MAGICJACK VOCALTEC LTD
Form 10-K
March 16, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

(MARK ONE)

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

For the fiscal year ended December 31, 2017

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 HAOMANUT STREET, 2ND FLOOR
POLEG INDUSTRIAL ZONE, NETANYA, ISRAEL 4250445
(Address of principal executive offices, including zip code)

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

Securities registered pursuant to Section 12(b) of the Act:

Ordinary Shares, No Par Value	The NASDAQ Stock Market LLC
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if smaller reporting company)	Smaller reporting company	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

The aggregate market value of the ordinary shares held by non-affiliates of the registrant computed by reference to the price of the registrant's Ordinary Shares as of the last business day of the registrant's most recently completed second fiscal quarter (based on the last reported sale price on the Nasdaq Global Stock Market as of such date) was $73,697,308.

The number of the registrant's ordinary shares outstanding as of February 28, 2018 was 16,189,894.

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DEFINITIONS

In this annual report on Form 10-K, 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 "common shares", "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. All references to "NIS" are to New Israeli Shekels and "PLN" are to Polish Zloty. Except as otherwise indicated, financial statements of, and information regarding, magicJack VocalTec are presented in U.S. dollars;
- references to the "Companies Law" are to Israel's Companies Law, 5759-1999, as currently amended;
- 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;
- references to the "SEC" are to the United States Securities and Exchange Commission; and
- references to the "magicJack devices" are to the original magicJack®, the magicJack PLUS ™, the New magicJack PLUS ™, the magicJackGO and the magicJackEXPRESS ™.

USE OF TRADEMARKS

VocalTec, MAGICJACK, MAGICJACK PLUS, MAGICJACK APP, MAGICJACK AMERICA, MAGICAPP & Design, M & App Icon Design, MAGICJACK Sensory/Sound Mark, MAGICJACKGO, MAGICJACK CONNECT and MAGICJACKEXPRESS (stylized) are trademarks of magicJack VocalTec. Trademark applications for MAGICJACK AMERICA, MAGICJACKEXPRESS (stylized), M & App Icon Design, MAGICAPP & Design, and MAGICJACK CONNECT are pending in the United States. Outside the United States, trademark registrations for the MAGICJACK mark have been obtained in Canada, China, the European Union, El Salvador, India, Mexico and Peru. The Company owns Canadian trademark registrations for MAGICJACK PLUS, and MAGICJACK APP, as well as, pending Canadian trademark applications for M & App Icon Design, MAGICAPP & Design, and MAGICJACKEXPRESS (stylized). Additionally, the Company has been granted trademark registrations for M & App Icon Design, MAGICAPP & Design, MAGICJACK AMERICA, MAGICJACKEXPRESS (stylized), and MAGICJACKGO in Mexico. These trademarks are important to our business. Although we have omitted the "®" and "TM" trademark designations for such trademarks in this annual report, all rights to such trademarks are nevertheless reserved.

PART I

This annual report on Form 10-K contains historical information and forward-looking statements within the meaning of section 27A of the Securities Act of 1933, as amended, and section 21E of the Securities Exchange act of 1934, as amended. Actual results could differ materially from those set forth in these forward-looking statements. The words "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "project," "should" and similar expressions, as they rela magicJack VocalTec or its management, are intended to identify forward-looking statements. Such statements reflect the current views and assumptions of magicJack VocalTec with respect to future events and are subject to risks and uncertainties. Many factors could cause the actual results, performance or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, both referenced and not referenced in this annual report. Such factors are set forth under Part I, Item 1A, "Risk Factors," below. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those expected. Any forward-looking statements in this annual report on Form 10-K are made as of the date hereof, and we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

ITEM 1. BUSINESS

Business Overview

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 to access its servers (“access right”), and the Company’s customers then continue to have the ability to obtain free telephone services. The Company currently offers the magicJack GO and magicJack EXPRESS, which are updated versions of the magicJack device that have their 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 magicJack mobile apps are applications that allow users to make and receive telephone calls through their smart phones using their magicJack account. Currently, consumers that do not have a magicJack account can purchase and download the magicJack mobile apps to make telephone calls from anywhere in the world into the U.S. or Canada for free. The mobile apps include the magicApp and the magicJack Connect App, which are available for both iOS and Android. 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 device. The Company also wholesales telephone service to VoIP providers and telecommunication carriers.

The Company's strategy since 2007 has been to vertically integrate its technology, design and suppliers, and it has completed four acquisitions between 2007 and 2010, including a merger with the company that invented VoIP, in order to implement this strategy.

From 2011 through 2015, the Company has offered several versions of the magicJack device and mobile apps. The device has been progressively upgraded to include superior voice quality, expanded memory and enhanced processing power. The initial access right period for the different versions of the device ranged from three to twelve months.

In March 2016, the Company acquired substantially all of the assets of North American Telecommunications Corporation (dba "Broadsmart"). Broadsmart is a hosted Unified Communication as a Service ("UCaaS") provider for medium-to-large multi-location enterprise customers. Broadsmart has experience provisioning and delivering complex UCaaS solutions to corporate customers on a nationwide basis. Broadsmart services multi-location, geographically diverse enterprises. With the acquisition of Broadsmart, the Company has diversified its operations into UCaaS targeting high end enterprise customers. This acquisition was intended to position the Company to compete long-term in the UCaaS market.

During the first quarter of 2016, the Company created a new subsidiary, magicJack SMB, Inc. ("SMB"). Through this subsidiary, the Company provides easy-to-buy, simple-to-use VoIP services to small to medium sized businesses at competitive prices. The Company began sales of its SMB product during the third quarter of 2016. During 2017, the Company rolled back its investment in the SMB product and launched the magicJack "Spark" product, a business focused mobile App product.

The Company has historically prepared its consolidated financial statements on the basis of being a single reporting entity. Beginning in the first quarter of 2016, the Company has been reporting the results of operations for these new business lines as separate Reportable Segments – "Core Consumer," "Enterprise" and "SMB". These segments are organized by the products and services that are sold and the customers that are served. The Core Consumer segment represents the historical magicJack consumer business. The Enterprise segment includes Broadsmart and the SMB segment includes SMB. Refer to Note 16, "Segment Reporting," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

In May 2016, we launched the magicJack Connect App for iOS and Android. The magicJack Connect App offers users free worldwide Wi-Fi App-to-App calling & messaging. The App also offers an unlimited U.S. calling plan which allows subscribers to call the U.S. from anywhere in the world plus receive a U.S. phone number for only $9.99 per year.

On November 9, 2017, the Company entered into a Merger Agreement with B. Riley Financial, Inc. ("B. Riley"), in which B. Riley proposes to acquire all of the outstanding shares of the Company for $8.71 per share. The purchase price of $8.71 per share represents a premium of approximately (i) 18.5% over the closing price of the Company's ordinary shares on the NASDAQ Global Select Market on March 14, 2017, the last completed trading day prior to the date that the Company announced that it had received unsolicited indications of interest and would be considering its strategic alternatives, (ii) 23.6% over the 90-day average closing price of the Company's ordinary shares for the period ended November 7, 2017, and (iii) 54.2% over the closing price of the Company's ordinary shares on November 8, 2017, the last completed trading day prior to the Company's announcement that it entered into the Merger Agreement. The Transaction is subject to various closing conditions, including Company shareholder approval and regulatory approvals. A Special Meeting of the Shareholders is scheduled for March 19, 2018, to vote on the Transaction. The Company anticipates completing the Transaction in the first half of 2018.

The Company’s corporate name is magicJack VocalTec Ltd. for both legal and commercial purposes. The Company is located at 12 Haomanut Street, 2nd Floor, Poleg Industrial Area, Netanya, Israel 4250445 (telephone number +972-9-970-3888). The Company was organized under the laws of the State of Israel in 1989 and is subject to the Israeli Companies Law, or the Companies Law. The Company’s subsidiary, YMax Corporation (“YMax”, and together with VocalTec, the “Combined Company”), is located at 560 Village Blvd., Suite 120, West Palm Beach, Florida, 33409 (telephone number 561-749-2255).

Product and Service Offerings

magicJack Devices

The magicJack is a VoIP device weighing about one ounce which includes an initial access right period. Customers receive free VoIP phone service for their home, enterprise or while traveling. The Company started selling the magicJack in late 2007. Since that time, the Company has offered several upgraded versions of the device with superior voice quality, expanded memory and enhanced processing power. The initial access right period for the different versions ranges from three to twelve months. The current device available for purchase is the magicJack GO, which includes a twelve month access right period. magicJack devices are sold either directly to customers through our website or through retailers.

Mobile apps

The Company also offers magicJack mobile apps, which are applications that allow users to make and receive telephone calls through their smart phones or devices. The Company currently offers the magicApp, magicJack Connect and magicJack Spark. The magicApp and magicJack Connect are mobile apps available for both iOS and Android. In 2017, the Company launched magicJack Spark on iOS and Android devices. The mobile apps allow customers to place and receive telephone calls in the U.S. or Canada on their mobile devices through either an existing or new magicJack account. The mobile apps also give users the ability to add a second phone number to their smart phone for a monthly or annual fee. Customers may purchase international minutes to place telephone calls through the magicJack device or mobile apps to locations outside of the U.S. and Canada.

Access Right Renewals

Customers who own a magicJack device or mobile app may renew access rights for periods ranging from one month to five years.

Other magicJack-Related Products

The Company offers customers other optional products related to their magicJack devices and services, such as custom or vanity phone numbers, Canadian phone numbers, the ability to either change their existing phone numbers or port them to a magicJack device, and battery powerbanks for mobile devices.

Prepaid Minutes

The Company’s customers can purchase international minutes on a prepaid basis.

Access and Wholesale Charges

The Company generates revenues from access fees charged to other carriers, as well as wholesaling telephone service to VoIP providers and telecommunication carriers.

UCaaS Services and Equipment

The Company provides hosted communication services and sells hardware and network equipment that are compatible with the service, through its subsidiary, Broadsmart, which has a track record of provisioning and delivering complex UCaaS solutions to blue chip corporate customers on a nationwide basis.

Sources of Revenues

The Company generates revenues from the following sources:

- Sales of the magicJack devices and access rights – represent revenues recognized from sales of the magicJack devices to retailers, wholesalers, or direct to customers, net of returns, over the period associated with the access right period. These revenues are recorded net of sales allowance, chargebacks, retailer discounts and advertising allowances;

- Access right renewals and mobile apps – represent revenues from customers purchasing rights to access our servers beyond the access right period included with a magicJack device or magicJack service. The extended access right ranges from one to five years. These fees charged to customers are initially deferred and recognized as revenue ratably over the extended access right period. Revenues from access rights granted to users of the magicApp, magicJack Connect App and magicJack Spark are recognized ratably over the access right period;

- Shipping and handling – represent charges for shipping and handling fees for magicJack devices shipped directly to customers. The fees are initially deferred and recognized as revenues over the access right period associated with the magicJack device;

- magicJack-related products – represent revenues recognized from the sale of other items related to the magicJack devices and access right renewals the Company offers its customers, including: (i) porting fees charged to customers to port their existing phone number to a magicJack device or service, (ii) fees charged for customers to select a custom, vanity or Canadian phone number, (iii) fees charged to customers to change their existing number, and (iv) sale of battery powerbanks for mobile devices. These revenues are recognized at the time of sale, with the exception of sales of the battery powerbank which are recognized when shipped;

- Prepaid minutes – represent revenues recognized primarily from the usage and expiration of international prepaid minutes, net of chargebacks. Revenues from prepaid minutes are recognized as minutes are used;

- Access and wholesale charges – represent revenues generated from: (i) access fees charged to other telecommunication carriers or providers for Inter-exchange Carriers (“IXC”) calls terminated to the Company’s end-users, and (ii) fees charged to telecommunication carriers or providers for origination of calls to their 800-numbers. These revenues are recorded based on rates set forth in the respective state and federal tariffs or negotiated contract rates, less provisions for billing adjustments. Revenues from access and wholesale charges are recognized as minutes are used;

- UCaaS – represents revenues recognized from: (i) recurring monthly service revenue from sales of its hosted services - customers are billed monthly in advance for these recurring services and in arrears for one time service charges and other certain usage charges, and (ii) non-recurring revenue from the sale of hardware and network equipment. Revenues for recurring monthly service are recorded in the period the services are provided over the term of the respective customer agreements and revenue from the sale of hardware and network equipment is recognized in the period that the equipment is delivered and put into service; and

- Other revenues – represent VoIP services provided to small to medium sized businesses and revenues generated by ancillary revenue sources.

Approximately 86%, 87% and 90% of the Company’s consolidated revenues for the years ended December 31, 2017, 2016 and 2015, respectively, were derived from sales to customers located in the United States.

The following table presents a breakdown of the Company’s net revenues by source for the periods indicated (in thousands).

	Year Ended December 31,		
	2017	2016	2015
Net revenues			
Sale of magicJack devices	$10,361	$12,775	$15,915
Access right renewals	51,925	58,513	65,761
Shipping and handling	1,308	889	794
magicJack-related products	4,730	5,435	4,289
Prepaid minutes	4,441	5,677	8,243
Access and wholesale charges	3,769	5,021	5,953
UCaaS	10,868	8,966	-
Other	591	122	7
Total net revenues	$87,993	$97,398	$100,962

Research and Development

The Company's research and development activities consist primarily of the design and development of its proprietary software used in the magicJack devices, the mobile apps and its servers, as well as the development of new products and applications for use in its VoIP service offerings.

Research and development expenses were $5.9 million, $5.2 million, and $4.5 million for the years ended December 31, 2017, 2016, and 2015, respectively. During the three months ended March 31, 2017, $0.6 million of research and development expense was related to the SMB segment prior to its being absorbed into the Core Consumer segment. The balance of research and development expense was related to the Core Consumer segment. The Company accounts for research and development costs in accordance with the applicable accounting pronouncements described in Note 2, "Summary of Accounting Policies," in the Notes to our Consolidated Financial Statements included in Item 8 herein.

Markets Where We Compete

The primary market in which the Company currently competes is the United States. As of December 31, 2017, approximately 98% of its property and equipment, net of depreciation, is located in the United States. For the year ended December 31, 2017, approximately 86% of its consolidated revenues were derived from sales to customers located in the United States. The remaining 14% of consolidated revenues were primarily derived from sales in Canada.

Business Seasonality

The Company's revenues are not subject to seasonal fluctuations. However, quarterly revenue amounts are impacted by the timing of customer renewals and the revenues for Broadsmart can be impacted by the timing of non-recurring equipment and other sales.

Manufacturing

In 2006, the Company entered into a manufacturing and supply agreement with a Chinese company to manufacture the magicJack devices. Certain components of the magicJack device are built for the Company, based on the Company's specifications, in Taiwan and Hong Kong and then sent to the Chinese manufacturer in China for final assembly.

The Company's supply chain and third party manufacturing arrangements are structured to allow the Company to control product quality, realize cost efficiencies and minimize the risks associated without having to disclose proprietary technology to multiple outside parties during production. The Company's strategy since 2007 has been to vertically integrate the Company's technology and design suppliers, and the Company has completed three acquisitions since 2007 to implement this strategy. As a result of these strategic acquisitions, the Company controls practically every stage in the design of the Company's products. Certain magicJack device parts are sourced directly by the production facility in China. The Company works closely with our suppliers to plan inventory procurement in quantities that will meet customer demand while minimizing inventory risks. The Company purchases components and sub-assemblies through separate purchase orders and does not currently have any long-term purchase contracts with these suppliers. Prices of our components have not fluctuated significantly in the past three fiscal years.

Marketing, Sales and Distribution

For its Core Consumer business, the Company has relied on various marketing methods to advertise its products, including digital marketing and long and short form television commercials. The Company currently distributes the magicJack devices through retail outlets, including Walmart, Best Buy, Fry's and others, as well as through direct sales via the Company's web-site.

For its Enterprise business, Broadsmart has not historically marketed through traditional advertising channels but has relied on direct sales and a network of strong, established third party re-seller relationships.

In the years ended December 31, 2017, 2016 and 2015, sales of the magicJack devices through retail outlets represented approximately 53%, 52% and 67%, respectively, of sales of all magicJack devices sold. For the same periods, direct sales represented approximately 47%, 48% and 33%, respectively, of magicJack devices sold.

For the years ended December 31, 2017, 2016 and 2015, no retailer accounted for more than 10% of operating revenues for the Core Consumer or SMB segments. For the years ended December 31, 2017 and 2016, two customers accounted for approximately 29% of operating revenues for the Enterprise segment: Advance Auto Parts of 18% and Lewis, Brisbois, Bisgaard & Smith of 11%.

Competition

The Company's Core Consumer business faces competition from traditional telephone companies, wireless companies, cable companies and alternative voice communication providers. Some of our principal competitors are the traditional telephone service providers, such as AT&T, Inc., CenturyLink, Inc. and Verizon Communications Inc., which provide telephone service based on the public switched telephone network. Some of these traditional providers also have added or are planning to add broadband telephone services to their existing telephone and broadband offerings. The Company also faces, or expects to face, competition from cable companies, such as Cablevision Systems Corp., Charter Communications, Inc., Comcast Corporation, Cox Communications, Inc. and Time Warner Cable (a division of Time Warner Inc.), which have added or are planning to add broadband telephone services to their existing cable television, voice and broadband offerings. Further, wireless providers, including AT&T Mobility, Inc., Sprint Nextel Corporation, T-Mobile USA Inc., Verizon Wireless, Inc. and Clearwire Corporation, offer services that some customers may prefer over wireline-based service. In the future, as wireless companies offer more minutes at lower prices, their services may become more attractive to customers as a replacement for wireline-based service. Some of these providers may be developing a dual mode phone that will be able to use broadband telephone service where broadband access is available and cellular phone service elsewhere, which will pose additional competition to our offerings.

The Company faces competition on magicJack device sales from Apple, Samsung and other manufacturers of smart phones, tablets and other hand held wireless devices. Also, the Company competes against established alternative voice communication providers, such as Vonage, Google Voice, and Skype, which are other non-interconnected voice providers, and may face competition from other large, well-capitalized Internet companies, such as America Online, Inc., Yahoo! Inc. and others. In addition, the Company competes with independent broadband telephone service providers.

Because most of its customers are purchasing communications services from one or more of these providers, success is dependent upon the Company's ability to attract customers away from their existing providers. The Company competes primarily through the quality and cost structure of its infrastructure and its low pricing.

The Company's new Enterprise segment and SMB business operate in a highly competitive market for business voice services which includes some of the same large competitors as its Core Consumer business (AT&T and Vonage) as well as other smaller competitors such as 8x8, Inc., Ooma, RingCentral, ShoreTel and Inteliquent.

Many of the Company's actual and potential competitors enjoy greater name recognition, longer operating histories, more varied products and services and larger marketing budgets, as well as substantially greater financial, technical and other resources than the Company does. In addition, the Company may also face future competition from new market entrants.

Our Competitive Positioning

The Company believes that the key competitive factors in our market include:

- pricing and cost structure;
- ease of initial set-up and use;
- call quality;
- customer care; and
- ease of use and the design of features and capabilities that are attractive to customers.

The Company believes that its large existing user base, competitive pricing, efficient customer acquisition model, low cost service delivery and customer care capabilities, position us well to compete effectively in the future.

Intellectual Property

The Company believes that the improvement of existing products and services, its technologies and the development of new products are important in establishing and maintaining a competitive advantage. The Company believes that the value of its products is dependent, to a certain extent, upon the maintenance of intellectual property rights, the license rights to use certain intellectual property rights, trade secrets or copyright protection of its proprietary software and technologies. The Company relies on a combination of trade secrets, copyrights, trademarks and patents, together with non-disclosure and invention assignment agreements, to establish and protect the technology used in its products.

magicJack VocalTec and its wholly-owned subsidiaries hold numerous patents in the United States and other countries with respect to certain technologies employed and to be employed in its products. In addition, VocalTec or its wholly owned subsidiaries have obtained licenses (in one case, an exclusive license) from other patent owners to use technology protected by those patents.

The Company's U.S. trademark registrations include VocalTec & Design, MAGICJACK, MAGICJACK PLUS, MAGICJACK APP, MAGICJACK Sensory/Sound Mark and MAGICJACKGO. Trademark applications for MAGICJACK AMERICA, MAGICJACKEXPRESS (stylized), M & App Icon Design, MAGICAPP & Design and MAGICJACK CONNECT are pending in the United States. Outside the United States, trademark registrations for the

MAGICJACK house mark have been obtained in Canada, China, the European Union, El Salvador, India, Mexico and Peru. The Company also owns Canadian trademark registrations for MAGICJACK PLUS and MAGICJACK APP, as well as, Canadian trademark applications for M & App Icon Design, MAGICAPP & Design, and MAGICJACKEXPRESS (stylized). Additionally, the Company has been granted trademark registrations for M & App Icon Design, MAGICAPP & Design, MAGICJACK AMERICA, MAGICJACKEXPRESS (stylized), and MAGICJACKGO in Mexico. These trademarks are important to our business. Although we have omitted the “®” and “tm” trademark designations for such trademarks in this annual report, all rights to such trademarks are nevertheless reserved. All other trademarks or registered trademarks used in this Annual Report on Form 10-K are the property of their respective owners.

The Company relies on a combination of patents, copyrights, trademarks and trade secrets, as well as confidentiality agreements, to establish and protect its intellectual property worldwide. The Company has filed numerous foreign and domestic patent right applications directed to its magicJack device and other products with E911 capability, emergency call routing, emergency call location determination, and other technologies. At present, the Company owns seven issued utility patents and two issued design patents in the United States, and it is the licensee (in one case, the exclusive licensee) of several issued U.S. patents. The Company is also actively researching new technologies and improvements to its existing technologies and intends to pursue intellectual property right protection for these technologies to the extent permissible by law and prudent for its business. The patents owned by the Company expire through or by April 2032. Many of the Company’s software and communication solutions have been developed internally and are proprietary.

Although the Company does not believe that its products infringe any valid claim of a patent owned by any third party, third parties have asserted infringement and other claims against it from time to time. These claims have been directed at certain basic and fundamental components of the Company’s products. There can be no assurance that third parties will not assert such claims against the Company in the future or that such claims will not be successful.

Effects of Governmental Regulations

In the United States, the Company’s Enterprise and SMB segments are subject to federal regulation under the rules and regulations of the Federal Communications Commission (“FCC” or the “Commission”) and various state and local regulations. The Company believes that, under current regulations, the Company’s Core Consumer segment, and its magicJack, LP subsidiary, is not an interconnected VoIP provider subject to those regulations.

The Company provides broadband telephone services using VoIP technology and/or services treated as information services by the FCC. The Company is also licensed as a Competitive Local Exchange Carrier (“CLEC”) and is subject to extensive federal and state regulation applicable to CLECs. The FCC has to date asserted limited statutory jurisdiction and regulatory authority over the operations and offerings of certain providers of broadband telephone services, including non-interconnected VoIP. FCC regulations may now, or may in the future, be applied to the Company’s broadband telephone operations. Other FCC regulations apply to the Company because it provides international calling capability. Some of the Company’s operations are also subject to regulation by state public utility commissions (“PUCs”).

Intercarrier Compensation

On November 18, 2011, the FCC released a Report and Order (the "FCC Order") and Further Notice of Proposed Rulemaking that comprehensively reforms the system under which regulated service providers compensate each other for terminating interstate and intrastate traffic. Regulated service providers are free to negotiate alternative arrangements, but the FCC Order establishes default rates in the absence of agreements between regulated service providers. The rules adopted by the FCC provide for a multiyear transition to a national bill-and-keep framework as the ultimate end state for all telecommunications traffic terminated by a local exchange carrier. Under bill-and-keep, providers do not charge an originating carrier for terminating traffic and instead recover the costs of termination from their own customers.

Pursuant to the FCC Order, rates are lowered for the most common termination functions performed by regulated service providers when exchanging traffic. The transition period depends on the type of regulated service provider. After the relevant transition is complete, service providers will be required to recoup certain termination costs directly from their customers and not from other service providers. As part of this transition, depending on the particular function performed and the type of regulated service provider, the rate for inter- and intrastate traffic was reduced to $0.0007 per minute effective July 1, 2016 for the most common termination functions performed by price cap regulated service providers and their competitors. Beginning July 1, 2018, these regulated service providers must recover the costs associated with the provision of terminating services from their customers rather than from other service providers.

The FCC Order also establishes new rules concerning traffic exchanged over Public Switch Telephone Network ("PSTN") facilities that originates or terminates in Internet Protocol format, referred to as "VoIP-PSTN" traffic. As with traditional and wireless telecommunications traffic, regulated service providers will ultimately be required to recoup all costs associated with terminating such traffic from their customers. But as part of the transition to that end point, the FCC Order adopts a VoIP-PSTN specific framework for compensation between regulated service providers, establishing two rates for such traffic: toll and local. The toll rate will match the relevant interstate access rate for traditional telecommunications traffic and the local rate will match the reciprocal compensation rate associated with traditional telecommunications traffic. Further, the FCC Order allows regulated service providers to tariff charges associated with handling VoIP-PSTN traffic in a manner consistent with the FCC's rules, which took effect on December 29, 2011.

The FCC Order broadly reformed the system of default rates that apply to payments between regulated service providers going forward, but did not resolve past disputes. While the rates for termination of VoIP-PSTN traffic are ultimately reduced, the FCC's ruling may provide the certainty needed to collect interstate access charges for such traffic during the transition to bill-and-keep. To the extent that another provider were to assert that the traffic we exchange with them is subject to higher levels of compensation than we, or the third parties terminating our traffic to the PSTN, pay today (if any), our termination costs could initially increase, but ultimately will be reduced as the intercarrier compensation system transitions to bill-and-keep.

The FCC clarified in January 2015 that its VoIP symmetry rule does not require a CLEC or its VoIP provider partner to provide the physical last-mile facility to the VoIP provider's end user customers in order to provide the functional equivalent of end office switching, and thus for the CLEC to be eligible to assess access charges for this service. The ruling confirms that the VoIP symmetry rule is technology and facilities neutral and applies regardless of whether a CLEC's VoIP partner is a facilities-based or over-the-top VoIP provider. However, in November 2016, the U.S. Court of Appeals for the D.C. Circuit vacated the FCC's ruling. The Company cannot predict how the D.C. Circuit's decision will affect the amounts the Company collects and/or pays to other providers in connection with the exchange of its traffic.

E911 Calling

The FCC has required providers of interconnected VoIP services to provide 911 emergency calling capabilities to their customers. While the Company believes it is not an interconnected VoIP provider as currently defined by the FCC and thus is not subject to the FCC's 911 rules, it nevertheless provides some 911 capability for its customers. In September 2010, the FCC released a nationwide industry "Notice of Inquiry" seeking additional comments on a number of issues including, but not limited to, whether nomadic interconnected VoIP providers should be required to offer automatic location information of their users without customers providing location information. The FCC also sought comment on how far it can extend E911 obligations to other types of companies including device manufacturers, software developers and others. In July 2011, the FCC released a Second Further Notice of Proposed Rulemaking, seeking comment on various issues including (i) whether to apply the FCC's 911 rules to "outbound-only" interconnected VoIP services (i.e., services that support outbound calls to the PSTN but not inbound voice calling from the PSTN); (ii) whether to develop a framework for ensuring that all covered VoIP providers can provide automatic location information for VoIP 911 calls; and (iii) whether to revise the FCC's definition of interconnected VoIP service to require an "Internet connection" rather than a broadband connection, and to "define connectivity in terms of the ability to terminate calls to all or substantially all United States E.l64 telephone numbers." As part of the same release, the FCC included a Notice of Proposed Rulemaking that sought comment on whether any amendment of the definition of interconnected VoIP service should be limited to 911 purposes, or should apply more broadly to other contexts. In September 2011, the FCC released a Notice of Proposed Rulemaking seeking comment on what role the FCC should play to facilitate the implementation of "next generation" 911 capabilities, including, for example, the short-term implementation of text-to-911 solutions; the prioritization of 911 traffic, especially during times of natural and manmade disasters; long-term implementation of IP-based alternatives for delivering text, photos, videos, and other data to 911; and the path towards integration and standardization of IP-based text-to-91l. At this time, the Company cannot predict the outcome of these proceedings nor can it predict their potential impact on its business. The Company's VoIP E911 services are more limited than the 911 services offered by traditional wireline telephone companies. These limitations may cause significant delays, or even failures, in callers' receipt of emergency assistance.

Many state and local governments have sought to impose fees on customers of VoIP providers, or to collect fees from VoIP providers, to support implementation of E911 services in their area. Such fees are often put in terms of a fee placed on monthly bills, or focused on use from a specific location. The application of such fees with respect to magicJack users and the Company is not clear because various statutes and regulation may not cover the Company's services, the Company does not bill its customers monthly, nor does it bill customers at all for telecommunications services. The Company may also not know the end user's location because the magicJack devices and services are nomadic. If fees are owed, they are owed by the end user and not the Company, as most statutes, to the extent they apply, would have the Company act as a billing and collection agent. Should a regulatory authority require payment of money from the Company for such support, magicJack LP may decide to not offer its 911 service in that area or to develop a mechanism to collect fees from its customers, which may or may not be satisfactory to the entity requesting us to be a billing agent. The Company cannot predict whether the collection of such additional fees or limitations on where its services are available would impact customers' interest in purchasing its products.

In 2013 as a result of settlement of litigation, the Company agreed that it would, at least once a year, issue bills for 911 emergency calling services to all U.S. customers who have access to 911 services through their magicJack services, and who have provided a valid address in a U.S. jurisdiction that provides access to 911 services and which is legally empowered to impose 911 charges on such users in accordance with applicable state and/or local law.

Certain E911 regulatory authorities have asserted or may assert in the future that the Company is liable for damages, including end user assessed E911 taxes, surcharges and/or fees, for not having billed and collected E911 fees from its customers in the past or in the future. Although the Company strongly disagrees with these assertions and believes that any such authority's claims are without merit, if a jurisdiction were to prevail, the decision could have an adverse effect on the Company's financial condition and results of operations.

Network Neutrality

On January 14, 2014, the D.C. Circuit Court of Appeals, in Verizon v. FCC, struck down major portions of the FCC's 2010 "net neutrality" rules governing the operating practices of broadband Internet access providers. The FCC originally designed the rules to ensure an "open Internet" and included three key requirements for broadband providers: 1) a prohibition against blocking websites or other online applications; 2) a prohibition against unreasonable discrimination among Internet users or among different websites or other sources of information; and 3) a transparency rule compelling the disclosure of specific information about the broadband service, including network management policies. The Court struck down the first two rules, concluding that they constitute "common carrier" restrictions that are not permissible given the FCC's earlier decision to classify Internet access as an "information service," rather than a "telecommunications service." The Court upheld the FCC's transparency rule.

In response to the D.C. Circuit's decision, the FCC released an order in March 2015 adopting new net neutrality rules. In doing so, the FCC reclassified broadband Internet access - the retail broadband service mass-market customers buy from cable, phone, and wireless providers - as a telecommunications service regulated under Title II of the Communications Act of 1934, although the FCC agreed to forbear from many requirements of Title II. Significantly, these rules applied equally to fixed and mobile broadband networks.

The FCC adopted three new bright-line rules as follows:

- No Blocking: Broadband providers may not block access to legal content, applications, services, or non-harmful devices.
- No Throttling: Broadband providers may not impair or degrade lawful Internet traffic on the basis of content, applications, services, or non-harmful devices.
- No Paid Prioritization: Broadband providers may not favor some lawful Internet traffic over other lawful traffic in exchange for consideration of any kind - in other words, no "fast lanes." This rule also banned Internet Service Providers (ISPs) from prioritizing content and services of their affiliates.

The FCC also adopted a fourth "general conduct" rule in the form of a forward-looking standard. This rule was intended to address concerns that may arise with new practices that do not fall within one of the three bright line rules by prohibiting questionable practices that unreasonably interfered with or unreasonably disadvantage the ability of consumers to use or for providers to make available lawful content, applications, services, or devices. The FCC also adopted enhanced transparency requirements with which broadband providers must comply.

After the FCC's new net neutrality rules went into effect in June 2015, various broadband providers and their trade associations challenged the FCC's decision before the U.S. Court of Appeals for the D.C. Circuit. In June 2016, the D.C. Circuit issued its decision upholding the FCC's rules. The D.C. Circuit also denied various parties have filed petitions seeking rehearing en banc of the D.C. Circuit court's decision. Various parties have sought review by the United States Supreme Court of the D.C. Circuit's decision, which remains pending, and the current FCC chairman had expressed his intent to revisit the FCC's rules. The Company cannot predict the outcome of these proceedings.

In December 2017, the FCC adopted its "Restoring Internet Freedom Order," which: 1) restored the classification of broadband Internet access services as unregulated information services, ending Title II regulation of these services; 2) eliminated the FCC's three "bright-line" net neutrality rules; 3) eliminated the FCC's "general conduct" rule; and 4) adopted a new transparency rule. The "Restoring Internet Freedom Order" has been published in the Federal Register and will take effect on April 23, 2018, except for the new transparency rule, which will not take effect until approved by the Office of Management and Budget.

Multiple parties have filed petitions seeking judicial review of the "Restoring Internet Freedom Order," which have been consolidated and assigned for hearing by the United States Court of Appeals for the Ninth Circuit (which may be asked to transfer the case to the D.C. Circuit). The Company cannot predict how these challenges will be resolved. However, a decision by a court upholding the FCC decision to eliminate legal prohibitions against broadband providers blocking, throttling, or otherwise degrading the quality of the Company's data packets or attempting to extract additional fees from the Company or its customers could adversely impact the Company's business. A court also could find that the FCC lacks legal authority to regulate broadband services, which could prevent a future FCC from adopting new rules to govern the operating practices of broadband providers.

Universal Service Fund ("USF") and Other Funds

The FCC and many PUCs have established USF programs to ensure that affordable telecommunications services are widely available in high cost areas and for low income telephone subscribers and to promote universal availability of modern networks capable of providing voice and broadband service. In addition to USF, the FCC imposes other fees to meet the costs of establishing and maintaining a numbering administration system, to recover the shared costs of long-term number portability, and to contribute to the Telecommunications Relay Services (“TRS”) Fund. All telecommunications carriers and other providers are required to contribute to these funds, including interconnected VoIP providers. The FCC and many PUCs have for a number of years been considering substantial changes to the USF system including changes in contribution methodology. Some proposals, if adopted, could have a material adverse effect on the Company.

On Thursday, December 14, 2017, the Federal Communications Commission voted 3-2 to reverse its 2015 order classifying the provision of broadband internet access services as a “telecommunication service” subject to Title II of the Communications Act of 1934, and restoring the classification of broadband internet access services as an “information service” under Title I of the Communications Act. This reclassification moves the provision of broadband internet services from treatment as a utility (with greater governmental oversight over the provision of the utility’s services) to treatment as another offering by a telecommunications service provider.

The December 14, 2017 Order consequentially rescinds the rules prohibiting blocking of lawful internet content and applications, throttling or degrading lawful internet traffic, and paid prioritization of certain internet traffic. These three prohibitions form the core of the "net neutrality" rules – essentially, the rules that required all internet traffic to be treated equally.

The order was made public on January 4, 2018, and the Company anticipates that various state attorneys general and others who want to reverse the repeal will challenge the FCC's decision. The repeal itself is not yet final since it takes effect 60 days after publication in the Federal Register.

The FCC has also indicated its intent to reexamine the current USF contribution methodology, which may include requiring contributions based on revenues from broadband and other Internet Protocol-based services. The Company cannot predict how any changes to the current USF contribution methodology may affect its business at this time.

On February 3, 2015, the FCC released a policy statement for a new methodology for calculating forfeitures for violations of the USF and other federal program payment rules. Under the new treble damages methodology, each violator's apparent base forfeiture liability will be three times its delinquent debts to the USF, TRS fund, Local Number Portability ("LNP") fund, North American Numbering Plan ("NANP") fund, and regulatory fee programs. As before, each single failure to pay a federal program assessment constitutes a separate violation that continues until the assessment is fully paid. The methodology will be used in future enforcement actions, although a group of industry trade associations have petitioned the Commission for review and a stay of this methodology. At this time the Company cannot predict the impact, if any, this policy statement will have on the Company's operations in the event the Company is found to have violated the Communications Act or FCC rules.

Customer Privacy and Promotional Activities

The Company is subject to various federal and state laws and regulations seeking to protect the privacy of customers' personal information that restrict the Company's ability to use such information for marketing and promotional purposes. The FCC limits telephone companies' and interconnected VoIP providers' use of customer proprietary network information ("CPNI") such as telephone calling records without customer approval, and requires those companies to protect CPNI from disclosure. Federal and state laws also limit the Company's and other companies' ability to contact customers and prospective customers by telemarketing, email or fax to advertise services.

Communications Assistance for Law Enforcement Act ("CALEA")

In September 2005, the FCC concluded that interconnected VoIP service providers must comply with the CALEA and configure their network and services to support law enforcement activity in the area of wiretaps and call records. The Company provides CALEA-compliant services even though the Company believes it is not an interconnected VoIP provider subject to CALEA.

Services for the Disabled

Interconnected VoIP providers and manufacturers of specially designed equipment used to provide those services must take steps to ensure that individuals with disabilities, including hearing impaired and other disabled persons, have reasonable access to their services, if such access is readily achievable. The Company believes it is not an interconnected VoIP provider as currently defined by the FCC.

Number Portability

The FCC requires interconnected VoIP providers to comply with LNP rules that allow subscribers remaining in the same geographic area to switch from a wireless, wireline or VoIP provider to any other wireless, wireline or VoIP provider and keep their existing phone numbers. The Company provides LNP, even though the Company believes it is not an interconnected VoIP service provider subject to the LNP rules.

Outage Reporting

In 2012, the FCC adopted a Report and Order requiring interconnected VoIP providers to report significant service outages to the FCC. The Report and Order defines outage reporting for interconnected VoIP service, establishes reporting criteria and thresholds, and discusses how the reporting process should work, what information should be reported, and confidential treatment of the outage reports. The Company believes it is not an interconnected VoIP provider subject to the outage reporting rules.

Discontinuance of Service Reporting

The FCC requires interconnected VoIP providers to file an application with the Commission and obtain approval prior to discontinuing, reducing, or impairing service. The Company believes it is not an interconnected VoIP provider subject to the service discontinuance rules.

Annual Traffic and Revenue Reports

In January 2013, the FCC extended annual traffic and revenue reporting requirements to non-interconnected VoIP service providers. Carriers engaged in providing international telecommunications service, and companies engaged in providing VoIP service connected to the PSTN, between the United States and any foreign point are required to file a report with the Commission showing revenues, payouts, and traffic for international telecommunications service and VoIP service connected to the PSTN provided during the preceding calendar year. The FCC is considering eliminating or narrowing its current international traffic reporting requirements. At this time the Company cannot predict the impact, if any, that these reporting requirements will have on the Company’s operations.

Broadband and Telephone Competition Reporting

Interconnected VoIP service providers, facilities-based providers of broadband connections to end user locations, providers of wired or fixed wireless local exchange telephone service, and facilities-based providers of mobile telephony service are required to submit to the FCC on an annual basis a Broadband and Telephone Competition Report. Through the report the FCC collects information to analyze the deployment of broadband infrastructure and competition. The Company believes it is not an interconnected VoIP provider subject to submitting a Broadband and Telephone Competition Report.

Effects of State Regulations

The Company has been, and will continue to be, subject to a number of PUC and other state regulations that govern the terms and conditions of the Company’s offerings, including billing practices, 911 fees, distribution of telephone numbers, customer disputes and other consumer protection matters. The Company cannot predict the outcome of current or future proceedings, nor can it predict the potential impact on the Company's business.

Rural Call Completion Reporting

To the extent a covered provider makes the initial long-distance path choice for more than 100,000 domestic retail subscriber lines, the provider is subject to the FCC’s record retention and reporting requirements. Specifically, the provider must record and retain information about call attempts to rural operating company numbers (“OCN”s) and must submit certified reports for call attempts to both rural and non-rural OCNs. The FCC’s Wireline Competition Bureau has clarified that: (1) covered providers may not count unanswered call attempts as answered calls under the FCC’s data retention and reporting rules; and (2) the explanatory notes in Appendix C of the FCC’s Order that describe “answered” calls and “busy,” “ring no answer,” and “unassigned number” call attempts are intended to serve as examples rather than exclusive definitions. As part of their quarterly reports to the FCC, covered providers should explain the method they used to identify these call attempt categories. The Company is currently collecting and reporting the required data. At this time, the Company cannot predict the impact, if any, that these reporting requirements will have on the Company’s operations.

State and Municipal Taxes

The Company believes that it files all required state and municipal tax returns and pays all required state and municipal taxes (such as sales, excise, utility, and ad valorem taxes), fees and surcharges. The Company’s Enterprise and SMB segments remit state and municipal taxes as required in the states where they are registered to do business. The Company believes that its Core Consumer segment is exempt from certain taxes, fees and surcharges because it does not charge for telephone services or render bills to its customers. The Company’s Core Consumer segment remits sales tax in Florida on sales of magicJack units because of the personnel, property and activities of its magicJack LP subsidiary that are in Florida. Certain states and municipalities may disagree with the Company’s policies regarding the Core Consumer business and may believe it should be remitting taxes for past or future sales on certain items or services. Although the Company strongly disagrees and believes any possible claims are without merit, if a state or municipality were to prevail, the decision could have an adverse effect on the Company’s financial condition and results of operation. magicJack LP does not have activities or have representation in any other states. However, many states are changing their statutes and interpretations thereof as part of new streamlined sales tax initiatives to collect sales taxes from nonresident vendors that sell merchandise over the Internet to in state customers. The Company’s Core Consumer segment may at some time be required to collect and remit sales taxes to states other than Florida. The Company’s Core Consumer business may also become required to pay other taxes, fees and surcharges to a large number of states and municipalities as a result of statutory changes in the basis on which such taxes, fees and surcharges are imposed. In the event that the Company’s Core Consumer segment is required to collect sales taxes or other taxes from direct sales for states other than Florida on the sale of magicJack devices or on the renewal of our service offerings, the Company will bill and collect such taxes from our customers. The Company will examine any future fees and surcharges imposed as a result of statutory changes and determine on a case by case basis whether to bill its customers or increase the initial or access right sales prices to cover the additional fees and surcharges.

Regulatory Environment

In addition to the foregoing regulations to which the Company may be subject directly, changes to FCC and PUC regulations could affect the services, and the terms and conditions of service, the Company is able to provide. Moreover, changes to any regulations to which the Company is subject directly or indirectly could create uncertainty in the marketplace that could reduce demand for its services, increase the cost of doing business as a result of costs of litigation or increased service delivery cost or could in some other manner have a material adverse effect on the Company's business, financial condition or results of operations. Any new legislation or regulation, or the application of laws or regulations from jurisdictions whose laws do not currently apply to the Company's business, could have a material adverse effect on its business.

Employees

As of December 31, 2017, the Company had 136 full-time employees, of whom 116 were in the United States, 9 were in Poland and 11 were in Israel. The Company's employees are not represented by a labor union. The Company believes that its relations with its employees are good. In Israel, the Company's relations with employees are governed by labor regulations that provide for specific terms of employment between the Company and its employees.

Neither the Company's employees nor the Company are parties to any collective bargaining agreements, except for provisions of such agreements that are applicable to the industry in which the Company is engaged by virtue of expansion orders of the Israeli Ministry of Labor and Welfare issued under applicable Israeli laws.

Available Information

The Company's annual report on Form 10-K (or Form 20-F for prior years), quarterly reports on Form 10-Q, current reports on Form 8-K (or Form 6-K for filings up to December 31, 2011), Proxy Statements, specialized disclosure reports on Form SD, as well as any amendments to those reports, will be provided in electronic format, free of charge, upon request, as soon as reasonably practicable after they are filed with or furnished to the SEC. You can learn more about the Company by reviewing its SEC filings under the "Financial Information" tab on its web site at http://www.vocaltec.com. The investor relations section of our website also includes charters for our audit committee and compensation committee of our board of directors, as well as our code of ethics that applies to all of our employees, officers and directors, including our chief executive officer and our chief financial officer.

The SEC also maintains a website at http://www.sec.gov that contains reports, proxy statements and other information about SEC registrants, including magicJack VocalTec. You may also obtain these materials at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You can obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

References to the Company's website and the SEC's website in this report are provided as a convenience and do not constitute, and should not be viewed as, incorporation by reference of the information contained on, or available through, such websites.

ITEM 1A. RISK FACTORS

The following are certain risks to which our business operations are subject. Any of these risks could have an adverse effect on the Company's business, financial condition, cash flow, results of operations or future performance. These risks could also cause our actual results to differ materially from those indicated in the forward looking statements contained herein and elsewhere. The risks described below are not the only risks we face. Additional risks not currently known to us or those we currently deem to be immaterial may also materially and adversely affect our business, financial condition, cash flows, results of operations or future performance.

RISKS RELATED TO OUR BUSINESS

We are in the process of executing a strategic alternatives process and have entered into an Agreement and Plan of Merger with B. Riley Financial, Inc., but the transaction requires the satisfaction of certain conditions including approval of shareholders as well as regulatory approval both in the United States and Israel, and there can be no assurance that we will be successful in obtaining the requisite approvals and completing the transaction or that the transaction will yield additional value for our shareholders or that the transaction will not have negative impacts on our business.

On November 9, 2017, we entered into an Agreement and Plan of Merger with B. Riley Financial, Inc. There can be no assurance that the transaction will be finalized, as it is subject to the satisfaction of certain conditions including approval by our shareholders, approval by government regulators in the United States and Israel and other specific conditions as outlined in the Merger Agreement.

We have incurred, and may continue to incur, substantial costs associated with running our strategic alternatives process, including the cost of legal and financial advisors. The process has been time consuming and disruptive to our business operations. If we are unable to effectively manage the strategic alternatives process, our business, financial condition, liquidity and results of operations could be materially adversely affected.

The market in which the Company participates is highly competitive and if the Company does not compete effectively, its operating results may be harmed by loss of market share and revenues.

The telecommunications industry is highly competitive. The Company faces intense competition from traditional telephone companies, wireless companies, cable companies and alternative voice communication providers and manufacturers of communication devices.

The principal competitors for the Company's products and services include the traditional telephone service providers, such as AT&T, Inc., CenturyLink, Inc. and Verizon Communications Inc., which provide telephone service using the public switched telephone network. Certain of these traditional providers have also added, or are planning to add, broadband telephone services to their existing telephone and broadband offerings. The Company also faces, or expects to face, competition from cable companies, such as Cablevision Systems Corp., Charter Communications, Inc., Comcast Corporation, Cox Communications, Inc. and Time Warner Cable (a division of Time Warner Inc.), which offer broadband telephone services to their existing cable television and broadband offerings. Further, wireless providers, including AT&T Mobility, Inc., Sprint Corporation, T-Mobile USA Inc., and Verizon Wireless, Inc. offer services that some customers may prefer over wireline-based service. In the future, as wireless companies offer more minutes at lower prices, their services may become more attractive to customers as a replacement for broadband or wireline-based phone service.

The Company faces competition on magicJack device sales from Apple, Samsung, Motorola and other manufacturers of smart phones, tablets and other hand held wireless devices. Also, the Company competes against established alternative voice communication providers, such as Vonage, Google Voice, Ooma, and Skype, which is another non-interconnected voice provider, and may face competition from other large, well-capitalized Internet companies. In addition, the Company competes with independent broadband telephone service providers.

Increased competition may result in our competitors using aggressive business tactics, including providing financial incentives to customers, selling their products or services at a discount or loss, offering products or services similar to our products and services on a bundled basis at a discounted rate or no charge, announcing competing products or services combined with aggressive marketing efforts, and asserting intellectual property rights or claims, irrespective of their validity.

We believe that some of our existing competitors may choose to consolidate or may be acquired in the future. Additionally, some of our competitors may enter into alliances or joint ventures with each other or establish or strengthen relationships with other third parties. Any such consolidation, acquisition, alliance, joint venture or other relationship could adversely affect our ability to compete effectively, lead to pricing pressure, our loss of market share and could harm our business, results of operations and financial condition.

Our future growth depends on the success of various initiatives we are pursuing. The failure of these growth initiatives could have a material adverse effect on our business, results of operations, financial condition and cash flows.

Our future growth depends primarily on (1) increased sales of magicJack devices and related products and services, (2) the successful implementation of monetization initiatives for our proprietary mobile apps, the magicApp, magicJack Connect and magicJack Spark and (3) the successful integration of the Broadsmart business and implementation of the new Small Office Home Office (“SOHO”) initiatives of the new management team. The failure to grow device and related revenues in the Core Consumer business through increased device sales in the future would make us more reliant on other growth initiatives and cause a longer-term decrease in our overall revenues which could have a material adverse effect on our business, results of operations, financial condition and cash flows.

The Company may face difficulty in attracting new customers, and if it fails to attract new customers, its business and results of operations may suffer.

Most traditional wireline and wireless telephone service providers and cable companies are substantially larger and better capitalized than the Company is and have the advantage of a large existing customer base. Because most of its customers are purchasing communications services from one or more of these providers, the Company’s success is dependent upon its ability to attract customers away from their existing providers. In addition, these competitors could focus their substantial financial resources to develop competing technology that may be more attractive to potential customers than what the Company offers. The Company’s competitors’ financial resources may allow them to offer services at prices below cost or even for free in order to maintain and gain market share or otherwise improve their competitive positions.

The Company’s competitors also could use their greater financial resources to offer broadband telephone service with more attractive service packages that include on-site installation and more robust customer service. In addition, because of the other services that the Company’s competitors provide, they may choose to offer broadband telephone service as part of a bundle that includes other products, such as video, high speed Internet access and wireless telephone service, which the Company does not offer. This bundle may enable the Company’s competitors to offer broadband telephone service at prices with which the Company may not be able to compete or to offer functionality that integrates broadband telephone service with their other offerings, both of which may be more desirable to consumers. Any of these competitive factors could make it more difficult for the Company to attract and retain customers to its products, and cause the Company to lower its prices in order to compete and reduce its market share and revenues.

The Company may be unable to obtain enough phone numbers in desirable area codes to meet demand, which may adversely affect its ability to attract new customers and its results of operations.

The Company’s operations are subject to varying degrees of federal and state regulation. It currently allows customers to select the area code for their desired phone number from a list of available area codes in cities throughout much of the United States. This selection may become limited if the Company is unable to obtain phone numbers, or a sufficient quantity of phone numbers, including certain area codes, due to exhaustion and consequent shortages of numbers in those area codes, restrictions imposed by federal or state regulatory agencies, or a lack of telephone numbers made available to it by third parties. If the Company is unable to provide its customers with a nationwide selection of phone numbers, or any phone numbers at all, in all geographical areas and is unable to obtain telephone numbers from another alternative source, or is required to incur significant new costs in connection with obtaining such phone numbers, the Company’s relationships with current and future customers may be damaged, causing a shortfall in expected revenue, increased customer attrition, and an inability to attract new customers. As a result, its business, results of operations and financial condition could be materially and adversely affected.

If the Company's services are not commercially accepted by its customers, its prospects for growth will suffer.

The Company's success in deriving a substantial amount of revenues from its broadband telephone service offering sold to consumers and businesses relies on the commercial acceptance of its offering from consumers and business. Although the Company is currently selling its services to a number of customers, it cannot be certain that future customers will find its services attractive. If customer demand for its services does not develop or develops more slowly than anticipated, it would have a material adverse effect on the Company's business, results from operations and financial condition. The Company's success relies on the commercial acceptance of its offering from these advertisers and retailers. The Company is not currently selling its advertising and retailing services and it cannot be certain future online advertisers and retailers will find its services attractive. If demand for these services does not develop or develops more slowly than anticipated, it would have a material adverse effect on the Company's business, results of operations and financial condition.

If the Company is unable to retain its existing customers, its revenue and results of operations would be adversely affected.

The Company offers services pursuant to a subscriber agreement that ranges generally from one month to five years in duration and allows its customers to gain access to its servers for telephone calls. The Company’s customers do not have an obligation to renew their subscriber agreement after their initial term period expires, and these agreements may not be renewed on the same or on more profitable terms. As a result, the Company’s ability to grow depends in part on retaining customers for renewals. The Company may not be able to accurately predict future trends in customer renewals, and its customers’ renewal rates may decline or fluctuate because of several factors, including their satisfaction or dissatisfaction with the Company’s services, the prices of its services, the fees imposed by government entities, the prices of comparable services offered by its competitors or reductions in its customers’ spending levels. If the Company’s customers do not renew their services, renew on less favorable terms, or do not purchase additional functionality, the Company’s revenue may grow more slowly than expected or decline, and its profitability and gross margins may be harmed.

The market for the Company’s services and products is characterized by rapidly changing technology and its success will depend on its ability to enhance its existing service and product offerings and to introduce new services and products on a timely and cost effective basis.

The market for the Company’s services and products is characterized by rapidly changing enabling technology, frequent enhancements and evolving industry standards. The Company’s continued success depends on its ability to accurately anticipate the evolution of new products and technologies and to enhance our existing products and services. Historically, several factors have deterred consumers and businesses from using voice over broadband service, including security concerns, inconsistent quality of service, increasing broadband traffic and incompatible software products. If the Company is unable to continue to address those concerns and foster greater consumer demand for its products and services, its business and results of operations will be adversely affected.

The Company’s success also depends on its ability to develop and introduce innovative new services and products that gain market acceptance. The Company may not be successful in selecting, developing, manufacturing and marketing new products and services or enhancing existing products and services on a timely basis. The Company may experience difficulties with software development, industry standards, design or marketing that could delay or prevent its development, introduction or implementation of new products, services and enhancements. The introduction of new products or services by competitors, the emergence of new industry standards or the development of entirely new technologies to replace existing service offerings could render its existing or future services obsolete. If the Company’s services become obsolete due to wide-spread adoption of alternative connectivity technologies, the Company’s ability to generate revenue may be impaired. In addition, any new markets into which the Company attempts to sell its services, including new countries or regions, may not be receptive. If the Company is unable to successfully develop or acquire new products or services, enhance its existing products or services to anticipate and meet customer preferences or sell its products and services into new markets, the Company’s revenue and results of operations would be adversely affected.

The Company’s future growth depends in part on its ability to effectively develop and sell additional products, services and features.

The Company invests in the development of new products, services and features with the expectation that it will be able to effectively offer them to consumers and businesses. Accordingly, the Company’s inability to successfully commercialize additional products, services and features in the future could have a material adverse effect on its efforts to diversify its product offerings and revenues and ultimately on its business, results of operations, financial condition or cash flows. In addition, the Company cannot assure you that the successful introduction of new products or services will not adversely affect sales of its current products and services.

The Company may experience delays in the deployment of new products. If it is not successful in the continued development, introduction or timely manufacture of new products, demand for its products could decrease.

There can be no assurance that the Company will successfully introduce new products on a timely basis or achieve sales of new products in the future. In addition, there can be no assurance that the Company will have the financial and product design resources necessary to continue to successfully develop new products or to otherwise successfully respond to changing technology standards and service provider service offerings. If the Company fails to deploy new products on a timely basis, then its product sales will decrease, its quarterly operating results could fluctuate, and its competitive position and financial condition would be materially and adversely affected.

While the Company has new products currently in development or beta versions currently in testing, its continued ability to adapt to a changing business environment will be a significant factor in maintaining or improving its competitive position and its prospects for growth. Factors resulting in potential delays in product development include:

- rapid technological changes in the broadband communications industry;
- federal, state and local regulations governing our products and services;
- relationships with manufacturers, other carriers and service providers; and
- the availability of third party technology for the development of new products

In addition, the Company’s pursuit of necessary technology may require substantial time and expense. It may need to license new technologies to respond to technological change. These licenses may not be available to the Company on terms that it can accept or may materially change the gross profits that it is able to obtain on its products. The Company may not succeed in adapting its products to new technologies as they emerge. Development and manufacturing schedules for technology products are difficult to predict, and there can be no assurance that the Company will achieve timely initial customer shipments of new products. The timely availability of these products in volume and their acceptance by customers are important to the Company’s future success. Any future delays, whether due to product development delays, manufacturing delays, lack of market acceptance, delays in regulatory approval, or otherwise, could have a material adverse effect on the Company’s results of operations.

The Company may be unsuccessful in protecting its proprietary rights or may have to defend itself against claims of infringement, which could impair or significantly affect its business.

The Company's means of protecting its proprietary rights may not be adequate and our competitors may independently develop technology that is similar to the Company's. Legal protections afford only limited protection for the Company's technology. The laws of many countries do not protect the Company's proprietary rights to as great an extent as do the laws of the United States. Despite its efforts to protect its proprietary rights, unauthorized parties have in the past attempted, and may in the future attempt, to copy aspects of the Company's products or to obtain and use information that it regards as proprietary. Third parties may also design around the Company's proprietary rights, which may render its protected products less valuable, if the design around is favorably received in the marketplace. In addition, if any of the Company's products or the technology underlying its products is covered by third-party patents or other intellectual property rights, the Company could be subject to various legal actions.

The Company cannot assure you that its products do not infringe intellectual property rights held by others or that they will not in the future. Third parties may assert infringement, misappropriation, or breach of license claims against the Company from time to time. Such claims could cause the Company to incur substantial liabilities and to suspend or permanently cease the use of critical technologies or processes or the production or sale of major products. Litigation may be necessary to enforce the Company's intellectual property rights, to protect its trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity, misappropriation, or other claims. Any such litigation could result in substantial costs and diversion of the Company's resources, which in turn could materially adversely affect its business and financial condition. Moreover, any settlement of or adverse judgment resulting from such litigation could require the Company to obtain a license to continue to use the technology that is the subject of the claim, or otherwise restrict or prohibit its use of the technology. Any required licenses may not be available to the Company on acceptable terms, if at all. If the Company attempts to design around the technology at issue or to find another provider of suitable alternative technology to permit it to continue offering applicable software or product solutions, the Company's continued supply of software or product solutions could be disrupted or its introduction of new or enhanced software or products could be significantly delayed.

If the Company does not correctly anticipate demand for its products, it may not be able to secure sufficient quantities or cost-effective production of its products or it could have costly excess production or inventories.

The Company has generally been able to increase production to meet periods of increasing demand. However, the demand for its products depends on many factors and is difficult to forecast. The Company expects that it will become more difficult to forecast demand as it introduces and supports multiple products, as competition in the market for its products intensifies and as the markets for some of its products mature to the mass market category. Significant unanticipated fluctuations in demand could cause problems in the Company's operations, such as:

- If demand increases beyond what the Company forecasts, it would have to rapidly increase production. It would depend on suppliers to provide additional volumes of components, and those suppliers might not be able or willing to increase production rapidly enough to meet unexpected demand.
- Rapid increases in production levels to meet unanticipated demand could result in higher costs for manufacturing and supply of components and other expenses. These higher costs could lower the Company's profit margins. Further, if production is increased rapidly, manufacturing quality could decline, which may also lower the Company's margins and reduce customer satisfaction.
- If forecasted demand does not develop, the Company could have excess production resulting in higher inventories of finished products and components, which would use cash and could lead to write-offs of some or all of the excess inventories. Lower than forecasted demand could also result in excess manufacturing capacity or reduced manufacturing efficiencies at the Company's facilities, which could result in lower margins.

Certain aspects of the Company's service materially differ from services offered by traditional telephone service providers, which may limit the acceptance of the Company's services by mainstream consumers and its potential for growth.

Certain aspects of the Company's service are not the same as traditional telephone service, which may limit the acceptance of its services by mainstream consumers and its potential for growth. The Company's growth is dependent on the adoption of its services by mainstream customers, and so these differences are becoming increasingly important. For example:

- the Company's E911 and emergency calling services differ, in significant respects, from the 911 service associated with traditional wireline and wireless telephone providers;

- the Company's customers may at times experience lower call quality than they are used to from traditional wireline telephone companies, including static, echoes and delays in transmissions;
- the Company's customers may at times experience higher dropped-call rates than they are used to from traditional wireline telephone companies;
- customers who obtain new phone numbers from the Company do not appear in the phone book and their phone numbers are not available through directory assistance services offered by traditional telephone companies;
- the Company's customers cannot accept collect calls;
- the Company's customers cannot reach certain telephone numbers; and
- in the event of a power loss or Internet access interruption experienced by a customer, the Company's service may be interrupted.

If customers do not accept the differences between the Company's service and traditional telephone service, they may choose to remain with their current telephone service provider or may choose to return to service provided by traditional telephone companies, and customer demand for services will decrease.

The Company's products must comply with various domestic and international regulations and standards and failure to do so could have an adverse effect on its business, operating results and financial condition.

The Company's products must comply with various domestic and international regulations and standards defined by regulatory agencies. If it does not comply with existing or evolving industry standards and other regulatory requirements or if it fails to obtain in a timely manner any required domestic or foreign regulatory approvals or certificates, the Company will not be able to sell its products where these standards or regulations apply, which may harm its business. Moreover, distribution partners or customers may require the Company, or the Company may otherwise deem it necessary or advisable, to alter its products to address actual or anticipated changes in the regulatory environment. The Company's inability to alter its products to address these requirements and any regulatory changes could have a material adverse effect on its business, financial condition, and operating results.

The Company's emergency and E911 calling services are different from those offered by traditional wireline telephone companies and may expose it to significant liability.

While the Company does not believe it is today subject to regulatory requirements to provide such capability, the Company provides our customers with emergency calling services/E911 calling services that significantly differ from the emergency calling services offered by traditional wireline telephone companies. Those differences may cause significant delays, or even failures, in callers' receipt of the emergency assistance they need. Traditional wireline telephone companies route emergency calls from a fixed location over a dedicated infrastructure directly to an emergency services dispatcher at the public safety answering point, or PSAP, in the caller's area. Generally, the dispatcher automatically receives the caller's phone number and actual location information. Because the magicJack devices are portable or nomadic, the only way the Company can determine to which PSAP to route an emergency call, and the only location information that the Company's E911 service can transmit to a dispatcher at a PSAP is the information that the Company's customers have registered with us. A customer's registered location may be different from the customer's actual location at the time of the call because customers can use their magicJack devices to make calls almost anywhere a broadband connection is available. Significant delays may occur in a customer updating its registered location information, and in applicable databases being updated and new routing implemented once a customer has provided new information. If the Company's customers encounter delays when making emergency services calls and any inability to route emergency calls properly, or of the answering point to automatically recognize the caller's location or telephone number, such delays can have devastating consequences. Customers may, in the future, attempt to hold the Company responsible for any loss, damage, personal injury or death suffered as a result.

Traditional phone companies also may be unable to provide the precise location or the caller's telephone number when their customers place emergency calls. However, traditional phone companies are covered by federal legislation exempting them from liability for failures of emergency calling services, and the Company is not afforded such protection. In addition, the Company has lost, and may in the future lose, existing and prospective customers because of the limitations inherent in our emergency calling services. Additionally, service interruptions from the Company's third-party providers could cause failures in its customers' access to E911 services. Finally, the Company may decide not to offer customers E911 services at all. Any of these factors could cause the Company to lose revenues, incur greater expenses or cause the Company's reputation or financial results to suffer.

State and local governments may seek to impose E911 fees.

Many state and local governments have sought to impose fees on customers of VoIP providers, or to collect fees from VoIP providers, to support implementation of E911 services in their area. The application of such fees with respect to magicJack users and the Company is not clear because various statutes and regulations may not cover the Company's services, the Company does not bill its customers monthly, nor does it bill customers at all for telecommunication services. The Company may also not know the end user's location because the magicJack devices and services are nomadic. Should a regulatory authority require payment of money from the Company for such support, magicJack LP may be required to develop a mechanism to collect fees from its customers, which may or may not be satisfactory to the entity requesting us to be a billing agent. The Company cannot predict whether the collection of such additional fees or limitations on where its services are available would impact customers' interest in purchasing its products.

In settlement of litigation, the Company agreed that it would, at least once a year, issue bills for 911 emergency calling services to each user who has access to 911 services through their magicJack services, and who has provided a valid address in a U.S. jurisdiction that provides access to 911 services and which is legally empowered to impose 911 charges on such users in accordance with applicable state and/or local law.

Certain E911 regulatory authorities have asserted or may assert in the future that the Company is liable for damages, including end user assessed E911 taxes, surcharges and/or fees, for not having billed and collected E911 fees from its customers in the past or in the future. If a jurisdiction were to prevail in such claims, the decision could have a material adverse effect on the Company's financial condition and results of operations.

The Company may decide to end its emergency and E911 calling services for its Core Consumer business in the future, which may affect its revenues and expose it to significant liability.

Although the Company currently makes available emergency and E911 services to all of its users, it does not believe that it is required by regulations to do so for its Core Consumer business. The Company may, in the future, decide to discontinue providing such services for its Core Consumer business. Discontinuing such services may adversely affect customer demand, may result in fines by the FCC and may affect the Company's revenues.

The success of the Company's business is dependent on cost-effective marketing and its growth may be adversely affected by increased media advertising costs.

A major portion of the Company's revenue growth is attributable to its media advertising, including television advertising and banner advertisements on websites. If advertising rates, which the Company does not control, are substantially increased by television stations or by other media and the Company is unable to utilize alternative advertising methods, such increases will have an adverse effect on the Company's business, results from operations and financial condition. Additionally, if advertisers using web-based banner advertising targeted towards the Company's magicJack App users do not achieve the results they desire or expect and cancel their advertising, the Company's revenues and results of operations may be adversely affected.

Failure to establish and expand strategic alliances could prevent the Company from executing its business model and adversely affect its growth.

The Company's success depends on its continued ability to develop strategic relationships with leaders in the retail, telephony, online advertising and online retail industry segments. These relationships enable the Company to expand its services and products to a larger number of customers; develop and deploy new services and products; enhance the magicJack brand; and generate additional revenue. The Company may not be able to maintain and/or establish relationships with key participants in the telephony, retail, online advertising and online retail industry segments. Once the Company has established strategic relationships, it depends on its partner's ability to generate increased acceptance and use of our services and products. If the Company loses any of these strategic relationships or if it fails to establish additional relationships, or if strategic relationships fail to benefit the Company as expected, it may not be able to execute its business plan and its business will suffer.

Increases in credit card processing fees and high chargeback costs would increase the Company's operating expenses and adversely affect its results of operations, and an adverse change in, or the termination of, the Company's relationship with any major credit card company would have a severe, negative impact on its business.

A significant number of the Company's customers purchase its products through the Company's website and pay for its products and services using credit or debit cards. The major credit card companies or the issuing banks may increase the fees that they charge for transactions using their cards. An increase in those fees would require the Company to either increase the prices it charges for its products, or suffer a negative impact on its profitability, either of which could adversely affect its business, financial condition and results of operations.

The Company has potential liability for chargebacks associated with the transactions it processes, or are processed on its behalf by merchants selling its products. If a customer returns his or her magicJack products at any time, or claims that the Company's product was purchased fraudulently, the returned product is "charged back" to the Company or its bank, as applicable. If the Company or its sponsoring banks are unable to collect the chargeback from the merchant's account, or, if the merchant refuses or is financially unable, due to bankruptcy or other reasons, to reimburse the merchant's bank for the chargeback, the Company bears the loss for the amount of the refund paid.

The Company is vulnerable to credit card fraud, as it sells its magicJack products directly to customers through its website. Card fraud occurs when a customer uses a stolen card (or a stolen card number in a card-not-present-transaction) to purchase merchandise or services. In a traditional card-present transaction, if the merchant swipes the card, receives authorization for the transaction from the card issuing bank and verifies the signature on the back of the card against the paper receipt signed by the customer, the card issuing bank remains liable for any loss. In a fraudulent card-not-present transaction, even if the merchant or the Company receive authorization for the transaction, the Company or the merchant are liable for any loss arising from the transaction. Because sales made directly from the Company's website are card-not-present transactions, the Company is more vulnerable to customer fraud. The Company is also subject to acts of consumer fraud by customers that purchase its products and services and subsequently claim that such purchases were not made.

In addition, as a result of high chargeback rates or other reasons beyond its control, the credit card companies or issuing bank may terminate their relationship with the Company, and there are no assurances that it will be able to enter into a new credit card processing agreement on similar terms, if at all. Upon a termination, if the Company's credit card processor does not assist it in transitioning its business to another credit card processor, or if the Company were not able to obtain a new credit card processor, the negative impact on the Company's liquidity likely would be significant. The credit card processor may also prohibit the Company from billing discounts annually or for any other reason. Any increases in the Company's credit card fees could adversely affect its results of operations, particularly if the Company elects not to raise its service rates to offset the increase. The termination of the Company's ability to process payments on any major credit or debit card, due to high chargebacks or otherwise, would significantly impair its ability to operate its business.

The Company has experienced periods of rapid growth in the past. If it fails to manage future growth effectively, the Company may be unable to maintain high levels of service or address competitive challenges adequately.

Since 2008, the Company has experienced periods where it sells a significant number of magicJack device units and where it has significantly increased the number of customers using its products and services. These increases have placed, and the Company's anticipated sales will continue to place, a significant strain on its resources. As a result of these sales, the Company may have to implement new operational and financial systems and procedures and controls, to expand, train and manage its employee base, and to maintain close coordination among its technical, marketing, support and finance staffs. The Company must also continue to attract, retain, and integrate personnel in all aspects of operations. To the extent the Company acquires new businesses, it must also assimilate new operations, technologies and personnel. The Company may be unable to manage its expenses effectively in the future, which may negatively impact its gross profit or operating expenses in any particular quarter.

Flaws in the Company's technology and systems could cause delays or interruptions of service, damage its reputation, cause it to lose customers and limit its growth.

The Company's service could be disrupted by problems with its technology and systems, such as malfunctions in its software or other facilities and overloading of its servers. The Company's customers could experience interruptions in the future as a result of these types of problems. Interruptions could in the future cause the Company to lose customers, which could adversely affect its revenue and profitability. In addition, because the Company's systems and its customers' ability to use its services are Internet-dependent, the Company services may be subject to "hacker attacks" from the Internet, which could have a significant impact on its systems and services. If service interruptions adversely affect the perceived reliability of the Company's service, it may have difficulty attracting and retaining customers and its brand reputation and growth may suffer.

Material defects or errors in the software the Company uses to deliver its services could harm its reputation, result in significant costs to the Company and impair its ability to sell its services.

The software applications underlying the Company’s products and services, or the products and services sold by its subsidiaries, are inherently complex and may contain material defects or errors, particularly when first introduced or when new versions or enhancements are released. The Company has from time to time found defects in its services, and new errors in its existing services may be detected in the future. Any defects that cause interruptions to the availability of our services could result in:

- a reduction in sales or delay in market acceptance of the Company’s services;
- product returns, repairs, replacements or sales credits or refunds to the Company’s customers;
- loss of existing customers and difficulty in attracting new customers;
- uncollectible accounts receivable and delays in collecting accounts receivable;
- legal actions by the Company’s customers or, with respect to VocalTec and VocalTec Communications LLC (“VocalTec US”, formerly known as Stratus Telecommunications, LLC) products, by its customers’ end users;
- loss of or delay in market acceptance of the Company’s products;
- diversion of development resources;
- harm to our reputation; and
- increased insurance costs.

After the release of the Company's products, defects or errors may also be identified from time to time by its internal team and by its customers. There can be no assurance that, despite testing, errors will not be found in its products after commencement of commercial deployment. The costs incurred in correcting any material defects or errors in its services may be substantial and could harm the Company's operating results.

The Company may in the future incur costs associated with support services. Moreover, as the Company's solutions grow in complexity, this risk may intensify over time and may result in increased expenses.

Customers may bundle, incorporate or connect the Company's telecommunication hardware and software products into or to complex systems that contain errors or defects that may be unrelated to the Company's products. As a result, when the Company's customers encounter problems, it may be difficult to identify the product that caused the problem. In addition, such occurrences may result in undue delays or cancellations of the implementation of the Company's customers' bundled products and services. In such cases, the Company's reputation could be harmed and its results of operations could be adversely affected, which could result in reduced revenues or increased expenses.

The Company's ability to provide its service is dependent upon third-party facilities and equipment, the failure of which could cause delays or interruptions of its service, damage its reputation, cause the Company to lose customers and limit its growth.

The Company's success depends on its ability to provide quality and reliable service, which is in part dependent upon the proper functioning of facilities and equipment owned and operated by third parties and is, therefore, beyond the Company's control. Unlike traditional wireline telephone service or wireless service, the Company's service requires its customers to have an operative broadband Internet connection and an electrical power supply, which are provided by the customer's Internet service provider and electric utility company, respectively, and not by the Company. The quality of some broadband Internet connections in certain geographic areas may be too poor for customers to use the Company's services properly. The Company's future growth could be limited if broadband connections are not, or do not become, widely available in markets that it targets.

In addition, if there is any interruption to a customer's broadband Internet service or electrical power supply, that customer will be unable to make or receive calls, including emergency calls, using the Company's service. The Company's customers may experience such interruptions in the future. In addition, the Company's E911 service is currently and will remain dependent upon one or more third-party providers. Interruptions in service from these vendors could cause failures in the Company's customers' access to E911 services. If service interruptions adversely affect the perceived reliability of the Company's service, it may have difficulty attracting new customers and its brand, reputation and growth will be negatively impacted.

The Company depends on overseas manufacturers, and for certain products, third-party suppliers, and its reputation and results of operations would be harmed if these manufacturers or suppliers fail to meet the Company's requirements.

The manufacture of the magicJack devices is conducted by a manufacturing company in China, and certain parts are produced in Taiwan and Hong Kong. These manufacturers supply substantially all of the raw materials and provide all facilities and labor required to manufacture the Company's products. If these companies were to terminate their arrangements with the Company or fail to provide the required capacity and quality on a timely basis, either due to actions of the manufacturers; earthquakes, typhoons, tsunamis, fires, floods, or other natural disasters; or the actions of their respective governments, the Company would be unable to manufacture its products until replacement contract manufacturing services could be obtained. To qualify a new contract manufacturer, familiarize it with the Company's products, quality standards and other requirements, and commence volume production is a costly and time-consuming process. The Company cannot assure you that it would be able to establish alternative manufacturing relationships on acceptable terms or in a timely manner that would not cause disruptions in its supply. The Company's reliance on these contract manufacturers involves certain risks, including the following:

- lack of direct control over production capacity and delivery schedules;
- lack of direct control over quality assurance, manufacturing yields and production costs;
- risk of loss of inventory while in transit from China, Hong Kong or Taiwan;
- the risk of currency fluctuation; and
- risks associated with international commerce, including unexpected changes in legal and regulatory requirements, changes in tariffs and trade policies, risks associated with the protection of intellectual property, political and economic instability and natural disasters, such as earthquakes, typhoons or tsunamis.

Any interruption in the manufacture of the Company’s products would be likely to result in delays in shipment, lost sales and revenue and damage to its reputation in the market, all of which would harm its business and results of operations. In addition, while the Company’s contract obligations with its contract manufacturer in China is denominated in U.S. dollars, changes in currency exchange rates could impact its suppliers and increase its prices.

The Company relies on independent retailers to sell the magicJack devices, and disruption to these channels would harm its business.

Because the Company sells a majority of its magicJack devices, other devices and certain services to independent retailers, it is subject to many risks, including risks related to their inventory levels and support for the Company's products. In particular, the Company's retailers maintain significant levels of its products in their inventories. If retailers attempt to reduce their levels of inventory or if they do not maintain sufficient levels to meet customer demand, the Company's sales could be negatively impacted.

Many of the Company's retailers also sell products offered by its competitors. If the Company's competitors offer its retailers more favorable terms, those retailers may de-emphasize or decline to carry the Company's products. In the future, the Company may not be able to retain or attract a sufficient number of qualified retailers. If the Company is unable to maintain successful relationships with retailers or to expand its distribution channels, its business will suffer.

To continue this method of sales, the Company will have to allocate resources to train vendors, systems integrators and business partners as to the use of its products, resulting in additional costs and additional time until sales by such vendors, systems integrators and business partners are made feasible. The Company's business depends to a certain extent upon the success of such channels and the broad market acceptance of their products. To the extent that the Company's channels are unsuccessful in selling their products, and as a result, the Company's products, its revenues and operating results will be adversely affected.

Many factors out of the Company's control could interfere with its ability to market, license, implement or support its products with any of its channels, which in turn could harm its business. These factors include, but are not limited to, a change in the business strategy of the Company's channels, the introduction of competitive product offerings by other companies that are sold through one or more of its channels, potential contract defaults by one or more of its channels, bankruptcy of one or more distribution channel, or changes in ownership or management of one or more of its channels. For example, in February 2015, RadioShack Corporation, one of the Company's retail customers, filed a voluntary petition in bankruptcy court. The Company was owed $1.3 million by RadioShack which it did not collect and the Company ceased making sales to RadioShack to limit its exposure. The Company has made limited sales to the RadioShack entity that emerged from the bankruptcy proceedings and terminated its relationship with that entity effective as of October 27, 2016. Some of the Company's competitors may have stronger relationships with its channels than the Company does or offer more favorable terms with respect to their products, and the Company has limited control, if any, as to whether those channels implement its products rather than its competitors' products or whether they devote resources to market and support its competitors' products rather than its offerings. If the Company fails to maintain relationships with these channels, fails to develop new channels, fails to effectively manage, train, or provide incentives to existing channels or if these channels are not successful in their sales efforts, sales of the Company's products may decrease and its operating results would suffer.

The Company may not be able to maintain adequate customer care during periods of growth or in connection with its addition of new and complex devices or features, which could adversely affect its ability to grow and cause its financial results to be negatively impacted.

The Company considers our offshore customer care to be critically important to acquiring and retaining customers. A portion of its customer care is provided by third parties located in Costa Rica and the Philippines. This approach exposes the Company to the risk that it may not maintain service quality, control or effective management within these business operations. The increased elements of risk that arise from conducting certain operating processes in some jurisdictions could lead to an increase in reputational risk. Interruptions in the Company's customer care caused by disruptions at its third-party facilities may cause it to lose customers, which could adversely affect its revenue and profitability. If the Company's customer base expands rapidly in the U.S. or abroad, it may not be able to expand its outsourced customer care operations quickly enough to meet the needs of its customer base, and the quality of its customer care will suffer and its access right renewal rate may decrease. As the Company broadens its magicJack offerings and its customers build increasingly complex home networking environments, it will face additional challenges in training its customer care staff. The Company could face a high turnover rate among its customer service providers. The Company intends to have its customer care provider hire and train customer care representatives in order to meet the needs of our customer base. If they are unable to hire, train and retain sufficient personnel to provide adequate customer care, the Company may experience slower growth, increased costs and higher levels of customer attrition, which would adversely affect its business and results of operations.

If the Company is unable to maintain an effective process for local number portability provisioning, its growth may be negatively impacted.

The Company complies with requests for local number portability from its customers at the end of the 30-day trial period. Local number portability means that its customers can retain their existing telephone numbers when subscribing to the Company’s services, and would in turn allow former customers of the Company to retain their telephone numbers should they subscribe to another carrier. All carriers, including interconnected VoIP service providers, must complete the porting process within one business day. If the Company is unable to maintain the technology to expedite porting its customers' numbers, demand for its services may be reduced, the Company may be subject to regulatory enforcement activity, and this will adversely affect its revenue and profitability.

Because much of the Company’s potential success and value lies in its use of internally developed hardware, systems and software, its failure to protect the intellectual property associated with them could negatively affect it. Additionally, other parties may have the right to use intellectual property important to the Company’s business.

The Company’s ability to compete effectively is dependent in large part upon the maintenance and protection of systems and software that it has developed internally. While the Company has several pending intellectual property right applications for future service offerings, it cannot patent all of the technology that is important to its business. In addition, the Company’s pending intellectual property right applications may not be successful. The Company will rely on copyright, trademark and trade secret laws, as well as confidentiality procedures and licensing arrangements, to establish and protect its rights to this technology. It may be possible for a third party to copy or otherwise obtain and use this technology without authorization. Policing unauthorized use of this technology is difficult. The steps the Company takes may not prevent misappropriation of the technology it relies on. Enforcement of its intellectual property rights also depends on the Company’s successful legal actions against these infringers, but these actions may not be successful, even when the Company’s rights have been infringed. In addition, effective protection may be unavailable or limited in some jurisdictions. The Company uses certain intellectual property rights under licenses granted to it. Because the Company may not have the exclusive rights to use some of its intellectual property, other parties may be able to compete with it.

We rely on our management team and any difficulties encountered managing our management transition, the loss of one or more key employees or our inability to attract and retain qualified personnel could harm our business.

Our success and future growth depend on the skills, working relationships and continued services of our management team and other key personnel. On March 15, 2017, we announced that Don Carlos Bell III had been appointed as our new President and Chief Executive Officer. We also announced that Thomas Fuller was appointed as our EVP of Finance transitioning to the role of Chief Financial Officer in May of 2017, Kristin Beischel was appointed as our EVP and Chief Marketing Officer, Dvir Salomon was elevated to our management team as our EVP and Chief Technology Officer, and Kerrin Parker was appointed as Chief Operating Officer of Broadsmart. In June 2017, the founders of Broadsmart left the Company. Management transitions can be inherently difficult to manage and may cause operational and administrative inefficiencies, added costs, uncertainty and decreased productivity among our employees, increase the likelihood of turnover, and result in the loss of personnel with deep institutional knowledge, which could result in significant disruptions to our operations. In addition, we must successfully integrate the new management team members within our organization in order to achieve our operating objectives, and changes in key management positions may temporarily affect our financial performance and results of operations as new management becomes familiar with our business. The presence of new management team members, and the loss of key personnel, may also impact our ability to attract and retain qualified personnel and could also adversely impact our relationships with customers and vendors, resulting in loss of business and loss of vendor relationships. The uncertainty inherent in our management changes could also lead to concerns from current and potential third parties with whom we do business, any of which could damage our business prospects.

The Company may make acquisitions or enter into joint venture arrangements that prove unsuccessful or strain or divert its resources.

The Company has made acquisitions of other companies or assets in its industry and entered into joint venture arrangements. It may consider additional acquisitions or joint ventures in the future that could complement its business, including the acquisition of entities that would expand its service offerings, increase its market share or offer access to other asset classes, technology or service offerings that it does not currently have. The Company has limited experience in completing acquisitions of other businesses or assets. If it does acquire other businesses or assets, it may not be able to successfully integrate these businesses or assets with its own and it may be unable to maintain its standards, controls and policies. The Company may fail in its attempt to integrate acquired companies, businesses, or assets in such a way that it can realize cross-selling opportunities and other synergies. Further, acquisitions may place additional constraints on the Company's resources by diverting the attention of its management from its business operations. Additionally, the Company may experience difficulties in developing or maintaining controls and procedures related to an acquisition or joint venture arrangement. Through acquisitions or joint venture arrangements, the Company may enter areas in which it has no or limited experience, and an acquisition or joint venture may be unsuccessful in accomplishing the intended benefits of the transaction. In addition, we cannot predict market reactions to any acquisitions or joint venture arrangements. While we will strive to conduct appropriate due diligence in connection with any acquisition or joint venture opportunity, there may be risks or liabilities that such due diligence efforts fail to disclose or that the Company inadequately assesses. The discovery of material liabilities associated with acquisitions or joint venture opportunities, economic risks faced by joint venture partners, or any failure of joint venture partners to perform their obligations could adversely affect our business, results of operations and financial condition. Moreover, any acquisition or joint venture arrangement may result in substantial transaction-related expenses, a potentially dilutive issuance of equity securities, the incurrence of debt or amortization of expenses and related intangible assets, all of which could have an adverse effect on the Company's business and results of operations.

The Company may incur operating losses in the future, and it has incurred historical operating losses.

The Company incurred losses in 2017, has had net losses in the past, and could have losses in the future. The Company's new Enterprise and SMB segments generated operating losses in 2016 and 2017. Additionally, the Company may incur significant operating and certain capital expenditures as it increases its sales and marketing activities to expand its customer base and increase its research and development activities as it develops new or enhanced technologies and features to improve its services, products and offerings. The Company may also increase its general, administrative and operating functions to support its growing operations. As a result, the Company will need to generate a significant amount of revenues to achieve and maintain profitability. These increased expenses could exceed any revenues the Company may generate. Its efforts to attract new customers and to provide its current communications applications and services to an increased number of customers may be more expensive than the Company currently anticipates. If it does not significantly increase revenues after investing in these efforts, the Company's results from operations would be harmed. The Company cannot assure you that it can sustain or increase profitability on a quarterly or annual basis in the future. If revenues do not grow, or if operating expenses exceed the Company's expectations or cannot be adjusted accordingly, its business, results of operations and financial condition could be adversely affected.

The Company has experienced, and may continue to experience, significant fluctuations in its quarterly results, which might make it difficult for investors to make reliable period-to-period comparisons and may contribute to volatility in the market price of the Company's ordinary shares.

The Company's operating results and other income (expense) have fluctuated and may continue to fluctuate from period to period for a number of reasons. Due to the past volatility of the markets the Company operates in or investments it makes, the Company cannot predict the impact on its revenues, results of operations or other income (expense) that any deterioration or other changes in such market may have.

Significant annual and quarterly fluctuations in the Company's results of operations may also be caused by its advertising and marketing activities and, among other factors, the timing and composition of orders from its customers, reduced prices for its products, the economic viability and credit-worthiness of its customers, the collectability of its receivables, the timing of new product announcements and releases of new products by it and by its competitors. Significant annual and quarterly fluctuations in other income (expense) are primarily caused by changes in the underlying value of investments and strategies.

The Company's future results may also be affected by its ability to continue to develop, introduce and deliver enhanced and new products in a timely manner, to offer new products at competitive prices, to offer existing products at lower prices, to compete with competitors that are larger than it and to anticipate and meet customer demands. There can be no assurance that sales in any particular quarter will not be lower than those of the preceding quarters, including comparable quarters.

As a result, the Company believes that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indications of future performance. The volatility in the Company's operating results may also result in significant volatility in its share price. It is also possible that the Company's quarterly results of operations may be below the expectations of public market analysts and investors. If this happens, the price of the Company's ordinary shares is likely to decrease.

The Company could consider expanding its operations internationally and such plans are subject to increased risks which could harm its business, operating results, and financial condition.

The Company has considered expanding its operations and markets for its products and services internationally. There are risks inherent in doing business internationally, including:

- evolving or more stringent telecommunication and broadband telephone service standards and requirements of obtaining required permits, licenses and certifications to conduct its business;
- different or more stringent consumer protection, content, data protection, privacy and other laws;
- import or export restrictions, tariffs and changes in trade regulations;
- economic volatility and the global economic slowdown, currency exchange rate fluctuations and inflationary pressures;
- profit repatriation restrictions and foreign currency exchange restrictions;
- laws and business practices that favor local competitors or prohibit foreign ownership of certain businesses;
- credit risk and higher levels of payment fraud;
- longer payment cycles;
- political or social instability; and
- potentially adverse tax developments.

Any of these risks could have a material adverse effect on the Company’s ability to expand its business and harm its business, operating results and financial condition.

The Company may have exposure to greater than anticipated tax liabilities.

The Company is an Israeli corporation that operates through various subsidiaries in a number of countries throughout the world. Consequently, the Company is subject to tax laws, treaties and regulations in and between the countries in which it operates. The Company’s sales and income taxes are based upon the applicable tax laws and tax rates in effect in the countries in which it operates and earns income as well as upon its operating structures in these countries. The Company’s provision for income taxes is complex and is based on a jurisdictional mix of earnings, statutory rates and enacted tax rules. Significant judgment is required in determining the Company’s provision for income taxes and in evaluating its tax positions, including the transfer pricing of our intercompany transactions, and there are many transactions and calculations where the ultimate tax determination is uncertain. Although the Company believes its tax judgments and estimates are reasonable based upon its interpretations of applicable tax laws in the jurisdictions in which it files, its tax positions may be challenged, and if successful, such challenges may materially differ from amounts recorded in the Company’s financial statements, which could have a significant adverse impact on its effective tax rate, and on its operating results and financial condition.

The Company’s income tax returns are subject to audit in various jurisdictions throughout the world and the Company’s U.S. federal income tax returns have been previously audited by the IRS.

The Company’s income tax returns are subject to review and audit in the United States and other jurisdictions in which it operates. The Company does not recognize the benefit of income tax positions it believes are more-likely-than-not to be disallowed upon challenge by a tax authority. If any tax authority successfully challenges the Company’s operational structure, transfer pricing policies, or the taxable presence of its key subsidiaries in certain countries or states, or if the terms of certain income tax treaties are interpreted in a manner that is adverse to the Company’s structure, or if the Company loses a material tax dispute in any country, its effective tax rate on its worldwide earnings could increase substantially and the Company’s earnings and cash flows from operations could be materially adversely affected.

The Company’s consolidated U.S. federal income tax returns for the fiscal years ended December 31, 2010, 2011, 2012, and 2013, were audited by the Internal Revenue Service (“IRS”). While the Company believes that its tax positions were appropriate when reported, the IRS challenged certain of these positions during audit. During 2015, the Company reached a settlement of these issues with the IRS which resulted in the Company being required to pay additional U.S. taxes and interest for the periods under audit. Additionally, the IRS could challenge the Company’s tax positions for the current or future periods and while the Company is prepared to vigorously defend any positions challenged, if the Company is unsuccessful in defending them it may be required to pay taxes, interest, fines or penalties, and/or be obligated to pay increased taxes in the future, any of which could have a material adverse effect on the Company’s business, financial condition and results of operations.

RISKS RELATED TO REGULATION IN THE UNITED STATES

The Company’s business is highly dependent on regulation that continues to change.

Much of the services that the Company provides are subject to significant regulation and may be adversely affected by regulatory developments at the federal, state and local levels. The Company operates in forty-seven states under complex and evolving state and local telecommunications and tax laws that vary from jurisdiction to jurisdiction. Although the Company believes that certain regulations do not currently apply to it, certain broadband telephone services have also been subjected to significant regulation and may be subjected to additional regulation in the future. Complying with new or expanded telecommunications, broadband telephone service, or tax regulations, and obtaining required permits, licenses or certifications in numerous jurisdictions, can be costly and disruptive to the Company’s business. If the Company fails to comply with applicable regulations, or if those regulations change or are expanded in a manner adverse to it, including in any of the ways described in these risk factors related to regulation, the Company’s business and operating results may suffer. Furthermore, new regulations, new laws or other factors may cause the Company to lose its ability to maintain certain certifications in various states, which could prevent it from providing telephone numbers to its customers. The Company may, instead, be required to purchase numbers from other CLECs, which would increase its expenses and would negatively impact its results. Moreover, there is no guarantee that the Company would be able to receive or purchase numbers from other CLECs. In such event, the Company would not have numbers to offer prospective customers, which would have a significant negative impact on its business.

If the Company cannot continue to obtain key switching elements from its primary competitors on acceptable terms, it may not be able to offer its local voice and data services on a profitable basis, if at all.

The Company will not be able to provide its local voice and data services on a profitable basis, if at all, unless it is able to obtain key switching elements from some of its primary competitors on acceptable terms. To offer local voice and data services in a market, the Company must connect its servers with other carriers in a specific market. This relationship is governed by an interconnection agreement or carrier service agreement between the Company and that carrier. The Company has such agreements with Verizon, AT&T, XO Communications Services and CenturyLink in a majority of its markets. If the Company is unable to continue these relationships, enter into new interconnection agreements or carrier service agreements with additional carriers in other markets or if these providers liquidate or file for bankruptcy, its business and profitability may suffer.

Regulatory initiatives may continue to reduce the maximum rates the Company is permitted to charge long distance service providers for completing calls by their customers to customers served by its servers.

The rates that the Company charges and is charged by service providers for terminating calls by their customers to customers served by its servers, and for transferring calls by its customers onto other carriers, cannot exceed rates determined by regulatory authorities. In 2011, the FCC adopted an order fundamentally overhauling its existing intercarrier compensation (“ICC”) rules, which govern payments between carriers for exchange traffic. This order established a new ICC regime that will result in the elimination of virtually all terminating switched access charges and reciprocal compensation payments over a transition period that will end in 2020. The reductions resulting from these new ICC rules have affected and will continue to affect the Company’s revenues and results of operations.

Regulation of broadband telephone services are developing and therefore uncertain; and future legislative, regulatory or judicial actions could adversely impact the Company’s business and expose it to liability.

The current regulatory environment for broadband telephone services is developing and therefore uncertain. The United States and other countries have begun to assert regulatory authority over broadband telephone service and are continuing to evaluate how broadband telephone service will be regulated in the future. Both the application of existing rules to the Company and its competitors and the effects of future regulatory developments are uncertain.

Future legislative, judicial or other regulatory actions could have a negative effect on the Company's business. If its VoIP telephony service or our other products and services become subject to the rules and regulations applicable to telecommunications providers, if current broadband telephone service rules are expanded and applied to the Company, or if additional rules and regulations applicable specifically to broadband telephone services are adopted, the Company may incur significant compliance costs, and it may have to restructure its service offerings, exit certain markets or start charging for its services at least to the extent of regulatory costs or requirements, any of which could cause its services to be less attractive to customers. The Company has faced, and may continue to face, difficulty collecting such charges from its customers and/or carriers, and collecting such charges may cause it to incur legal fees. The Company may be unsuccessful in collecting all of the regulatory fees owed to it. The imposition of any such additional regulatory fees, charges, taxes and regulations on VoIP communications services could materially increase the Company's costs and may limit or eliminate its competitive pricing advantages.

Regulatory and governmental agencies may determine that the Company should be subject to rules applicable to certain broadband telephone service providers or seek to impose new or increased fees, taxes, and administrative burdens on broadband telephone service providers. The Company also may change its product and service offerings in a manner that subjects it to greater regulation and taxation. Such obligations could include requirements that the Company contribute directly to federal or state Universal Service Funds. The Company may also be required to meet various disability access requirements, number portability obligations, and interception or wiretapping requirements, such as the Communications Assistance for Law Enforcement Act. The imposition of such regulatory obligations or the imposition of additional federal, state or local taxes on its services could increase the Company's cost of doing business and limit its growth.

The Company offers its products and services in other countries, and therefore could also be subject to regulatory risks in each such foreign jurisdiction, including the risk that regulations in some jurisdictions will prohibit it from providing its services cost-effectively or at all, which could limit its growth. Currently, there are several countries where regulations prohibit the Company from offering service. In addition, because customers can use the Company's services almost anywhere that a broadband Internet connection is available, including countries where providing broadband telephone service is illegal, the governments of those countries may attempt to assert jurisdiction over the Company. Violations of these laws and regulations could result in fines, criminal sanctions against the Company, its officers or its employees, and prohibitions on the conduct of its business. Any such violations could include prohibitions on the Company's ability to offer its products and services in one or more countries, could delay or prevent potential acquisitions, expose the Company to significant liability and regulation and could also materially damage its reputation, its brand, its international expansion efforts, its ability to attract and retain employees, its business and its operating results. The Company's success depends, in part, on its ability to anticipate these risks and manage these difficulties.

The success of the Company's business relies on customers' continued and unimpeded access to broadband service. Providers of broadband services may be able to block the Company's services or charge their customers more for also using its services, which could adversely affect its revenue and growth.

The Company's customers must have broadband access to the Internet in order to use its service. Providers of broadband access, some of whom are also competing providers of voice services, may take measures that affect their customers' ability to use the Company's service, such as degrading the quality of the data packets they transmit over their lines, giving those packets low priority, giving other packets higher priority than the Company's, blocking its packets entirely or attempting to charge their customers more for also using its services.

In 2015, the FCC adopted net neutrality rules that prohibited broadband providers from: 1) blocking legal content, applications, services, or non-harmful devices; 2) impairing or degrading lawful Internet traffic on the basis of content, applications, services, or non-harmful devices; 3) engaging in paid prioritization by favoring some lawful Internet traffic over other lawful traffic in exchange for consideration of any kind or by prioritizing content and services of their affiliates; and 4) unreasonably interfering with or unreasonably disadvantaging the ability of consumers to select, access, and use the lawful content, applications, services, or devices of their choosing; or of edge providers to make lawful content, applications, services, or devices available to consumers. In doing so, the FCC reclassified broadband Internet access - the retail broadband service mass-market customers buy from cable, phone, and wireless providers - as a telecommunications service regulated under Title II of the Communications Act of 1934, although the FCC agreed to forbear from many requirements of Title II. Significantly, these rules applied equally to fixed and mobile broadband networks.

After the FCC's new net neutrality rules went into effect in June 2015, various broadband providers and their trade associations challenged the FCC's decision before the U.S. Court of Appeals for the D.C. Circuit. In June 2016, the D.C. Circuit issued its decision upholding the FCC's rules. The D.C. Circuit also denied various petitions seeking rehearing en banc of the court's decision. Various parties have sought review by the United States Supreme Court of the D.C. Circuit's decision, which remains pending. The Company cannot predict the outcome of these proceedings.

In December 2017, the FCC adopted its "Restoring Internet Freedom Order," which: 1) restored the classification of broadband Internet access services as unregulated information services, ending Title II regulation of these services; 2) eliminated the FCC's three "bright-line" net neutrality rules; 3) eliminated the FCC's "general conduct" rule; and 4) adopted a new transparency rule. The "Restoring Internet Freedom Order" has been published in the Federal Register and will take effect on April 23, 2018, except for the new transparency rule, which will not take effect until approved by the Office of Management and Budget.

Multiple parties have filed petitions seeking judicial review of the "Restoring Internet Freedom Order," which have been consolidated and assigned for hearing by the United States Court of Appeals for the Ninth Circuit (which may be asked to transfer the case to the D.C. Circuit). The Company cannot predict how these challenges will be resolved. However, a decision by a court upholding the FCC decision to eliminate legal prohibitions against broadband providers blocking, throttling, or otherwise degrading the quality of the Company’s data packets or attempting to extract additional fees from the Company or its customers could adversely impact the Company’s business. A court also could find that the FCC lacks legal authority to regulate broadband services, which could prevent a future FCC from adopting new rules to govern the operating practices of broadband providers.

The Company may be bound by certain FCC regulations relating to the provision of E911 service, and if it fails to comply with FCC regulations requiring it to provide E911 emergency calling services, it may be subject to fines or penalties.

In 2005, the FCC issued regulations requiring interconnected voice-over broadband providers to provide E911 services and to notify customers of any differences between the broadband telephone service emergency calling services and those available through traditional telephone providers and obtain affirmative acknowledgments from customers of those notifications. While the Company does not believe the FCC’s rules currently apply to its business, the FCC could, however, extend or modify its rules to obligate the Company to provide E911 services according to its specific requirements. A proposal to broaden the scope of its E911 requirements was under consideration by the FCC. According to the FCC’s rules, certain broadband communications companies must offer enhanced emergency calling services, or E911, to all customers located in areas where E911 service is available from their traditional wireline telephone company. E911 service allows emergency calls from customers to be routed directly to an emergency dispatcher in a customer’s registered location and gives the dispatcher automatic access to the customer’s telephone number and registered location information.

Limitations on the Company’s ability to provide E911 service or a requirement to comply with potential new mandates of the FCC could materially limit its growth and have a material adverse effect on its profitability. The Company could be subjected to various fines and forfeitures. FCC rulings could also subject the Company to greater regulation in some states.

Regulatory rulings and/or carrier disputes could affect the manner in which the Company interconnects and exchanges traffic with other providers and the costs and revenues associated with doing so.

The Company exchanges calls with other providers pursuant to applicable law and interconnection agreements and other carrier contracts that define the rates, terms, and conditions applicable to such traffic exchange. The calls the Company exchanges originate from and terminate to a customer that uses a broadband Internet connection to access its services and are routed using telephone numbers of the customer’s choosing. There is uncertainty, however, with respect to intercarrier compensation for such traffic while rules continue to be challenged in various courts. The FCC Order in November 2011 has asserted its jurisdiction over such traffic. Various state commissions have also issued rulings with respect to the exchange of different categories of traffic under interconnection agreements. To the extent that another provider were to assert that the traffic the Company exchanges with them is subject to higher levels of compensation than the Company, or the third parties terminating the Company’s traffic to the PSTN, pay today (if any), or if other providers from whom the Company currently collects compensation for the exchange of such traffic refuse to pay it going forward, the Company may need to seek regulatory relief to resolve such a dispute. Given the recent changes to the intercarrier compensation regime, the Company cannot guarantee that the outcome of any proceeding would be favorable, and an unfavorable ruling could adversely affect the amounts the Company collects and/or pays to other providers in connection with the exchange of its traffic. The FCC clarified in January 2015 that its VoIP symmetry rule does not require a CLEC or its VoIP provider partner to provide the physical last-mile facility to the VoIP provider’s end user customers in order to provide the functional equivalent of end office switching, and thus for the CLEC to be eligible to assess access charges for this service. The ruling confirms that the VoIP symmetry rule is technology and facilities neutral and applies regardless of whether a CLEC’s VoIP partner is a facilities-based or over-the-top VoIP provider. However, in November 2016, the U.S. Court of Appeals for the D.C. Circuit vacated the FCC’s ruling. The Company cannot predict how the D.C. Circuit’s decision will affect the amounts the Company collects and/or pays to other providers in connection with the exchange of its traffic.

Government regulation is evolving and unfavorable changes could harm the Company’s business.

The Company is subject to general business regulations and laws, as well as regulations and laws specifically governing the Internet, e-commerce, and electronic devices. Existing and future laws and regulations may impede the

Company's growth. These regulations and laws may cover taxation, privacy, data protection, pricing, content, copyrights, distribution, mobile communications, electronic device certification, electronic waste, electronic contracts and other communications, consumer protection, web services, the provision of online payment services, unencumbered Internet access to the Company's services, the design and operation of websites, and the characteristics and quality of products and services. It is not clear how existing laws governing issues such as property ownership, libel, and personal privacy apply to the Internet, e-commerce, digital content and web services. Jurisdictions may regulate consumer-to-consumer online businesses, including certain aspects of the Company's seller programs. Unfavorable regulations and laws could diminish the demand for the Company's products and services and increase its cost of doing business.

RISKS RELATED TO THE OPERATION AND SECURITY OF OUR SYSTEM

Server failures or system breaches could cause delays or adversely affect the Company's service quality, which may cause it to lose customers and revenue.

In operating its servers, the Company may be unable to connect and manage a large number of customers or a large quantity of traffic at high speeds. Any failure or perceived failure to achieve or maintain high-speed data transmission could significantly reduce demand for the Company's services and adversely affect its operating results. In addition, computer viruses, break-ins, human error, natural disasters and other problems may disrupt the Company's servers. The system security and stability measures the Company implements may be circumvented in the future or otherwise fail to prevent the disruption of its services. The costs and resources required to eliminate computer viruses and other security problems may result in interruptions, delays or cessation of services to the Company's customers, which could decrease demand, decrease the Company's revenue and slow its planned expansion.

Hardware and software failures, delays in the operation of the Company's computer and communications systems or the failure to implement system enhancements may harm its business.

The Company's success depends on the efficient and uninterrupted operation of its software and communications systems. A failure of its servers could impede the delivery of services, customer orders and day-to-day management of the Company's business and could result in the corruption or loss of data. Despite any precautions the Company may take, damage from fire, floods, hurricanes, power loss, telecommunications failures, computer viruses, break-ins and similar events at its various facilities could result in interruptions in the flow of data to the Company's servers and from its servers to the Company's customers. In addition, any failure by the Company's computer environment to provide its required telephone communications capacity could result in interruptions in the Company's service. Additionally, significant delays in the planned delivery of system enhancements and improvements, or inadequate performance of the systems once they are completed, could damage the Company's reputation and harm its business. Finally, long-term disruptions in infrastructure caused by events such as natural disasters, the outbreak of war, the escalation of hostilities, and acts of terrorism (particularly involving cities in which it has offices) could adversely affect the Company's businesses. Although the Company maintains general liability insurance, including coverage for errors and omissions, this coverage may be inadequate, or may not be available in the future on reasonable terms, or at all. The Company cannot assure you that this policy will cover any claim against it for loss of data or other indirect or consequential damages and defending a lawsuit, regardless of its merit, could be costly and divert management's attention. In addition to potential liability, if the Company experiences interruptions in its ability to supply its services, its reputation could be harmed and the Company could lose customers.

The Company's service requires an operative broadband connection, and if the adoption of broadband does not progress as expected, the market for its services will not grow and the Company may not be able to grow its business and increase its revenue.

Use of the Company's service requires that the user be a subscriber to an existing broadband Internet service, most typically provided through a cable or digital subscriber line, or DSL, connection. Although the number of broadband subscribers in the U.S. and worldwide has grown significantly over the last five years, this service has not yet been adopted by all consumers and is not available in every part of the United States and Canada, particularly rural locations. If the adoption of broadband services does not continue to grow, the market for the Company's services may not grow.

The Company's business is subject to privacy and online security risks, including security breaches, and it could be liable for such breaches of security. If the Company is unable to protect the privacy of its customers making calls using its service, or information obtained from its customers in connection with their use or payment of its services, in violation of privacy or security laws or expectations, the Company could be subject to significant liability and damage to its reputation.

Although the Company has developed systems and processes that are designed to protect customer information and prevent fraudulent transactions, data loss and other security breaches, such systems and processes may not be sufficient to prevent fraudulent transactions, data loss and other security breaches. Failure to prevent or mitigate such breaches may adversely affect the Company's operating results.

Customers may believe that using the Company's services to make and receive telephone calls using their broadband connection could result in a reduction of their privacy, as compared to traditional wireline carriers. Additionally, the Company's website, www.magicJack.com, serves as an online sales portal. The Company currently obtains and retains personal information about its website users in connection with such purchases. In addition, the Company obtains personal information about its customers as part of their registration to use its products and services. Federal, state and foreign governments have enacted or may enact laws or regulations regarding the collection and use of personal information.

The Company’s businesses involve the storage and transmission of users' proprietary information, and security breaches could expose it to a risk of loss or misuse of this information, litigation, and potential liability. An increasing number of websites, including several other Internet companies, have recently disclosed breaches of their security, some of which have involved sophisticated and highly targeted attacks on portions of their sites. Because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems, change frequently and often are not recognized until launched against a target, the Company may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of its security occurs, the market perception of the effectiveness of the Company’s security measures could be harmed and it could lose users. A party that is able to circumvent the Company’s security measures could misappropriate the Company’s or its users' proprietary information, cause interruption in the Company’s operations, damage its computers or those of its users, or otherwise damage the Company’s reputation and business. Any compromise of the Company’s security could result in a violation of applicable privacy and other laws, significant legal and financial exposure, damage to the Company’s reputation, and a loss of confidence in its security measures, which could harm its business.

Currently, a significant number of the Company’s users authorize it to bill their credit card accounts directly for all transaction fees charged by the Company. The Company relies on encryption and authentication technology licensed from third parties to provide the security and authentication to effectively secure transmission of confidential information, including customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in the technology used by the Company to protect transaction data being breached or compromised. Non-technical means, for example, actions by a suborned employee, can also result in a data breach.

Possession and use of personal information in conducting the Company’s business subjects it to legislative and regulatory burdens that could require notification of data breach, restrict its use of personal information and hinder the Company’s ability to acquire new customers or market to existing customers. The Company may incur expenses to comply with privacy and security standards and protocols imposed by law, regulation, industry standards or contractual obligations.

Under payment card rules and the Company’s contracts with its card processors, if there is a breach of payment card information that the Company stores, it could be liable to the payment card issuing banks for their cost of issuing new cards and related expenses. In addition, if the Company fails to follow payment card industry security standards, even if there is no compromise of customer information, the Company could incur significant fines or lose its ability to give customers the option of using payment cards to fund their payments or pay their fees. If the Company were unable to accept payment cards, its business would be seriously damaged.

The Company’s servers are also vulnerable to computer viruses, physical or electronic break-ins, and similar disruptions. The Company may need to expend significant resources to protect against security breaches or to address problems caused by breaches. These issues are likely to become more difficult as the Company expands the number of places where it operates. Security breaches, including any breach by the Company or by parties with which it has commercial relationships that result in the unauthorized release of the Company’s users' personal information, could damage its reputation and expose the Company to a risk of loss or litigation and liability. The Company’s insurance policies carry coverage limits that may not be adequate to reimburse it for losses caused by security breaches.

The Company’s users, as well as those of other prominent Internet companies, have been and will continue to be targeted by parties using fraudulent “spoof” and “phishing” emails to misappropriate passwords, credit card numbers, or other personal information or to introduce viruses or other malware through “trojan horse” programs to the Company’s users' computers. These emails appear to be legitimate emails sent by magicJack, but direct recipients to fake websites operated by the sender of the email or request that the recipient send a password or other confidential information via email or download a program. Despite the Company’s efforts to mitigate “spoof” and “phishing” emails through product improvements and user education, “spoof” and “phishing” remain a serious problem that may damage the Company’s brands, discourage use of its websites, and increase its costs.

The Company has a stringent privacy policy covering the information it collects from its customers and has established security features to protect this information. However, the Company's security measures may not prevent security breaches. The Company may need to expend resources to protect against security breaches or to address problems caused by breaches. If unauthorized third parties were able to penetrate its security and gain access to, or otherwise misappropriate, the Company's customers' personal information or be able to access their telephone calls, it could harm the Company's reputation and, therefore, its business and the Company could be subject to liability. Such liability could include claims for misuse of personal information or unauthorized use of credit cards. These claims could result in litigation, the Company's involvement in which, regardless of the outcome, could require it to expend significant financial resources. Internet privacy is a rapidly changing area and the Company may be subject to future requirements and legislation that are costly to implement and negatively impact its results.

RISKS RELATING PRIMARILY TO THE COMPANY’S INCORPORATION IN ISRAEL

The Company has operations located in Israel, and therefore its results may be adversely affected by political, economic and military conditions in Israel.

The Company’s business and operations may be directly influenced by the political, economic and military conditions affecting Israel at any given time. A change in the security and political situation in Israel could have a material adverse effect on the Company’s business, operating results and financial condition. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, including Hezbollah in Lebanon and Hamas in the Gaza Strip. In the last few years, these conflicts involved missile strikes against civilian targets in various parts of Israel and negatively affected business conditions in Israel. In addition, political uprisings and conflicts in various countries in the Middle East, including Syria and Iraq, and including terrorist organizations gaining control and political power in the region such as the Islamic State of Iraq and Syria, or ISIS, are affecting the political stability of those countries. It is not clear how this instability will develop and how it will affect the political and security situation in the Middle East.

Our commercial insurance does not cover losses that may occur as a result of events associated with the security situation in the Middle East. Although the Israeli government currently covers the reinstatement value of direct damages that are caused by terrorist attacks or acts of war, we cannot assure you that this government coverage will be maintained. Any losses or damages incurred by us could have a material adverse effect on our business, operating results and financial condition.

Furthermore, several countries, principally in the Middle East, restrict doing business with Israel and Israeli companies, and additional countries may impose restrictions on doing business with Israel and Israeli companies if hostilities in the region continue or intensify. Any hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could have a material adverse effect on our business, operating results and financial condition.

The tax benefits, grants and other incentives available to us require us to continue to meet various conditions and may be terminated, repaid or reduced in the future, which could increase our costs and taxes.

The Israeli government currently provides major tax and capital investment incentives to domestic companies, as well as grant and loan programs relating to research and development and marketing and export activities. In recent years, the Israeli Government has reduced the benefits available under these programs and the Israeli Governmental authorities have indicated that the government may in the future further reduce, seek repayment or eliminate the benefits of those programs. The Company currently takes advantage of these programs. There is no assurance that the Company will continue to meet the conditions of such benefits and programs or that such benefits and programs would continue to be available to the Company in the future. If the Company fails to meet the conditions of such benefits and programs or if they are terminated or further reduced, it could have an adverse effect on the Company’s business, operating results and financial condition.

The Company’s operations could be disrupted as a result of the obligation of its personnel to perform military service.

Several of the Company’s employees reside in Israel and may be required to perform annual military reserve duty and may be called for active duty under emergency circumstances at any time. The Company’s operations could be disrupted by the absence for a significant period of time of one or more of these employees due to military service. Any such disruption could adversely affect the Company’s business, results of operations and financial condition.

Provisions of Israeli law and the Company’s Articles of Association may prevent or make it difficult for the Company to be acquired and adversely affect the market price of its ordinary shares.

Israeli corporate law regulates mergers, requires that a tender offer be effected when more than a specified percentage of shares in a company are purchased, requires special approvals for certain transactions involving directors, officers or significant shareholders and regulates other matters that may be relevant to these types of transactions. For instance, subject to various exceptions, the Israeli Companies Law prohibits any acquisition of shares or voting power in a public company that would result in the purchaser holding 25% or more, or more than 45% of the voting power in the company, if there is no other person holding 25% or more, or more than 45% of the voting power in a company, respectively, without conducting a special tender offer. The Israeli Companies Law further provides that a purchase of shares or voting power of a public company or a class of shares of a public company, which will result in the purchaser's holding more than 90% of the company's shares, class of shares or voting rights, is prohibited unless the purchaser conducts a full tender offer for all of the company's shares or class of shares. The purchaser will be allowed to purchase all of the company's shares or class of shares if either (i) the shareholders who do not accept the offer hold less than 5% of the issued and outstanding share capital of the company or of the applicable class, and more than half of the shareholders who do not have a personal interest in the offer accept the offer, or (ii) the shareholders who do not accept the offer hold less than 2% of the issued and outstanding share capital of the company or of the applicable class. At the request of an offeree of a full tender offer which was accepted, the court may determine that the consideration for the shares purchased under the tender offer was lower than their fair value and compel the offeror to pay to the offerees the fair value of the shares as determined by the court.

Furthermore, Israeli tax considerations may make potential transactions unappealing to the Company or to its shareholders, especially for those shareholders whose country of residence does not have a tax treaty with Israel which exempts such shareholders from Israeli tax. With respect to mergers, Israeli tax law allows for tax deferral in certain circumstances but makes the deferral contingent on the fulfillment of a number of conditions, including, in some cases, a holding period of two years from the date of the transaction during which sales and dispositions of shares of the participating companies are restricted. Moreover, with respect to certain share swap transactions, the tax deferral is limited in time, and when such time expires, the tax becomes payable even if no disposition of the shares has occurred.

Certain provisions of our Articles of Association, or the Articles, may have the effect of rendering more difficult or discouraging an acquisition of the Company deemed desirable by its Board of Directors. These provisions include a requirement that most amendments of the Company’s Articles must be approved by the holders of not less than seventy-five percent (75%) of the voting power represented at the meeting in person or by proxy and voting thereon.

These provisions of Israeli law and the Company’s Articles could have the effect of delaying or preventing an acquisition of the Company or changes in control, some of which could be deemed by certain shareholders to be in their best interests and which could affect the price some investors are willing to pay for the Company’s ordinary shares.

It may be difficult to pursue an action in the U.S. or to enforce a U.S. judgment, including actions or judgments based upon the civil liability provisions of the U.S. federal securities laws, against the Company and its executive officers and directors, or to assert U.S. securities law claims in Israel.

Certain of the Company’s directors are not residents of the United States and certain of their assets and the Company’s assets are located outside the United States. Without consent to service of process, additional procedures may be necessary to serve individuals who are not U.S. residents. Therefore, it may be complicated to serve process on those directors who are not U.S. residents in order to commence any lawsuit against them before a U.S. court, including an action based on the civil liability provisions of U.S. federal securities laws.

An investor also may find it difficult to enforce a U.S. court judgment in an Israeli court, including a judgment based on federal securities laws. An Israeli court will not enforce a foreign judgment if it was given in a state whose laws do not provide for the enforcement of judgments of Israeli courts (subject to exceptional cases) or if its enforcement is likely to prejudice the sovereignty or security of the State of Israel.

An investor may also find it difficult to bring an original action in an Israeli court to enforce liabilities based upon the U.S. federal securities laws against the Company, or against its directors and officers. Israeli courts may refuse to hear a claim based on a violation of U.S. securities laws and rule that Israel is not the most appropriate forum in which to bring such a claim. In addition, if an Israeli court agrees to hear such a claim, it may determine that Israeli law, and not U.S. law, is applicable to the claim. If U.S. law is found to be applicable, the content of applicable U.S. law must be proved as a fact, which can be a time-consuming and costly process.

Your rights and responsibilities as a shareholder will be governed by Israeli law, which differs in some respects from the rights and responsibilities of shareholders of U.S. companies.

Since the Company is incorporated under Israeli law, the rights and responsibilities of its shareholders are governed by the Company’s articles of association and by Israeli law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in U.S.-based corporations. For example, a shareholder of an Israeli company has a duty to act in good faith and in a customary manner in exercising its rights and performing its obligations towards the company and other shareholders and to refrain from abusing its power in the company, including, among other things, voting at a general meeting of shareholders on certain matters, such as amendments to a company’s articles of association, increases in a company’s authorized share capital, mergers and acquisitions and related party transactions requiring shareholder approval. In addition, a shareholder who is aware that it possesses the power to determine the outcome of a shareholder vote or to appoint or prevent the appointment of a director or executive officer in the company has a duty of fairness toward the company. There is limited case law available to assist us in understanding the nature of this duty or the implications of these provisions. These provisions may be interpreted to impose additional obligations and liabilities on holders of the Company's ordinary shares that are not typically imposed on shareholders of U.S. corporations.

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's headquarters are located in Netanya, Israel. The Company does not own any of its properties. All of the Company's properties, including the properties utilized by its subsidiaries, are leased. The following table contains additional information about the Company's properties as of March 16, 2018:

Location	Principal Use	Approximate Square Feet	Lease Expiration Date
Netanya, Israel	Administrative offices, technical team and research and development.	2,637	March 2018
West Palm Beach, FL	Warehouse and distribution center.	10,580	July 2019
	Executive, administrative offices, customer care call center.	8,405	October 2019
Plano, TX	Research and development for the magicJack devices and certain related products and network support.	2,334	May 2018
Sunnyvale, CA	Research and development for the magicJack devices and certain related products.	1,232	June 2018
Franklin, TN	Technology management, hosting equipment and servers	3,722	February 2019
Alpharetta, GA	Research and development for the magicJack devices and certain related products.	1,106	September 2020
Warsaw, Poland	Research and development for the magicJack devices and certain related products.	3,017	April 2022

The Company currently pays a total annual rental amount of approximately $0.8 million for all its facilities. The Company believes that its facilities are suitable for their purposes and sufficient to support its needs through 2018, and that, if necessary, current leases can be renewed or additional facilities can be secured for the Company's anticipated general corporate needs.

ITEM 3. LEGAL PROCEEDINGS

Legal Proceedings

The Company is subject to various legal proceedings and claims, including intellectual property claims, contractual and commercial disputes, employment claims, state and local tax matters and other matters which arise in the ordinary course of business. The Company's policy is to vigorously defend any legal proceedings. Management regularly evaluates the status of legal proceedings in which the Company is involved in order to assess whether a loss is probable or there is a reasonable possibility that a loss or additional loss may have been incurred and to determine if accruals are appropriate. While the outcome of these claims cannot be predicted with certainty, management does not believe that the outcome of any of these legal matters will have a material adverse effect on the Company's business, operating results, financial condition or cash flows. However, an unexpected adverse resolution of one or more of these matters could have a material adverse effect on the Company’s results of operations in a particular fiscal year or quarter. For additional information, refer to Note 10, “Commitments and Contingencies,” in the Notes to our Consolidated Financial Statements included in Item 8 herein.

On March 11, 2016, a purported class action lawsuit was filed against the Company, its Chief Executive Officer, Gerald Vento ("Mr. Vento"), and its Chief Financial Officer, Jose Gordo ("Mr. Gordo"), in the United States District Court for the Southern District of New York. The complaint alleges that the Company and Messrs. Vento and Gordo made false and misleading statements regarding the financial performance and guidance during the alleged class period of November 12, 2013 to March 12, 2014. The complaint alleges that the Company and Messrs. Vento and Gordo violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended and Rule 10b-5 promulgated thereunder. The complaint seeks damages, attorneys' fees and costs, and equitable/injunctive relief or such other relief as the court deems proper. The Court issued a decision denying the Company’s motion to dismiss and on June 23, 2017, the parties held a mediation and agreed in principle to a settlement in which the Company would pay $3,650,000 to settle all claims, while denying all claims and allegations against them by the plaintiffs. The agreement was approved by the Company’s Board of Directors and a definitive Stipulation of Settlement was agreed to and submitted to the Court and approved on January 19, 2018, dismissing the action pursuant to the terms of the settlement. Pursuant to the Stipulation of Settlement, the payment of the $3,650,000 settlement amount was funded by means of the Company’s Directors and Officers policy insurer paying $3,343,292.67 and the Company paying $306,707.33 into a settlement escrow fund on October 3, 2017 Additional defense costs related to the litigation and settlement will be paid by the insurer since the Company’s $1,000,000 retention has been exhausted. As of December 31, 2017, the Company does not believe that it has any further liability related to this matter.

On August 11, 2017, a putative class action lawsuit was filed against the Company and its Board of Directors in the United States District Court for the Southern District of Florida. The complaint alleges claims against the Company and the current members of its Board of Directors as well as two former members for violations of Sections 14(a) and 20(a) of the Securities Exchange Act of 1934, arising from proxy statements issued in connection with the April 19, 2017 Proxy shareholders meeting and the July 31, 2017 shareholders meeting that allegedly misrepresented material facts concerning the "true value" of Broadsmart Global, Inc. and its future prospects in order that the individual defendants (The Board members) could entrench themselves on the Board and extract unwarranted compensation from the Company in connection with their attempt to sell the Company. In January 2018, the plaintiff filed an Amended Complaint. On February 16, 2018, the Company and all of the individual defendants filed a motion to dismiss the Amended Complaint. The Company cannot estimate the likelihood of liability or the amount of potential damages, if any, that could arise from this matter.

On March 8, 2018, Hunter Raines, a purported shareholder of the Company, filed a complaint titled Raines v. magicJack VocalTec Ltd. et al., Case 9:18-cv-80927, in the U.S. District Court for the Southern District of Florida. It alleges that the definitive proxy statement on Schedule 14A filed by the Company with the SEC on February 8, 2018 relating to the extraordinary general meeting of shareholders to consider and vote upon, inter alia, approval of the Agreement and Plan of Merger (the "Merger Agreement") by and among the Company, B. Riley Financial, Inc. and B. R. Acquisition Ltd. (the "Definitive Proxy Statement") contains materially false and misleading statements in violation of Section 14(a) of the Securities Exchange Act of 1934, as amended ("Exchange Act"). The complaint names as defendants the Company and the individual members of the Board of Directors. It also asserts claims against the directors pursuant to Section 20(a) of the Exchange Act on the theory that they are "control persons" of the Company. The complaint, which has been filed as a purported class action on behalf of Company shareholders, seeks, among other things, damages and an injunction barring the shareholder vote scheduled for March 19, 2018.

On March 9, 2018, two additional similar complaints were filed in the U.S. District Court for the Southern District of Florida. Plaintiff Melvyn Klein, a purported shareholder of the Company, filed a complaint titled Klein v. magicJack VocalTec, Ltd et al., Case 9:18-cv-80307, and plaintiff Morris Akerman, also a purported shareholder of the Company, filed a complaint titled Akerman v. magicJack VocalTec Ltd. et al., Case 9:18-cv-80310. Both complaints assert that the Definitive Proxy Statement contains materially false and misleading statements in violation of Section 14(a) of the Exchange Act, both name as defendants the Company and the individual members of the Board of Directors, and both also assert "control person" claims against the directors pursuant to Section 20(a) of the Exchange Act. Both purport to assert class action claims, and seek, among other things, damages and an injunction barring the shareholder vote.

The Company denies the allegations in all three complaints and denies that there are any material misrepresentations or omissions in the Definitive Proxy Statement.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.