

MAGICJACK VOCALTEC LTD
Form 10-Q
August 09, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended June 30, 2013

OR

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

For transition period from _____ to _____

Commission file number: 000-27648

MAGICJACK VOCALTEC LTD.
(Exact name or Registrant as specified in this charter)

STATE OF ISRAEL
(State or Other Jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

12 BENNY GAON STREET, BUILDING 2B
POLEG INDUSTRIAL AREA, NETANYA, ISRAEL 42504
(Address of principal executive offices, including zip code)

(561) 749-2255
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of

this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

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

Yes No

There were 18,717,823 shares of ordinary shares with no par value outstanding at July 31, 2013.

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DEFINITIONS

In this quarterly report on Form 10-Q, unless the context otherwise requires:

- references to “magicJack VocalTec,” the “Company,” “we,” “us” or “our” are to magicJack VocalTec Ltd., a company organized under the laws of the State of Israel (the “Registrant”), and its subsidiaries;
- references to “ordinary shares”, “our shares” and similar expressions refer to the Registrant’s Ordinary Shares, no par value;
- references to “\$” or “dollars” are to U.S. dollars and all references to “NIS” are to New Israeli Shekels. Except as otherwise indicated, financial statements of, and information regarding, magicJack VocalTec are presented in U.S. dollars;
 - references to the “Exchange Act” are to the Securities Exchange Act of 1934, as amended;
 - references to “NASDAQ” are to the NASDAQ Global Stock Market; and
 - references to the “SEC” are to the United States Securities and Exchange Commission.
- references to the “magicJack devices” are to the original magicJack®, the magicJack PLUSTM and the New magicJack PLUS.

PART I – FINANCIAL INFORMATION

ITEM 1. Consolidated Financial Statements

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	June 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$42,625	\$18,959
Marketable securities, at fair value	5,948	19,390
Accounts receivable, net of allowance for doubtful accounts and billing adjustments of \$5,427 and \$20,498, respectively	4,054	6,004
Inventories	6,485	5,340
Deferred costs	6,277	7,066
Deferred tax assets, current	1,843	1,114
Prepaid income taxes	2,647	98
Deposits and other current assets	935	1,313
Total current assets	70,814	59,284
Property and equipment, net	2,189	2,348
Intangible assets, net	13,965	16,136
Goodwill	32,304	32,304
Deferred tax assets, non-current	9,831	9,831
Deposits and other non-current assets	644	864
Total assets	\$129,747	\$120,767
LIABILITIES AND CAPITAL DEFICIT		
Current liabilities:		
Accounts payable	\$2,389	\$3,651
Accrued expenses and other current liabilities	12,853	13,569
Deferred revenue, current portion	69,193	67,038
Total current liabilities	84,435	84,258
Deferred revenue, net of current portion	55,082	58,165
Other non-current liabilities	2,574	3,114
Total liabilities	142,091	145,537
Commitments and contingencies (Note 9)		
Capital deficit:		
Ordinary shares, No par value; 100,000 shares authorized; 24,728 shares issued and outstanding	108,048	108,048
Additional paid-in capital	1,630	1,729
Accumulated other comprehensive loss	(3,109)	(1,494)
Treasury stock (6,176 and 6,018 shares, respectively)	(95,495)	(93,541)

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Accumulated deficit	(23,418)	(39,512)
Total capital deficit	(12,344)	(24,770)
Total liabilities and capital deficit	\$ 129,747	\$ 120,767

See accompanying notes to condensed consolidated financial statements.

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MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share information)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013 (Unaudited)	2012 (Unaudited)	2013 (Unaudited)	2012 (Unaudited)
Net revenues	\$32,902	\$38,559	\$69,779	\$76,146
Cost of revenues	12,056	15,059	23,199	30,619
Gross profit	20,846	23,500	46,580	45,527
Operating expenses:				
Advertising	2,757	5,740	5,571	14,444
General and administrative	6,676	6,872	13,494	13,706
Research and development	1,774	570	2,636	1,228
Total operating expenses	11,207	13,182	21,701	29,378
Operating income	9,639	10,318	24,879	16,149
Other income (expense):				
Gains on investments	195	235	722	832
Interest and dividend income	74	201	230	452
Interest expense	(84)	(105)	(177)	(224)
Fair value (loss) gain on common equity put options	-	(371)	(1,047)	1,285
Other income, net	-	11	1	21
Total other income (expense)	185	(29)	(271)	2,366
Income before income taxes	9,824	10,289	24,608	18,515
Income tax expense	3,316	19	8,514	49
Net income	\$6,508	\$10,270	\$16,094	\$18,466
Income per ordinary share:				
Basic	\$0.35	\$0.51	\$0.86	\$0.89
Diluted	\$0.35	\$0.50	\$0.86	\$0.87
Weighted average ordinary shares outstanding:				
Basic	18,552	20,211	18,618	20,652
Diluted	18,560	20,586	18,627	21,317

See accompanying notes to condensed consolidated financial statements.

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (in thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013 (Unaudited)	2012 (Unaudited)	2013 (Unaudited)	2012 (Unaudited)
Net income	\$6,508	\$ 10,270	\$16,094	\$ 18,466
Other comprehensive income (loss):				
Reclassification of unrealized (gain) loss on marketable securities to gains on investments	(204)	267	420	539
Net unrealized loss on marketable securities	(692)	(434)	(2,035)	(243)
Comprehensive income	\$5,612	\$ 10,103	\$14,479	\$ 18,762

See accompanying notes to condensed consolidated financial statements.

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CAPITAL DEFICIT
(in thousands)

	Ordinary Shares		Additional	Accumulated	Treasury Stock		Accumulated	Total
	Number	Amount	Paid-in	Other	Number	Amount	Deficit	Capital
			Capital	Loss				Deficit
Balance, January 1, 2013	24,728	\$108,048	\$1,729	\$ (1,494)	(6,018)	\$(93,541)	\$ (39,512)	\$(24,770)
Treasury stock issued to settle liability	-	-	(99)	-	32	499	-	400
Purchase of treasury stock	-	-	-	-	(190)	(2,453)	-	(2,453)
Unrealized loss on marketable securities	-	-	-	(1,615)	-	-	-	(1,615)
Net income	-	-	-	-	-	-	16,094	16,094
Balance, June 30, 2013 (unaudited)	24,728	\$108,048	\$1,630	\$ (3,109)	(6,176)	\$(95,495)	\$ (23,418)	\$(12,344)

See accompanying notes to condensed consolidated financial statements.

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	For the Six Months Ended June 30,	
	2013 (Unaudited)	2012 (Unaudited)
Cash flows from operating activities:		
Net income	\$16,094	\$18,466
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts and billing adjustments	2,000	4,550
Share-based issuance to settle liability	400	372
Depreciation and amortization	2,531	1,250
Deferred income tax provision	47	46
Interest expense - non-cash	177	224
Gains on investments	(722)	(832)
Fair value loss (gain) on common equity put options	1,047	(1,285)
Contributed services	-	40
Change in operating assets and liabilities:		
Accounts receivable	(50)	(3,583)
Inventories	(1,145)	658
Deferred costs	789	(1,978)
Deposits and other current assets	305	449
Prepaid income taxes	(2,549)	(1,000)
Deposits and other non-current assets	184	146
Accounts payable	(1,262)	(2,338)
Accrued expenses and other current liabilities	1,524	2,658
Deferred revenue	(928)	18,283
Other non-current liabilities	7	(6)
Net cash provided by operating activities	18,449	36,120
Cash flows from investing activities:		
Purchases of investments	-	(42,938)
Proceeds from sales of investments	12,622	60,711
Purchases of property and equipment	(84)	(217)
Acquisition of intangible assets	(117)	(1,228)
Net cash provided by investing activities	12,421	16,328
Cash flows from financing activities:		
Purchase of treasury stock	(5,704)	(45,740)
Proceeds from sale of common equity put options	-	14,690
Proceeds from exercise of ordinary share options	-	1,171
Payment of other non-current liabilities	(1,500)	(1,500)
Net cash used in financing activities	(7,204)	(31,379)
Net increase in cash and cash equivalents	23,666	21,069
Cash and cash equivalents, beginning of period	18,959	12,961
Cash and cash equivalents, end of period	\$42,625	\$34,030

See accompanying notes to condensed consolidated financial statements.

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MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
 (in thousands)

	For the Six Months Ended June 30,	
	2013	2012
	(Unaudited)	(Unaudited)
Supplemental disclosures:		
Interest paid	\$-	\$-
Income taxes paid	\$12,078	\$2
Non-cash investing and financing activities:		
Ordinary shares issued for purchase of intangible asset	\$-	\$400

See accompanying notes to condensed consolidated financial statements.

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Information as of June 30, 2013 and for the Three and Six Months Periods
Ended June 30, 2013 and 2012 is Unaudited

NOTE 1 –DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Description of Business

magicJack VocalTec Ltd. and its Subsidiaries (the “Company”) is a cloud communications leader that is the inventor of the magicJack devices and other magicJack products and services. magicJacks weigh about one ounce and plug into the USB port on a computer or into a power adapter and high speed Internet source, providing users with complete phone service for home, enterprise and while traveling. The Company charges highly competitive rates for the right (the "access right") to access its servers, and the Company's customers then continue to have the ability to obtain free telephone services. The Company also provides additional products and services, which include voice apps on smart phones, as well as the magicJack PLUS, which is a standalone magicJack that has its own CPU and can connect a regular phone directly to the user's broadband modem/router and function as a standalone phone without using a computer. The Company's products and services allow users to make and/or receive free telephone calls to and from anywhere in the world where the customer has broadband access to the Internet, and allow customers to make free calls back to the United States and Canada from anywhere legally permitted in the world.

magicJack VocalTec is a vertically integrated group of companies. The Company owns a micro processor chip design company, an appserver and session border controller company, a wholesale provider of voice-over-Internet-Protocol (“VoIP”) services, a softphone company, and the developer and provider of the magicJack product line. The Company intends to expand these existing platforms to allow its customers to use search, shopping, click-to-call and other services via the Internet through intellectual property rights pending and proprietary technologies. The Company also wholesales telephone service to VoIP providers and telecommunication carriers.

The Company was incorporated in the State of Israel in 1989 and is domiciled in Netanya, Israel.

Basis of Presentation

The Company's unaudited condensed consolidated financial statements are prepared in conformity with United States generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of regulation S-K. Accordingly, the Company's unaudited condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements that are included in the Company's Annual report on Form 10-K for the year ended December 31, 2012. The balance sheet at December 31, 2012 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. Management believes, however, that all adjustments of a normal, recurring nature considered necessary for a fair presentation have been included.

The Company's unaudited condensed consolidated financial statements are the basis for the discussion and analysis of the Company's results of operations, liquidity and capital resources. References to authoritative accounting literature in this report, where applicable, are based on the Accounting Standards Codification (“ASC”). The Company's functional and reporting currency is the United States Dollar (“U.S. Dollar”), which is the currency of the primary economic environment in which its consolidated operations are conducted. Transactions and balances originally denominated in U.S. Dollars are presented at their original amounts. Transactions and balances in currencies other than U.S. Dollars, including Israeli New Shekel (“NIS”), are re-measured in dollars and any gains or losses are recognized in the

Company's unaudited condensed consolidated financial statements in the period they occur.

The Company prepares its unaudited condensed consolidated financial statements on the basis of being a single reporting entity. Over 90% of the Company's revenues in the three and six months ended June 30, 2013 and 2012 were derived from sales to customers located in the United States. The majority of the Company's revenues were generated from sales of the magicJack product line and from the software access right that accompanies these products, which were \$28.2 million and \$33.2 million for the three months ended June 30, 2013 and 2012, respectively, and \$60.4 million and \$62.1 million for the six months ended June 30, 2013 and 2012, respectively. The Company also provides its customers the ability to make prepaid calls using a magicJack device or magicJack APP by purchasing prepaid minutes. Revenues generated from the usage of prepaid minutes were \$3.2 million and \$3.1 million for the three months ended June 30, 2013 and 2012, respectively, and \$6.4 million and \$8.9 million for the six months ended June 30, 2013 and 2012, respectively. In February 2012, the Company made an operational change which allowed it to identify the point in time when prepaid minutes expire under the terms of service and approximately \$3.0 million attributable to prepaid minutes that expired between February 2008 and February 2012 were reversed from deferred revenue and recognized as revenue during the quarter ended March 31, 2012 since such amounts were considered earned. As a result, the Company's diluted earnings per ordinary share for the six months ended June 30, 2012 were increased by approximately \$0.14 per ordinary share.

The Company has evaluated all subsequent events through the date the accompanying consolidated financial statements were issued.

Basis of Consolidation

The Company's unaudited condensed consolidated financial statements include the accounts of magicJack VocalTec and its wholly-owned subsidiaries, YMax Corporation, YMax Communications Corp., magicJack Holdings Corporation, magicJack, LP, SJ Labs, Inc., Tiger Jet Network, Inc., VocalTec Communications, LLC ("VocalTec US", formerly Stratus Telecommunications, LLC), and Predictive Marketing, LLC and B Kruse and Associates, LLC (collectively, "Dialmaxx"). All intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications may have been made to prior period financial statement amounts to conform to the current presentation. The results for the three and six months ended June 30, 2013 may not be indicative of the results for the entire year. The interim unaudited condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations included in this report and in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 filed on April 2, 2013.

NOTE 2 – SUMMARY OF ACCOUNTING POLICIES

A summary of significant accounting policies used in preparing the Company's financial statements, including a summary of recent accounting pronouncements that may affect its financial statements in the future, follows:

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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. Significant estimates include allowances for billing adjustments and doubtful accounts, the recoverability of long-lived assets and goodwill, income tax valuation allowance (and related matters), the expected forfeitures of ordinary share options and estimates of likely outcomes related to certain contingent liabilities.

The Company evaluates its estimates on an ongoing basis. The Company's estimates and assumptions are based on factors such as historical experience, trends within the Company and the telecommunications industry, general economic conditions and on various other assumptions that it believes to be reasonable under the circumstances. The results of such assumptions form the basis for making judgments about the carrying values of assets and liabilities that are not readily available. Actual results may differ from the Company's estimates and assumptions as a result of varying market and economic conditions, and may result in lower revenues and lower net income.

Net Revenues

Net revenues consists of revenue from sales of magicJack devices to retailers, wholesalers or directly to customers, access right renewal fees, fees charged for shipping magicJack, usage of prepaid minutes, access charges to other carriers and other miscellaneous charges. Revenue is recorded net of sales returns and allowances.

Revenue Recognition

magicJack Devices Revenue

The Company recognizes revenues from sales and shipping of direct sales of magicJack devices over the period associated with the initial access right period. Customers may purchase access rights for continued use of its software

to access the Company's servers for additional years either when the original purchase is made, or at any time thereafter. The revenue associated with the access right for additional years is deferred and recognized ratably over the extended access right period.

Sales Return Policy

The Company offers some of its direct sales customers a 30-day free trial before they have to pay for their magicJack device. The Company does not record or recognize revenue until the 30-day trial period has expired and a customer's credit card has been charged.

Returns from retailers are accepted on an authorized basis for devices deemed defective. The Company may offer certain retailers the limited right to return any unsold merchandise from their initial stocking orders. The Company estimates potential returns under these arrangements at point of sale and re-estimates potential returns on a quarterly basis. For the three and six months ended June 30, 2013 and 2012, the Company's estimates of returns and actual returns from initial stocking orders have not been materially different.

Telephony Services Revenue

Telephony revenue is recognized as minutes are used. Telephony revenue is generated from the usage of prepaid minutes, fees for origination of calls to 800-numbers and access fees charged to other telecommunication carriers on a per-minute basis for Interexchange Carriers ("IXC") calls terminated on the Company's servers. Revenues from access fee charges to other telecommunication carriers are recorded based on rates set forth in the respective state and federal tariffs or negotiated contract rates, less a provision for billing adjustments of \$0.8 million and \$1.9 million for the three months ended June 30, 2013 and 2012, respectively, and \$2.0 million and \$4.1 million for the six months ended June 30, 2013 and 2012, respectively.

Deferred Revenues

Deferred revenues consist primarily of billings and payments for magicJack devices and sales of telecommunication service agreements received in advance of revenue recognition. The Company bills and collects in advan