|-----------|--------------|------------------------------------|------------------------------------|
| Goodwill  | \$ 30,954                           | \$ 4      | \$ —         | \$ 44                              | \$ 31,002                          |
| Intangible assets with<br>indefinite lives      | 2,063                               | 72        | —            | —                                  | 2,135                              |
| Intangible assets<br>subject to<br>amortization | 19,337                              | 2,104     | (797)        | 8                                  | 20,652                             |
|   | \$ 52,354                           | \$ 2,180  | \$ (797)     | \$ 52                              | \$ 53,789                          |

Intangible assets with indefinite lives relate primarily to a trade name. As of March 31, 2007, intangible assets subject to amortization relate primarily to the following (in thousands):

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|                        | <b>Weighted-Average<br/>Amortization<br/>Period</b> | <b>Historical<br/>Cost</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b> |
|------------------------|---|----------------------------|-------------------------------------|------------|
| Patents                | 9.6 years   | \$ 17,272                  | \$ 3,545                            | \$ 13,727  |
| Technology             | 2.5 years   | 3,373                      | 3,012                               | 361        |
| Customer relationships | 4.7 years   | 3,627                      | 1,887                               | 1,740      |
| Trade name             | 16.6 years  | 5,428                      | 604                                 | 4,824      |
| Total                  |   | \$ 29,700                  | \$ 9,048                            | \$ 20,652  |

Amortization expense, included in general and administrative expense, during the three-month periods ended March 31, 2007 and 2006 approximated \$0.8 million and \$0.6 million, respectively. Amortization expense is estimated to approximate \$2.3 million, \$3.0 million, \$2.7 million, \$2.5 million and \$1.9 million and \$8.3 million for fiscal years 2007 through 2011 and thereafter, respectively.

## 6. Litigation

In February 2004 and July 2005, the Company filed two lawsuits against Venali in the United States District Court for the Central District of California for infringement of several of our U.S. patents. On June 21, 2006, Venali filed suit against the Company and its affiliate in the United States District Court for the Southern District of Florida, alleging violations of antitrust law and various related claims arising out of the Company's procurement and enforcement of its patents. In lieu of any response to Venali's complaint, the parties reached an agreement whereby Venali dismissed its complaint without prejudice and re-filed certain of its claims as counterclaims in the patent infringement actions in California. On December 27, 2006, Venali filed amended counterclaims in the July 2005 action alleging several violations of antitrust law (fraudulent procurement of patents, fraudulent enforcement of patents, tying, and attempted monopolization) as well as tortious interference with business relationships, trademark infringement, and unfair and deceptive trade practices. Venali is seeking damages, including treble damages for the antitrust claims, injunctive relief, attorneys' fees and costs. Venali's claims relate in substantial part to the patent infringement claims by the Company against Venali. On February 16, 2007, the Company moved to dismiss certain of Venali's counterclaims for failure to state a claim and moved to strike certain counterclaims under the California Anti-SLAPP statute.

On December 12, 2006, Venali filed suit against the Company in the United States District Court for the Southern District of Florida, alleging infringement of U.S. Patent Number 7,114,004. Venali is seeking damages in the amount of lost profits or a reasonable royalty, a permanent injunction against continued infringement, treble damages, attorneys' fees, interest and costs. On March 6, 2007, the Company filed an answer to the complaint denying liability.

From September through November 2006, four derivative actions were commenced against the Company (as a nominal defendant) and certain of the Company's current and former directors and/or officers. Two of these actions were filed in California Superior Court for the County of Los Angeles and two in the United States District Court for the Central District of California. The plaintiffs in the state actions included Melinda and Anthony Hasselbring and Clement Shaw, and in the federal actions include Phillip Lawrence and Beverly Holt. The complaints alleged that the individual defendants breached their fiduciary duties and disseminated false financial statements by participating in improperly backdating stock option grants to provide increased compensation to Company insiders. The plaintiffs purported to assert claims for breach of fiduciary duty, unjust enrichment, abuse of control, mismanagement, corporate waste, violations of California Corporations Code Section 25402 and 25403 and, in the federal actions, violations of Section 10(b) of the Securities Exchange Act of 1934. The lawsuits sought a variety of legal and equitable relief, including damages, cancellation of stock options, an accounting, recovery of profits earned by certain individual defendants in exercising the challenged options, and treble damages for violations of the California Corporations Code. On March 19, 2007, the parties to both the state and federal actions entered into a settlement agreement that provides for dismissal of the four derivative cases and a release of all current and potential claims relating to the Company's stock option granting practices. On April 18, 2007, the state court heard argument on a

motion for approval and approved the settlement, but reserved ruling on the plaintiffs' attorneys' fees pending submission of additional information by plaintiffs. Pursuant to the terms of the settlement,

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on April 19, 2007, the parties to the federal actions filed a stipulation and proposed order dismissing those actions with prejudice with the federal court.

On October 17, 2006, Go Daddy Group, Inc. ("Go Daddy") filed suit against the Company and its affiliate in the United States District Court for the District of Arizona. In its complaint, Go Daddy alleges several violations of antitrust law, both federal and Arizona (fraudulent procurement of patents, fraudulent enforcement of patents, conspiracy to monopolize, monopolization and attempted monopolization) as well as unfair competition, and seeks declaratory judgments of invalidity and non-infringement. Go Daddy's claims relate in substantial part to the patent infringement action by the Company against Go Daddy as described in Part II, Item 1. Go Daddy is seeking damages, including treble damages for the antitrust claims, punitive damages, attorneys' fees and costs. The Company has moved to dismiss the action in its entirety, or alternatively, to stay the action pending the reexamination of certain of its patents at issue in the case.

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

## **7. Income Taxes**

The Company adopted the provisions of FIN 48 effective January 1, 2007. As a result of the implementation of FIN 48, the Company recognized an increase in the liability for unrecognized tax benefits of approximately \$18.6 million, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. Prior to the adoption of FIN 48, the Company recorded reserves related to uncertain tax positions as a current liability, whereas upon adoption of FIN 48, the Company reclassified tax reserves of approximately \$6.0 million related to uncertain tax positions for which a cash tax payment is not expected within the next twelve months to noncurrent liabilities. As of January 1, 2007, the total amount of unrecognized tax benefits was \$24.6 million, substantially all of which would have an impact on the Company's effective tax rate if subsequently recognized. For the three months ended March 31, 2007, the Company recognized an additional \$1.4 million of unrecognized tax benefits relating to tax positions taken during the quarter.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. The Company has approximately \$1.2 million in interest and penalties related to unrecognized tax benefits accrued as of January 1, 2007. For the three months ended March 31, 2007, the Company recognized an additional \$0.2 million of interest and penalties, net of deferred income tax benefit, within income tax expense.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdiction. Management believes that its accrual for tax liabilities is adequate for all open audit years based on its assessment of many factors including past experience and interpretation of tax law. This assessment relies on estimates and assumptions and may involve a series of complex judgments about future events. With a few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for the years before 2003.

Although the timing of any audits and their resolution is highly uncertain, the Company does not believe it is reasonably possible that the unrecognized tax benefits would materially change in the next twelve months.

## **8. Stockholders' Equity**

### *Common Stock Repurchase Program*



In March 2006, the Company's Board of Directors approved a common stock repurchase program authorizing the repurchase of up to 2,000,000 shares of the Company's common stock through December 2008. For the three months ended March 31, 2007, the Company repurchased 400,000 shares of common stock under this program at an aggregated cost of approximately \$10.2 million (including commission fees of \$12,000), representing an average price per share of \$25.43. As of March 31, 2007, there were 1,129,100 shares of common stock available for repurchase under this program.

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*Stock Split*

In April 2006, the Company's Board of Directors approved a two-for-one stock split of its common stock to be effected in the form of a stock dividend. The Board's approval was subject to approval at the Company's May 3, 2006 Annual Meeting of Stockholders of a proposal to amend "Article Fourth" of j2 Global's Amended and Restated Certificate of Incorporation to increase to 95,000,000 the number of shares of common stock authorized for issuance. This proposal was approved at the Annual Meeting of Stockholders and the stock split was effected May 25, 2006 for shareholders of record at the close of business on May 15, 2006. Each shareholder of record received one additional share for each share held on the record date. All share and per share numbers contained herein, for all periods presented, reflect this stock split.

**9. Stock Options and Employee Stock Purchase Plan**

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

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

The 1997 Stock Option Plan (the "1997 Plan") was adopted in November 1997 and has twice been amended and restated. This plan provides for the granting of incentive stock options, nonqualified stock options and restricted stock awards. In May 2006, the Company's shareholders approved an increase in the number of authorized shares of common stock reserved for issuance upon exercise of options or as restricted stock from 10,000,000 to 12,000,000. Options under the 1997 Plan may be granted at exercise prices determined by the Board of Directors, provided that the exercise prices shall not be less than the fair market value of the Company's common stock on the date of grant for incentive stock options and not less than 85% of the fair value of the Company's common stock on the date of grant for non-statutory stock options. At March 31, 2007, there were 1,871,077 additional shares underlying options and shares of restricted stock available for grant under the 1997 Plan and no additional shares available for grant outside of the 1997 Plan.

*Stock Options*

The following table represents stock option activity for the three months ended March 31, 2007:

|   | <b>Number<br/>of<br/>Shares</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-Average<br/>Remaining<br/>Contractual<br/>Term<br/>(in years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|---|---------------------------------|---|---|--|
| Outstanding at January 1, 2007                | 4,639,614                       | \$ 8.58   |   |  |
| Granted                                       | 290,100                         | 28.50   |   |  |
| Exercised                                     | (400,566)                       | 6.31  |   |  |
| Canceled                                      | (22,630)                        | 17.71   |   |  |
| Outstanding at March 31, 2007                 | 4,506,518                       | 10.04   | 6.3   | \$ 79,898,999                            |
| Exercisable at March 31, 2007                 | 2,863,346                       | 4.55  | 5.1   | 66,352,038                               |
| Vested and expected to vest at March 31, 2007 | 4,079,293                       | 9.04  | 6.1   | 76,376,789                               |

For the three months ended March 31, 2007, the Company granted 290,100 options to purchase shares of common stock pursuant to the 1997 Plan to newly hired and existing members of management. The stock options vest 20% per year and expire 10 years from the date of grant.



The per share weighted-average grant-date fair values of stock options granted during the three months ended March 31, 2007 and 2006 were \$21.64 and \$17.81, respectively.

The aggregate intrinsic values of options exercised during the three months ended March 31, 2007 and 2006 were \$8.4 million and \$1.9 million, respectively.

As of March 31, 2007, there was \$19.3 million of total unrecognized compensation expense related to non-vested stock-based compensation awards granted under the 1997 Plan. That expense is expected to be recognized ratably over a weighted-average period of 3.9 years (i.e., the remaining requisite service period).

#### Fair Value Disclosure

The Company uses the Black-Scholes option pricing model to calculate the fair-value of each option grant. The expected volatility for the three months ended March 31, 2007 was based on historical volatility of the Company's common stock. The Company elected to use the simplified method for estimating the expected term as allowed by Staff Accounting Bulletin No. 107. Under the simplified method, the expected term is equal to the midpoint between the vesting period and the contractual term of the stock option. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a term equal to the expected term of the option assumed at the date of grant. Forfeitures are estimated at the date of grant based on historical experience. The weighted-average fair values of stock options granted have been estimated utilizing the following assumptions:

|                             | <b>Three Months Ended March<br/>31,</b> |             |
|-----------------------------|---|-------------|
|                             | <b>2007</b>                             | <b>2006</b> |
| Risk-free interest rate     | 4.5%                                    | 4.7%        |
| Expected term (in years)    | 6.5                                     | 6.5         |
| Dividend yield              | 0%                                      | 0%          |
| Expected volatility         | 85%                                     | 93%         |
| Weighted-average volatility | 85%                                     | 93%         |

#### Stock-Based Compensation Expense

The following table represents the stock-based compensation expense that was included in cost of revenues and operating expenses in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2007 and 2006 (in thousands):

|                                       | <b>Three Months Ended March 31,</b> |             |
|---------------------------------------|-------------------------------------|-------------|
|                                       | <b>2007</b>                         | <b>2006</b> |
| Cost of revenues                      | \$ 182                              | \$ 109      |
| Operating expenses:                   |                                     |             |
| Sales and marketing                   | 278                                 | 265         |
| Research, development and engineering | 173                                 | 110         |
| General and administrative            | 1,097                               | 940         |
|                                       | \$ 1,730                            | \$ 1,424    |

#### Restricted Stock

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

value on the date of grant and is recognized as stock-based compensation expense over a five-year vesting

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period. The Company granted 33,800 shares of restricted stock to newly hired members of management pursuant to the 1997 Plan during the three months ended March 31, 2007 and recognized approximately \$0.3 million of related compensation expense in the three months ended March 31, 2007 related to restricted stock awards. As of March 31, 2007, the Company has unrecognized stock-based compensation cost of approximately \$5.5 million associated with these awards. The cost is expected to be recognized over a weighted-average period of 3.8 years.

Restricted stock activity for the three months ended March 31, 2007 is set forth below:

|                              | <b>Shares</b> | <b>Weighted-Average<br/>Grant-Date<br/>Fair Value</b> |
|------------------------------|---------------|---|
| Nonvested at January 1, 2007 | 307,840       | \$ 19.32  |
| Granted                      | 33,800        | 28.50   |
| Vested                       | (3,334)       | 22.31   |
| Canceled                     | —             | —   |
| Nonvested at March 31, 2007  | 338,306       | 20.20   |

*(b) Employee Stock Purchase Plan*

The 2001 Employee Stock Purchase Plan (the "Purchase Plan") provides for stock purchases by all eligible employees. Under the Purchase Plan, eligible employees can have up to 15% of their earnings withheld, up to certain maximums, to be used to purchase shares of the Company's common stock at certain plan-defined dates. The price of the common stock purchased under the Purchase Plan for the offering periods is equal to 90% of the lower of the fair market value of the common stock on the commencement date of each three-month offering period or the specified purchase date. Effective May 1, 2006, the Company's Board of Directors removed the compensatory features of the Purchase Plan by changing the purchase price of a share of common stock for each offering period to 95% of its fair market value at the end of the offering period. For the three months ended March 31, 2007 and 2006, 2,456 and 3,264 shares were purchased under the plan, respectively. Cash received upon the issuance of common stock under the Purchase Plan was \$62,000 and \$130,000 for the three months ended March 31, 2007 and 2006, respectively.

*(c) Section 409A Tax Compensation*

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

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

In addition, to the extent employees and directors have already incurred a tax liability under Section 409A, the Company plans to reimburse such individuals for that liability plus a gross-up for income taxes owed as a result of such reimbursement. The estimated impact of these reimbursements was included in general and administrative expense in the condensed consolidated statement of operations for the fourth quarter of 2006 and amounted to \$0.7

million, net of tax.

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**10. Earnings Per Share**

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

|  | <b>Three Months Ended March 31,</b> |             |
|--|-------------------------------------|-------------|
|  | <b>2007</b>                         | <b>2006</b> |
| Numerator for basic and diluted net earnings per common share: |                                     |             |
| Net earnings   | \$ 16,439                           | \$ 12,311   |
| Denominator:   |                                     |             |
| Weighted-average outstanding shares of common stock            | 48,822,735                          | 49,249,778  |
| Dilutive effect of:  |                                     |             |
| Employee stock options   | 1,751,180                           | 1,715,104   |
| Restricted stock   | 106,178                             | 72,496      |
| Common stock and common stock equivalents                      | 50,680,093                          | 51,037,378  |
| Net earnings per share:  |                                     |             |
| Basic  | \$ 0.34                             | \$ 0.25     |
| Diluted  | \$ 0.32                             | \$ 0.24     |

**11. Comprehensive Income**

The components of comprehensive income were net earnings and accumulated other comprehensive income. The change in accumulated other comprehensive income for all periods presented resulted from foreign translation gains and losses and the unrealized gains and losses in marketable securities. Comprehensive income for the three months ended March 31, 2007 and 2006 is as follows (in thousands):

|  | <b>Three Months Ended March 31,</b> |             |
|--|-------------------------------------|-------------|
|  | <b>2007</b>                         | <b>2006</b> |
| Net earnings                             | \$ 16,439                           | \$ 12,311   |
| Foreign currency translation adjustment  | 166                                 | 217         |
| Unrealized loss in marketable securities | —                                   | (6)         |
| Comprehensive income                     | \$ 16,605                           | \$ 12,522   |



**12. Geographic Information**

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

|                     | <b>Three Months Ended March 31,</b> |                  |
|---------------------|-------------------------------------|------------------|
|                     | <b>2007</b>                         | <b>2006</b>      |
| <b>Revenue:</b>     |                                     |                  |
| United States       | \$ 48,077                           | \$ 37,627        |
| All other countries | 6,064                               | 4,391            |
|                     | <b>\$ 54,141</b>                    | <b>\$ 42,018</b> |

|                           | <b>March 31,</b> | <b>December 31,</b> |
|---------------------------|------------------|---------------------|
|                           | <b>2007</b>      | <b>2006</b>         |
| <b>Long-lived assets:</b> |                  |                     |
| United States             | \$ 16,384        | \$ 17,377           |
| All other countries       | 1,778            | 1,574               |
|                           | <b>\$ 18,162</b> | <b>\$ 18,951</b>    |

**13. Supplemental Cash Flow Information**

Cash paid for interest during the three months ended March 31, 2007 and 2006 approximated \$2,000 and \$11,000, respectively, substantially all of which related to long-term debt.

The Company paid approximately zero and \$1.3 million for income taxes during the three months ended March 31, 2007 and 2006, respectively.

During the three months ended March 31, 2007, the Company acquired property and equipment and intangible assets for approximately \$135,000 and \$182,000, respectively, which have not yet been paid at March 31, 2007.

Through the three months ended March 31, 2007 and 2006, the Company recorded the tax benefit from the exercise of stock options as a reduction of its income tax liability in the amount of approximately \$2.8 million and \$0.5 million, respectively.

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

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

**Overview**

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

We deliver many of our services through our global telephony/Internet Protocol ("IP") network, which spans more than 2,800 cities in 40 countries across five continents. We have created this network, and continuously seek to expand it, through negotiating with U.S. and foreign telecommunications and co-location providers for telephone numbers (also referred to as Direct Inward Dial numbers or "DIDs"), Internet bandwidth and co-location space for our equipment. We maintain and seek to grow an inventory of telephone numbers to be assigned to new customers. Most of these numbers are "local" (as opposed to toll-free), which enables us to provide our paying subscription customers telephone numbers with a geographic identity. In addition to growing our business internally, we have used small acquisitions to grow our customer base, enhance our technology and acquire skilled personnel.

Our core services include fax, voicemail, email and call handling, as well as bundled suites of certain of these services. These are business services that make our customers more efficient, more mobile, more cost-effective and more secure than traditional alternatives. We generate substantially all of our revenue from subscribers that pay activation, subscription and usage fees. Activation and subscription fees are referred to as "fixed" revenues, while usage fees are referred to as "variable" revenues. We also generate revenues from advertising, patent licensing fees and revenue share from our customers' use of premium rate telephone numbers. Of the nearly 11.3 million telephone numbers deployed as of March 31, 2007, more than 930,000 were serving paying subscribers, with the balance deployed to free subscribers, including those with premium rate telephone numbers. We operate in one reportable segment: value-added messaging and communications services, which provides for the delivery of fax, voice and email messages via the telephone and/or Internet networks.

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

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

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The following table sets forth our key operating metrics for the three months ended March 31, 2007 and 2006 (in thousands, except for percentages and average revenue per paying telephone numbers):

|  | <b>March 31,</b>                    |             |
|--|-------------------------------------|-------------|
|  | <b>2007</b>                         | <b>2006</b> |
| Free service telephone numbers                                     | 10,356                              | 10,226      |
| Paying telephone numbers   | 930                                 | 788         |
| Total active telephone numbers                                     | 11,286                              | 11,014      |
|  |                                     |             |
|  | <b>Three Months Ended March 31,</b> |             |
|  | <b>2007</b>                         | <b>2006</b> |
| Subscriber revenues:   |                                     |             |
| Fixed  | \$ 37,765                           | \$ 28,537   |
| Variable   | 12,528                              | 12,025      |
| Total subscriber revenues  | \$ 50,293                           | \$ 40,562   |
| Percentage of total subscriber revenues:                           |                                     |             |
| Fixed  | 75.1%                               | 70.4%       |
| Variable   | 24.9%                               | 29.6%       |
| Revenues:  |                                     |             |
| DID-based  | \$ 48,130                           | \$ 38,718   |
| Non-DID-based  | 6,011                               | 3,300       |
| Total revenues   | \$ 54,141                           | \$ 42,018   |
| Average monthly revenue per paying telephone number <sup>(1)</sup> | \$ 16.96                            | \$ 16.39    |

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

### **Critical Accounting Policies and Estimates**

In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements. Actual results could differ significantly from those estimates under different assumptions and conditions. The Company's critical accounting policies are described in the Company's 2006 Annual Report on Form 10-K filed with the SEC on March 12, 2007. During the three months ended March 31, 2007, we updated our critical accounting policies as follows:

#### *Income Taxes*

Effective January 1, 2007, we adopted Financial Accounting Standard Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, *Accounting for Income Taxes*. We utilize a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. See Note 7 to the accompanying financial statements for

information regarding the effects of adopting FIN 48.

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**Results of Operations for the Three Months Ended March 31, 2007*****Revenues***

*Subscriber Revenues.* Subscriber revenues consist of both a fixed monthly recurring subscription component and a variable component which is driven by the actual usage of our service offerings. Over the past three years, the fixed portion of our subscriber revenues has consistently contributed approximately 70% to our subscriber revenues. Subscriber revenues were \$50.3 million and \$40.6 million for the three months ended March 31, 2007 and 2006, respectively. The increase in subscriber revenues was due to a price increase discussed below and an increase in our paying subscribers. The increase in our base of paying subscribers was primarily the result of new sign-ups derived from subscribers coming directly to our websites, free-to-paid subscriber upgrades, small to mid-sized corporate and enterprise sales, direct large enterprise and government sales, direct marketing spend for acquisition of paying subscribers and international sales, net of cancellations.

During the third quarter of 2006, we began implementing a price increase to new and existing domestic eFax individual subscribers. The monthly subscription fee was increased from \$12.95 to \$16.95 and annual programs were increased as well. As of March 31, 2007, we have implemented the price change to more than 60% of these customers and we expect to be substantially complete in the second quarter of 2007. Thus far, the results of this price change has exceeded our expectations in terms of the rate of new customer sign-ups and a lesser increase in cancellations. However, due to a number of factors affecting the Company's net sign-ups and related revenues during a given reporting period, it is not possible to quantify the financial impact of the price increase.

*Other Revenues.* Other revenues were \$3.8 million and \$1.5 million for the three months ended March 31, 2007 and 2006, respectively. Other revenues consist primarily of patent licensing revenues and advertising revenues generated by delivering email messages to our free customers on behalf of advertisers. The increase in other revenues for the three months ended March 31, 2007 resulted primarily from an increase in patent licensing revenues of approximately \$2 million from a license agreement with CallWave entered into during the three months ended March 31, 2007 (as further described in Part II, Item 1).

***Stock-Based Compensation***

The following table represents the stock-based compensation expense that was included in cost of revenues and operating expenses in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2007 and 2006 (in thousands):

|                                       | <b>Three Months Ended March 31,</b> |                 |
|---------------------------------------|-------------------------------------|-----------------|
|                                       | <b>2007</b>                         | <b>2006</b>     |
| Cost of revenues                      | \$ 182                              | \$ 109          |
| Sales and marketing                   | 278                                 | 265             |
| Research, development and engineering | 173                                 | 110             |
| General and administrative            | 1,097                               | 940             |
|                                       | <b>\$ 1,730</b>                     | <b>\$ 1,424</b> |

***Cost of Revenues***

Cost of revenues is primarily comprised of costs associated with data and voice transmission, telephone numbers, network operations, customer service, on-line processing fees and equipment depreciation. Cost of revenues was \$11.0 million, or 20% of total revenues, and \$9.0 million, or 21% of total revenues, for the three months ended March 31, 2007 and 2006, respectively. The cost of revenues as a percentage of revenues for the three months ended March 31, 2007 improved from March 31, 2006 primarily due to enhanced utilization of network capacity. In addition, other

revenues as discussed above generally has little or no cost associated with it and therefore the cost of revenues as a percentage of revenues declined period over period.

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## ***Operating Expenses***

***Sales and Marketing.*** Our sales and marketing costs consist primarily of Internet-based advertising, sales and marketing personnel costs and other business development-related expenses. Sales and marketing expenses were \$8.8 million, or 16% of total revenues, and \$6.9 million, or 16% of total revenues, for the three months ended March 31, 2007 and 2006, respectively. The increase in sales and marketing expenses for the three months ended March 31, 2007 was primarily due to increased Internet-based advertising and partner marketing spend and additional marketing personnel which primarily consisted of increased international marketing spend and the testing of new forms of marketing such as radio advertisements.

***Research, Development and Engineering.*** Our research, development and engineering costs consist primarily of personnel-related expenses. Research, development and engineering costs were \$2.7 million, or 5% of total revenues, and \$1.9 million, or 5% of total revenues, for the three months ended March 31, 2007 and 2006, respectively. The increase in research, development and engineering costs for the three months ended March 31, 2007 as compared to the same periods in the prior year was primarily due to an increase in personnel costs to maintain our existing services, accommodate our service enhancements, develop and implement additional service features and functionality and continue to bolster our infrastructure security.

***General and Administrative.*** Our general and administrative costs consist primarily of personnel-related expenses, depreciation and amortization, stock-based compensation expense, bad debt expense and insurance costs. General and administrative costs were \$9.8 million, or 18% of total revenues, and \$7.9 million, or 19% of total revenues, for the three months ended March 31, 2007 and 2006, respectively. General and administrative expenses as a percentage of revenue for the three months ended March 31, 2007 have remained consistent compared to the same period in the prior year. The increase in general and administrative expenses for the three months ended March 31, 2007 was primarily attributable to higher professional fees and bad debt expense, additional personnel due to internal growth and acquisitions, and additional payroll tax expenses.

***Interest and Other Income, Net.*** Our interest and other income, net, is generated primarily from interest earned on cash, cash equivalents and short- and long-term investments. Interest and other income was \$1.7 million and \$1.3 million for the three months ended March 31, 2007 and 2006, respectively. The increase in interest and other income, net, was primarily due to higher cash and investment balances and higher interest rates period over period.

***Income Taxes.*** Our effective tax rate is based on pre-tax income, statutory tax rates, tax regulations and different tax rates in the various jurisdictions in which we operate. Income tax expense amounted to approximately \$7.1 million and \$5.3 million for the three months ended March 31, 2007 and 2006, respectively. Income tax expense for the three months ended March 31, 2007 is based on a worldwide estimated effective tax rate for 2007 of approximately 30%, which is the same effective tax rate for the three months ended March 31, 2006. We expect our fiscal 2007 effective tax rate to be approximately 30% compared to an effective tax rate for fiscal 2006 of approximately 27%. This expected increase in our income tax rate is primarily attributable to an expected increase in the proportion of our taxable income being sourced in the U.S. with higher tax rates than in foreign jurisdictions.

## **Liquidity and Capital Resources**

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

At March 31, 2007, we had cash and investments of \$210.3 million, consisting of cash and cash equivalents of \$103.9 million, short-term investments of \$103.2 million and long-term investments of \$3.2 million. Our investments are comprised primarily of readily marketable corporate debt securities, U.S. government agency securities, auction rate debt and preferred securities. For financial statement presentation, we classify our investments primarily as held-to-maturity, and thus, they are reported as short-term and long-term based upon their maturity dates. Short-term investments primarily mature within one year of the date of the financial statements and long-term investments mature

between one and five years from the date of the financial statements. We classify auction rate securities as short-term investments as the established interest rate reset periods are less than one year.

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### ***Cash Flows***

Our primary sources of liquidity are cash flows generated from operations, together with cash and cash equivalents and short-term investments. Net cash provided by operating activities was \$26.7 million and \$19.2 million for the three months ended March 31, 2007 and 2006, respectively. Our operating cash flows resulted primarily from cash received from our subscribers, offset by cash payments we make to third parties for their services, employee compensation and tax payments. Our cash and cash equivalents and short-term investments were \$207.1 million at March 31, 2007.

Net cash used in investing activities was approximately \$12.9 million and \$5.2 million for the three months ended March 31, 2007 and 2006, respectively. For the three months ended March 31, 2007, net cash used in investing activities was primarily attributable to net purchases of investments, purchases of intangible assets, and purchases of property and equipment. For the three months ended March 31, 2006, net cash used in investing activities was primarily attributable to net purchases of investments, purchases of intangible assets and purchases of property and equipment.

Net cash (used in) provided by financing activities was approximately \$(5.6) million and \$0.6 million for the three months ended March 31, 2007 and 2006, respectively. For the three months ended March 31, 2007, net cash used in financing activities was primarily comprised of the repurchase of our common stock and repayment of long-term debt, offset by proceeds from the exercise of stock options and common shares issued under our employee stock purchase plan and excess tax benefits resulting from stock option exercises. For the three months ended March 31, 2006, net cash provided by financing activities was primarily comprised of the excess tax benefits resulting from stock option exercises, proceeds from the exercise of stock options and common shares issued under our employee stock purchase plan offset by the repayments of long-term debt.

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

In March 2006, our Board of Directors approved a program authorizing the repurchase of up to 2,000,000 shares of our common stock through December 2008. For the three months ended March 31, 2007, we repurchased a total of 400,000 shares at an aggregated cost of approximately \$10.2 million (including commission fees of \$12,000), representing an average price per share of \$25.43. As of March 31, 2007, there were 1,129,100 shares of our common stock available for repurchase under this program.

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

## Forward-Looking Information

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

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

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

In addition, our financial results could be materially impacted by risks associated with new accounting pronouncements, including but not limited to the impact on our tax rate of FASB Interpretation No. 48, *Accounting for*

*Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109.*

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

|   | <b>Three Months Ended March 31,</b>                                       |             |
|---|---|-------------|
|   | <b>2007</b>   | <b>2006</b> |
|   | (In thousands except average monthly revenue per paying telephone number) |             |
| DID-based revenues  | \$ 48,130   | \$ 38,718   |
| Less other revenues   | 1,396   | 1,157       |
| Total paying telephone number revenues  | \$ 46,734   | \$ 37,561   |
| <br>  |   |             |
| Average paying telephone number monthly revenue (total divided by number of months) | \$ 15,578   | \$ 12,520   |
| <br>  |   |             |
| Number of paying telephone numbers  |   |             |
| Beginning of period   | 907   | 740         |
| End of period   | 930   | 788         |
| <br>  |   |             |
| Average of period   | 918   | 764         |
| <br>  |   |             |
| Average monthly revenue per paying telephone number <sup>(1)</sup>                  | \$ 16.96  | \$ 16.39    |

(1) Due to rounding, individual numbers may not recalculate.

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

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

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We maintain an investment portfolio of various holdings, types and maturities. The primary objectives of our investment activities are to preserve our principal while at the same time maximizing yields without significantly increasing risk. To achieve these objectives, we maintain our portfolio of cash equivalents and investments in a mix of tax-exempt and taxable instruments that meet high credit quality standards, as specified in our investment policy. Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of March 31, 2007, the carrying value of our cash and cash equivalents approximated fair value. Our return on these investments is subject to interest rate fluctuations. None of our investments is held for trading purposes.

Our short- and long-term investments are comprised primarily of readily marketable corporate debt securities, debt instruments of the U.S. government and its agencies, auction rate debt, preferred securities and certificates of deposits. Investments in fixed rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. Our interest income is sensitive to changes in the general level of U.S. and foreign countries' interest rates. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates. As of March 31, 2007, we had investments in debt securities with effective maturities between three months and one year of approximately \$103.2 million. Such investments had a weighted-average yield of approximately 4.1%. As of March 31, 2007, we had investments in debt securities with effective maturities between one and five years of approximately \$3.2 million. Such investments had a weighted average yield of approximately 5.3%. Based on our cash and cash equivalents and short-term and long-term investment holdings as of March 31, 2007, an immediate 100 basis point decline in interest rates would decrease our annual interest income by approximately \$2.1 million.

**Foreign Currency Risk**

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

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

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

Foreign exchange gains and losses were not material to our earnings for the three months ended March 31, 2007. However, we periodically review our strategy for hedging transaction risks. Our objective in managing foreign exchange risk is to minimize the potential exposure to changes that exchange rates might have on earnings, cash flows and financial position.

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

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**Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

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

(b) Changes in Internal Controls

There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

#### Overview of Patent Litigation

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

In the previously disclosed patent infringement action by us against CallWave, Inc., we reached an agreement on March 13, 2007 to settle our dispute. Under this agreement, CallWave has paid \$4 million plus agreed to a running royalty of at least 10% on fax services, and all litigation has been dismissed without prejudice.

#### Overview of Legal Proceedings Against Us

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

In February 2004 and July 2005, we filed two lawsuits against Venali in the United States District Court for the Central District of California for infringement of several of our U.S. patents. On June 21, 2006, Venali filed suit against us and our affiliate in the United States District Court for the Southern District of Florida, alleging violations of antitrust law and various related claims arising out of our procurement and enforcement of our patents. In lieu of any response to Venali’s complaint, the parties reached an agreement whereby Venali dismissed its complaint without prejudice and re-filed certain of its claims as counterclaims in the patent infringement actions in California. On December 27, 2006, Venali filed amended counterclaims in the July 2005 action alleging several violations of antitrust law (fraudulent procurement of patents, fraudulent enforcement of patents, tying, and attempted monopolization) as well as tortious interference with business relationships, trademark infringement, and unfair and deceptive trade practices. Venali is seeking damages, including treble damages for the antitrust claims, injunctive relief, attorneys’ fees and costs. Venali’s claims relate in substantial part to the patent infringement claims by us against Venali. On February 16, 2007, we moved to dismiss certain of Venali’s counterclaims for failure to state a claim and moved to strike certain counterclaims under the California Anti-SLAPP statute.

On December 12, 2006, Venali filed suit against us in the United States District Court for the Southern District of Florida, alleging infringement of U.S. Patent Number 7,114,004. Venali is seeking damages in the amount of lost profits or a reasonable royalty, a permanent injunction against continued infringement, treble damages, attorneys’ fees, interest and costs. On March 6, 2007, we filed an answer to the complaint denying liability.

From September through November 2006, four derivative actions were commenced against us (as a nominal defendant) and certain of our current and former directors and/or officers. Two of these actions were filed in California Superior Court for the County of Los Angeles and two in the United States District Court for the Central District of California. The plaintiffs in the state actions included Melinda and Anthony Hasselbring and Clement Shaw, and in the federal actions include Phillip Lawrence and Beverly Holt. The complaints alleged that the individual defendants breached their fiduciary duties and disseminated false financial statements by participating in improperly backdating stock option grants to provide increased compensation to Company insiders. The plaintiffs purported to assert claims for breach of fiduciary duty, unjust enrichment, abuse of control, mismanagement, corporate waste, violations of California Corporations Code Section 25402 and 25403 and, in the federal actions,



violations of Section 10(b) of the Exchange Act. The lawsuits sought a variety of legal and equitable relief, including damages, cancellation of stock options, an accounting, recovery of profits earned by certain individual

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defendants in exercising the challenged options, and treble damages for violations of the California Corporations Code. On March 19, 2007, the parties to both the state and federal actions entered into a settlement agreement that provides for dismissal of the four derivative cases and a release of all current and potential claims relating to our stock option granting practices. On April 18, 2007, the state court heard argument on a motion for approval and approved the settlement, but reserved ruling on the plaintiffs' attorneys' fees pending submission of additional information by plaintiffs. Pursuant to the terms of the settlement, on April 19, 2007, the parties to the federal actions filed a stipulation and proposed order dismissing those actions with prejudice with the federal court.

On October 17, 2006, Go Daddy filed suit against us and our affiliate in the United States District Court for the District of Arizona. In its complaint, Go Daddy alleges several violations of antitrust law, both federal and Arizona (fraudulent procurement of patents, fraudulent enforcement of patents, conspiracy to monopolize, monopolization and attempted monopolization) as well as unfair competition, and seeks declaratory judgments of invalidity and non-infringement. Go Daddy's claims relate in substantial part to the patent infringement action by us against Go Daddy referred to above. Go Daddy is seeking damages, including treble damages for the antitrust claims, punitive damages, attorneys' fees and costs. We have moved to dismiss the action in its entirety, or alternatively, to stay the action pending the reexamination of certain of our patents at issue in the case.

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

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

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

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

##### **Issuer Purchases of Equity Securities**

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

The following table details the repurchases that were made under the program during the three months ended March 31, 2007:

| <b>Period</b>                      | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid Per Share (1)</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Program</b> | <b>Maximum Number of Shares That May Yet Be Purchased Under the Program</b> |
|------------------------------------|---|---|---|---|
| January 1, 2007 - January 31, 2007 | 303,000                                 | \$ 25.29                                | 773,900   | 1,226,100   |

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|   |        |    |       |         |           |
|---|--------|----|-------|---------|-----------|
| February 1, 2007 -<br>February 28, 2007 | 97,000 | \$ | 25.86 | 870,900 | 1,129,100 |
| March 1, 2007 - March<br>31, 2007       | —      |    | —     | 870,900 | 1,129,100 |

(1) Average price paid per share excludes commissions.

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**Item 6. Exhibits**

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

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

32(a) Section 1350 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32(b) Section 1350 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

**SIGNATURES**

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

**j2 Global Communications, Inc.**

Date: May 9, 2007

By: /s/ R. SCOTT TURICCHI  
R. Scott Turicchi  
Co-President and Chief Financial  
Officer  
(Principal Financial Officer)

Date: May 9, 2007

By: /s/ GREGGORY KALVIN  
Greggory Kalvin  
Chief Accounting Officer  
(Principal Accounting Officer)

**INDEX TO EXHIBITS**

**Exhibit Number**

**Description**

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32(a) Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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