Crexendo, Inc.
Form 10-Q
August 14, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from ________ to ________.

Commission file number 001-32277

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

Delaware (State or other jurisdiction of incorporation or organization)	87-0591719 (I.R.S. Employer Identification No.)
1615 South 52nd Street, Tempe, AZ (Address of Principal Executive Offices)	85281 (Zip Code)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the

Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

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

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

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

The number of shares outstanding of the registrant’s common stock as of August 1, 2013 was 10,709,904.

INDEX

PART I – FINANCIAL INFORMATION

PART II – OTHER INFORMATION

Back to Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

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

	June 30, 2013	December 31, 2012
Assets		
Current Assets:		
Cash and cash equivalents	$4,930	$7,440
Restricted cash	1,444	1,444
Trade receivables, net of allowance of doubtful accounts of $641		
as of June 30, 2013 and $1,326 as of December 31, 2012	1,341	3,043
Inventories	131	171
Equipment financing receivables	51	28
Income taxes receivable	63	434
Prepaid expenses and other	510	333
Total Current Assets	8,470	12,893
Certificate of deposit	250	500
Long-term trade receivables, net of allowance of doubtful accounts of $106		
as of June 30, 2013 and $196 as of December 31, 2012	152	395
Long-term equipment financing receivables	196	96
Property and equipment, net	2,658	3,172
Deferred income tax assets, net	105	103
Intangible assets	671	6
Goodwill	340	265
Other long-term assets	95	97
Total Assets	$12,937	$17,527
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	$307	$418
Accrued expenses and other	1,307	3,010
Deferred income tax liability	105	103
Deferred revenue, current portion	1,348	3,052
Contingent consideration	87	-
Total Current Liabilities	3,154	6,583
Deferred revenue, net of current portion	143	399
Other long-term liabilities	-	253
Total Liabilities	3,297	7,235

Stockholders' Equity:		
Preferred stock, par value $0.001 per share - authorized 5,000,000 shares; none issued	-	-
Common stock, par value $0.001 per share - authorized 100,000,000 shares; 10,709,904		
shares outstanding as of June 30, 2013 and 10,669,201 shares outstanding		
as of December 31, 2012	11	11
Additional paid-in capital	50,364	49,824
Contingent consideration	276	-
Accumulated deficit	(41,011)	(39,543)
Total Stockholders' Equity	9,640	10,292
Total Liabilities and Stockholders' Equity	$ 12,937	$ 17,527

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

Back to Table of Contents

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenue	$2,737	$4,914	$5,759	$10,169
Operating expenses:				
Cost of revenue	970	1,298	2,012	2,719
Selling and marketing	717	984	1,625	1,917
General and administrative	1,852	2,741	3,290	5,774
Research and development	414	505	895	1,099
Total operating expenses	3,953	5,528	7,822	11,509
Loss from operations	(1,216)	(614)	(2,063)	(1,340)
Other income (expense):				
Interest income	146	524	365	1,266
Other income (expense), net	(26)	(14)	(33)	14
Total other income, net	120	510	332	1,280
Loss before income tax provision	(1,096)	(104)	(1,731)	(60)
Income tax benefit (provision)	26	(13)	263	140
Net income (loss)	$(1,070)	$(117)	$(1,468)	$80
Net income (loss) per common share:				
Basic	$(0.10)	$(0.01)	$(0.14)	$0.01
Diluted	$(0.10)	$(0.01)	$(0.14)	$0.01
Dividends per common share:	$-	$-	$-	$0.02
Weighted average common shares outstanding:				
Basic	10,682,393	10,634,104	10,675,990	10,582,372
Diluted	10,682,393	10,634,104	10,675,990	10,614,888

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

Back to Table of Contents

CREXENDO, INC. AND SUBSIDIARIES
Condensed Consolidated Statement of Stockholders' Equity
For the Six Months Ended June 30, 2013
(In thousands, except share data)
(unaudited)

	Common Stock Shares	Amount	Additional Paid-in Capital	Contingent Consideration	Accumulated Deficit	Total Stockholders' Equity
Balance, January 1, 2013	10,669,201	$11	$49,824	$ -	$ (39,543)	$ 10,292
Expense for stock options granted to employees	-	-	430	-	-	430
Proceeds from the exercise of stock options	2,187	-	3	-	-	3
Contingent consideration	-	-	-	276	-	276
Issuance of common stock for business acquisition	38,516	-	107	-	-	107
Net loss	-	-	-	-	(1,468)	(1,468)
Balance, June 30, 2013	10,709,904	$11	$50,364	$ 276	$ (41,011)	$ 9,640

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

Back to Table of Contents

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

	Six Months Ended June 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$(1,468)	$80
Adjustments to reconcile net (loss) income to net		
cash provided by (used for) operating activities:		
Lease abandonment	(606)	-
Depreciation and amortization	598	759
Expense for stock options issued to employees	430	455
Change in uncertain tax positions	(253)	(167)
Changes in assets and liabilities:		
Trade receivables	1,945	6,157
Equipment financing receivables	(123)	(25)
Inventories	40	28
Income taxes receivable	371	38
Prepaid expenses and other	(177)	(37)
Other long-term assets	2	20
Accounts payable, accrued expenses and other	(1,202)	(573)
Deferred revenue	(1,960)	(6,000)
Other long-term liabilities	-	4
Net cash (used for) provided by operating activities	(2,403)	739
CASH FLOWS FROM INVESTING ACTIVITIES		
Redemption of certificate of deposit	250	-
Acquisition of property and equipment	(60)	(1,024)
Acquisition of PBX Central	(300)	-
Net cash used for investing activities	(110)	(1,024)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options	3	498
Payments made on contingent consideration	-	(6)
Dividend payments	-	(422)
Net cash provided by financing activities	3	70
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,510)	(215)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	7,440	8,658
CASH AND CASH EQUIVALENTS, END OF PERIOD	$4,930	$8,443
Supplemental disclosure of cash flow information:		
Cash received during the period:		
Income taxes	$(382)	$(11)
Supplemental disclosure of non-cash investing and financing information:		
Purchases of property and equipment included in accounts payable	$-	$16
Business acquisition with stock (Note 9)	$107	$-

Contingent consideration related to acquisition (Note 9)	$363	$-

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

Back to Table of Contents

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

(1) Significant Accounting Policies

Description of Business - Crexendo, Inc. is incorporated in the state of Delaware. As used hereafter in the notes to consolidated financial statements, we refer to Crexendo, Inc. and its wholly owned subsidiaries, as “we,” “us,” or “our Company”. In May 2011, our stockholders approved an amendment to our Certificate of Incorporation to change our name from "iMergent, Inc." to "Crexendo, Inc." The name change was effective May 18, 2011. Our ticker symbol "IIG" on the New York Stock Exchange was changed to “EXE” on May 18, 2011. We are a hosted services company that provides web hosting, hosted telecommunications services, search engine optimization management, link building, e-commerce software, website development, and broadband internet services for businesses and entrepreneurs. Our services are designed to make enterprise-class hosting services available to small and medium-sized businesses at affordable monthly rates. The Company has three operating segments, which consist of Crexendo Network Services, Crexendo Web Services and StoresOnline.

In July 2011, we announced the suspension of our direct mail seminar sales channel in our StoresOnline segment. Accordingly, we have shifted our focus toward growing our Crexendo Network Services and Crexendo Web Services segments. As a result, the Company has transformed into a start-up company with the inherent risks and uncertainties of funding operations until profitability is achieved. Due to changes in our business model and the rapidly evolving nature of our business and the markets we serve, we believe period-to-period comparisons of our operating results, including operating expenses as a percentage of revenue and cash flows, are not necessarily meaningful and should not be relied upon as an indication of future performance. We currently plan to fund our growth during the next twelve months using our cash and cash equivalents of $4,930,000, the collection of remaining accounts receivable from our former StoresOnline business, and restricted cash expected to be released from restriction. In addition, in March 2013, the Company received a letter from the CEO, and majority shareholder, that if there is a shortfall in cash, that the CEO would provide additional financial support if necessary up to $2.0 million. The Company believes that it has sufficient funds to sustain its operations during the next 12 months. Beyond the next twelve months, the Company’s forecast indicates that given current trends and growth projections, the Company may need to raise additional capital. There can be no assurances that such additional capital, if needed, would be available on acceptable terms or at all, which would adversely affect our Company’s ability to achieve our business objectives. In addition, if our future operating performance during the next twelve months is below our expectations, our liquidity and ability to operate our business could be adversely affected unless the Company is able to raise additional capital during that period to offset the shortfall in performance.

Basis of Presentation – These unaudited condensed consolidated financial statements include the accounts and operations of Crexendo, Inc. and its wholly owned subsidiaries, which include Avail 24/7 Inc., Crexendo Business Solutions, Inc., Galaxy Mall, Inc., StoresOnline Inc., StoresOnline International Canada ULC, StoresOnline International, Inc., StoresOnline International Ltd., StoresOnline International Canada, Ltd., Internet Training Group, Inc., Crexendo International, Inc., Crexendo Telecom, Inc., Crexendo India Limited, and Crexendo Property Management, LLC. All intercompany account balances and transactions have been eliminated in consolidation. The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles, consistent in all material respects with those applied in our financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. Because these financial statements address interim periods, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Such interim financial information is unaudited but reflects all adjustments that in the opinion of management are necessary for the fair presentation of the interim periods presented. The results of operations presented in this Quarterly Report on Form 10-Q are not necessarily indicative of the results that may be expected for the year ending December 31, 2013 or for any future periods. This Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited financial statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

Back to Table of Contents

Cash and Cash Equivalents - We consider all highly liquid, short-term investments with maturities of three months or less at the time of purchase to be cash equivalents.

Restricted Cash – We classified $1,444,000 as restricted cash as of June 30, 2013 and December 31, 2012, respectively. Cash is restricted for state licensing letters of credit, compensating balance requirement of our merchant accounts, and purchasing card agreements. The Company expects the restrictions to be removed during the next year and therefore classified restricted cash as current. As of June 30, 2013, we had restricted cash in financial institutions in excess of federally insured limits in the amount of $1,444,000.

Trade Receivables – We have historically offered to our StoresOnline customers the option to finance, typically through 24 and 36-month extended payment term arrangements (“EPTAs”), purchases made at our Internet Training Workshops through our StoresOnline segment. EPTAs are reflected as short-term and long-term trade receivables, as applicable, as we have the intent and ability to hold the receivables for the foreseeable future, until maturity or payoff. EPTAs are recorded on a nonaccrual status beginning on the contract date.

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

Interest Income - Interest income is primarily earned from EPTA contracts. EPTA contract terms generally contain an 18% simple interest rate. Interest income is recognized on these accounts only to the extent cash is received as the receivables are generally 24 and 36-months in length and collection of the full amount of the receivable is not probable. We recognized $146,000 and $524,000 for the three months ended June 30, 2013 and 2012, respectively. We recognized $365,000 and $1,266,000 for the six months ended June 30, 2013 and 2012, respectively.

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

Certificate of Deposit - We hold a $250,000 certificate of deposit as collateral for merchant accounts, which automatically renews every 12 months. The certificate of deposit is classified as long-term in the condensed consolidated balance sheets.

Property and Equipment - Depreciation and amortization expense is computed using the straight-line method in amounts sufficient to allocate the cost of depreciable assets over their estimated useful lives ranging from two to five years. The cost of leasehold improvements is amortized using the straight-line method over the shorter of the estimated useful life of the asset or the term of the related lease. Depreciation and amortization expense is included in general and administrative expenses and totaled $317,000 and $391,000 for the three months ended June 30, 2013 and 2012, respectively and $574,000 and $502,000 for the six months ended June 30, 2013 and 2012, respectively. Depreciable lives by asset group are as follows:

Back to Table of Contents

Computer and office equipment	2 to 5 years
Computer software	3 years
Furniture and fixtures	4 years
Leasehold improvements	2 to 5 years
Building	20 years

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

Goodwill – Goodwill of $265,000 was recorded in connection with the acquisition of CastleWave in 2010. Goodwill of $75,000 was recorded in connection with the acquisition of PBX Central on June 4, 2013. Goodwill is tested for impairment using a fair-value-based approach on an annual basis (December 31) and between annual tests if indicators of potential impairment exist.

Intangible Assets - Our intangible assets consist primarily of assets acquired in the acquisition of CastleWave and PBX Central, which include customer relationships, developed technology, technical know-how, and a non-compete agreement. The fair value of identifiable intangible assets is based upon the lower of discounted future cash flow projections or the amount paid in an arm's length transaction. The intangible assets are amortized following the patterns in which the economic benefits are consumed. Amortization expense from these acquired assets is included in general and administrative expenses and totaled $17,000 and $18,000 for the three months ended June 30, 2013 and 2012, respectively and $24,000 and $36,000 for the six months ended June 30, 2013 and 2012, respectively.

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

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

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

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

Back to Table of Contents

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

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

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

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

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

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

Back to Table of Contents

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

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

Commission Revenue - We have contracts with third-party entities with respect to telemarketing product sales to our customers following the sale of the initial software licenses. These products and services are intended to assist the customers with their Internet businesses. These products are sold and delivered completely by third parties. We receive commissions from these third parties, and recognize the revenue as the commissions are received, net of expected customer refunds.

Cost of Revenue – Cost of revenue consists primarily of salaries for fulfillment services, and the cost of telecommunications equipment, services, and other products sold.

Prepaid Sales Commissions - For arrangements where we recognize revenue over the relevant contract period, we defer related commission payments to our direct sales force and amortize these amounts over the same period that the related revenues are recognized. This is done to match commissions with the related revenues. Commission payments are nonrefundable unless amounts due from a customer are determined to be uncollectible or if the customer subsequently changes or terminates the level of service, in which case commissions which were paid are recoverable by us. We deferred $53,000 and $0 of commissions and amortized to sales and marketing expense $5,000 and $0 as of June 30, 2013 and December 31, 2012, respectively.

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

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

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

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

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets in non-active markets;
Inputs other than quoted prices that are observable for the asset or liability; and
Inputs that are derived principally from or corroborated by other observable market data.

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

Back to Table of Contents

Financial Instruments - The carrying values of cash and cash equivalents, restricted cash, certificates of deposit, and merchant account deposits approximate their fair values due to either the short maturity of the instruments or the recent date of the initial transaction.

Income Taxes - We recognize a liability or asset for the deferred tax consequences of all temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements that will result in taxable or deductible amounts in future years when the reported amounts of the assets and liabilities are recovered or settled. Accruals for uncertain tax positions are provided for in accordance with accounting guidance. Accordingly, we may recognize the tax benefits from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting guidance is also provided on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in the financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our financial position, results of operations, and cash flows. In assessing the need for a valuation allowance, we evaluate all significant available positive and negative evidence, including historical operating results, estimates of future taxable income and the existence of prudent and feasible tax planning strategies. We have placed a full valuation allowance on deferred tax assets, see Note 5.

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

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

Stock-Based Compensation - For equity-classified awards, compensation expense is recognized over the requisite service period based on the computed fair value on the grant date of the award. Equity classified awards include the issuance of stock options and restricted stock. The restricted stock includes all dividend rights and is a participating security; however, the restricted stock does not change earnings per share under the two-class method.

Comprehensive Income (Loss) – There were no other components of comprehensive income (loss) other than net income (loss) for the three and six months ended June 30, 2013 and 2012.

Operating Segments - Accounting guidance establishes standards for the way public business enterprises are to report information about operating segments in annual financial statements and requires enterprises to report selected information about operating segments in financial reports issued to stockholders. The Company has three operating segments, which consist of StoresOnline, Crexendo Web Services and Crexendo Network Services. Effective October 1, 2012, the Company changed its reporting segments to reflect the allocation of previously unallocated corporate expenses to each of the three operating segments. The Company revised its segment reporting to reflect changes in how the Chief Operating Decision Maker (CODM) internally measures performance and allocates resources. Segment operating results for the three and six months ended June 30, 2012 have been recast to conform to current quarter segment operating results presentation. Accounting guidance also establishes standards for related disclosure about products and services, geographic areas and major customers. We generate over 90% of our total revenue from customers within North America (United States and Canada) and less than 10% of our total revenues from customers in other parts of the world.

12

Back to Table of Contents

Significant Customers – No customer accounted for 10% or more of our total revenue or total accounts receivable for the three and six months ended June 30, 2013 and 2012.

(2) Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing the net income (loss) for the period by the weighted-average number of common shares outstanding during the period. Diluted net income per common share is computed giving effect to all dilutive common stock equivalents, consisting of common stock options and restricted shares held in escrow. Diluted net loss per common share for the three months ended June 30, 2013 and 2012 was the same as basic net loss per common share, as the common share equivalents were anti-dilutive. Diluted net loss per common share for the six months ended June 30, 2013 was the same as basic net loss per common share, as the common share equivalents were anti-dilutive. Diluted net income per common share for the six months ended June 30, 2012 included 7,000 restricted shares held in escrow. The following table sets forth the computation of basic and diluted net income (loss) per common share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net (loss) income (in thousands)	$(1,070)	$(117)	$(1,468)	$80
Weighted-average share reconciliation:				