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.

TABLE OF CONTENTS

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.

2

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;

4

- 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.

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.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Price Range of Ordinary Shares and Dividend Policy

The Company's ordinary shares are quoted on the NASDAQ under the symbol "CALL." The following table sets forth the high and low adjusted closing prices for the Company's ordinary shares as reported on the NASDAQ for the periods indicated, as adjusted to the nearest cent.

	High	Low
Year Ended December 31, 2017:		
Fourth quarter	$8.50	$5.65
Third quarter	$8.05	$6.90
Second quarter	$8.60	$6.35
First quarter	$8.90	$7.10
Year Ended December 31, 2016:		
Fourth quarter	$7.50	$5.75
Third quarter	$6.81	$5.28
Second quarter	$6.70	$5.56
First quarter	$9.21	$6.30

On March 12, 2018, the last reported sale price of our ordinary shares on the NASDAQ was $8.35 per share. As of March 12, 2018, there were approximately 97 record holders of our ordinary shares.

Dividends

The Company has not paid any cash dividend during the two most recently completed fiscal years. The Company currently intends to retain any earnings for use in its business, for investment in acquisitions and to repurchase shares of its ordinary shares.

As of December 31, 2017, we had approximately $52.6 million in cash and cash equivalents. The distribution of funds to shareholders is governed by Israeli law which places certain restrictions on a company's ability to declare dividends, perform share buy-backs and make other cash distributions. As an Israeli entity, the Company must comply with those restrictions, which would cause any such cash distribution or use of cash to be subject to significant delays.

Securities Authorized for Issuance Under Equity Compensation Plans

The Company is currently granting share-based awards under the shareholder-approved Amended and Restated magicJack VocalTec Ltd. 2013 Stock Incentive Plan and the Amended and Restated magicJack VocalTec Ltd. 2013 Israeli Stock Incentive Plan (together, the "2013 Plans"). The aggregate number of shares that may be subject to awards under the 2013 Plans is 5,600,000. The Company had previously granted shares under the VocalTec amended Master Stock Plan (the "2003 Plan") which expired in April 2013. During the year ended December 31, 2016, the Company issued 1,000,000 ordinary share options outside of the 2013 Plans as an inducement for the two founders of Broadsmart to become employed by the Company. These options were all either exercised or forfeited in the year ended December 31, 2017, leaving none outstanding at December 31, 2017.

The following relates to our equity compensation plans as of December 31, 2017:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options (a)	Weighted Average Exercise Price of Outstanding Options, ($) (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities reflected in Column (a)) (c)
Equity compensation plans approved by security holders (1)	3,424,647	9.92	975,197

(1) Consists of the Amended and Restated magicJack VocalTec Ltd. 2013 Stock Incentive Plan and the Amended and Restated magicJack VocalTec Ltd. 2013 Israeli Stock Incentive Plan.

Issuer Purchases of Equity Securities

In December 2017, the Company purchased 182,260 of its ordinary shares at an average price of $8.33 per share, for an aggregate purchase price of approximately $1.5 million, in settlement of the withholding tax liability of certain of its executive officers and other employees on the vesting of restricted stock units and for the cost of shares and withholding tax liability on the exercise of stock options.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Program (in thousands)
October 1, 2017 - October 31, 2017	0	$ -	0	$ -
November 1, 2017 - November 30, 2017	0	$ -	0	$ -
December 1, 2017 - December 31, 2017	182,260	$ 8.33	0	$ -
Total	182,260		0	

Performance Graph

The following graph compares the cumulative total shareholder return on the Company's common stock from January 1, 2012 to December 31, 2017 to that of the total return of the Nasdaq Telecom Index and the S&P 500 Index. The comparison assumes $100 was invested in the Company's common stock on January 1, 2012 and in each of the forgoing indices on January 1, 2012, and assumes the reinvestment of dividends. The graph is furnished and not "filed" with the Securities and Exchange Commission or "soliciting material" under the Securities Exchange Act of 1934 and shall not be incorporated by reference into any such filings, irrespective of any general incorporation contained in such filing.

Comparison of Cumulative Five Year Total Stockholder Return

ITEM 6. SELECTED FINANCIAL DATA

The Company's consolidated financial statements are prepared in accordance with United States Generally Accepted Accounting Principles ("GAAP") and are presented in U.S. dollars. Information as of December 31, 2017, 2016, 2015, 2014 and 2013 and for each of the years then ended is derived from the Company's audited consolidated financial statements.

The information presented below (in thousands, except earnings per share) is qualified by the more detailed consolidated financial statements set forth elsewhere in this report, and should be read in conjunction with the consolidated financial statements and notes thereto, and with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	Year Ended December 31,				
	2017	2016	2015	2014	2013
Statement of Operations:					
Net revenues	$87,993	$97,398	$100,962	$116,322	$143,492
Cost of revenues (1)	32,938	36,734	34,142	42,541	49,094
Gross profit	55,055	60,664	66,820	73,781	94,398
Operating expenses (1) (2)	83,236	46,909	41,477	60,217	46,952
Operating (loss) income	(28,181)	13,755	25,343	13,564	47,446
Interest expense	-	-	(57)	(192)	(307)
Other income (expense), net (3)	89	20	26	158	9
(Loss) income before income taxes	(28,092)	13,775	25,312	13,530	47,148
(Benefit) provision for income taxes	(3,129)	8,719	11,802	9,745	(23,163)
Net (loss) income	(24,963)	5,056	13,510	3,785	70,311
Net loss attributable to noncontrolling interest	-	635	-	-	-
Net (loss) income attributable to magicJack VocalTec Ltd. common shareholders	$(24,963)	$5,691	$13,510	$3,785	$70,311
(Loss) income per share attributable to magicJack VocalTec Ltd. common shareholders					
Basic (4)	$(1.55)	$0.36	$0.80	$0.21	$3.81
Diluted (4)	$(1.55)	$0.35	$0.79	$0.21	$3.81
Weighted average ordinary shares outstanding					
Basic	16,088	15,815	16,975	17,831	18,468
Diluted	16,088	16,064	17,045	17,868	18,476
Balance Sheet Data:					
Cash and cash equivalents	$52,638	$52,394	$78,956	$76,312	$54,779
Total assets	$141,042	$174,517	$168,836	$194,233	$171,894
Property and equipment, net	$2,772	$3,805	$3,302	$3,564	$1,959
Goodwill and other identified intangibles, net	$42,494	$76,039	$38,991	$41,777	$47,960
Other non-current liabilities (5)	$13,787	$10,866	$11,098	$13,438	$6,487
Total capital equity	$36,562	$58,200	$47,668	$49,086	$37,442
Total ordinary shares outstanding, net of treasury shares	16,190	16,051	15,610	17,868	17,827
Other Data:					
Depreciation of property and equipment	$1,283	$1,191	$799	$619	$565
Amortization of intangible assets	$3,091	$3,542	$2,786	$4,168	$4,293

Impairment of intangible assets (6)	$31,527	$998	$-	$2,500	$-

(1) Cost of revenues for the years ended December 31, 2017, 2016, 2015 and 2014 included a bonus to employees and outside consultants for services rendered in those years of $0.2 million, $0.3 million, $0.3 million and $0.1 million, respectively. There were no bonus amounts allocated to cost of revenues in 2013. Operating expenses for the years ended December 31, 2017, 2016, 2015, 2014 and 2013 included a bonus to employees and outside consultants for services rendered in those years of $1.5 million, $1.6 million, $1.7 million, $0.3 million and $1.4 million, respectively.

(2) Operating expenses for the year ended December 31, 2017 included an impairment of intangible assets and goodwill of $31.5 million. Refer to Note 3, "Impairment of Intangible Assets, Including Goodwill," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

(3) Other income (expense), net includes gains (losses) on investments, interest and dividend income, fair value gain (loss) on common equity put options and investment advisory fees. Other income for the years ended December 31, 2017, 2016, 2015 and 2014 was not significant. Other income in 2013 was primarily related to $0.3 million in interest and dividend income and $0.7 million in gains on investments, offset by $1.0 million in fair value loss on common equity put options.

(4) Refer to Note 14, "Net Income (Loss) Attributable to Common Shareholders per Share," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

(5) As of December 31, 2017, 2016, 2015, 2014 and 2013, this item represents (a) the non-current portion of outstanding indebtedness in connection with an agreement entered during June 2011 for the purchase of certain intangible assets (b) deferred income tax liabilities, non-current, and (c) $13.1 million, $10.4 million, $10.8 million and $12.0 million, provision for uncertain tax position recorded in 2017, 2016, 2015 and 2014, respectively. Refer to Note 9, "Other Liabilities," and Note 13, "Income Taxes," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

(6) Impairments of intangible assets for the year ended December 31, 2017 were comprised of customer relationships, process know how, tradename and goodwill for the Enterprise segment. Impairments of intangible assets for the year ended December 31, 2016 were comprised of an amortizable software license deemed obsolete, certain domain names not subject to amortization that were not renewed, and a trade name not subject to amortization. Impairment of intangible assets for the year ended December 31, 2014 was comprised of a non-compete agreement with the Company's founder and former CEO who passed away during 2014. Refer to Note 3, "Impairment of Intangible Assets, Including Goodwill," Note 6, "Intangible Assets," and Note 7 "Goodwill", in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

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

The following discussion of the company's financial condition and results of operations should be read in conjunction with its consolidated financial statements and related notes included elsewhere in this annual report on Form 10-K.

magicJack VocalTec Ltd. and its subsidiaries (the "Company") is the cloud communications leader that invented the magicJack device as well as other telecommunication products and services. The Company is a vertically integrated group of companies, with capabilities including Voice-over-Internet-Protocol ("VoIP") services and related equipment sales, micro-processor chip design and development of the magicJack device. In addition to residential consumers, the Company provides VoIP services and related equipment to small to medium sized businesses at competitive prices and wholesales telephone service to VoIP providers and telecommunication carriers. In 2016, the Company acquired a provider of hosted Unified Communication as a Service ("UCaaS") and seller of hardware and network equipment focusing on medium-to-large, multi-location enterprise customers.

The Company was incorporated in the State of Israel in 1989 and is domiciled in Netanya, Israel, with executive and administrative offices, and a customer care call center in West Palm Beach, Florida. In addition the Company has offices for technology management in Franklin, Tennessee, research and development in Plano, Texas, Alpharetta, Georgia, Sunnyvale, California and Warsaw, Poland and the UCaaS provider in West Palm Beach and Fort Lauderdale, Florida.

Basis of Presentation

Our consolidated financial statements are prepared in conformity with U.S. GAAP, and are the basis for the discussion and analysis of our results of operations, liquidity and capital resource. References to authoritative accounting literature in this report, where applicable, are based on the Accounting Standards Codification ("ASC"). Our functional and reporting currency is the United States Dollar ("U.S. Dollar"), which is the currency of the primary economic environment in which our consolidated operations are conducted. Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in currencies other than dollars, including Israeli New Shekel (”NIS") and Polish Zloty ("PLN"), are re-measured in dollars and any gains or losses are recognized in our consolidated financial statements in the period they occur.

We have historically prepared our consolidated financial statements on the basis of being a single reporting entity. Beginning in the first quarter of 2016, with the acquisition of Broadsmart and the internal development of our SMB division, we have been reporting the results of operations for these new business lines as separate Reportable Segments – "Core Consumer," "Enterprise" and "SMB". During the first quarter of 2017, management restructured the Company to absorb all operations and functions of the SMB Segment within the Core Consumer segment. Accordingly, this segment will not show activity for periods after March 31, 2017. Refer to Note 16, "Segment Reporting," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

Approximately 86%, 87% and 90% of our revenues in the years ended December 31, 2017, 2016 and 2015, respectively, were derived from sales to customers located in the United States. The majority of our revenues were generated from sales of the magicJack device and from the accompanying software access rights, which were $68.3 million, $77.6 million and $86.8 million for the years ended December 31, 2017, 2016 and 2015, respectively. We also provide our customers the ability to make prepaid calls using a magicJack device or mobile app by purchasing prepaid minutes. Revenues generated from the usage of prepaid minutes were $4.4 million, $5.7 million and $8.2 million for the years ended December 31, 2017, 2016 and 2015, respectively. Revenues generated from access and wholesale charges were $3.8 million, $5.0 million and $6.0 million for the years ended December 31, 2017, 2016 and 2015, respectively.

The majority of our Enterprise segment revenues recognized were generated from Broadsmart hosted UCaaS services and sales of hardware and equipment which were $10.9 million for the year ended December 31, 2017 and $9.0 million post acquisition for the year ended December 31, 2016. We had no UCaaS revenue from Broadsmart for the year ended December 31, 2015, prior to acquisition.

Our SMB segment did not generate significant revenue for three months ended March 31, 2017 or the year ended December 31, 2016. There was no revenue for SMB for the year ended December 31, 2015.

Basis of Consolidation

Our consolidated financial statements include the accounts of magicJack VocalTec Ltd. and its wholly-owned subsidiaries, YMax Corporation, YMax Communications Corp., magicJack Holdings Corporation, magicJack, LP, Tiger Jet Network, Inc., VocalTec Communications, LLC ("VocalTec US", formerly Stratus Telecommunications, LLC), Broadsmart Global, Inc., and magicJack SMB, Inc.. The results of Broadsmart Global, Inc. have been included since March 17, 2016. Refer to Note 15, "Acquisition of Business," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details. The results of SMB have been included since the first quarter of 2016. All intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period financial statement amounts to conform to the current presentation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Such estimates and judgments are revised periodically as required. Actual results could differ from those estimates. Significant estimates include the recoverability of long-lived assets and goodwill, income taxes, income tax valuation allowance, uncertain tax liabilities, the value of ordinary shares issued in business combinations or underlying our ordinary share options, the expected forfeitures of ordinary share options and estimates of likely outcomes related to certain contingent liabilities.

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

CRITICAL ACCOUNTING POLICIES

We have identified below our critical accounting policies. These policies are both the most important to the portrayal of our financial condition and results of operations and require our management's most difficult, subjective and complex judgments and estimates. Actual results may differ from these estimates under different assumptions or conditions.

REVENUE RECOGNITION

We recognize revenue in accordance with ASC Topic 605, "Revenue Recognition" ("ASC 605"), which provides authoritative guidance on revenue recognition. For arrangements that include more than one product or service ("deliverables"), we apply Section 25 of ASC 605, "Multiple-Element Arrangements". ASC 605-25 establishes criteria for separating deliverables into different units of accounting and allocating consideration to those units of accounting. The Company is transitioning to ASC 606, "Revenue from Contracts with Customers", ("ASC 606") which will be implemented in 2018.

Core Consumer Segment

For the Core Consumer business, net revenues consist of revenues from sales of the magicJack devices to retailers, wholesalers or directly to customers, access rights fees, fees charged for shipping the magicJack devices, usage of prepaid minutes, access charges to other carriers and other miscellaneous charges for telecommunication related products and services. Revenues are recorded net of sales returns and allowances.

magicJack Devices

magicJack devices include an initial access right, which qualify as multiple deliverables per ASC 605-25. Since the device and initial access right are interdependent and not sold separately, they are accounted for as a combined unit of accounting. Direct sales of devices include shipping charges and 30 days to return the device and cancel the service. For retail sales of devices, there is a delay between shipment to the retailer and the ultimate sale to a customer (end-user). Based on sales and inventory data provided by retail partners, our estimate of the delay for the years ending December 31, 2017, 2016 and 2015 was 30 days, 90 days and 90 days, respectively. We defer revenue recognition on direct sales for the 30 day return period and on retail sales for the delay period, after which we recognize the revenue from device sales and shipping charges, if applicable, ratably over the remaining initial access right period.

Access Right Renewals and Mobile Apps

Customers may renew access rights for periods ranging from one month to five years. The revenue associated with access right renewals is deferred and recognized ratably over the extended access right period. Revenue from mobile apps is included as part of Access Right Renewals and recognized ratably over the access right period.

Other magicJack-Related Products

We offer 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. 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 and Access and Wholesale Charges

We generate revenues from sales of prepaid international minutes to customers, fees charged to telecommunication carriers or providers for origination of their calls to 800-numbers, and access fees charged to other telecommunication carriers or providers on a per-minute basis for IXC calls terminated to our end-users. Revenues from access fee charges to other telecommunication carriers are recorded based on rates set forth in the respective state and federal tariffs or negotiated contract rates, less a provision for billing adjustments. Revenues from prepaid minutes and access and wholesale charges are recognized as minutes are used.

Sales Return Policy

We offer some of our direct sales customers a 30-day free trial before they have to pay for their magicJack device. We do not recognize revenue until the 30-day trial period has expired and a customer's credit card has been charged.

Returns from retailers are accepted on an authorized basis for devices deemed defective. We may offer certain retailers the limited right to return any unsold merchandise from their initial stocking orders. We also accept returns of battery powerbanks for mobile devices within 30 days of sale. We estimate potential returns under these arrangements at point of sale and re-estimate them on a quarterly basis. For the years ended December 31, 2017, 2016 and 2015, our estimates of returns and actual returns from initial stocking orders have not been materially different.

Enterprise Segment

For the Enterprise segment, net revenues consist of revenues from the sale of hosted services, usage charges, hardware and network equipment sales, and other one-time miscellaneous service charges.

UCaaS services and equipment provided by our Broadsmart subsidiary qualify as multiple deliverables per ASC 605-25. Since the equipment and services are sold separately and can be used with other products and services, they are accounted for as separate units of accounting. We recognize revenues from sales of our hosted services in the period the services are provided over the term of the respective customer agreements. Customers are billed monthly in advance for these recurring services and in arrears for one time service charges and other certain usage charges. Revenues from sales of hardware and network equipment are recognized in the period that the equipment is delivered. Revenues from the sale of equipment purchased but not yet delivered is deferred and recognized in the period that the hardware or equipment is put into service.

SMB Segment

SMB provided phone equipment and services that were interdependent and not sold separately. As such, they were accounted for as a combined unit of accounting under ASC 605-25. Some agreements included a refund period or a promotion for free introductory service. Revenue recognition was deferred for either period, after which we recognized the revenue for the combined unit ratably over the remaining service period. Revenues from this segment were not significant for the three months ended March 31, 2017 or the year ended December 31, 2016.

INTANGIBLE ASSETS, INCLUDING GOODWILL

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets acquired. Goodwill and other identifiable intangible assets with indefinite lives are not amortized to operations, but are instead reviewed for impairment at least annually, or more frequently if there is an indicator of impairment. Indicators include, but are not limited to: sustained operating losses or a trend of poor operating performance and a decrease in our market capitalization below its book value.

The valuation methodology we use for assessing potential impairment requires management to make judgments and assumptions based on historical experience and projections of future operating performance. If these assumptions differ materially from actual future results, we may record impairment charges in the future.

In prior years, we used the two-step goodwill impairment test. In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2017-04, “Intangibles – Goodwill and Other” which eliminated step two of the goodwill impairment test. The Company adopted ASU 2017-04 on a prospective basis in the first quarter of 2017.

As part of our quarterly impairment review for intangible assets with indefinite lives, including goodwill, we determined there were impairment indicators at the Enterprise segment as of March 31, 2017.

As was disclosed in prior year, the Broadsmart business which comprises the Enterprise segment was underperforming and steps were being taken to improve operating results including the hiring of a new Chief Operating Officer for the segment and additional sales and marketing personnel dedicated to obtaining new business. The new Chief Operating Officer for the Enterprise segment and our new Executive Management team completed a comprehensive review of the Enterprise segment’s business prospects and, through this process, revised the projections. Additionally, Broadsmart received notification in early April 2017 that a major customer would not be renewing its contract and later in April management anticipated the loss of another one of the Enterprise segment’s significant customers. Combined, these customers accounted for approximately 29% of the Enterprise segment’s revenue in 2016. We considered the revised projections and customer losses to be indicators of potential impairment, and accordingly performed impairment testing of the segment's long-lived assets and indefinite-lived intangible assets, including goodwill, as of March 31, 2017 utilizing the revised projections.

Based on the impairment indicators as of March 31, 2017 discussed above, we engaged an independent third party to perform a valuation of the Enterprise segment's long-lived assets and indefinite-lived intangible assets, including goodwill as of March 31, 2017. The valuation estimated the fair value of Broadsmart's identified intangible assets not subject to amortization based on the relief from royalty method, which requires an estimate of a reasonable royalty rate, identification of relevant projected revenues and expenses, and selection of an appropriate discount rate. We recognized an impairment charge of $0.9 million for the carrying value in excess of the fair value.

For long-lived assets including definite-lived intangible assets subject to amortization, we totaled the undiscounted cash flows expected to result from the use of these assets and their eventual disposition and noted that the sum did not exceed the carrying amount of the assets, indicating further impairment testing was necessary for these assets as of March 31, 2017. The estimated fair value of definite-lived intangible assets subject to amortization as of March 31, 2017, was based on discounted future cash flows. We recorded impairment losses of $15.7 million for the carrying value of these assets in excess of the fair value.

Based on a discounted future cash-flows approach, the valuation estimated the fair value of the Enterprise reporting unit to be $17.9 million. Recognition of the goodwill impairment resulted in a tax benefit which was recorded as a deferred tax asset. Since the deferred tax asset increases the carrying value of the reporting unit, it would result in an additional impairment. The accounting guidance requires an entity to calculate the impairment charge and the deferred tax effect using a simultaneous equation method, which effectively grosses up the goodwill impairment charge to account for the related deferred tax benefit so that the resulting carrying value does not exceed the calculated fair value. The simultaneous equation calculation resulted in an impairment charge that exceeded the carrying value of the goodwill. Since the guidance limits goodwill impairments to the carrying value of goodwill, we recognized an impairment loss of $14.9 million, the full carrying value of goodwill.

In total, impairment losses of $31.5 million were recognized in operating expenses and a related deferred income tax benefit of $11.7 million was recognized in the Enterprise segment for the quarter ended March 31, 2017. The impaired assets were (in thousands):

	March 31, 2017		
	Carrying Amount	Fair Value	Impairment
Customer Relationships	$19,572	$4,400	$ 15,172
Process Know How	974	400	574
Tradename	1,700	800	900
Goodwill	14,881	-	14,881
	$37,127	$5,600	$ 31,527

Refer to Note 3, “Impairment of Intangible Assets, Including Goodwill”, Note 6, “Intangible Assets” and Note 7, “Goodwill” in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

As of October 1, 2017 (the “Measurement Date”), the Company engaged an independent third party to perform its annual goodwill impairment test for all of its reporting units in order to determine on an individual reporting unit basis if there was potential impairment. Fair value of each reporting unit was estimated using a discounted cash flow analysis. The estimated fair value of goodwill for the Core Consumer reporting unit exceeded its book value, therefore no further testing was required and no impairment was recognized.

As part of the Company’s impairment reviews for intangible assets, management determined that there continued to be impairment indicators at the Enterprise segment as of the testing date of October 1, 2017. As a result, the Company engaged an independent third party to perform a recoverability test of the Enterprise segment’s long-lived assets as of October 1, 2017. The sum of undiscounted cash flows of the intangible assets exceeded their book value, therefore no impairment was recognized.

INCOME TAXES

We recognize deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their book basis using enacted tax rates. Any changes in enacted rates or tax laws are included in the provision for income taxes in the year of enactment. Our net deferred tax assets consist primarily of foreign net operating loss carryforwards and timing differences between the recognition of income for book and tax purposes. We record a valuation allowance to reduce the net deferred tax assets to the amount that we estimate is more-likely-than-not to be realized. We evaluated the valuation allowance as of December 31, 2017, 2016 and 2015 which resulted in adjustments of $0.5 million to bring the allowance to $16.8 million, ($1.2) million to bring the allowance to $16.3 million, and $1.3 million to bring the allowance to $17.5 million, respectively. These amounts adjust the net deferred tax assets to the amount that will more-likely-than-not be realized. We periodically review the composition of our net deferred tax assets and related valuation allowances and will continue to make adjustments if available evidence indicates that it is more-likely-than-not a change in the carrying amounts is required.

We assess our income tax positions and record tax benefits for all years subject to examination based upon our evaluation of the facts, circumstances and information available at the reporting date. For those tax positions where there is a greater than 50% likelihood that a tax benefit will be sustained, we have recorded the largest amount of tax benefit that may potentially be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where there is 50% or less likelihood that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. For the year ended December 31, 2017, we recorded a provision for uncertain tax positions of $2.6 million. For the year ended December 31, 2016, we reduced our provision for uncertain tax positions by ($0.3) million. For the year ended December 31, 2015, our provision for uncertain tax positions was reduced by ($10.1) million primarily due to the settlement of the IRS audits for tax years 2010 through 2013. As of December 31, 2017 and 2016, the liability for uncertain tax positions totaled $13.1 million and $10.4 million, respectively, which has been reflected in other non-current liabilities.

On December 22, 2017, the United States enacted tax reform legislation commonly known as the Tax Cuts and Jobs Act (the “Act”), resulting in significant modifications to existing law. Based upon currently available information, we analyzed the accounting implications of the significant effects of the Act during the period ended December 31, 2017, and recorded provisional incremental income tax expense of $6.1 million for the expected impact of the new tax regulations on the value of our deferred tax assets. See Note 13, “Income Taxes” in the Notes to our consolidated financial statements included in Item 8 herein for further details.

We file U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. During fiscal 2013, we received notice that the IRS was going to examine our tax returns for 2010 and 2011. In October 2014, we were informed that the IRS was going to expand its audit to include our 2012 and 2013 tax returns. During 2015, we reached agreement with the IRS on a settlement of all years under audit. The settlement resulted in an increase to the jurisdictional income of the U.S. The additional tax and interest due to the IRS and various state taxing authorities as a result of the increased U.S. jurisdictional income was $6.8 million and $0.9 million, respectively. We were able to utilize approximately $4.2 million of benefits related to other favorable adjustments identified during the exam to satisfy a portion of the federal liability, resulting in net tax and interest paid to the IRS of $2.6 million. The $0.9 million state liability is reflected as a reduction to prepaid income taxes in our December 31, 2015 consolidated balance sheets. The increase to the U.S. jurisdictional income resulted in a decrease in our Israeli jurisdictional income. The decrease in Israeli income, in turn, increased our Israeli net operating losses, resulting in a tax benefit of $5.6 million. For the year ended December 31, 2017, we recorded an income tax benefit of ($3.1) million, which is lower than the expected tax benefit of ($9.6) million, using the statutory rate of 34%, due in part, to a change in the U.S. federal income tax rate which resulted in us revaluing our deferred tax assets and lowering their value by $6.1 million, state income taxes of ($0.9) million, the revaluation of the Israel net operating loss carryforwards of ($1.3) million, increases to uncertain tax positions of $2.6 million, return to provision adjustments of ($2.6) million, and a reduction to deferred tax assets related to the surrender of stock options and option forfeitures of $2.7 million. The discrete items noted above were partially offset by the lower jurisdictional tax rate charged on the operating income of the Company’s Israeli operations. The tax years 2011 through 2017 remain open to examination by other major taxing jurisdictions to which we are subject.

SHARE-BASED COMPENSATION

Share-based compensation generally consists of option grants or ordinary share and restricted stock awards to directors, officers, employees or consultants. We account for share-based compensation in accordance with ASC Topic 718, "Compensation - Stock Compensation" (“ASC 718”). ASC 718 requires companies to estimate the fair value of equity-based payment awards on the date of grant based on the fair value of the award. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service periods in our consolidated statements of operations.

BUSINESS TRENDS

Revenues in our Core Consumer segment continued to decline during the year ended December 31, 2017. We remain encouraged by the loyalty of our existing customer base and we continue to undertake efforts to improve retention, invest in new product development and innovation, capitalize on our strong retail distribution, and optimize the marketing of our magicJack products. During the year ended December 31, 2017, we implemented initiatives to optimize auto-renewal and reduce breakage. We remain encouraged at the progress we have made. We believe that because of our brand awareness, our existing investment in mobile apps, and our vertically integrated operations and Competitive Local Exchange Carrier (“CLEC”) network with significant excess capacity, we can effectively compete in the fast-growing mobile second line market and build new revenue streams for the future. We believe that there will continue to be solid demand for our low priced, unlimited phone service, whether through our magicJack devices, our mobile Apps, or a combination of both.

During the year ended December 31, 2017, we continued steps to improve the operating results and bolster integration efforts for the Enterprise segment. We continue to focus on improving customer churn and expanding Broadsmart sales channels. In the first quarter of 2017, following a thorough review of the operations, sales pipeline, business practices and the current customer base, management re-evaluated the segment’s projections and made significant adjustments to future revenue growth assumptions. Because of the continued underperformance compared to projections and the anticipated customer churn, during the quarter ended March 31, 2017, we recognized a $31.5 million impairment on the intangible assets, including goodwill, of the Enterprise segment. Refer to Note 3, “Impairment of Intangible Assets, Including Goodwill”, Note 6, “Intangible Assets” and Note 7, “Goodwill” in the Notes to our consolidated financial statements included in Item 8 herein for further details.

In 2017, we launched our new “Spark” services targeting Small Office Home Office (“SOHO”), pursuing a mobile-first, web-first strategy. We believe that because of our vertically integrated operations and CLEC network with significant excess capacity, we can be both competitively price disruptive and profitable at the same time, similar to the historical magicJack Core Consumer business. We believe this strategy leverages existing assets and recent R&D investment, and is a webfocused customer acquisition and UCaaS model. We have worked to consolidate operations and to eliminate redundant SMB segment functions in Atlanta. We have also eliminated unproductive or less-promising ventures, including our partnership with Telefonica and the HoteliJack initiative.

However, the initial sales from our Spark initiative have been lower than anticipated and in the fourth quarter of 2017 we made the decision to reduce planned marketing spend on the initiative and re-evaluate and refine the business and marketing strategy for the product.

With the acquisition of Broadsmart, the investment in the magicJack SMB business and the continued efforts in improving and promoting our apps, we have taken significant steps to diversify our business from the Core Consumer segment into the SOHO and UCaaS space, with magicJack Spark and SMB targeting smaller businesses and Broadsmart serving medium to large enterprises.

SIGNIFICANT CHANGES IN FINANCIAL POSITION

The following table presents significant changes in our consolidated balance sheets for the periods indicated (in thousands).

	December 31, 2017	December 31, 2016	December 31, 2015	2017 compared to 2016	2016 compared to 2015
Cash and cash equivalents	$ 52,638	$ 52,394	$ 78,589	$ 244	$ (26,195)
Inventories	$ 1,880	$ 4,441	$ 5,723	$ (2,561)	$ (1,282)
Prepaid income taxes	$ 2,016	$ 527	$ 2,747	$ 1,489	$ (2,220)
Receivable from earnout escrow	$ -	$ 2,000	$ -	$ (2,000)	$ 2,000
Intangible assets, net	$ 10,190	$ 28,854	$ 6,687	$ (18,664)	$ 22,167
Goodwill	$ 32,304	$ 47,185	$ 32,304	$ (14,881)	$ 14,881
Deferred tax assets	$ 31,726	$ 26,568	$ 30,689	$ 5,158	$ (4,121)
Income tax payable	$ -	$ 1,527	$ -	$ (1,527)	$ 1,527
Accrued expenses and other current liabilities	$ 6,454	$ 8,426	$ 6,284	$ (1,972)	$ 2,142
Total deferred revenue	$ 81,040	$ 92,708	$ 102,700	$ (11,668)	$ (9,992)
Other non-current liabilities	$ 13,787	$ 10,866	$ 11,098	$ 2,921	$ (232)

YEAR ENDED DECEMBER 31, 2017 COMPARED TO YEAR ENDED DECEMBER 31, 2016

During the year ended December 31, 2017, cash and cash equivalents increased $0.2 million, primarily reflecting estimated tax payments for fiscal 2016, personnel related disbursements including payment of 2016 accrued bonus, and severance payments related to the restructuring of the SMB business, costs associated with changes to our customer service team and the change in executive management team, investment in the SMB business, and legal fees and other costs associated with our response to activist shareholder initiatives, the strategic process and other ongoing litigation matters. These decreases were offset by the receipt of the $2.0 million receivable from the earn-out escrow and an additional $1.0 million in escrow funds related to the Broadsmart acquisition. Refer to Note 15, “Broadsmart Acquisition” in the Notes to our consolidated financial statements included in Item 8 herein for further details. A detailed discussion of this change is provided in “Liquidity and Capital Resources”.

During the year ended December 31, 2017, inventories decreased $2.6 million reflecting a $0.4 million write-down of obsolete inventory components and reduced purchases of magicJack devices reflecting lower year-over-year sales volumes.

During the year ended December 31, 2017, prepaid income taxes increased $1.5 million primarily due to a $3.0 million estimated federal tax payment made during the first quarter which was partially offset by the receipt of a $0.9 million state tax refund.

During the year ended December 31, 2017, receivable from earnout escrow decreased $2.0 million due to collection of the escrow funds.

During the year ended December 31, 2017, intangible assets decreased $18.7 million. The decrease in intangible assets is primarily attributable to the $16.6 million impairment of intangible assets for the Enterprise segment, and $3.1 million in amortization expense, partially offset by $1.1 million in acquisitions. Refer to Note 3, “Impairment of Intangible Assets, Including Goodwill” and Note 6, “Intangible Assets,” in the Notes to our consolidated financial statements included in Item 8 herein for further details.

During the year ended December 31, 2017, goodwill decreased $14.9 million due to the impairment of goodwill for the Enterprise segment. Refer to Note 3, “Impairment of Intangible Assets, Including Goodwill” and Note 7, “Goodwill” in the Notes to our consolidated financial statements included in Item 8 herein for further details.

During the year ended December 31, 2017, deferred tax asset increased $5.2 million due primarily to the $31.5 million impairment of intangible assets, including goodwill, for the Enterprise segment. Refer to Note 3, “Impairment of Intangible Assets, Including Goodwill”, Note 6, “Intangible Assets,” and Note 7, “Goodwill” in the Notes to our consolidated financial statements included in Item 8 herein for further details. This increase was partially offset by the surrender of stock options from two former executive officers and forfeitures of options by other executives. Refer to Note 12, “Share-based Compensation” in the Notes to our consolidated financial statements included in Item 8 herein for further details. Furthermore, the deferred tax assets were revalued as of December 31, 2017, reflecting the impact of changes to United States tax law which resulted in the carrying value of our deferred tax assets being reduced by approximately $6.1 million.

During the year ended December 31, 2017, income tax payable decreased $1.5 million reflecting the $3.0 million estimated tax payment for the prior year noted above and the current year to date income tax benefit not generating any new tax liability.

During the year ended December 31, 2017, accrued expenses and other current liabilities decreased $2.0 million due primarily to the following items that were accrued for as of December 31, 2016 that were satisfied during the year ended December 31, 2017; (i) a $0.6 million accrual for retailer promotions, (ii) a $0.5 million accrual for in-transit inventory, and (iii) $0.6 million in accrued expenses related to the SMB business.

During the year ended December 31, 2017, total deferred revenue decreased $11.7 million due primarily to the recognition of 2016 deferred revenue exceeding the deferral associated with 2017 sales.

During the year ended December 31, 2017, other non-current liabilities increased $2.9 million due primarily to a $2.6 million increase in the uncertain tax provision.

YEAR ENDED DECEMBER 31, 2016 COMPARED TO YEAR ENDED DECEMBER 31, 2015

During the year ended December 31, 2016, cash and cash equivalents decreased $26.2 million, primarily reflecting $40.0 million used in the acquisition of Broadsmart, partially offset by $15.3 million provided by operations. A detailed discussion of this change is provided in “Liquidity and Capital Resources”.

During the year ended December 31, 2016, inventories decreased $1.3 million due to reduced purchases of magicJack devices reflecting lower year-over-year sales volumes.

During the year ended December 31, 2016, prepaid income taxes decreased $2.2 million, income tax payable increased $1.5 million and other non-current liabilities decreased $0.2 million due to recognition of 2016 income taxes.

During the year ended December 31, 2016, receivable from earnout escrow increased $2.0 million. This item represents amounts placed in escrow as part of the Broadsmart acquisition, as contingent consideration to the sellers if the Broadsmart business generated 2016 revenues equal to or exceeding $15.6 million (the "Earnout Payment"). The 2016 revenue target was not achieved and the funds are now expected to be returned to us.

During the year ended December 31, 2016, intangible assets increased $22.2 million. The increase in intangible assets is primarily attributable to $26.4 million in additions from the acquisition of Broadsmart, partially offset by: (i) amortization expense of $3.5 million and (ii) impairments of $1.0 million.

During the year ended December 31, 2016, goodwill increased $14.9 million due to the acquisition of Broadsmart.

During the year ended December 31, 2016, total deferred revenue decreased $10.0 million due primarily to the recognition of 2015 deferred revenue exceeding the deferral associated with 2016 sales.

RESULTS OF OPERATIONS

The following table presents our consolidated results of operations for the periods indicated (in thousands, except per share information). The consolidated statements of operations below have been expanded to show the composition of our net revenues and cost of revenues items to enable a more meaningful discussion of our operations. The components of our operating revenue and cost of revenues as presented in the following table are described below the table.

	Year ended December 31, 2017	2016	2015	2017 Compared to 2016		2016 Compared to 2015	
Net revenues							
Sale of magicJack devices	$10,361	$12,775	$15,915	$(2,414)	(18.9)%	$(3,140)	(19.7)%
Access right renewals	51,925	58,513	65,761	(6,588)	(11.3)	(7,248)	(11.0)
Shipping and handling	1,308	889	794	419	47.1	95	12.0
magicJack-related products	4,730	5,435	4,289	(705)	(13.0)	1,146	26.7
Prepaid minutes	4,441	5,677	8,243	(1,236)	(21.8)	(2,566)	(31.1)
Access and wholesale charges	3,769	5,021	5,953	(1,252)	(24.9)	(932)	(15.7)
UCaaS	10,868	8,966	-	1,902	21.2	8,966	100.0
Other	591	122	7	469	*	115	*
Total net revenues	87,993	97,398	100,962	(9,405)	(9.7)	(3,564)	(3.5)
Cost of revenues							
Cost of devices and related products	7,903	8,684	8,320	(781)	(9.0)	364	4.4
Shipping and handling	1,322	1,729	1,194	(407)	(23.5)	535	44.8
Credit card processing fees	1,692	1,828	2,260	(136)	(7.4)	(432)	(19.1)
Network and carrier charges	9,706	12,310	15,352	(2,604)	(21.2)	(3,042)	(19.8)
UCaaS	7,303	7,224	-	79	1.1	7,224	100.0
Other	5,012	4,959	7,016	53	1.1	(2,057)	(29.3)
Total cost of revenues	32,938	36,734	34,142	(3,796)	(10.3)	2,592	7.6
Gross profit	55,055	60,664	66,820	(5,609)	(9.2)	(6,156)	(9.2)
Operating expenses:							
Marketing	8,282	9,085	9,409	(803)	(8.8)	(324)	(3.4)
General and administrative	38,425	33,327	27,547	5,098	15.3	5,780	21.0
Impairment of goodwill and intangible assts	31,527	998	-	30,529	*	998	*
Research and development	5,896	5,199	4,521	697	13.4	678	15.0
Consideration adjustment/ Gain on mark-to-market	(894)	(1,700)	-	806	47.4	(1,700)	(100.0)
Total operating expenses	83,236	46,909	41,477	36,327	77.4	5,432	13.1
Operating (loss) income	(28,181)	13,755	25,343	(41,936)	(304.9)	(11,588)	(45.7)
Other income (expense):							
Interest and dividend income	123	26	26	97	*	-	*
Interest expense	-	-	(57)	-	*	57	*
Other (expense) income, net	(34)	(6)	-	(28)	*	(6)	*
Total other (expense) income	89	20	(31)	69	*	51	*

(Loss) income before income taxes	(28,092)	13,775	25,312	(41,867)	(303.9)	(11,537)	(45.6)
Income tax (benefit) expense	(3,129)	8,719	11,802	(11,848)	(109.5)	(3,083)	(26.1)
Net (loss) income	(24,963)	5,056	13,510	(30,019)	(639.2)	(8,454)	(62.6)
Loss attributable to noncontrolling interest	-	(635)	-	635	*	(635)	*
Net (loss) income attributable to common shareholders	$(24,963)	$5,691	$13,510	$(30,654)	*	$(7,819)	*
(Loss) income per common share:							
Basic	$(1.55)	$0.36	$0.80	$(1.91)	*	$(0.44)	*
Diluted	$(1.55)	$0.35	$0.79	$(1.90)	*	$(0.44)	*

* - Not meaningful.

Core Consumer Segment

	Year Ended December 31,			2017 Compared to 2016		2016 Compared to 2015	
	2017	2016	2015				
Net revenues	$77,124	$88,420	$100,962	$(11,296)	(12.8)	$(12,542)	(12.4)%
Cost of revenues	25,635	29,429	34,142	(3,794)	(12.9)	(4,713)	(13.8)
Gross profit	51,489	58,991	66,820	(7,502)	(12.7)	(7,829)	(11.7)
Operating expenses:							
Marketing	7,056	8,265	9,409	(1,209)	(14.6)	(1,144)	(12.2)
General and administrative	34,868	29,188	27,547	5,680	19.5	1,641	6.0
Impairment of goodwill and intangible assets	-	498	-	(498)	(100.0)	498	100.0
Research and development	5,890	5,172	4,521	718	13.9	651	14.4
Consideration adjustment/ Gain on mark-to-market	(894)	(1,700)	-	806	47.4	(1,700)	(100.0)
Total operating expenses	46,920	41,423	41,477	5,497	13.3	(54)	(0.1)
Operating income	4,569	17,568	25,343	(12,999)	(74.0)	(7,775)	(30.7)

Enterprise Segment

	Year Ended December 31,		2017 Compared to 2016	
	2017	2016		
Net revenues	$11,003	$9,043	$1,960	21.7 %
Cost of revenues	7,303	7,224	79	1.1
Gross profit	3,700	1,819	1,881	103.4
Operating expenses:				
Marketing	1,226	380	846	222.6
General and administrative	3,691	3,141	550	17.5
Impairment of goodwill and intangible assets	31,527	500	31,027	*
Research and development	6	22	(16)	(72.7)
Total operating expenses	36,450	4,043	32,407	*
Operating (loss)	(32,750)	(2,224)	(30,526)	*

Other Segment

	Year Ended December 31,		2017 Compared to 2016	
	2017	2016		
Net revenues	$-	$13	$(13)	(100.0)%
Cost of revenues	-	81	(81)	(100.0)
Gross profit	-	(68)	68	100.0
Operating expenses:				
Marketing	-	440	(440)	(100.0)
General and administrative	-	1,076	(1,076)	(100.0)

Research and development	-	5	(5)	(100.0)
Total operating expenses	-	1,521	(1,521)	(100.0)
Operating (loss)	-	(1,589)	1,589	100.0

Components of Net Revenues

Our net revenues are comprised of 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 initial 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 mobile apps 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 sale of other items related to the magicJack devices and access right renewals we offer our 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. 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 – represents 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 our 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 the sales of 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 revenues from the sale of hardware and network equipment are 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

Components of Cost of Revenues

Our cost of revenues is comprised of the following components:

- Cost of devices and related products – represent the costs of components and manufacturing of the magicJack devices, as well as production, packaging and other inventory-related costs and broker commissions on devices and mobile apps. The costs of the magicJack devices and mobile apps are recognized over the initial three, six or twelve month access right period. The cost of battery powerbanks is expensed as incurred;

- Shipping and handling – represent freight, postage and other transportation costs related to: (i) transportation of the magicJack devices from the manufacturer to our warehouse and distribution center, and (ii) freight, shipping and handling fees incurred to ship the magicJack devices to retailers and direct customers. These costs are expensed as incurred;

- Credit card processing fees – represent transaction and other fees incurred as a result of accepting credit card payments for sales of magicJack devices, access right renewals, shipping and handling charges, magicJack related products and prepaid minutes sold direct to customers through our website. These fees are expensed as incurred;

- Network and carrier charges – represent facilities charges to establish and maintain our network as well as network usage fee charges from other telecommunication carriers. These rates or charges are based upon commercial agreements or applicable state and/or federal tariffs. These charges are expensed as incurred; and

- UCaaS – represents the cost of providing the recurring monthly hosted services including, network usage charges, customer internet access, amortization expense and commissions as well as the cost of hardware and network equipment related to non-recurring sales, provided by our Broadsmart subsidiary. These costs are expensed as incurred; and

- Other cost of revenues – represents allocation of personnel-related costs, amortization and depreciation expense related to assets employed in generating our revenues, as well as costs from discontinued revenue sources.

YEAR ENDED DECEMBER 31, 2017 COMPARED TO YEAR ENDED DECEMBER 31, 2016

Net Revenues

Total net revenue was $88.0 million and $97.4 million for the year ended December 31, 2017 and 2016, respectively, representing a decrease of $9.4 million, or 9.7%. The decrease was primarily attributable to the following:

- $2.4 million decrease in revenues from the sale of magicJack devices primarily reflecting lower retail sales volume, lower average revenue per unit sold due to promotional offers and a proposed consumer telecommunications tax settlement (since these taxes were not collected from customers and we report revenue net of such taxes this amount was recorded as a reduction of revenue);
- $6.6 million decrease in access right renewal revenues due to customer churn, promotional offers and the number of long-term renewals in the customer base that are at lower average annual revenues;
- $1.2 million decrease in revenues from prepaid minutes resulting from declining usage levels; and
- $1.3 million decrease in revenues from access and wholesale charges resulting from lower network traffic.

These decreases in components of net revenue were partially offset by i) an increase of $1.9 million in revenues from UCaaS reflecting a full year of revenue in the current year, ii) an increase of $0.4 million in shipping and handling and iii) an increase of $0.5 million in other revenues.

For the year ended December 31, 2017 and 2016, sales of the magicJack devices through retail outlets represented approximately 53% and 52%, respectively, of sales of all magicJack devices sold. For the same periods, direct sales represented approximately 47% and 48%, respectively, of magicJack devices sold. For the year ended December 31, 2017 and 2016, no retailer accounted for more than 10% of our consolidated net revenue.

Cost of Revenues

Total cost of revenues was $32.9 million and $36.7 million for the year ended December 31, 2017 and 2016, respectively, representing a decrease of approximately $3.8 million, or 10.3%. The primary changes in cost of revenues were: (i) a $2.6 million decrease in network and carrier charges primarily as a result of lower traffic substantially resulting from the elimination of free app users at the end of the second quarter of 2016, (ii) $0.8 million decrease in cost of devices and related products due to lower sales volume, and (iii) $0.4 million decrease in shipping and handling costs.

Operating Expenses

Total operating expenses were $83.2 million and $46.9 million for year ended December 31, 2017 and 2016, respectively, representing an increase of $36.3 million, or 77.4%. This change in operating expenses is primarily attributable to:

- A $30.5 increase in impairment of intangible assets consisting of a $31.5 million impairment of intangible assets, including goodwill, related to the Enterprise segment in 2017 compared to $1.0 million impairment of domain names and other intangibles in 2016. Refer to Note 3, “Impairment of Intangible Assets, Including Goodwill”, Note 6, “Intangible Assets” and Note 7, “Goodwill” in the Notes to our consolidated financial statements included in Item 8 herein for further details.
- a $0.8 million decrease in marketing expense, primarily related to a reduction in media buys from the prior year,
- a $5.1 million increase in G&A expense due to several factors including:

  i. a $5.7 million increase in costs related to the Core Consumer segment, primarily composed of: a) a $2.8 million increase in personnel related expenses primarily reflecting severance and new executive officer compensation including sign-on bonuses, b) a $5.6 million increase in legal fees related to the response to activist shareholders, strategic process and other litigation matters, c) a $0.4 million increase in accounting fees related to valuation work, ASC 606 implementation costs and the SOX integration of Broadsmart, d) a $0.5 million asset impairment related to our exit from our joint venture in the home consumer product market, e) a $0.2 million increase in customer care costs, f) a $0.2 million increase in insurance related costs and g) a $1.0 million increase in other G&A costs primarily due to consulting fees related to the management transition and the strategic process; partially offset by a $5.0 million decrease in costs related to SMB activity reflecting the scaling back of the Alpharetta location.

ii. An increase of $0.5 million of costs at Broadsmart, primarily reflecting a full year of operations in 2017 as compared to a partial year in 2016.

iii. These increases were partially offset by a $1.1 million decrease in costs related to other initiatives.

- a $0.7 million increase in R&D expense, primarily related to increases in personnel for the Core Consumer segment for product development of the new Spark mobile app and a new chip for future device upgrades.
- A $0.8 million decrease in unusual consideration adjustment/gains on mark-to-market related to Broadsmart. Refer to Note 15, "Broadsmart Acquisition" in the Notes to our consolidated financial statements included in Item 8 herein for further details.

Income Taxes

Total income tax (benefit) expense was ($3.1) million and $8.7 million for the year ended December 31, 2017 and 2016, respectively. The calculation of our effective income tax rate for the year ended December 31, 2017 and 2016 was (in thousands):

	Year Ended December 31, 2017	2016
Income before taxes	$(28,092)	$13,775
Income tax expense (benefit)	(3,129)	8,719
Effective income tax rate	11.14 %	63.30 %

We operate primarily in the United States and Israel. Our U.S. operations are subject to a federal statutory income tax rate of 34% in 2017 and 2016 and our Israeli operations are subject to statutory income tax rates of 24% in 2017 and 25% in 2016. The U.S. operations will be subject to a federal statutory income tax rate of 21% in 2018 and the Israeli operations will be subject to a statutory income tax rate of 23% in 2018.

For the year ended December 31, 2017, we recorded an income tax benefit of ($3.1) million, which is lower than the expected tax benefit of ($9.6) million, using the statutory rate of 34%, due in part, to a change in the U.S. federal income tax rate which resulted in us revaluing our deferred tax assets and lowering their value by $6.1 million reflecting our initial estimate of the impact of the Act, state income taxes of ($0.9) million, the revaluation of the Israel net operating loss carryforwards of ($1.3) million, increases to uncertain tax positions of $2.6 million, return to provision adjustments of ($2.6) million, and a reduction to deferred tax assets related to the surrender of stock options and option forfeitures of $2.7 million. The discrete items noted above were partially offset by the lower jurisdictional tax rate charged on the operating income of the Company's Israeli operations

The 2018 estimated annual effective tax rate is expected to approximate 24.0%, excluding discrete tax items, but may fluctuate during the year due to changes in our jurisdictional income and due to the timing of other discrete period transactions.

Net (Loss) Income Attributable to Common Shareholders

As a result of the foregoing items, net (loss) income attributable to common shareholders decreased to a net loss of ($25.0) million in the year ended December 31, 2017, as compared to net income attributable to common shareholders of $5.7 million in the year ended December 31, 2016. Net loss attributable to common shareholders per diluted ordinary share was ($1.55) for the year ended December 31, 2017, as compared to net income attributable to common shareholders of $0.35 per diluted ordinary share in the prior year. The change was primarily due to the impairment of the Enterprise segment intangible assets, declining revenue in the Core business and an increase in operating expenses related to the Company's response to activist shareholders and other legal matters as well as costs associated with management change.

YEAR ENDED DECEMBER 31, 2016 COMPARED TO YEAR ENDED DECEMBER 31, 2015

Net Revenues

Total net revenues were $97.4 million and $101.0 million for the years ended December 31, 2016 and 2015, respectively, representing a decrease of $3.6 million, or 3.5%. The decreases in the components of net revenues were primarily attributable to the following:

- $7.2 million net decrease in access right renewal and mobile App revenues;
- $2.6 million decrease in revenues from prepaid minutes resulting from lower usage levels;
- $3.1 million decrease in magicJack device sales revenues, primarily reflecting lower retail sales volumes; and
- $0.9 million decrease in revenues from access and wholesale charges.

These decreases in components of net revenues were partially offset by $9.0 million in sales related to Broadsmart UCaaS revenues and a $1.1 million increase in revenues from the sale of magicJack-related products.

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

For the years ended December 31, 2016 and 2015, no retailer accounted for more than 10% of net revenues for the Core Consumer segment. For the year ended December 31, 2016, two customers accounted for 29% of net revenue for the Enterprise segment. Revenue for the SMB segment was not significant for the year ended December 31, 2016.

Cost of Revenues

Total cost of revenues was $36.7 million and $34.1 million for the years ended December 31, 2016 and 2015, respectively, representing an increase of approximately $2.6 million, or 7.6%. This increase in cost of revenues was primarily attributable to:

- $7.2 million in Broadsmart UCaaS related cost of goods sold, which included approximately $2.1 million in depreciation and amortization expense related to acquired assets,
- a $0.5 million increase in shipping and handling costs reflecting an increase in direct sales volume, and
- a $0.4 million increase in the cost of devices and related products due to (a) a $0.8 million increase in broker commissions, primarily related to the mobile app sales, and (b) a $0.6 million increase in the cost of powerbanks, partially offset by a $1.0 million decrease in the cost of magicJack devices.

These increases in components of cost of revenues were partially offset by: (i) a $3.0 million decrease in network and carrier charges primarily as a result of lower traffic substantially resulting from the elimination of free App users at the end of Q2 2016, (ii) $2.1 million decrease in other cost of revenues primarily attributable to a decrease in overhead allocation reflecting lower personnel related costs and amortization expense, and (iii) a $0.4 million decrease in credit card processing fees.

Operating Expenses

Total operating expenses were $46.9 million and $41.5 million for the years ended December 31, 2016 and 2015, respectively, representing an increase of $5.4 million, or 13.1%. This increase in operating expenses is primarily attributable to:

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- a $6.8 million increase in G&A expense due to several factors including: (a) $6.1 million in costs associated with the SMB segment, (b) $3.1 million in costs associated with the Broadsmart UCaaS business, (c) $1.1 million in costs associated with our joint venture, and (c) $1.0 million impairment of intangible assets; partially offset by cost reductions in the Core Consumer segment totaling $4.5 million, primarily in the areas of personnel related costs and customer care related costs; and
- a $1.3 million increase in R&D expenses related to the new SMB segment, partially offset by cost reductions of $0.7 million in the Core Consumer segment.

These increases were partially offset by a $1.7 million consideration adjustment/gain on mark-to-market related to the Broadsmart Earnout Payment. There was also a small net decrease of $0.3 million in consolidated marketing expense. By segment, the changes were a $4.6 million decrease in the Core Consumer segment due to reduced media buys and personnel related costs, partially offset by the addition of: (a) $3.5 million in costs associated with the SMB segment, (b) $0.4 million in costs associated with the Enterprise segment (Broadsmart), and (c) $0.4 million in costs associated with the “Other” segment.

Other Income (Expense)

Total other income (expense) was not significant for the years ended December 31, 2016 and 2015.

Income Taxes

Total income tax expense was $8.7 million and $11.8 million for the years ended December 31, 2016 and 2015, respectively. The calculation of our effective income tax rate for the years ended December 31, 2016 and 2015 is as follows (in thousands):

	Year Ended December 31, 2016	2015
Income before taxes	$13,775	$25,312
Income tax expense (benefit)	8,719	11,802
Effective income tax rate	63.30 %	46.63 %

We primarily operate in the U.S. and Israel. Our U.S. operations are subject to a federal statutory income tax rate of 34% in 2016 and 2015 and our Israeli operations are subject to a statutory income tax rate of 25.0% in 2016 and 26.5% in 2015. Our Israeli operations will be subject to a statutory income tax rate of 24.0% in 2017 and 23.0% in 2018. The income tax provision for 2016 and 2015 included items that have resulted in significant variances in our effective tax rate in comparison to statutory rates.

For the year ended December 31, 2016, we recorded an income tax expense of $8.7 million, which is higher than the expected tax provision of $4.7 million, using the statutory income tax rate of 34% due, in part, to the net impact of a decrease in the Israeli corporate tax rate from 26.5% to 23.0% which was effective in December 2016. The decrease in the rate resulted in the need to reduce our Israeli deferred tax assets, primarily net operating loss carryforwards, which resulted in deferred tax expense and a reduction in the value of related deferred tax assets of $5.2 million. Additionally, the effective tax rate was impacted by increases to uncertain tax positions of ($0.8 million), decreases in valuation allowances of ($1.2 million), and other items of $0.8 million. The items noted above were partially offset by the lower jurisdictional tax rate charged on the operating income of our Israeli operations.

The 2017 estimated annual effective tax rate is expected to approximate 35%, excluding discrete tax items, but may fluctuate during the year due to changes in our jurisdictional income and due to the timing of other discrete period transactions.

For the year ended December 31, 2015, we recorded income tax expense of $11.8 million, which differed from the expected provision of $8.6 million, using the statutory rate of 34%, primarily due to changes in valuation allowances of $1.3 million established against certain Israeli capital losses and state net operating loss carryforwards, increases to uncertain tax positions of $0.5 million, a decrease to deferred tax assets associated with expired stock options of $0.7 million, and other one-time discrete items of $0.7 million. State income tax (benefit), net of federal tax benefit, is presented in the effective tax rate reconciliation exclusive of changes in valuation allowances on state income tax deferred items.

As of December 31, 2016 and 2015, we had an income tax payable and prepaid income taxes balance of $1.0 million and $2.7 million, respectively.

Noncontrolling Interest

During the year ended December 31, 2016, we formed a new subsidiary and entered into a joint venture with an unrelated third party which resulted in a 60% controlling interest in the joint venture which began selling a line of high-technology residential consumer products in the fourth quarter of fiscal year 2016. To date we have spent approximately $1.6 million funding the operations of this joint venture. The operations of the joint venture for the year ended December 31, 2016 have not been significant to our financial statements. Our consolidated financial statements for the year ended December 31, 2016, include an adjustment to income attributable to magicJack VocalTec Ltd. common shareholders of $635 thousand, to recognize the impact of the noncontrolling interest. We have determined that the joint venture does not meet either the aggregation criteria to be combined with the existing Core Consumer segment or the quantitative thresholds to be treated as a separately reportable segment. As such, it is included in “Other” in our segment reconciliation. Refer to Note 16, “Segment Reporting,” in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

Net Income Attributable to Common Shareholders and Income Per Share

As a result of the foregoing items, net income attributable to common shareholders decreased to $5.7 million in 2016 as compared to $13.5 million in 2015, primarily as a result of net losses of $11.0 million, $2.2 million and $1.6 million in the SMB, Enterprise and “Other” segments, respectively. The losses were partially offset by an increase in net income of $7.0 million from the Core Consumer segment and an adjustment of $0.6 million for the impact of the noncontrolling interest. Income per diluted share attributable to magicJack VocalTec Ltd. common shareholders decreased to $0.35 per common share in 2016 as compared to $0.79 per common share in 2015 due to the decrease in net income, partially offset by a decrease of approximately 1.0 million (or 5.8%) in the weighted average number of common shares outstanding in 2016 as compared to 2015 primarily due to our 2015 share repurchase program.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of liquidity are cash generated from operations, cash on hand, and investments. As of December 31, 2017, we had cash and cash equivalents of $52.6 million, investments of $0.4 million and accounts receivables of $2.4 million. Accounts payable and income taxes payable at December 31, 2017, were $3.2 million and $0.0 million, respectively. During the year ended December 31, 2017, our cash increased from $52.4 million as of December 31, 2016 to $52.6 million as of December 31, 2017. The relatively small change in our cash balance reflects reduced operating cash flows due to lower revenue combined with one time charges related to the strategic process, executive management change and the proxy contest, as well as our investment in the SMB business.

During the year ended December 31, 2017, we generated positive operating cash flows of $2.0 million, as compared to $15.3 million for the year ended December 31, 2016. The $13.3 million decrease was primarily attributable to the decrease in net income discussed above. Net loss was ($25.0) million for the year ended December 31, 2017 as compared to net income of $5.1 million for the year ended December 31, 2016.

As of December 31, 2017, we had approximately $52.6 million in cash and cash equivalents. The distribution of funds to shareholders is governed by Israeli law which places certain restrictions on a company's ability to declare dividends, perform share buy-backs and make other cash distributions. As an Israeli entity, the Company must comply with those restrictions, which would cause any such cash distribution or use of cash to be subject to significant delays.

We currently believe that available funds and cash flows generated by operations will be sufficient to fund our working capital and capital expenditure requirements for at least the next twelve months. If we decide to make future acquisitions, we may require new sources of funding, including additional debt, equity financing or some combination thereof. There can be no assurances that we will be able to secure additional sources of funding or that such additional sources of funding will be available on acceptable terms.

Cash Flow – Operating Activities

Net cash provided by operating activities was $2.0 million, $15.3 million and $25.4 million for the years ended December 31, 2017, 2016 and 2015, respectively.

During the year ended December 31, 2017, net cash provided by operating activities was primarily attributable to:

- ($25.0) million of net loss, which included $37.2 million in non-cash items, consisting primarily of (i) $31.5 million impairment loss on intangible assets, including goodwill, of the Enterprise segment, (ii) $4.4 million of depreciation and amortization expense, (iii) $3.0 million of stock-based compensation expense, and (iv) a $2.6 million increase in uncertain tax positions, partially offset by a $4.6 million deferred income tax benefit; and
- Changes in operating assets and liabilities of (i) a $3.4 million increase in prepaid income taxes, (ii) an $11.4 million decrease in deferred revenue, and (iii) a $2.0 million decrease in accrued expenses and other current liabilities. These items were partially offset by (i) a $0.7 million decrease in accounts receivable, ii) a $2.5 million decrease in inventory levels, iii) a $2.0 million decrease in receivable from earnout escrow and iv) a $0.7 million increase in accounts payable.

During the year ended December 31, 2016, net cash provided by operating activities was primarily attributable to:

- $5.1 million of net income; which included $12.7 million in non-cash items consisting primarily of (i) $4.2 million of share-based compensation expense, (ii) $4.7 million of depreciation and amortization expense, (iii) a $2.0 million impairment of intangible assets, (iv) a $0.3 million increase in uncertain tax positions, and (v) a $4.4 million decrease in deferred income tax provision, partially offset by a $1.7 million gain on mark-to-market related to the Broadsmart Earnout Payment;
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Changes in operating assets and liabilities of (i) a $1.6 million decrease in inventory levels; (ii) a $2.0 million decrease in prepaid income taxes; (iii) a $1.5 million increase in accounts payable, and (iv) a $1.5 million increase in income taxes payable. These items were partially offset by: (i) a $10.2 million decrease in deferred revenue; (ii) a $1.0 million decrease in accrued expenses and other current liabilities; and (iii) a $0.4 million increase in deposits and other current assets.

During the year ended December 31, 2015, net cash provided by operating activities was primarily attributable to:

- $13.5 million net income, which included $20.1 million in net non-cash items consisting primarily of (i) $5.3 million in share-based compensation related primarily to ordinary share options and restricted stock units issued to executives, (ii) $3.6 million of depreciation and amortization expense, (iii) $12.9 million in deferred tax expense, (iv) $0.1 million in the provision for billing adjustments, and (v) $0.1 million in non-cash interest, offset in part by a $1.8 million decrease in uncertain tax positions,

- Changes in operating assets and liabilities of (i) $0.7 million decrease in deferred costs related to the magicJack device, (ii) a $3.1 million decrease in prepaid income taxes, (iii) a $1.6 million increase in accrued bonus, and (iv) $0.9 million decrease in accounts receivable; offset in part by (i) $8.5 million decrease in deferred revenues primarily as a result of lower sales of magicJack devices, (ii) $0.1 million increase in inventories, (iii) $1.0 million increase in deposits and other current assets, (iv) $1.8 million decrease in accounts payable, (v) a $0.9 million decrease in income taxes payable and (vi) $2.3 million decrease in accrued expenses and other current liabilities.

Cash Flow – Investing Activities

Net cash used in investing activities was $1.4 million, $41.0 million and $1.0 million for the years ended December 31, 2017, 2016 and 2015, respectively. Net cash used in investing activities during the year ended December 31, 2017 was primarily attributable to the acquisition of software licenses and property and equipment. Net cash used in investing activities during the year ended December 31, 2016 was primarily attributable to the acquisition of Broadsmart. Net cash used in investing activities during the year ended December 31, 2015 was attributable to $1.0 million used for purchases of property and equipment.

Cash Flow –Financing Activities

Net cash used in financing activities was $0.4 million $0.4 million and $21.7 million for the years ended December 31, 2017, 2016 and 2015, respectively.

Net cash used in financing activities for the years ended December 31, 2017 and 2016 relates primarily to the repurchase of shares to settle executives' tax withholding liability upon the vesting of restricted stock units during the years.

Net cash used in financing activities during the year ended December 31, 2015 primarily consisted of: (i) $20.0 million in cash used to purchase treasury stock as part of our share repurchase program, (ii) payment of $1.5 million for the last of five installment payments for the purchase of certain intangible assets in 2011, and (iii) $0.2 million in cash used to repurchase shares to settle executives' tax withholding liability upon the vesting of restricted stock units during the year.

Stock Repurchase Program

In the first quarter of 2015, our Board of Directors authorized a stock repurchase program to enable us to purchase our ordinary shares at such times as management deemed appropriate up to a maximum cumulative repurchase authority of $20.0 million. The objective of our stock repurchase program was to improve stockholders' returns. As of December 31, 2015, we had expended the maximum authorized amount of $20.0 million for the acquisition of ordinary shares under the 2015 stock repurchase program. All shares purchased, and not yet retired, are recorded as treasury shares. We repurchased 2,329,003 ordinary shares under this program through December 31, 2015. We had no stock repurchase activity in the years ended December 31, 2016 and 2017.

Our Board of Directors had previously authorized a stock repurchase program to enable us to purchase our ordinary shares at such times as management deemed appropriate up to a maximum cumulative repurchase authority of $100.0 million. The objective of our stock repurchase program was to improve stockholders' returns. As of December 31, 2014, we had repurchased $91.3 million of ordinary shares under the previous stock repurchase program, and there was $8.7 million that remained authorized to purchase ordinary shares pursuant to the stock repurchase program. This program was terminated when our Board of Directors approved the new $20.0 million program in the first quarter of 2015. All shares purchased, and not yet retired, were recorded as treasury shares. There was no repurchase activity related to our previous stock repurchase program for the years ended December 31, 2017, 2016 or 2015. We repurchased 6,143,731 ordinary shares under this program through December 31, 2015.

We have in the past bought call option contracts and sold put option contracts in connection with our share repurchase program in order to attempt to lower the average share price paid for ordinary shares it purchased. There were no outstanding put option contracts at December 31, 2017, 2016 or 2015, and we do not expect to buy call options or sell common equity put options in the future as part of any share repurchase program. We did not purchase any call option contacts or sell any put option contracts during the years ended December 31, 2017, 2016 or 2015.

Other Liabilities

Refer to Note 9, “Other Liabilities,” in the Notes to our Consolidated Financial Statements included in Item 8 herein for details.

RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Note 2, Summary of Accounting Policies, in the Notes to our Consolidated Financial Statements included in Item 8 herein for details.

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

Contractual Obligations

The impact that our aggregate contractual obligations as of December 31, 2017 are expected to have on our liquidity and cash flow in future periods is as follows (in thousands):

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating lease obligations	$1,407	$741	$535	$131	$-
Accrued severance pay (1)	$468	$-	$-	$-	$468
Uncertain tax positions	$13,063	$1,360	$1,707	$5,501	$4,495
Total contractual obligations	$14,938	$2,101	$2,242	$5,632	$4,963

(1) As of December 31, 2017, we had $0.3 million in severance pay funds in reserve to settle such liabilities.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of December 31, 2017.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to financial market risks that are inherent in its financial statements, including changes in interest rates, equity and derivative prices and foreign currency exchange rates that could adversely affect its results of operations or financial condition.

Exposure to Interest Rates

The primary objective of the Company’s investment activities is to preserve its capital until it is required to fund operations while at the same time maximizing the income the Company receives from its investments without incurring investment market volatility risk. The Company’s investment income is sensitive to the general level of United States interest rates. In this regard, changes in the United States interest rates affect the interest earned on the Company’s cash and cash equivalents. Due to the short-term nature of the Company’s cash and cash equivalent holdings, a 10% movement in market interest rates would not materially impact the total fair market value of the Company’s portfolio as of December 31, 2017.

Exposure to Exchange Rates

The Company’s overseas expenses are incurred primarily in connection with the manufacturing of the magicJack devices and expenses related to its operations in Israel. The majority of the Company’s overseas expenses are influenced by exchange rate fluctuations in local currencies, including NIS, PLN, Hong Kong dollars, Taiwan dollars and Chinese yuan. Due to the small percentage of the Company’s expenses that are influenced by exchange rate fluctuations, a 10% movement in currency exchange rates would not materially impact the Company’s results of operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors
magicJack VocalTec, Ltd. and Subsidiaries
Netanya, Israel

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of magicJack VocalTec, Ltd. (the “Company”) and subsidiaries as of December 31, 2017 and 2016, the related consolidated statements of operations, capital equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company and subsidiaries at December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 16, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BDO USA, LLP

Certified Public Accountants

We have served as the Company's auditor since 2007.

West Palm Beach, Florida

March 16, 2018

59

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

	December 31, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$52,638	$52,394
Investments, at fair value	369	447
Accounts receivable, net of allowance for doubtful accounts and billing adjustments of $234 and $402, respectively	2,428	3,171
Inventories	1,880	4,441
Deferred costs	1,936	2,319
Prepaid income taxes	2,016	527
Receivable from earnout escrow	-	2,000
Deposits and other current assets	1,874	1,970
Total current assets	63,141	67,269
Property and equipment, net	2,772	3,805
Intangible assets, net	10,190	28,854
Goodwill	32,304	47,185
Deferred tax assets	31,726	26,568
Deposits and other non-current assets	909	836
Total assets	$141,042	$174,517
LIABILITIES AND CAPITAL EQUITY		
Current liabilities:		
Accounts payable	$3,199	$2,790
Income tax payable	-	1,527
Accrued expenses and other current liabilities	6,454	8,426
Deferred revenue, current portion	42,243	48,507
Total current liabilities	51,896	61,250
Deferred revenue, net of current portion	38,797	44,201
Other non-current liabilities	13,787	10,866
Total liabilities	104,480	116,317
Commitments and contingencies (Note 10)		
Capital equity		
Ordinary shares, No par value; 100,000 shares authorized; 25,072 and 25,039 shares issued at December 31, 2017 and 2016, respectively	112,038	111,783
Additional paid-in capital	13,848	13,567
Treasury stock (8,882 and 8,988 shares at December 31, 2017 and 2016, respectively)	(118,146)	(120,300)
Retained earnings	28,822	53,785
Total magicJack VocalTec Ltd. shareholders' equity	36,562	58,835
Noncontrolling interest	-	(635)
Total capital equity	36,562	58,200
Total liabilities and capital equity	$141,042	$174,517

See accompanying notes to consolidated financial statements.

60

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

	Year Ended December 31,		
	2017	2016	2015
Net revenues	$87,993	$97,398	$100,962
Cost of revenues	32,938	36,734	34,142
Gross profit	55,055	60,664	66,820
Operating expenses:			
Marketing	8,282	9,085	9,409
General and administrative	38,425	33,327	27,547
Impairment of intangible assets and goodwill	31,527	998	-
Research and development	5,896	5,199	4,521
Consideration adjustment/ Gain on mark-to-market	(894)	(1,700)	-
Total operating expenses	83,236	46,909	41,477
Operating (loss) income	(28,181)	13,755	25,343
Other income (expense):			
Interest and dividend income	123	26	26
Interest expense	-	-	(57)
Other (expense) income, net	(34)	(6)	-
Total other income (expense)	89	20	(31)
(Loss) income before income taxes	(28,092)	13,775	25,312
Income tax (benefit) expense	(3,129)	8,719	11,802
Net (loss) income	(24,963)	5,056	13,510
Net loss attributable to noncontrolling interest	-	635	-
Net (loss) income attributable to magicJack VocalTec Ltd. common shareholders	$(24,963)	$5,691	$13,510
(Loss) income per share attributable to magicJack VocalTec Ltd. common shareholders:			
Basic	$(1.55)	$0.36	$0.80
Diluted	$(1.55)	$0.35	$0.79
Weighted average common shares outstanding:			
Basic	16,088	15,815	16,975
Diluted	16,088	16,064	17,045

See accompanying notes to consolidated financial statements.

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CAPITAL EQUITY
For the Years Ended December 31, 2017, 2016 and 2015
(in thousands)

	Common Stock		Additional Paid-in Capital	Treasury Stock		Retained Earnings	Noncontrolling Interest	Total Capital Equity
	Number	Amount		Number	Amount			
Balance, December 31, 2014	25,032	$111,771	$ 10,414	(7,164)	$(107,683)	$34,584	$ -	$49,086
Exercise of ordinary share options	4	2	-	-	-	-	-	2
Share-based compensation	-	-	5,268	-	-	-	-	5,268
Issuance of ordinary shares	-	-	(1,109)	90	1,109	-	-	-
Purchase of treasury stock	-	-	-	(2,352)	(20,198)	-	-	(20,198)
Net income	-	-	-	-	-	13,510	-	13,510
Balance, December 31, 2015	25,036	$111,773	$ 14,573	(9,426)	$(126,772)	$48,094	$ -	$47,668
Exercise of ordinary share options	3	10	-	-	-	-	-	10
Share-based compensation	-	-	4,220	-	-	-	-	4,220
Issuance of ordinary shares	-	-	(3,293)	267	3,293	-	-	-
Issuance of shares for acquisition	-	-	(1,933)	233	3,609	-	-	1,676
Purchase of treasury stock	-	-	-	(62)	(430)	-	-	(430)
Net income	-	-	-	-	-	5,691	(635)	5,056
Balance, December 31, 2016	25,039	$111,783	$ 13,567	(8,988)	$(120,300)	$53,785	$ (635)	$58,200
Exercise of ordinary share options	-	-	(939)	181	2,239	-	-	1,300
Share-based compensation	-	-	3,042	-	-	-	-	3,042
Issuance of ordinary shares	17	140	(1,912)	144	1,772	-	-	-
Reclassification of shares*	16	115	90	(16)	(205)	-	-	-
Purchase of treasury stock	-	-	-	(203)	(1,652)	-	-	(1,652)
Deconsolidation of subsidiary	-	-	-	-	-	-	635	635
Net loss	-	-	-	-	-	(24,963)	-	(24,963)
Balance, December 31, 2017	25,072	$112,038	$ 13,848	(8,882)	$(118,146)	$28,822	$ -	$36,562

* represents shares previously recorded as treasury stock that were reclassified as they were issued as new shares.

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2017	2016	2015
Cash flows from operating activities:			
Net (loss) income	$(24,963)	$5,056	$13,510
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Provision for doubtful accounts and billing adjustments	-	203	81
Share-based compensation	3,042	4,220	5,268
Depreciation and amortization	4,374	4,733	3,585
Gain on mark-to-market	-	(1,700)	-
Impairment of intangible assets and goodwill	31,527	998	-
(Decrease) increase of uncertain tax positions	2,628	(315)	(1,789)
Deferred income tax provision (benefit)	(4,605)	4,418	12,863
Interest expense - non-cash	-	-	57
Loss on disposal of assets	243	-	-
Change in operating assets and liabilities, net of business acquisitions			
Accounts receivable	736	118	897
Inventories	2,456	1,584	(88)
Deferred costs	300	(222)	668
Deposits and other current assets	(3,285)	2,366	2,125
Receivable from earnout escrow	2,000	-	-
Other non-current assets	206	11	(8)
Accounts payable	653	1,522	(1,782)
Income taxes payable	38	1,527	(873)
Accrued expenses and other current liabilities	(2,004)	966	(679)
Deferred revenue	(11,394)	(10,164)	(8,527)
Other non-current liabilities	75	(71)	56
Net cash provided by operating activities	2,027	15,250	25,364
Cash flows from investing activities:			
Proceeds from sales of investment in joint venture	245	-	-
Proceeds from sales of property and equipment	25	-	-
Purchases of marketable securities	-	(80)	-
Purchases of property and equipment	(611)	(605)	(1,024)
Acquisition of intangible assets	(1,090)	(321)	-
Acquisition of Broadsmart, net of cash acquired	-	(40,019)	-
Net cash used in provided by investing activities	(1,431)	(41,025)	(1,024)
Cash flows from financing activities:			
Purchase of treasury stock	-	-	(20,000)
Repurchase of ordinary shares to settle withholding liability	(455)	(430)	(198)
Proceeds from exercise of ordinary share options	103	10	2
Payment of other current liabilities	-	-	(1,500)
Net cash used in financing activities	(352)	(420)	(21,696)
Net increase (decrease) in cash and cash equivalents	244	(26,195)	2,644
Cash and cash equivalents, beginning of year	52,394	78,589	75,945

Cash and cash equivalents, end of year	$52,638	$52,394	$78,589

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2017	2016	2015
Supplemental disclosures:			
Income taxes paid	$3,321	$1,495	$5,213
Non-cash investing and financing activities:			
Property and equipment (acquired but not paid)	$-	$182	$-
Ordinary shares issued for purchase of Broadsmart	$-	$1,676	$-

See accompanying notes to consolidated financial statements.

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Description of Business

magicJack VocalTec Ltd. and its subsidiaries (the “Company”) is the cloud communications leader that invented the magicJack device as well as other telecommunication products and services. The Company is a vertically integrated group of companies, with capabilities including Voice-over-Internet-Protocol (“VoIP”) services and related equipment sales, micro-processor chip design and development of the magicJack device. In addition to residential consumers, the Company provides VoIP services and related equipment to small to medium sized businesses at competitive prices and wholesales telephone service to VoIP providers and telecommunication carriers. In 2016, the Company acquired a provider of hosted Unified Communication as a Service (“UCaaS”) and seller of hardware and network equipment focusing on medium-to-large, multi-location enterprise customers.

magicJack devices 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, business and travel. magicJack devices come with the right to access the Company’s servers ("access right"), which provides customers the ability to obtain free telephone services. Access rights are renewable. The Company currently offers the magicJack GO version of the device, which has its own CPU and can connect a regular phone directly to the user’s broadband modem/router and function as a standalone phone without using a computer. The sale of devices is done through distribution channels that include retailers, wholesalers and direct to customer sales via the Company’s web-site.

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.

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 that it will complete the Transaction in the first half of 2018.

The Company was incorporated in the State of Israel in 1989 and is domiciled in Netanya, Israel, with executive and administrative offices, and a customer care call center in West Palm Beach, Florida. In addition the Company has offices for technology management in Franklin, Tennessee, research and development in Plano, Texas, Sunnyvale, California, Alpharetta, Georgia and Warsaw, Poland and the UCaaS provider in West Palm Beach and Fort Lauderdale, Florida.

Basis of Presentation

The Company's consolidated financial statements are prepared in conformity with United States generally accepted accounting principles (“GAAP”). References to authoritative accounting literature in this report, where applicable, are based on the Accounting Standards Codification (“ASC”). The Company's functional and reporting currency is the United States Dollar (“U.S. Dollar”), which is the currency of the primary economic environment in which the Company's consolidated operations are conducted. Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in currencies other than dollars, including Israeli New Shekel (”NIS”) and Polish Zloty (“PLN”), are re-measured in dollars and any gains or losses are recognized in the Company's earnings in the period they occur.

Prior to 2016, the Company prepared its consolidated financial statements on the basis of being a single reporting entity. In 2016, with the acquisition of North American Telecommunications Corporation (“NATC”) d/b/a Broadsmart (“Broadsmart”) and the internal development of magicJack SMB, Inc. (“SMB”), the Company began reporting the results of its operations as separate reportable segments – “Core Consumer,” “Enterprise” and “SMB”. During the first quarter of 2017, management restructured the Company to absorb all operations and functions of the SMB Segment within the Core Consumer segment. Accordingly, this segment will not show activity for periods after March 31, 2017. Refer to Note 16, “Segment Reporting” for further details.

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

Basis of Consolidation

The Company's consolidated financial statements include the accounts of magicJack VocalTec Ltd. and its wholly-owned subsidiaries, YMax Corporation, YMax Communications Corp., magicJack Holdings Corporation, magicJack, LP, SJ Labs, Inc., Tiger Jet Network, Inc., VocalTec Communications, LLC ("VocalTec US", formerly Stratus Telecommunications, LLC), Broadsmart Global, Inc. ("Broadsmart"), and magicJack SMB, Inc. The results of Broadsmart Global, Inc. have been included since March 17, 2016. Refer to Note 15, "Acquisition of Business," for further details. The results of SMB have been included since the first quarter of 2016. All intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior periods consolidated financial statement amounts to conform to the current presentation.

Noncontrolling Interest

During the year ended December 31, 2016, the Company formed a new subsidiary and entered into a joint venture with an unrelated third party which resulted in the Company having a 60% controlling interest in the joint venture which began selling a line of high-technology residential consumer products in the fourth quarter of fiscal year 2016. On March 31, 2017, this interest was reduced to 36% and on June 30, 2017 the Company sold its remaining interest to the unrelated third party. Based on the difference between the sales price from the agreement and the carrying value of the asset, the Company recognized an impairment loss of $0.4 million in general and administrative expense in the Core Consumer segment of the consolidated statement of operations for the year ended December 31, 2017.

The operations of the joint venture for the years ended December 31, 2017 and 2016 have not been significant to the Company's financial statements. The Company's consolidated financial statements for the year ended December 31, 2016, include an adjustment to income attributable to magicJack VocalTec Ltd. common shareholders of $635 thousand, to recognize the impact of the noncontrolling interest. The Company has determined that the joint venture did not meet either the aggregation criteria to be combined with the existing Core Consumer segment or the quantitative thresholds to be treated as a separate reportable segment. As such, it is included in the "Other" category of the Company's segment reconciliation. Refer to Note 16, "Segment Reporting," for further details.

NOTE 2 – SUMMARY OF ACCOUNTING POLICIES

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

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Such estimates and judgments are revised periodically as required. Actual results could differ from those estimates. Significant estimates include the recoverability of long-lived assets and goodwill, income taxes, income tax valuation allowance, uncertain tax liabilities, the value of ordinary shares issued in asset acquisitions, business combinations or underlying the Company's ordinary share options, the expected forfeitures of ordinary share options and estimates of likely outcomes related to certain contingent liabilities.

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

Fair Value

The Company accounts for financial instruments in accordance with ASC Topic 820, "Fair Value Measurements and Disclosures " (“ASC 820”), which provides a framework for measuring fair value and expands required disclosure about fair value measurements of assets and liabilities. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1 – Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Valuations based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 – Valuation based on inputs that are unobservable and significant to the overall fair value measurement.

When available, the Company uses quoted market prices to determine fair value, and it classifies such measurements within Level 1. Fair value measurements are classified according to the lowest level input or value-driver that is significant to the valuation. Fair value includes the consideration of nonperformance risk. Nonperformance risk refers to the risk that an obligation (either by a counterparty or the Company) will not be fulfilled. For the Company's financial assets traded in an active market (Level 1), the nonperformance risk is included in the market price. The Company's assets and liabilities measured on a recurring basis at fair value may include marketable securities and time deposits. As of December 31, 2017 and 2016, all of them are Level 1 instruments, except for debt securities, which are Level 2 instruments. The fair value of Level 2 securities is estimated based on observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts payable and accrued expenses are expected to approximate fair value because of their immediate availability, near term maturities or potential interest payments at settlement.

Cash and Cash Equivalents

The Company considers all highly-liquid financial instruments with a maturity at acquisition of three months or less to be cash equivalents.

Investments

Investments consist of time deposits with maturity dates of greater than 90 days totaling $369 thousand and $447 thousand at December 31, 2017, and 2016, respectively. The fair value of time deposits at December 31, 2017 and 2016 was determined based on its face value, which approximates its fair value and is a Level 1 input. There was no realized gain or loss on investments for the years ended December 31, 2017, 2016 and 2015.

Allowance for Doubtful Accounts and Billing Adjustments

The Company maintains an allowance for doubtful accounts and billing adjustments based on the expected collectability of its accounts receivables. That estimate is based on historical collection experience, current economic and market conditions and a review of the current status of each customer's trade accounts receivable. The allowance includes estimates of billing adjustments, which are negotiated with other telecommunication carriers and are common in the telecommunication industry. The changes in allowance for doubtful accounts and billing adjustments for the years ended December 31, 2017, 2016 and 2015 are as follows (in thousands):

	Year Ended December 31,		
	2017	2016	2015
Balance, beginning of period	$402	$455	$1,171
Change in provision for doubtful accounts	3	214	75
Change in provision for billing adjustments	(3)	(12)	6

Recoveries	-	-	(10)
Write-offs	(168)	(255)	(787)
Balance, end of period	$234	$402	$455

67

The Company settled certain Enterprise segment receivable disputes during the year ended December 31, 2017, which resulted in the write-offs of approximately $0.2 million of accounts receivables the Company had previously reserved. The Company settled certain carrier receivable disputes during the years ended December 31, 2016 and 2015, which resulted in the write-offs of approximately $0.3 million and $0.8 million, respectively, of accounts receivables the Company had previously reserved.

Certain Risks and Concentrations

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, marketable securities and accounts receivable. Cash equivalents generally consist of money market instruments.

The Company places its cash and cash equivalents in high quality financial institutions and management believes that the Company is not exposed to any significant risk on its cash accounts. The Company maintains accounts with various banks and brokerage organizations and constantly monitors the creditworthiness of these institutions. Cash accounts at each U.S. bank are insured by the FDIC up to $250 thousand in the aggregate and may exceed federally insured limits. Cash accounts at each foreign bank are not insured. The Company has never experienced any losses related to these balances. At December 31, 2017, the Company had cash and cash equivalents totaling $52.6 million, which included (i) $52.0 million in U.S. banks, and (ii) $0.6 million in foreign financial institutions.

The Company's non-interest bearing cash balances in U.S. banks, which included $1.7 million in one individual financial institution, were fully insured, except for $11 thousand that exceeded insurance limits at December 31, 2017. The Company had money market accounts with financial institutions with balances totaling approximately $50.2 million.

For the Core Consumer segment, no telecommunication carriers accounted for more than 10% of the segment's gross accounts receivable at December 31, 2017 and 2016. For the years ended December 31, 2017, 2016 and 2015, no telecommunication carrier accounted for more than 10% of the segment's total operating revenue.

For the Core Consumer segment, one customer accounted for approximately 11% of the segment's gross accounts receivable at December 31, 2017. Three customers accounted for approximately 34% of the segment's gross accounts receivable at December 31, 2016. For the years ended December 31, 2017, 2016 and 2015, no retailer accounted for more than 10% of the segment's total operating revenues.

For the Enterprise segment, two U.S. customers accounted for approximately 55% of gross accounts receivable at December 31, 2017. No customer accounted for more than 10% of gross accounts receivable at December 31, 2016. For the years ended December 31, 2017 and 2016, two customers accounted for approximately 29% of the segment's total operating revenues.

For the former SMB segment, accounts receivable were not significant at December 31, 2016. The former segment's operating revenues were not significant for the year ended December 31, 2016 or the three months ended March 31, 2017.

Inventories

Inventories are stated at the lower of cost or net realizable value, with cost primarily determined using the first-in first-out cost method. Inventory is written off at the point it is determined to be obsolete.

Receivable from Earnout Escrow

The 2016 acquisition of Broadsmart, described in Note 15, “Acquisition of Business,” included a contingent earnout payment of $2.0 million in cash, if the acquired assets generated 2016 revenues of at least $15.6 million. The $2.0 million was paid into escrow at the time of closing. Revenues for the year ended December 31, 2016 did not reach the target and the Company recorded the funds on the accompanying consolidated balance sheet as a receivable from earnout escrow. These funds were received during the year ended December 31, 2017.

Property, Equipment and Depreciation Expense

Property and equipment are accounted for under ASC 350 and consist primarily of servers, computer hardware, furniture, and leasehold improvements. Property and equipment are stated at cost and depreciated using the straight-line method over their estimated useful lives, which range from three to fifteen years. Leasehold improvements are depreciated over the shorter of the term of the lease or useful life of the assets. The cost of substantial improvements is capitalized while the cost of maintenance and repairs are charged to operating expenses as incurred. Refer to Note 5, “Property and Equipment” for further details.

The Company reviews property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss is based on the fair value of the asset compared to its carrying value. Property and equipment to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

The Company’s hardware consists of routers, gateways and servers that enable the Company’s telephony services. Some of these assets may be subject to technological risks and rapid market changes due to the introduction of new technology, products and services and changing customer demand. These changes may result in future adjustments to the estimated useful lives and the carrying value of these assets. Changes in estimated useful lives are accounted on a prospective basis starting with the period in which the change in estimate is made in accordance with ASC Subtopic 250-10, “Accounting Changes and Error.”

Intangible Assets

Identifiable intangible assets are stated at cost and accounted for based on whether the useful life of the asset is definite or indefinite. Identified intangible assets with definite useful lives are amortized using the accelerated and straight-line methods over their estimated useful lives, which range from one to seventeen years. Intangible assets with indefinite lives are not amortized to operations, but instead are reviewed for impairment at least annually, or more frequently if there is an indicator of impairment.

The Company reviews definite lived intangible assets subject to amortization for possible impairment using a three-step approach. Under the first step, management determines whether an indicator of impairment is present (a “Triggering Event”). If a Triggering Event has occurred, the second step is to test for recoverability based on a comparison of the asset’s carrying amount with the sum of the undiscounted cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the undiscounted cash flows is less than the carrying amount of the asset, the third step is to recognize an impairment loss for the excess of the asset’s carrying amount over its fair value. Intangible assets subject to amortization to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

The Company recognized impairment charges of $16.6 million and $1.0 million on intangible assets during the years ended December 31, 2017 and 2016. In the year ended December 31, 2015, there were no deemed impairments of assets. Refer to Note 3, “Impairment of Intangible Assets, Including Goodwill” and Note 6, “Intangible Assets” for further details.

The costs of developing the Company’s intellectual property rights, intellectual property right applications and technology are charged to research and development expense as incurred.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets acquired in a business combination. Goodwill is not amortized to operations, but instead is reviewed for impairment at least annually, or more frequently if there is an indicator of impairment. Indicators include, but are not limited to: sustained operating losses or a trend of poor operating performance and a decrease in the Company’s market capitalization below its book value.

The Company’s valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and projections of future operating performance. If these assumptions differ materially from future results, the Company may record impairment charges in the future.

With the acquisition of Broadsmart and the founding of SMB in 2016, management began evaluating each of these new business lines separately and has allocated goodwill between the three reporting units that correspond to the reportable segments – “Consumer,” “Enterprise” and “SMB”. Refer to Note 7, “Goodwill” and Note 16, “Segment Reporting” further details.

The Company may utilize a qualitative assessment to determine if it is "more-likely-than-not" that the fair value of the reporting unit is less than its carrying value. If so, the two-step goodwill impairment test is required to be performed.

If not, no further testing is required and the Company documents the relevant qualitative factors that support the strength in its fair value. Qualitative factors may include, but are not limited to: macroeconomic conditions, industry and market considerations, cost factors that may have a negative effect on earnings, overall financial performance, and other relevant entity-specific events.

In prior years, the Company used the two-step goodwill impairment test. In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-04, "Intangibles – Goodwill and Other" which eliminated step two of the goodwill impairment test. The Company adopted ASU 2017-04 on a prospective basis in the first quarter of 2017.

The Company recognized impairment charges of $14.9 million on goodwill for the Enterprise reporting unit, the full balance for that unit, during the year ended December 31, 2017. There was no impairment of goodwill during the years ended December 31, 2016 and 2015. Refer to Note 3, "Impairment of Intangible Assets, Including Goodwill" and Note 7, "Goodwill" for further details.

Deferred Revenues

Deferred revenues for the Core Consumer segment consist primarily of billings and payments for magicJack devices and access rights renewals received in advance of revenue recognition. The Company bills and collects in advance for magicJack devices, which include an initial access right period, and access right renewals. The Company recognizes revenue from device sales and access right renewals ratably over the access right period, as described above.

For the Enterprise segment, deferred revenue consists of hardware or equipment purchased but not yet delivered and put into service. The Company recognizes revenue from UCaaS hardware or equipment sales in the period they are put into service.

Deferred revenues to be recognized over the next twelve months are classified as current and included in deferred revenue, current portion in the Company's consolidated balance sheets. The remaining amounts are classified as non-current in the consolidated balance sheets and included in deferred revenue, net of current portion.

Treasury Stock

The Company presents the cost of repurchasing treasury shares as a reduction in capital equity.

Net Revenues

Net revenues consist of revenue from sales of magicJack devices to retailers, wholesalers or directly to customers, access right renewal fees, fees charged for shipping magicJack devices, usage of domestic and international prepaid minutes, access charges to other carriers recurring sales of the Company's hosted UCaaS voice services, non-recurring sales of equipment related to its UCaaS services and other miscellaneous charges. The Company typically enters into multi-year agreements, with durations of three to five years, to provide the hosted voice and other services. The Company earns revenue from the sale of the hardware and network equipment necessary to operate its UCaaS services directly to its customers. All revenues are recorded net of sales returns and allowances.

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

Revenue Recognition

The Company recognizes revenue in accordance with ASC Topic 605, "Revenue Recognition" ("ASC 605"), which provides authoritative guidance on revenue recognition. For arrangements that include more than one product or service (deliverables), the Company applies Section 25 of ASC 605, "Multiple-Element Arrangements". ASC 605-25 establishes criteria for separating deliverables into different units of accounting and allocating consideration to those units of accounting. The Company is transitioning to ASC 606, “Revenue from Contracts with Customers” (“ASC 606”), which will be implemented in 2018.

Core Consumer Segment

magicJack Devices Revenue

magicJack devices include an access right, which qualify as multiple deliverables per ASC 605-25. Since the device and initial access right are interdependent and not sold separately, they are accounted for as a combined unit of accounting. Direct sales of devices include shipping charges and 30 days to return the device and cancel the service. For retail sales of devices, there is a delay between shipment to the retailer and the ultimate sale to a customer (end-user). Based on sales and inventory data provided by retail partners, the Company’s estimate of the delay for the years ended December 31, 2017, 2016 and 2015 was 30 days, 90 days and 90 days, respectively. The Company defers revenue recognition on direct sales for the 30 day return period and on retail sales for the delay period, after which the Company recognizes the revenue from device sales ratably over the remaining access right period.

Access Right Renewals and Mobile Apps

Customers may renew access rights for periods ranging from one month to five years. The revenue associated with access right renewals is deferred and recognized ratably over the extended access right period. Revenue from the sales of mobile app access rights is recognized ratably over the access right period.

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. 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 and Access and Wholesale Charges

The Company generates revenues from the sales of prepaid international minutes to customers, fees for origination of calls to 800-numbers, and access fees charged to other telecommunication carriers on a per-minute basis for Interexchange Carriers (“IXC”) calls terminated on the Company’s servers. Revenues from access fee charges to other telecommunication carriers are recorded based on rates set forth in the respective state and federal tariffs or negotiated contract rates, less a provision for billing adjustments. Revenues from prepaid minutes and access and wholesale charges are recognized as minutes are used.

Sales Return Policy

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

Returns from retailers are accepted on an authorized basis for devices deemed defective. The Company may offer certain retailers the limited right to return any unsold merchandise from their initial stocking orders. The Company also accepts returns of battery powerbanks for mobile devices within 30 days of sale. The Company estimates potential returns under these arrangements at point of sale and re-estimates potential returns on a quarterly basis. For the years ended December 31, 2017, 2016 and 2015, the Company’s estimates of returns and actual returns from initial stocking orders have not been materially different.

Enterprise Segment

UCaaS services and equipment sales related to the Broadsmart subsidiary qualify as multiple deliverables per ASC 605-25. Since the equipment and services are sold separately and can be used with other products and services, they are accounted for as separate units of accounting. The Company recognizes revenues from sales of its hosted services in the period the services are provided over the term of the respective customer agreements. Customers are billed monthly in advance for these recurring services and in arrears for one time service charges and other certain usage charges. Revenues from sales of hardware and network equipment are recognized in the period that the equipment is delivered. Revenue from the sale of equipment purchased but not yet delivered is deferred and recognized in the period that the hardware or equipment is put into service.

SMB Segment

SMB provided phone equipment and services that were interdependent and not sold separately. As such they were accounted for as a combined unit of accounting under ASC 605-25. Some agreements included a refund period or a promotion for free introductory service. Revenue recognition was deferred for either period, after which the Company recognized the revenue for the combined unit ratably over the remaining service period. Revenue from this segment was not significant for the three months ended March 31, 2017 or the year ended December 31, 2016. During the first quarter of 2017, management restructured the Company to absorb all operations and functions of the SMB segment within the Core Consumer segment. Accordingly, this segment will not show activity for periods after March 31, 2017.

Cost of Revenues

Core Consumer Segment

Cost of revenues for the Core Consumer segment include direct costs of operation of the Company's servers, which are expensed as incurred. These costs include the Company's internal operating costs, depreciation and amortization expense, access and interconnection charges to terminate domestic and international telephone calls on the public switched telephone network and related taxes. Direct costs also include regulatory costs, server maintenance, and costs to co-locate the Company's equipment in other telephone companies' facilities. Direct costs of producing magicJack devices are deferred on shipment and charged to cost of sales ratably over the initial access right period. Deferred costs are included in current assets in the Company's consolidated balance sheets.

Costs incurred for shipping and handling and credit card charges are included in cost of revenues and are expensed as incurred. Costs for shipping and handling and credit card charges were \$3.0 million, \$3.6 million and \$3.5 million for the years ended December 31, 2017, 2016 and 2015, respectively. Starting in the second quarter of 2017, these amounts include SMB.

Enterprise Segment

Cost of revenues related to the Company's UCaaS services include direct costs of providing the services, which are expensed as incurred. These costs include charges for access to the public switched telephone network, internet service for its customers, maintenance costs for its software, commissions, credit card charges, contract labor for installation and depreciation and amortization. The Company also incurs costs for hardware and equipment sold to customers, along with related shipping and installation costs, which are recognized in the period they are delivered and put into service.

SMB Segment

Cost of revenues for the SMB segment included direct costs of providing the services, which were expensed as incurred, and costs for phone equipment, which were recognized ratably over the service period. Cost of revenues from this segment were not significant for the three months ended March 31, 2017 or the year ended December 31, 2016.

Marketing Expenses

Marketing expenses consist primarily of advertising media buys for television commercials, Internet advertising and print advertising, as well as marketing related personnel costs and other marketing projects including sponsorships. Marketing costs are expensed when incurred. A break-down of marketing expenses by category is as follows (in thousands):

	Year Ended December 31,		
	2017	2016	2015
Advertising media buys	\$2,901	\$5,139	\$6,698
Marketing personnel related	2,373	2,037	1,487
Other marketing projects	3,008	1,909	1,224
Total marketing expenses	\$8,282	\$9,085	\$9,409

Research and Development Expenses

The Company's research and development activities consist primarily of the design and development of its proprietary software used in the magicJack devices, magicJack App and its servers, as well as the development of new products and applications for use in its VoIP service offerings. The Company accounts for research and development costs in accordance with applicable accounting pronouncements. These pronouncements specify that costs incurred internally in researching and developing a product should be charged to expense until technological feasibility has been established for the product. Once technological feasibility is established, all costs should be capitalized until the product is available for general release to customers. The Company has determined that technological feasibility for its products is reached after all high-risk development issues have been resolved through internal and customer base testing. Generally, new products offered to customers and improvements to the Company's servers are placed in service on attainment of technological feasibility. The Company has not capitalized any of its research and development costs.

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.

Share-based Compensation

Share-based compensation generally consists of option grants or ordinary share and restricted stock awards to directors, officers, employees or consultants. We account for share-based compensation in accordance with ASC 718, "Compensation - Stock Compensation", which requires companies to estimate the fair value of equity-based payment awards on the date of grant based on the fair value of the award. The value of the portion of the award that is ultimately expected to vest is recognized as an expense over the requisite service period. Refer to Note 12, “Share-Based Compensation” for further details.

Consideration Adjustment/Gain on Mark-to-Market

The acquisition of Broadsmart in March 2016, described in Note 15, “Acquisition of Business,” included an additional contingent payment of $2.0 million in cash to Todd A. Correll and Thomas J. Tharrington (Messrs. Correll and Tharrington are collectively referred to as the "Seller Shareholders"), if the acquired assets generate 2016 revenues equal to or exceeding $15.6 million (the "Earnout Payment"). The Earnout Payment will not exceed $2.0 million. The $2.0 million Earnout Payment was paid into escrow at the time of closing. With the help of a third party valuation firm, the value of this contingent consideration was determined to be $1.7 million which was included in total consideration of the business acquired. In the third quarter ended September 30, 2016, management concluded that it was remote that 2016 revenues of the acquired assets would equal or exceed $15.6 million, and accordingly recorded a $2.0 million receivable from earnout escrow in the consolidated balance sheets. Corresponding income of $1.7 million from change in contingent consideration was recorded as a reduction of operating expense labeled consideration adjustment/gain on mark-to-market in the consolidated statements of operations.

On June 23, 2017, the founders of Broadsmart left the Company. On August 4, 2017, the Company reached a mutual agreement with the founders that included release to the Company of $1.0 million of the $3.0 million held in escrow to cover indemnification claims and the $2.0 million earn-out amount. The remaining $2.0 million in the escrow to cover indemnification claims will remain in escrow until March 2019, pursuant to the provisions of the purchase agreement, to cover potential claims by the Company for telecommunications taxes. During the year ended December 31, 2017, the Company collected both escrow amounts. The $1.0 million was recorded as a consideration adjustment/gain on mark-to-market, less amounts due from the founders.

Interest and Dividend Income

Interest and dividends earned on the Company’s investments are accrued as income when earned.

Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their book basis using enacted tax rates. Any changes in enacted rates or tax laws are included in the provision for income taxes in the year of enactment. The Company’s net deferred tax assets consist primarily of foreign net operating loss carryforwards and timing differences between recognition of income for book and tax purposes. The Company records a valuation allowance to reduce the net deferred tax assets to the amount that it estimates is more-likely-than-not to be realized. The Company periodically reviews the composition of its deferred tax assets and related valuation allowances and will make adjustments if available evidence indicates that it is more likely than not a change in the carrying amounts is required.

The Company assesses its income tax positions and records tax benefits for all years subject to examination based upon its evaluation of the facts, circumstances and information available at the reporting date. For those tax positions where it is more likely than not that a tax benefit will be sustained, the Company has recorded the largest amount of tax benefit that may potentially be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions that are not more likely than not, no tax benefit has been recognized in the financial statements.

Earnings (Loss) per Share Attributable to Common Shareholders

Net income (loss) per share attributable to the Company’s shareholders – basic, is calculated by dividing net income (loss) attributable to common shareholders by the weighted average number of common shares outstanding during each period. Net income (loss) per share attributable to the Company’s shareholders – diluted, is computed using the weighted average number of common and potentially dilutive common share equivalents outstanding during the period. Potential common shares consist of shares issuable upon the exercise of options to purchase ordinary shares or the vesting of restricted stock.

Business Combinations

The Company accounts for business combinations under ASC 805, using the acquisition method of accounting. The acquisition method of accounting requires that the purchase price, including the fair value of contingent consideration, of the acquisition be allocated to the assets acquired and liabilities assumed using the fair values determined by management as of the acquisition date. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of assets acquired and the liabilities assumed. While the Company uses its best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the acquisition date, the Company's estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company records adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill to the extent the Company identifies adjustments to the preliminary purchase price allocation. Upon the conclusion of the measurement period and final determination of the values of assets acquired or liabilities assumed, any subsequent adjustments are recorded to the consolidated statements of operations. The Company includes the results of all acquisitions in its Consolidated Financial Statements from the date of acquisition. Acquisition related transaction costs, such as banking, legal, accounting and other costs incurred in connection with an acquisition, are expensed as incurred in general and administrative expense.

Acquisition-related integration costs also include expenses directly related to integrating and reorganizing acquired businesses, employee retention costs, recruiting costs, certain moving costs, certain duplicative costs during integration and asset impairments. These costs are expensed as incurred in general and administrative expense.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers", which is the new ASC 606. The new standard requires entities to recognize revenue through the application of a five-step model, which includes identification of the contract, identification of the performance obligations, determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue as the entity satisfies the performance obligations. Subsequently, the FASB has issued amendments to certain aspects of the guidance including the effective date. On July 9, 2015, the FASB deferred the effective dates of the new standard by one year. As a result, the new standard will be effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted, but cannot precede the original effective date (annual and interim reporting periods beginning after December 15, 2016).

ASC 606 is effective for the Company beginning January 1, 2018. The Company has adopted the requirements of the new standard using the modified retrospective transition method under which ASC 606 is being applied only to the most current period presented and the cumulative effect of applying the new standard is recognized at the date of initial application as a cumulative adjustment to retained earnings. We are substantially complete with our assessment of the overall impact the adoption of ASC 606 has on our consolidated financial statements, and we are continuing our evaluation of certain aspects of the new standard including potential changes to future financial reporting and disclosures.

Based on our assessment performed to date, the Company identified two distinct performance obligations in the sale of the magicJack devices under the new standard. Accordingly, the transaction price for our magicJack device sales will be allocated between equipment and service based on stand-alone selling prices. Revenues allocated to equipment will be recognized when control transfers to the customer, and service revenue will be recognized over the service term. Total revenue over the full contract term will be unchanged and there will be no change to customer billing, the timing of cash flows or the presentation of cash flows. We will no longer delay revenue recognition for devices sold with a right of return prior to the expiration of the 30 day trial period and will instead estimate the returns as part of the transaction price.

Additionally, the new standard requires the deferral of incremental costs to obtain a customer contract, which are then amortized to expense over the respective periods of expected benefit. As a result, sales commission costs associated with our multi-year service renewal plans, which were historically expensed as incurred under our previous accounting, will be deferred and amortized. We will utilize the practical expedient permitting expensing of costs to obtain a contract when the expected amortization period is one year or less.

The anticipated cumulative effect of initially applying ASC 606 on January 1, 2018 is estimated to be an increase to retained earnings of approximately $1.0 million, with offsetting adjustments to deferred revenue and deferred costs.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory". This ASU applies to inventory that is measured using first-in, first-out ("FIFO") or average cost. Under the updated guidance, an entity should measure inventory that is within scope at the lower of cost and net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predicable costs of completion, disposal and transportation. Subsequent measurement is unchanged for inventory that is measured using last-in, first-out ("LIFO"). The Company adopted ASU 2015-11 on a prospective basis in the first quarter of 2017. Prior periods were not retrospectively adjusted.

In February 2016, the FASB issued ASU 2016-02, “Leases”. ASU 2016-02 requires that long-term lease arrangements be recognized on the balance sheet. The standard is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. The Company is currently evaluating the guidance to determine the potential impact on the Company’s financial condition, results of operations and cash flows, but the standard will result in the Company recording both assets and liabilities for leases currently classified as operating leases.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting”. ASU 2016-09 changed the accounting for certain aspects of stock options and other share-based compensation. This accounting standard requires companies to recognize excess tax benefits or expenses related to the vesting or settlement of employee share-based awards (i.e., the difference between the actual tax benefit realized and the tax benefit initially recognized for financial reporting purposes) as income tax benefits or expenses in the quarterly Financial Statements. The standard also requires companies to record a windfall tax benefit when it arises, subject to normal valuation allowance considerations, instead of delaying recognition until the benefit reduces current taxes payable. The Company adopted ASU 2016-09 on a prospective basis in the first quarter of 2017. For the year ended December 31, 2017, this adoption had no tax impact to the Company. The Company will continue to monitor this for each reporting period going forward.

In August 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments". ASU 2016-15 reduces the diversity of how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. The standard is effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted. The ASU should be applied retrospectively to all periods presented. The Company does not anticipate that the new standard will have an impact on the Company's financial condition, results of operations and cash flows.

In October 2016, the FASB issued ASU 2016-16, "Intra-Entity Transfers of Assets Other than Inventory". ASU 2016-16 requires an entity to recognize the income tax consequences of intra-entity transfers of assets other than inventory when the transfer occurs. The standard is effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted. The ASU should be applied retrospectively as an adjustment to retained earnings. The Company does not anticipate that the new standard will have an impact on the Company's financial condition, results of operations and cash flows.

In January 2017, the FASB issued ASU 2017-04, "Intangibles – Goodwill and Other". ASU 2017-04 eliminates step two of the goodwill impairment test. The standard is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted. The Company early adopted ASU 2017-04 on a prospective basis in the first quarter of 2017. Prior periods were not retrospectively adjusted.

In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation: Scope of Modification Accounting". ASU 2017-09 provides guidance on determining which changes to share-based awards require modification accounting under ASC 718. The standard is effective for annual and interim periods beginning after December 15, 2017, and early adoption is permitted. The Company is currently evaluating the guidance to determine the potential impact on the Company's financial condition, results of operations and cash flows.

NOTE 3 – IMPAIRMENT OF INTANGIBLE ASSETS, INCLUDING GOODWILL

As part of the Company's quarterly impairment reviews for intangible assets with indefinite lives, including goodwill, management determined that there were impairment indicators at the Enterprise segment as of March 31, 2017.

As was previously disclosed in the Company's Form 10-K filed on March 16, 2017, the Broadsmart business which comprises the Enterprise segment was underperforming and steps were being taken to improve operating results including the February 2017 hiring of a new Chief Operating Officer for the segment and the hiring of additional sales and marketing personnel dedicated to obtaining new business. The new Chief Operating Officer for the Enterprise segment and the new Executive Management team completed a comprehensive review of the Enterprise segment's business prospects and through this process revised the projections for its operating results downward. Additionally, Broadsmart received notification in early April 2017 that a major customer would not be renewing its contract and later in April, management anticipated the potential loss of another one of the Enterprise segment's significant customers. Combined, these customers accounted for approximately 29% of the Enterprise segment's revenue in 2016. Management considered the revised projections and customer losses to be indicators of potential impairment, and accordingly performed impairment testing of its long-lived assets and indefinite-lived intangible assets, including goodwill, as of March 31, 2017 utilizing its revised projections for Broadsmart.

Based on the impairment indicators as of March 31, 2017 discussed above, the Company engaged an independent third party to perform a valuation of the Enterprise reporting unit's long-lived assets and indefinite-lived intangible assets, including goodwill as of March 31, 2017. The valuation estimated the fair value of Broadsmart's identified intangible assets not subject to amortization based on the relief from royalty method, which requires an estimate of a reasonable royalty rate, identification of relevant projected revenues and expenses, and selection of an appropriate discount rate. The Company recorded an impairment charge of $0.9 million for the carrying value of the tradename in excess of the fair value.

For long-lived assets, including definite-lived intangible assets subject to amortization, management totaled the undiscounted cash flows expected to result from the use of these assets and their eventual disposition and noted that the sum did not exceed the carrying amount of the assets, indicating further impairment testing was necessary for these assets as of March 31, 2017. The estimated fair value of definite-lived intangible assets subject to amortization as of March 31, 2017, was based on discounted future cash flows. The Company recorded impairment losses of $15.7 million for the carrying value in excess of the fair value.

Based on a discounted future cash-flows approach, the third party valuation estimated the fair value of the Enterprise reporting unit to be $17.9 million. Recognition of the goodwill impairment resulted in a tax benefit which was recorded as a deferred tax asset. Since the deferred tax asset increases the carrying value of the reporting unit, it would result in an additional impairment. The accounting guidance requires an entity to calculate the impairment charge and the deferred tax effect using a simultaneous equation method, which effectively grosses up the goodwill impairment charge to account for the related deferred tax benefit so that the resulting carrying value does not exceed the calculated fair value. The simultaneous equation calculation resulted in an impairment charge that exceeded the carrying value of the goodwill. Since the guidance limits goodwill impairments to the carrying value of goodwill, the Company recognized an impairment loss of $14.9 million, the full carrying value of goodwill.

In total, impairment losses of $31.5 million were recognized in operating expenses of the Enterprise segment for the first quarter ended March 31, 2017. The impaired assets were (in thousands):

	March 31, 2017		
	Carrying Amount	Fair Value	Impairment
Customer Relationships	$19,572	$4,400	$ 15,172
Process Know How	974	400	574
Tradename	1,700	800	900
Goodwill	14,881	-	14,881
	$37,127	$5,600	$ 31,527

NOTE 4 – INVENTORIES

Raw materials represent components used in the manufacturing of the magicJack devices, held by the Company or by a Chinese manufacturer on consignment. Finished goods are comprised primarily of magicJack devices on hand or in transit to the Company's distribution center in the United States and customer equipment, as well as hardware and equipment pending delivery or sale to Enterprise segment customers. Inventories are comprised of the following (in thousands):

	December 31,	
	2017	2016
Raw materials	$746	$1,455
Finished goods	1,134	2,986
Total	$1,880	$4,441

The Company wrote-off approximately $370 thousand of obsolete inventory during the year ended December 31, 2017. The Company wrote-off approximately $499 thousand of obsolete inventory during each of the years ended December 31, 2016 and 2015. Inventory write-offs are reflected in cost of revenues in the accompanying consolidated statements of operations.

NOTE 5 – PROPERTY AND EQUIPMENT

Property and equipment are summarized as follows (in thousands):

Estimated Useful Lives (in years)	December 31,	
	2017	2016

Switches	3 - 15	$6,851	$9,699
Computers	3	2,457	2,866
Furniture	5 - 7	100	269
Leasehold-improvements	*	615	893
Accumulated depreciation		(7,251)	(9,922)
Total		$2,772	$3,805

* The estimated useful life for leasehold improvements is the shorter of the term of the lease or life of the asset.

Depreciation expense for years ended December 31, 2017, 2016 and 2015 was $1.3 million, $1.2 million and $0.8 million, respectively. Refer to Note 16, “Segment Reporting” for further details.

NOTE 6 – INTANGIBLE ASSETS

Identified intangible assets consist of the following (in thousands):

	Estimated Useful Lives (in years)	December 31, 2017 Gross Carrying Amount	Accumulated Amortization	Net	Weighted-Average Life	December 31, 2016 Gross Carrying Amount	Accumulated Amortization	Net	Weighted-Average Life
Technology	3 - 17	$3,110	$(2,973)	$137	5.29	$3,110	$(2,854)	$256	4.71
Intellectual property rights	3 - 17	14,162	(11,996)	2,166	4.87	14,162	(10,794)	3,368	4.87
Covenants not-to-compete and not-to-sue	2 - 5	2,185	(2,137)	48	1.42	2,185	(2,107)	78	3.17
Tradename	3 - 6	131	(131)	-	0.00	131	(131)	-	0.00
Customer relationships	5 - 10	4,900	(900)	4,000	8.21	22,600	(2,249)	20,351	9.21
Software license	2 - 10	2,297	(554)	1,743	1.46	1,207	(80)	1,127	8.00
Process know how	5	400	(49)	351	5.00	1,100	(87)	1,013	6.08
Intangible assets subject to amortization		$27,185	$(18,740)	$8,445		$44,495	$(18,302)	$26,193	
Tradename		$1,700	$-	$1,700	N/A	$2,600	$-	$2,600	N/A
Domain names		45	-	45	N/A	61	-	61	N/A
Intangible assets not subject to amortization		$1,745	$-	$1,745		$2,661	$-	$2,661	
Total intangible assets		$28,930	$(18,740)	$10,190		$47,156	$(18,302)	$28,854	

Amortization expense for the years ended December 31, 2017, 2016 and 2015 was $3.1 million, $3.5 million and $2.8 million, respectively. Refer to Note 16, “Segment Reporting” for further details.

As part of the Company’s quarterly impairment reviews for intangible assets with indefinite lives, including goodwill, management determined that there were impairment indicators at the Enterprise segment as of March 31, 2017. Due to the knowable impairment indicators discussed in Note 3, “Impairment of Intangible Assets, Including Goodwill”, the Company engaged an independent third party to perform a valuation of the Enterprise segment’s long-lived assets and indefinite-lived intangible assets, including goodwill, as of March 31, 2017. Based on the results of the valuation, impairment losses of $16.6 million were recognized on the following intangible assets in operating expenses under the Enterprise segment in the consolidated statements of operations for the year ended December 31, 2017:

	March 31, 2017 Carrying Amount	Fair Value	Impairment
Customer Relationships	$19,572	$4,400	$ 15,172
Process Know How	974	400	574
Tradename	1,700	800	900

$22,246	$5,600	$ 16,646

As part of the Company's impairment reviews for intangible assets, management determined that there continued to be impairment indicators at the Enterprise segment as of the annual testing date of October 1, 2017. As a result, the Company engaged an independent third party to perform a recoverability test of the Enterprise segment's long-lived assets as of October 1, 2017. The sum of undiscounted cash flows of the intangible assets exceeded their book value, therefore no impairment was recognized.

In the year ended December 31, 2016, impairment charges of $0.5 million on identified intangible assets were recognized in general and administrative expense under both the Core Consumer and Enterprise segments in the consolidated statement of operations. The impairments in the Core Consumer segment were comprised of: (i) a Telecom license included in the "Other" category of amortizable intangible assets for $249 thousand (net of accumulated amortization) deemed obsolete, and (ii) domain names not subject to amortization for $249 thousand that were not renewed. The impairment in the Enterprise segment was comprised of a reduced fair value of the Broadsmart trade name of $0.5 million.

Based on the carrying value of identified intangible assets subject to amortization recorded at December 31, 2017, the amortization expense for the future fiscal years is expected to be as follows (in thousands):

Fiscal Year	Amortization Expense
2018	$ 2,231
2019	1,619
2020	1,079
2021	772
2022	707
Thereafter	2,037
	$ 8,445

NOTE 7 – GOODWILL

With the acquisition of Broadsmart and the founding of SMB in 2016, management began evaluating each of these new business lines separately and has assigned goodwill to the three reporting units that correspond to the reportable segments – "Consumer," "Enterprise" and "SMB". Refer to Note 15, "Acquisition of Business" and Note 16, "Segment Reporting" for further details.

The changes in the carrying amount of goodwill for the years ended December 31, 2017 and 2016, by reporting unit are as follows (in thousands):

	Core Consumer	Enterprise	SMB	Other	Consolidated
Balance, January 1, 2016	$ 32,304	$ -	$ -	$ -	$ 32,304
Goodwill acquired with Broadsmart acquisition	-	14,881	-	-	14,881
Balance, December 31, 2016	$ 32,304	$ 14,881	$ -	$ -	$ 47,185
2017 impairment	-	(14,881)	-	-	(14,881)
Balance, December 31, 2017	$ 32,304	$ -	$ -	$ -	$ 32,304

As part of the Company's quarterly impairment reviews for intangible assets with indefinite lives, including goodwill, management determined that there were impairment indicators at the Enterprise segment as of March 31, 2017. Due to the knowable impairment indicators discussed in Note 3, "Impairment of Intangible Assets, Including Goodwill", the Company engaged an independent third party to perform a valuation of the Enterprise reporting unit's long-lived assets and indefinite-lived intangible assets, including goodwill, as of March 31, 2017.

Based on a discounted future cash-flows approach, the third party valuation estimated the fair value of the Enterprise reporting unit to be $17.9 million. Recognition of the goodwill impairment resulted in a tax benefit which was recorded as a deferred tax asset. Since the deferred tax asset increases the carrying value of the reporting unit, it would result in an additional impairment. The accounting guidance requires an entity to calculate the impairment charge and the deferred tax effect using a simultaneous equations method, which effectively grosses up the goodwill impairment charge to account for the related deferred tax benefit so that the resulting carrying value does not exceed the calculated fair value. The resulting impairment is limited to the carrying value of goodwill. In the valuation performed for the Company the impairment calculated using the simultaneous equation method resulted in an impairment charge that exceeded the carrying value of the goodwill. Accordingly, an impairment loss of $14.9

million on goodwill was recognized in operating expenses under the Enterprise segment in the consolidated statements of operations for the year ended December 31, 2017.

As of October 1, 2017 (the “Measurement Date”), the Company engaged an independent third party to perform its annual goodwill impairment test for all of its reporting units in order to determine on an individual reporting unit basis if there was potential impairment. Fair value of each reporting unit was estimated using a discounted cash flow analysis. The implied fair value of goodwill for the Core Consumer reporting unit exceeded its book value, therefore no further testing was required and no impairment was recognized.

The application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgment, and the use of significant estimates and assumptions, is required to estimate the fair value of reporting units, including estimating future cash flows, future market conditions, and determining the appropriate discount rates, growth rates, and operating margins, among others.

The discounted cash flow analyses factor in assumptions on revenue and expense growth rates. These estimates are based upon the Company's historical experience, best estimates of future activity, and a cost structure necessary to achieve the related revenues.

Additionally, these discounted cash flow analyses factor in expected amounts of working capital and weighted average cost of capital. The Company believes the assumptions are reasonable. However, there can be no assurance that its estimates and assumptions made for purposes of the goodwill impairment testing will prove to be accurate predictions of the future. Changes in these estimates and assumptions as previously noted, could result in the need to conduct additional goodwill impairment tests in the future and could ultimately result in an impairment charge. In addition, a change in the Company's reporting units could materially affect the determination of the fair value for each reporting unit, which could trigger impairment in the future. The Company will continue to review its results against forecasts and assess its assumptions to ensure they continue to be appropriate.

NOTE 8 – DEFERRED COSTS AND REVENUES

Deferred costs and revenues to be recognized over the next twelve months are classified as current and included in the Company's consolidated balance sheets. The remaining deferred revenue amounts are classified as non-current in the consolidated balance sheets.

Deferred revenues are comprised of the following at December 31, 2017 and 2016 (in thousands):

	December 31,	
	2017	2016
magicJack devices	$5,277	$7,962
Access right renewals	34,607	37,323
Prepaid minutes	2,254	2,851
Other	105	371
Deferred revenue, current	42,243	48,507
Deferred revenue, non-current*	38,797	44,201
Total deferred revenues	$81,040	$92,708

* Deferred revenue, non-current, is comprised of deferred revenues originating from the sale of access right renewals.

Deferred revenues as of December 31, 2017 are expected to be recognized in future years as follows (in thousands):

Fiscal Year	Estimated Recognition of Deferred Revenues
2018	$ 42,243
2019	16,413
2020	10,937
2021	6,141
2022	2,789
Thereafter	2,517
	$ 81,040

Costs necessary to fulfill the Company's obligations to provide VoIP telephone service to new and existing customers who have purchased magicJack devices or access rights are expensed as incurred. Such costs were approximately $12.2 million $14.8 million and $15.4 million for the years ended December 31, 2017, 2016 and 2015, respectively. For the Core Consumer segment, such costs were approximately $9.8 million, $12.3 million and $15.4 million for the years ended December 31, 2017, 2016 and 2015, respectively. For the Enterprise segment, such costs were approximately $2.4 million and $2.5 million for the years ended December 31, 2017 and 2016, respectively.

NOTE 9 – OTHER LIABILITIES

As of December 31, 2017 and 2016, other non-current liabilities primarily consisted of provisions for uncertain tax positions of $13.1 million and $10.4 million, respectively.

NOTE 10 – COMMITMENTS AND CONTINGENCIES

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.

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.

Tax Contingencies

The Company believes that it files all required tax returns and pays all required federal, state and municipal taxes (such as sales, excise, utility, and ad valorem taxes), fees and surcharges. The Company is the subject of inquiries and examinations by various state and municipalities in the normal course of business. In accordance with generally accepted accounting principles, the Company makes a provision for a liability for taxes when it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. The Company vigorously defends its rights and tax positions. However, if a government entity were to prevail in any matter, it could have a material adverse effect on the Company's financial condition, results of operation and cash flows. In addition, it is at least reasonably possible that a potential loss may exist for tax contingencies in addition to the provisions taken by the Company. For those potential additional tax contingencies which can be reasonably estimated, that additional potential liability ranges from $0 to $2.5 million.

The Company is currently under examination for potential state tax liabilities. On June 8, 2017, the Company offered to settle the examinations for payment of $0.6 million and the agreement to remit certain taxes on a prospective basis. The taxing authority subsequently rejected the Company's offer, and as of December 31, 2017, the Company has not reached agreement with the taxing authority and the examination was in process.

Regulation

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 operates servers and provides international calling capability. Some of the Company's operations are also subject to regulation by state public utility commissions ("PUCs").

80

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 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 new 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, the new rules will apply 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 bans Internet Service Providers (ISPs) from prioritizing content and services of their affiliates.

The FCC also adopted a fourth new rule in the form of a forward-looking standard. This rule is intended to address concerns that may arise with new practices that do not fall within one of the three bright line rules. It will be applied on a case-by-case basis to address questionable practices as they occur that unreasonably interfere with or unreasonably disadvantage the ability of consumers to use or edge 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. Various parties have filed petitions seeking rehearing en banc of the D.C. Circuit's decision, which remain 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. However, a decision by a court or the FCC striking down or narrowing the FCC's net neutrality rules could adversely impact the Company's business to the extent 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 are eliminated. A court or the FCC also could find that the FCC lacks legal authority to regulate broadband services, which could prevent the 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, 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 Commission 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, 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 (OCNs) 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, 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 segment 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.

Operating Leases

Minimum annual commitments under non-cancellable operating leases as of December 31, 2017 are as follows (in thousands):

Fiscal Year	Estimated Rent Payments
2018	$ 741
2019	419
2020	116
2021	98
2022	33
Thereafter	-
	$ 1,407

Rent expense for the Company's real property leases was $0.8 million, $0.9 million and $0.8 million for the years ended December 31, 2017, 2016 and 2015, respectively, and is included in general and administrative expense in the accompanying Consolidated Statements of Operations.

NOTE 11 –TREASURY STOCK

During the first quarter of 2015, the Company's Board of Directors authorized a new share repurchase program under which the Company could repurchase up to $20.0 million of its outstanding common stock from time to time on the open market or in privately negotiated transactions. The remaining $8.7 million remaining under the Company's prior $100 million repurchase program was terminated. During the year ended December 31, 2015, the Company expended the maximum $20.0 million under the newly authorized amount. The Company repurchased 2,329,003 ordinary shares under this program through December 31, 2015.

During the years ended December 31, 2017 and 2016, no new share repurchase programs were authorized.

In January 2017, the Company reclassified 16,666 shares previously issued out of treasury stock as they had been issued as new ordinary shares. In April 2017, the Company issued 6,996 of its ordinary shares held as treasury shares with a cost of $86 thousand, or $12.32 per share, to Board members as a result of restricted stock vesting. In May 2017, the Company issued 76,211 of its ordinary shares held as treasury shares with a cost of $939 thousand, or $12.32 per share, to an executive officer as a result of restricted stock vesting. In May 2017, the Company purchased 20,844 of its ordinary shares at $6.50 per share, for an aggregate purchase price of approximately $135 thousand, in settlement of the withholding tax liability on the vesting of the restricted stock. In August 2017, the Company issued 2,333 of its ordinary shares held as treasury shares with a cost of $29 thousand, or $12.32 per share, to a Board member as a result of restricted stock vesting. In November 2017, the Company issued 15,000 shares held as treasury shares with a cost of $185 thousand, or $12.32 per share upon the exercise of options by an employee. In December 2017, the Company issued 241,671 of its ordinary shares held as treasury shares with a cost of $3.0 million, or $12.32 per share, to an executive officer, employees, former employees and a consultant as a result of restricted stock vesting and the exercise of options. In December 2017, the Company purchased 182,160 of its ordinary shares at an average price $8.33 per share, for an aggregate purchase price of approximately $1.5 million, in settlement of the withholding tax liability on the vesting of the restricted stock and for the cost of the shares and the withholding tax liability for the options.

In December 2016, the Company issued 203,618 of its ordinary shares held as treasury shares with a cost of $2.5 million, or $12.32 per share, to two of its executive officers and certain other employees as a result of restricted stock vesting. In October 2016, the Company issued 50,600 of its ordinary shares held as treasury shares with a cost of $623 thousand, or $12.32 per share, to certain of its employees as a result of the vesting of restricted stock and the exercise of options. In August 2016, the Company issued 2,333 of its ordinary shares held as treasury shares with a cost of $29 thousand, or $12.33 per share, to a Board member as a result of vesting. In addition, in April 2016, the Company issued 9,336 of its ordinary shares held as treasury shares with a cost of $115 thousand, or $12.31 per share, to Board members as a result of restricted stock that was issued in mid-2014, vesting. In March 2016, the Company issued 2,016 of its ordinary shares held as treasury shares with a cost of $25 thousand, or $12.24 per share, to a Board member as a result of restricted stock, that was issued in mid-2013, vesting. On March 17, 2016, the Company issued 233,402 of its ordinary shares held as treasury stock with a cost of $3.6 million, or $15.46 per shares, as part of the consideration paid for the Broadsmart acquisition. Refer to Note 15, “Acquisition of Business” for further details.

In December 2016, the Company purchased 62,726 of its ordinary shares at $6.85 per share, for an aggregate purchase price of approximately $430 thousand, in settlement of the withholding tax liability of certain of its executive officers and other employees on the vesting of restricted stock.

On December 31, 2015, the Company issued 53,419 of its ordinary shares held as treasury shares with a cost of $0.7 million, $12.32 per share (and fair value of $0.5 million, $9.45 per share), to its executive officers as a result of restricted stock, that was issued in mid-2013, vesting. In June 2015, the Company issued 24,410 of its ordinary shares held as treasury shares with a cost of $301 thousand, $12.32 per share (and fair value of $188 thousand, $7.70 per share), to a former Executive Officer as a result of restricted stock, that was issued in late-2013, vesting in accordance with a separation agreement. In May 2015, the Company issued 834 of its ordinary shares held as treasury shares with a cost of $10 thousand, $12.32 per share (and fair value of $6 thousand, $7.09 per share), to a Consultant as a result of restricted stock, that was issued in mid-2014, vesting. In April 2015, the Company issued 9,336 of its ordinary shares held as treasury shares with a cost of $115 thousand, $12.32 per share (and fair value of $64 thousand, $6.87 per share), to Board members as a result of restricted stock, that was issued in mid-2014, vesting. In March 2015, the Company issued 2,015 of its ordinary shares held as treasury shares with a cost of $25 thousand, $12.24 per share (and fair value of $14 thousand, $6.99 per share), to a Board member as a result of restricted stock, that was issued in mid-2013, vesting.

In June 2015, the Company repurchased 12,161 of its ordinary shares at $7.70 per share, for an aggregate purchase price of approximately $94 thousand, and in December 2015 the Company purchased 10,989 of its ordinary shares at $9.45 per share, for an aggregate purchase price of approximately $104 thousand, in settlement of the withholding tax liability of certain of its executive officers on the vesting of restricted stock.

NOTE 12 – SHARE-BASED COMPENSATION

The Company has granted ordinary share options and restricted stock as an alternative or supplement to the compensation of its executives, employees, directors and outside consultants. The Company’s share-based compensation program is a long-term retention program intended to attract and reward talented executives, employees and outside consultants, and align their interests with shareholders. The Company is currently granting share-based awards under the Amended and Restated magicJack VocalTec Ltd. 2013 Stock Incentive Plan and the amended and Restated magicJack VocalTec Ltd. 2013 Israeli Stock Incentive Plan (together, the “2013 Plans”) which were approved by shareholders in July 2013 at the annual general meeting of shareholders to allow grants of ordinary share options, restricted stock and ordinary shares. In April 2014 and July 2017, the shareholders approved amendments to the 2013 Plans increasing the number of share based awards available for grant. As of December 31, 2017, the aggregate number of shares subject to awards under the 2013 Plans was 5,600,000. The Company had previously granted shares under the VocalTec amended Master Stock Plan (the “2003 Plan”) which expired in April 2013. During the year ended December 31, 2016, the Company issued 1,000,000 ordinary share options outside of the 2013 Plans as an inducement for the two founders of Broadsmart to become employed by the Company. As of December 31, 2017, there were

975,197 awards available for grant under the 2013 Plans. The Company's policy is to recognize compensation expense for awards with only service conditions and a graded vesting on a straight-line basis over the requisite vesting period for the entire award.

The Company's share-based compensation expense consisting of ordinary share options and restricted stock for the years ended December 31, 2017, 2016 and 2015 was as follows (in thousands):

	Year Ended December 31,		
	2017	2016	2015
Ordinary share options	$1,615	$2,138	$4,108
Restricted stock units	1,427	2,082	1,160
	$3,042	$4,220	$5,268

The detail of total share-based compensation recognized by income statement classification is as follows (in thousands):

	Year Ended December 31,		
	2017	2016	2015
Cost of revenues	$219	$76	$76
Marketing	133	146	551
General and administrative	2,700	3,755	4,194
Research and development	(10)	243	447
	$3,042	$4,220	$5,268

Ordinary Share Options

Ordinary share options granted under the 2013 Plans have a five-year life and typically vest over a period of 36 months beginning at the date of grant. The 2013 Plans currently allow for a maximum term of five years for awards granted. The following table provides additional information regarding ordinary share options issued, outstanding and exercisable for years ended December 31, 2017, 2016 and 2015 (aggregate intrinsic value in thousands):

Date of Grant	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value[1]
January 1, 2015	2,043,857	$ 14.87	3.80	$ -
Granted	998,614	$ 9.33		
Exercised	(4,250)	$ 0.57		
Forfeited	(247,257)	$ 14.42		
Expired or cancelled	(263,537)	$ 12.67		
December 31, 2015	2,527,427	$ 12.98	3.61	$ -
Granted	1,107,040	$ 7.09		
Exercised	(2,500)	$ 3.96		
Forfeited	(34,740)	$ 8.83		
Expired or cancelled	(109,168)	$ 13.57		
December 31, 2016	3,488,059	$ 11.13	3.11	$ -
Granted	2,896,304	$ 9.42		
Exercised	(181,666)	$ 7.15		
Forfeited[2]	(2,501,614)	$ 11.12		
Expired or cancelled	(276,436)	$ 11.01		
December 31, 2017	3,424,647	$ 9.92	3.77	$ 1.47
Vested at December 31, 2017	561,677	$ 12.31	0.81	$ -
Exercisable at December 31, 2017 and expected to vest	561,677	$ 12.31	0.81	$ -

(1) The aggregate intrinsic value is the amount by which the market value for the Company's common stock exceeds the weighted average exercise price of the outstanding stock options on the date indicated.

(2) In 2017, two former executive officers surrendered a total of 1,244,777 ordinary share options with a weighted average exercise price of $14.57. Additionally, 1,256,837 options with a weighted average strike price of $7.70 were forfeited by terminated executives in the SMB and Enterprise segments. The surrender of options resulted in a

$2.4 million increase in tax expense during the second quarter.

Share-based compensation expense recognized for ordinary share options was approximately $1.6 million, $2.1 million and $4.1 million for the years ended December 31, 2017, 2016 and 2015, respectively. The total intrinsic value of ordinary share options exercised during the years ended December 31, 2017, 2016 and 2015 was $208 thousand, $7 thousand and $14 thousand, respectively. As of December 31, 2017, there was approximately $5.1 million of unrecognized share-based compensation expense related to unvested ordinary share options, which is expected to be recognized over a weighted average remaining period of 2.17 years.

The Company uses the Black-Scholes option pricing model to determine the fair value of stock options. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price, as well as assumptions regarding a number of complex and subjective variables. These variables include the Company's expected stock price volatility over the term of the awards, assumed employee exercise behaviors, risk-free interest rate and expected dividends. For purposes of valuing ordinary share options, the Company used historical volatility at the date of grant. The approximate risk-free interest rate was based on the U.S. Treasury yield for comparable periods. The Company has experienced forfeitures in the past and estimates a forfeiture rate for awards issued when deemed applicable. Due to the small sample size, historical share option exercise experience is not considered representative of future activity. Therefore, the expected term of the ordinary share options was calculated using the simplified method in accordance with section 10-S99 of ASC Topic 718, "Compensation - Stock Compensation" ("ASC 718"). The Company does not expect to pay dividends on its ordinary shares in the foreseeable future. Accordingly, the Company used a dividend yield of zero in its option pricing model.

The weighted average fair value of ordinary share options granted during the years ended December 31, 2017, 2016 and 2015 was $2.14, $2.75 and $3.60, and was measured at the date of grant using the following assumptions:

	Year Ended December 31,		
	2017	2016	2015
Expected term (in years)	3.22 to 3.50	3.5	3.5
Dividend yield	0.00 %	0.0 %	0.0 %
Expected volatility	48.88%	52.2% to 52.5 %	51.8%
Risk free interest rate	1.53% to 1.63 %	0.95% to 1.13 %	1.29%
Forfeiture rate	0.00 %	0.0 %	20.0%

Restricted Stock

The Company may also award restricted stock to its executives, employees, directors and outside consultants under the 2013 Plans, which may vest based on service or a combination or service and other conditions, such as market share price. The compensation expense for the award will be recognized assuming that the requisite service is rendered regardless of whether the market conditions are achieved. During the years ended December 31, 2017, 2016 and 2015, the Company granted 276,890, 320,305 and 385,852 restricted stock awards, respectively, under the 2013 Plans, as amended.

The following table summarizes the Company's restricted stock unit activity for the year ended December 31, 2017, 2016 and 2015:

	Number of Shares	Average Fair Value at Grant Date
January 1, 2015	147,264	$ 15.05
Granted	385,852	$ 9.33

Vested	(90,014)	$ 13.13
Forfeited	-	$ -
Non-vested at December 31, 2015	443,102	$ 10.20
Granted	320,305	$ 6.07
Vested	(267,300)	$ 8.11
Forfeited	(14,022)	$ 7.40
Non-vested at December 31, 2016	482,085	$ 7.70
Granted	276,890	$ 8.08
Vested	(160,544)	$ 9.32
Forfeited	(248,876)	$ 7.45
Non-vested at December 31, 2017	349,555	$ 7.65

During the years ended December 31, 2017, 2016 and 2015, the Company recognized $1.4 million, $2.1 million and $1.2 million in share-based compensation expense related to restricted stock. As of December 31, 2017, there was $2.1 million in unrecognized share-based compensation costs related to restricted stock. The unrecognized share-based compensation expense is expected to be recognized over a weighted average vesting period of 0.49 years.

The Company recorded share-based compensation costs from ordinary share options and restricted stock, related deferred tax assets and tax benefits of $3.0 million, $3.8 million and $1.0 million, respectively, in 2017, $4.2 million, $5.7 million and $2.2 million, respectively, in 2016, and $5.3 million, $4.7 million and $1.8 million, respectively, in 2015.

NOTE 13 – INCOME TAXES

The information in this note is on a consolidated basis, but uses the United States as the primary taxing authority as the Company's primary operations are in the United States. The parent Company is an Israeli company, whose primary taxable income is from the provision, directly or indirectly through its affiliates, of telecommunication services.

Components of Income Before Tax Expense

The components of income (loss) before income tax expense are as follows (in thousands):

	Year Ended December 31,		
	2017	2016	2015
United States	$(32,246)	$8,513	$18,343
Foreign	4,154	5,262	6,969
	$(28,092)	$13,775	$25,312

Components of Income Tax Provision

The components of the income tax provision (benefit) in 2017, 2016 and 2015 are as follows (in thousands):

	Year Ended December 31,		
	2017	2016	2015
Current:			
Federal	$(851)	$3,666	$8,951
State	(36)	949	76
Foreign	(266)	-	-
Current (benefit) provision	(1,153)	4,615	9,027
Deferred:			
Federal	(3,805)	(637)	7,203
State	(1,251)	(59)	604
Foreign	451	5,114	5,056
Deferred (benefit) provision	(4,605)	4,418	12,863
Uncertain tax positions	2,629	(314)	(10,088)
Total income tax (benefit) provision	$(3,129)	$8,719	$11,802

Effective Tax Rate Reconciliation

The following is a reconciliation of the Company's estimated annual effective income tax rate to the U.S. federal statutory rate for the years ended December 31, 2017, 2016 and 2015:

	Year Ended December 31,					
	2017		2016		2015	
Federal tax at statutory rate	$(9,551)	34.00 %	$4,684	34.00 %	$8,606	34.00%
State and local taxes, net of federal	(924)	3.29	138	1.00	1,311	5.18
Foreign results at rates other than domestic	(728)	2.60	(778)	(5.65)	(273)	(1.08)

Uncertain tax positions	2,629	(9.36)	(798)	(5.79)	506	2.00
Expiration of stock options	2,682	(9.55)	160	1.16	691	2.73
Noncontrolling interest	-	0.00	216	1.57	-	0.00
Israeli tax rate changes	-	0.00	5,252	38.13	-	0.00
U.S. tax rate changes	6,077	(21.63)	-	0.00	-	0.00
Deferred tax charges on intercompany sales	297	(1.06)	298	2.16	-	0.00
Return-to-provision adjustments	(2,607)	9.28	959	6.96	(687)	(2.71)
Other	(211)	0.75	50	0.36	13	0.05
Valuation allowance	(793)	2.82	(1,461)	(10.61)	1,635	6.46
Effective tax rate	$(3,129)	11.14 %	$8,719	63.30 %	$11,802	46.63%

The Company operates primarily in the U.S. and Israel. Its U.S. operations are subject to a federal statutory income tax rate of 34% in 2017, 2016 and 2015 and its Israeli operations are subject to statutory income tax rates of 24.0% in 2017, 25.0% in 2016 and 26.5% in 2015. The U.S. operations will be subject to a federal statutory income tax rate of 21% in 2018, and the Israel operations will be subject to statutory income tax rates of 23% in 2018. The income tax provision for 2017, 2016, and 2015 included items that have resulted in significant variances in the Company's effective tax rate in comparison to statutory rates.

For the year ended December 31, 2017, the Company recorded an income tax benefit of ($3.1) million, which is lower than the expected tax benefit of ($9.6) million, using the statutory rate of 34%, due in part, to a change in the U.S. federal income tax rate which resulted in it revaluing its deferred tax assets and lowering their value by $6.1 million, state income taxes of ($0.9) million, the revaluation of the Israel net operating loss carryforwards of ($1.3) million, increases to uncertain tax positions of $2.6 million, return to provision adjustments of ($2.6) million, and a reduction to deferred tax assets related to the surrender of stock options and option forfeitures of $2.7 million. The discrete items noted above were partially offset by the lower jurisdictional tax rate charged on the operating income of the Company's Israeli operations

For the year ended December 31, 2016, the Company recorded income tax expense of $8.7 million, which is higher than the expected tax provision of $4.7 million, using the statutory rate of 34%, due, in part, to the net impact of a decrease in the Israeli corporate tax rate from 26.5% to 23.0% which was effective in December 2016. The decrease in the rate resulted in the Company needing to reduce its Israeli deferred tax assets, primarily net operating loss carryforwards, which resulted in deferred tax expense and a reduction in the value of related deferred tax assets of $5.2 million. Additionally, the effective tax rate was impacted by increases to uncertain tax positions of ($0.8 million), decreases in valuation allowances of ($1.2 million) and other items of $0.8 million. The discrete items noted above were partially offset by the lower jurisdictional tax rate charged on the operating income of the Company's Israeli operations.

For the year ended December 31, 2015, the Company recorded income tax expense of $11.8 million, which differed from the expected provision of $8.6 million, using the statutory rate of 34%, primarily due to changes in valuation allowances of $1.3 million established against certain Israeli capital losses and state net operating loss carryforwards, increases to uncertain tax positions of $0.5 million, a decrease to deferred tax assets associated with expired stock options of $0.7 million, and other one-time discrete items of $0.7 million. State income tax expense, net of federal tax benefit, is presented in the effective tax rate reconciliation exclusive of changes in valuation allowances on state income tax deferred items.

The effective tax rate in the future may be affected by the realization of previously unrecognized deferred tax assets being recovered from future taxable income, the mix of foreign sourced versus domestic income and the effect of any significant changes in foreign currency rates.

Components of Deferred Income Tax

The significant components of estimated deferred income tax assets and liabilities as of December 31, 2017 and 2016 are as follows (in thousands):

	December 31,	
	2017	2016
Deferred tax assets:		
Deferred revenue, net of deferred costs	$830	$1,043
Domestic net operating loss carryforwards	1,109	1,214
Foreign net operating loss carryforwards	31,466	30,103
Basis difference in intangible assets	9,638	5,343
Allowance for doubtful accounts	19	91

Currently non-deductible expenses and other	1,680	2,914
Capital loss carryforwards	1,665	1,413
Stock based compensation	950	2,198
Foreign tax credit carryforward	1,558	1,558
Basis difference in goodwill	-	(2,079)
Basis difference in fixed assets	(395)	(911)
Total deferred tax assets	48,520	42,887
Valuation allowance	(16,794)	(16,319)
Gross deferred taxes	$31,726	$26,568
Deferred tax liabilities:		
Basis difference in long-lived assets	(256)	-
Total deferred tax liabilities	(256)	-
Net deferred taxes	$31,470	$26,568

On December 22, 2017, the United States enacted tax reform legislation commonly known as the Tax Cuts and Jobs Act (the "Act"), resulting in significant modifications to existing law. Under ASC 740, Income Taxes, an entity is required to recognize the effect of tax law changes during the period of enactment. As such, the Company has reflected the impact of this law within its December 31, 2017 financial statements. Due to the complexities of the new legislation and associated accounting considerations, SEC SAB 118 provides for an entity to utilize a provisional estimate within its financial statements for the impact of the Act. Based upon currently available information, the Company has analyzed the accounting for the significant effects of the Act during the period ended December 31, 2017. The Company's financial statements for the year ended December 31, 2017 reflect certain effects of the Act which includes a reduction in the corporate tax rate from 34% to 21%, as well as other changes. As a result of these changes to tax laws and tax rates under the Act, the Company has recorded a provisional incremental income tax expense of $6.1 million during the year ended December 31, 2017, which consisted primarily of the remeasurement of deferred tax assets and liabilities from 34% to 21%. The Company does not expect to incur a liability related to the one-time deemed repatriation transition tax on unrepatriated foreign earnings. However, we are still analyzing certain aspects of the Tax Act and refining our calculations, which could potentially affect the measurement of these balances or give rise to new deferred tax amounts.

Valuation Allowance

At December 31, 2017 and 2016, the Company had valuation allowances related to deferred tax assets associated with net operating losses of an inactive foreign subsidiary, foreign capital and revaluation losses, unrealized gains on prior year transactions associated with the Company's common equity put options, and domestic state net operating losses. These deferred tax assets do not meet the more likely than not threshold that they will be realized.

More broadly, the Company's assessment for the years ended December 31, 2017, 2016 and 2015 considered the following positive and negative evidence.

Positive evidence

The Company has generated cumulative pre-tax income in Israel of $16.4 million for the three year period ended December 31, 2017, and has utilized some of its available tax assets to reduce the tax liabilities that would have otherwise arisen in those periods.

The U.S. and Israel require approximately $44.7 million and $83.3 million in future taxable income, respectively, to realize the deferred tax assets at December 31, 2017. The Company's Israeli net operating loss carryforwards are not subject to expiration and its financial performance has continued to generate pre-tax operating income despite challenging macroeconomic conditions.

Negative evidence

At December 31, 2017, the negative evidence consists primarily of a pre-tax (loss) of ($5.4) million in the United States for the three year period ended December 31, 2017. The cumulative pre-tax loss in the U.S. is primarily the result of a one-time impairment charge of $31.5 million related to the Enterprise segment which management does not expect to reoccur in future periods. The Company has reorganized the Enterprise segment which has reduced costs. The historical performance in the Consumer segment of the business is positive and is expected to continue. The Company believes that this positive evidence outweighs the negative evidence of the cumulative pre-tax loss in the United States and that it is more likely than not that the Company will be able to utilize the net deferred tax assets in the United States.

The Company has a history of significant pre-tax losses dating back to years prior to 2010 in Israel. In total, the U.S. group of companies has approximately $0.6 million of state deferred tax assets, before application of valuation allowances, related to $10.2 million of state net operating losses which expire over periods ranging through 2037. The

Israeli group of companies has approximately $34.3 million of deferred tax assets, before application of valuation allowances, related to $138.9 million of net operating loss carryforwards, which has accumulated over many years. Of the total Israeli group combined net operating losses, $56.7 million are limited in use as these net operating losses relate to specific subsidiaries, which are currently inactive and a valuation allowance remains against those losses. The Company believes that the combined impact of a number of Company specific and industry specific developments over recent years makes it unlikely that the repeated annual losses incurred prior to the year ended December 31, 2012 would recur.

In addition, the Company considered negative evidence in connection with various industry specific factors. The market in which the Company participates is highly competitive and could be impacted by changes in technology. If the Company does not compete effectively, its operating results may be harmed by loss of market share and revenues. The Company may also face difficulty in attracting new customers, and if it fails to attract new customers, its business and results of operations may suffer. The Company also relies on independent retailers to sell the magicJack devices, and disruption to these channels would harm its business.

After consideration of both the positive and negative evidence, the Company believes that its positive evidence outweights the negative evidence. The operating profits in recent years compared to the historical operating losses prior to 2012 is an objectively verifiable piece of positive evidence and is the result of a number of factors, which have been present to a greater or lesser extent in prior years, but have only recently gathered sufficient weight to deliver consistent taxable profits. A key consideration in the Company’s analysis was that the unlimited carryforward periods of its Israel net operating losses make the realization of those assets less sensitive to variations in the Company’s projections of future taxable income than would otherwise be the case if the carryforward periods were time limited.

Valuation allowances of $16.8 million, $16.3 million and $17.5 million at December 31, 2017, 2016 and 2015, respectively, were provided for deferred tax assets associated with net operating losses of an inactive foreign subsidiary, foreign capital and revaluation losses, unrealized gains on prior year transactions associated with the Company’s common equity put options, and domestic state net operating losses.

The reconciliation of the valuation allowance for the years ended December 31, 2017 and 2016 is as follows (in thousands):

	Years Ended December 31,	
	2017	2016
Balance, beginning of period	$16,319	$17,544
Changes to the valuation allowance	475	(1,225)
Balance, end of period	$16,794	$16,319

Uncertain Tax Positions

The Company reassesses its income tax positions and records tax benefits for all years subject to examination based upon its evaluation of the facts, circumstances and information available at the reporting date. For those tax positions where it is more-likely-than-not that a tax benefit will be sustained, the Company has recorded the largest amount of tax benefit with a greater than 50% likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where it is not more-likely-than-not that a tax benefit will be sustained, no tax benefit has been recognized in the Company's consolidated financial statements.

The Company files U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. During 2013, the Company received notice that the IRS was going to examine its tax returns for 2010 and 2011. In October 2014, the Company was informed by the IRS that it was going to expand its audit to include the Company's 2012 and 2013 tax returns. During 2015, the Company reached agreement with the IRS on a settlement of all years under audit. The settlement resulted in an increase to the jurisdictional income of the U.S. The additional tax and interest due to the IRS and various state taxing authorities as a result of the increased U.S. jurisdictional income was $6.8 million and $0.9 million, respectively. The Company was able to utilize approximately $4.2 million of benefits related to other favorable adjustments identified during the exam to satisfy a portion of the federal liability, resulting in net tax and interest paid to the IRS of $2.6 million. The $0.9 million state liability is reflected as a reduction to prepaid income taxes in the Company's December 31, 2015 consolidated balance sheets. The increase to the U.S. jurisdictional income resulted in a decrease in the Company's Israeli jurisdictional income. The decrease in Israeli income, in turn, increased the Company's Israeli net operating losses, resulting in a tax benefit of $5.6 million. The tax years 2011 through 2017 remain open to examination by other major taxing jurisdictions to which the Company is subject.

A reconciliation of the gross amounts of unrecognized tax benefits, excluding accrued interest and penalties, is as follows (in thousands):

	Years Ended December 31,		
	2017	2016	2015
Unrecognized tax benefits, opening balance	$9,136	$9,929	$18,860
Gross increases (decreases) - tax positions in prior periods	1,468	(356)	(1,030)
Gross increases - tax positions in current period	19	79	5
Settlements	-	(516)	(7,906)
Lapse of statute of limitations	-	-	-
Unrecognized tax benefits, ending balance	$10,623	$9,136	$9,929

All amounts in the reconciliation above are reported on a gross basis and do not reflect a federal tax benefit on state income taxes. The Company does not anticipate a significant reduction in unrecognized tax benefits within the next twelve months due to lapse of statute of limitation.

As of December 31, 2017, 2016 and, 2015, there were $10.1 million, $8.3 million and $9.2 million, respectively, of unrecognized tax benefits, respectively, that if recognized, would favorably affect the Company's annual effective tax rate. These amounts include a federal tax benefit on state income taxes and exclude interest and penalties. The Company recognizes interest and penalties accrued related to unrecognized tax benefits as income tax expense as a component of the income tax (benefit) expense in the Company's consolidated statements of operations and the corresponding liability is included in income taxes payable and other non-current liabilities in its consolidated balance sheets.

As of December 31, 2017, 2016 and 2015, $13.1 million, $10.4 million and $10.8 million, respectively, was included in other non-current liabilities in the Company's consolidated balance sheets for uncertain tax positions. The amount of accrued interest and penalties recognized by the Company in the years ended December 31, 2017, 2016 and 2015 was $3.0 million, $2.1 million and $1.6 million, respectively.

NOTE 14 – NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS PER SHARE

Net income (loss) attributable to common shareholders per share – basic, is calculated by dividing net (loss) income attributable to the Company's common shareholders (the "Numerator"), by the weighted average number of common shares outstanding during the period, (the "Denominator"). Net (loss) income attributable to common shareholders per share – diluted, is computed by increasing the basic denominator to include the number of ordinary shares that would have been issued if the Company's dilutive potential common shares had been exercised or vested. The Company's potential common shares are the share-based awards (ordinary share options and restricted stock) discussed in Note 12, "Share-Based Compensation".

The Company calculates the diluted denominator using the treasury stock method, which assumes that all exercise proceeds are used to repurchase common shares, reducing the net number of shares to be added. Share-based awards only have a dilutive effect when the average stock price for the period exceeds their exercise price ("in the money") and the entity has net income.

The following table presents the computation of basic and diluted net (loss) income per common share attributable to shareholders (in thousands, except for per share information):

	Year Ended December 31,		
	2017	2016	2015
Numerator:			
Net (loss) income attributable to common shareholders	$(24,963)	$5,691	$13,510
Denominator:			
Denominator for basic net income per share - weighted average common shares outstanding	16,088	15,815	16,975
Effect of dilutive options and/or restricted stock units to purchase common shares	-	-	2
Effect of dilutive options and/or restricted stock units exercised or expired during the year	-	249	68
Denominator for diluted net income per share - weighted average common shares outstanding *	16,088	16,064	17,045
Net income per common share:			
Basic	$(1.55)	$0.36	$0.80
Diluted	$(1.55)	$0.35	$0.79
*Anti-dilutive share-based awards not included above	3,774,202	2,701,564	2,968,029

NOTE 15 – BROADSMART ACQUISITION

In March 2016, the Company acquired the assets of Broadsmart for approximately (i) $38.0 million in cash, (ii) 233,402 shares of the Company's ordinary shares issued from treasury stock with a fair value of $1.7 million based on closing market price per share as of the date of the acquisition, and (iii) additional contingent cash payments of (a) up to $0.2 million, if two certain individuals ($0.1 million for each) previously employed by Broadsmart do not accept the Company's employment offer, and (b) $2.0 million, if the acquired assets generated 2016 revenues of at least $15.6 million.

The Company incurred $0.8 million in acquisition related transaction costs, which are included in general and administrative expense in the accompanying consolidated statements of operations.

At the time of closing, $3.0 million of the cash consideration was paid into escrow to cover indemnification claims by the Company against the sellers. No asset or liability is included in the accompanying consolidated balance sheets for this item.

The acquired assets and liabilities were recorded at their estimated fair values on the balance sheet for the Enterprise segment on March 17, 2016. The results of operations of the Broadsmart business have been included in the Company’s consolidated financial statements, under the Enterprise segment, since that date.

The acquisition was accounted for using the acquisition method of accounting under which assets and liabilities of Broadsmart were recorded at their respective fair values including an amount for goodwill representing the difference between the acquisition consideration and the fair value of the identifiable net assets. The Company expects this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment. Refer to Note 7, “Goodwill” for further details. The acquisition price was allocated to the tangible and identified intangible assets acquired and liabilities assumed as of the closing date. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management’s estimates and assumptions. The Company finalized the valuation as of December 31, 2016.

The table below summarizes the Broadsmart assets acquired and liabilities assumed as of March 17, 2016, including any measurement period adjustments (in thousands):

	Estimated Fair Value
Assets	
Current assets:	
Accounts receivable	$ 567
Inventories	302
Deposits and other current assets	143
Total current assets	1,012
Property and equipment	355
Intangible assets	26,385
Deposits and other non-current assets	96
Total assets acquired	27,848
Liabilities	
Current liabilities:	
Accrued expenses and other current liabilities	900
Deferred revenue	172
Total current liabilities	1,072
Other non-current liabilities	62
Total liabilities assumed	1,134
Net identifiable assets acquired	26,714
Goodwill	14,881
Total purchase price	$ 41,595

The intangible assets as of the closing date of the acquisition included:

	Amount
Customer relationships	$ 22,100
Non-compete agreements	100
Tradename	2,200
Process know how	1,100
Software license	885
	$ 26,385

Indications of fair value of the intangible assets acquired in connection with the acquisition were determined using either the income, market or replacement cost methodologies. The intangible assets are being amortized over periods which reflect the pattern in which economic benefits of the assets are expected to be realized. The customer relationships are being amortized on an accelerated basis over an estimated useful life of ten years and the non-compete agreements, process know how and software license are being amortized on a straight-line basis over four years, five years and ten years, respectively. Tradename is not subject to amortization but is subject to an annual review for impairment.

During the year ended December 31, 2016, the Company recognized an impairment loss of $0.5 million on one of the Broadsmart intangible assets. During the first quarter ended March 31, 2017, the Company recognized impairment charges of $31.5 million on Broadsmart intangible assets, including goodwill. The carrying value of the Broadsmart business after the impairment was $18.5 million at March 31, 2017. Refer to Note 3, “Impairment of Intangible Assets, Including Goodwill”, Note 6, “Intangible Assets” and Note 7, “Goodwill” for further details.

Neither of the contingent payments had been made as of December 31, 2017. The $0.2 million is included in accrued expenses and other current liabilities in the accompanying consolidated balance sheets. The $2.0 million was paid into escrow at the time of closing. Revenues for the year ended December 31, 2016 did not reach the target and the Company recorded a $2.0 million receivable from earnout escrow and a consideration adjustment/gain on mark-to-market in the accompanying consolidated balance sheet as of December 31, 2016 and the consolidated statement of operations for the year ended December 31, 2016.

On June 23, 2017, the founders of Broadsmart left the Company. On August 4, 2017, the Company reached a mutual agreement with the founders that included release to the Company of $1.0 million of the $3.0 million held in escrow to cover indemnification claims and the $2.0 million earn-out amount. The remaining $2.0 million will remain in escrow until March 2019, pursuant to the provisions of the purchase agreement, to cover potential claims by the Company for telecommunications taxes. During the year ended December 31, 2017, the Company collected both escrow amounts. The $1.0 million was recorded as a consideration adjustment/gain on mark-to-market, less amounts due from the founders and the $2.0 million receivable from earnout escrow was removed.

The agreement also provided that the Company will execute an agreement to acquire certain assets of North American Telecommunications Inc. ("NATC") for $10 thousand, subject to any required regulatory approvals. Subsequently, the Company and NATC entered into an agreement allowing NATC to seek other third party offers for the business. As of the date of this filing, no agreement for the sale or purchase of the assets has been executed.

Pro Forma Financial Information

The following table presents the unaudited pro forma combined results of operations of the Company and Broadsmart for the year ended December 31, 2016 as if the acquisition of Broadsmart had occurred on January 1, 2016. The pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of 2016.

	Year Ended December 31, 2016
Net revenues	$ 99,938
Net income	$ 5,407

The pro forma results are based on estimates and assumptions, which the Company believes are reasonable. The pro forma results include adjustments primarily related to amortization of acquired intangible assets, depreciation, interest expense, and transaction costs expensed during the period.

NOTE 16 – SEGMENT REPORTING

Reportable segments are defined under U.S. GAAP as components of an enterprise for which separate financial information is available and evaluated regularly by a company's chief operating decision makers in deciding how to allocate resources and assess performance.

Prior to 2016, the Company did not have separate reportable segments. However, with the acquisition of Broadsmart and the founding of the SMB business during 2016, management evaluated each of these new business lines separately and determined that the Company had three reportable segments – "Core Consumer," "Enterprise" and "SMB". These segments were organized by the products and services that are sold and the customers that are served. During the first quarter of 2017, management restructured the Company to absorb all operations and functions of the SMB segment within the Core Consumer segment. Accordingly, the SMB segment will not show activity for periods after March 31, 2017. The below table includes an "Other" segment to capture the Company's interest in a joint venture that did not meet either the aggregation criteria to be combined with the existing Core Consumer segment or the quantitative thresholds to be treated as a reportable segment. The Company measures and evaluates its reportable segments based on revenues and gross profit margins. The Company's segments and their principal activities consist of the following:

Core Consumer

This segment represents a vertically integrated group of companies, a micro-processor chip design company, an Appserver and session border controller company, a wholesale provider of VoIP services, a softphone company, the developer and provider of the magicJack device, and a wholesaler of telephone service to VoIP providers and telecommunication carriers. This segment represents the historical magicJack Core Consumer business.

magicJack is the cloud communications leader that invented the magicJack device and other magicJack products and services. magicJack devices and mobile apps provide customers the ability to make and receive telephone calls in the U.S. or Canada with no additional cost. Customers may also purchase international minutes to place telephone calls outside of the U.S. and Canada.

Enterprise

This segment includes Broadsmart, which is a provider of UCaaS hardware and connectivity for enterprise customers.

SMB

Through this segment, started during 2016, the Company provides VoIP services to small to medium sized businesses. The expenses of this restructuring included severance for the majority of the employees in the segment and future rent payments for the Alpharetta, Georgia office.

Other

This segment includes the Company’s 60% controlling interest in a joint venture which began selling a line of high-technology residential consumer products in the fourth quarter of fiscal year 2016. The Company’s consolidated financial statements for the year ended December 31, 2016, include an adjustment to comprehensive income attributable to common shareholders of $635 thousand, to recognize the impact of the noncontrolling interest. On March 31, 2017, this interest was reduced to 36% and on June 30, 2017 the Company sold its remaining interest to the unrelated third party. The Company has determined that the joint venture did not meet either the aggregation criteria to be combined with the existing Core Consumer segment or the quantitative thresholds to be treated as a reportable segment. As such, it is included in the “Other” segment.

Selected information as of and for the years ended December 31, 2017 and 2016 is presented by reportable segment below (in thousands):

	For the Year ended December 31, 2017						
	Previous Core Consumer	SMB	Restated Core Consumer	Enterprise	Other	Intercompany	Consolidated
Net revenues	$77,008	116	77,124	11,003	-	(134)	$ 87,993
Cost of revenues	25,504	131	25,635	7,303	-	-	32,938
Gross profit (loss)	51,504	(15)	51,489	3,700	-	(134)	55,055
Marketing	6,947	109	7,056	1,226	-	-	8,282
General and administrative	33,812	1,056	34,868	3,691	-	(134)	38,425
Impairment of goodwill and intangible assets	-	-		31,527	-	-	31,527
Research and development	5,294	596	5,890	6	-	-	5,896
Consideration adjustment/ Gain on mark-to-market	(894)	-	(894)	-	-	-	(894)
Operating expenses	45,159	1,761	46,920	36,450	-	(134)	83,236
Operating income (loss)	$6,345	(1,776)	4,569	(32,750)	-	-	$ (28,181)
Goodwill	$32,304	-	32,304	-	-	-	$ 32,304
Total assets	$125,537	-	125,537	15,601	-	(96)	$ 141,042
Depreciation expense	$1,025	21	1,046	237	-	-	$ 1,283
Amortization expense	$1,692	-	1,692	1,399	-	-	$ 3,091

	For the Year ended December 31, 2016						
	Previous Core Consumer	SMB	Restated Core Consumer	Enterprise	Other	Intercompany	Consolidated
Net revenues	$88,315	105	88,420	9,043	13	(78)	$ 97,398
Cost of revenues	29,250	179	29,429	7,224	81	-	36,734

Gross profit (loss)	59,065	(74)	58,991	1,819	(68)	(78)	60,664
Marketing	4,768	3,497	8,265	380	440	-	9,085
General and administrative	23,086	6,102	29,188	3,141	1,076	(78)	33,327
Impairment of intangible assets	498	-	498	500	-	-	998
Research and development	3,859	1,313	5,172	22	5	-	5,199
Consideration adjustment/ Gain on mark-to-market	(1,700)	-	(1,700)	-	-	-	(1,700)
Operating expenses	30,511	10,912	41,423	4,043	1,521	(78)	46,909
Operating income (loss)	$28,554	(10,986)	17,568	(2,224)	(1,589)	-	$ 13,755
Goodwill	$32,304	-	32,304	14,881	-	-	$ 47,185
Total assets	$142,870	(9,447)	133,423	40,839	255	-	$ 174,517
Depreciation expense	$994	40	1,034	155	2	-	$ 1,191
Amortization expense	$1,604	-	1,604	1,938	-	-	$ 3,542

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
SUPPLEMENTAL FINANCIAL INFORMATION

SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly financial results for the years ended December 31, 2017 and 2016 were as follows (in thousands, except per share data):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2017					
Net revenues	$23,197	$22,381	$21,657	$20,758	$87,993
Gross profit	13,746	14,215	13,827	13,267	55,055
Operating income (loss) (1)	(34,512)	1,089	3,981	1,261	(28,181)
Net income (loss) (2)	(23,168)	(1,494)	2,451	(2,752)	(24,963)
Net income (loss) attributable to magicJack VocalTec Ltd common shareholders	(23,101)	(1,561)	2,451	(2,752)	(24,963)
Earnings per magicJack VocalTec Ltd common share: (3)					
Basic	(1.44)	(0.10)	0.15	(0.17)	(1.55)
Diluted	(1.44)	(0.10)	0.15	(0.17)	(1.55)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2016					
Net revenues	$23,699	$25,301	$24,572	$23,826	$97,398
Gross profit	15,490	15,463	15,063	14,648	60,664
Operating income (loss) (4)	4,234	4,206	5,428	(113)	13,755
Net income (loss)	734	2,515	3,222	(1,415)	5,056
Net income (loss) attributable to magicJack VocalTec Ltd common shareholders	734	2,819	3,399	(1,261)	5,691
Earnings per magicJack VocalTec Ltd common share: (3)					
Basic	0.05	0.18	0.21	(0.08)	0.36
Diluted	0.05	0.18	0.21	(0.08)	0.35

(1) During the first quarter of 2017, the Company recognized an impairment loss of $31.5 million on goodwill and intangible assets. During the third quarter of 2017, the Company recognized a consideration adjustments/gain on mark-to-market of $0.9 million.
(2) Results for the fourth quarter of 2017 include a $6.1 million adjustment for the initial estimated impact from the change in the U.S. federal income tax rate due to the recently enacted U.S. Tax Cuts and Jobs Act, which resulted in the Company revaluing its deferred tax assets and lowering their value.
(3) The sum of quarterly earnings per ordinary share amounts may not add to the annual earnings per ordinary share amount due to the weighting of ordinary shares and equivalent ordinary shares outstanding during each of the respective periods.
(4) During the third quarter of 2016, the Company recognized a $2.0 million a consideration adjustments/gain on mark-to-market related to the Broadsmart Earnout and an impairment loss of $0.5 million on intangible assets. During the fourth quarter of 2016, the Company reduced the consideration adjustments/gain on mark-to-market by $0.3 million and recognized a $0.5 million loss on impairment of intangible assets.

97

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of December 31, 2017, our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(b) promulgated under the Exchange Act. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of December 31, 2017, our disclosure controls and procedures were effective in ensuring that material information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, including ensuring that such material information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rule 13a-15(f). Our internal control system was designed to provide reasonable assurance to our management and the Board of Directors regarding the preparation and fair presentation of published financial statements. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2017. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO, in Internal Control—Integrated Framework (the 2013 COSO framework). Based on our assessment we believe that, as of December 31, 2017, our internal control over financial reporting is effective based on those criteria. The effectiveness of our internal control over financial reporting as of December 31, 2017 has been audited by BDO USA, LLP, an independent registered public accounting firm, as stated in their report which appears below.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors
magicJack VocalTec Ltd. and Subsidiaries
Netanya, Israel

Opinion on Internal Control over Financial Reporting

We have audited magicJack VocalTec, Ltd's (the "Company's") and subsidiaries internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company and subsidiaries as of December 31, 2017 and 2016, the related consolidated statements of operations, capital equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes and our report dated March 16, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BDO USA, LLP

Certified Public Accountants

West Palm Beach, Florida

March 16, 2018

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

Name	Age	Position
Izhak Gross	71	Director, Chairman of the Board
Tal Yaron-Eldar	54	Director
Alan B. Howe	56	Director
Dr. Yuen Wah Sing	63	Director
Richard Harris	70	Director
Don C. Bell III	48	President, Chief Executive Officer and Director
Thomas Fuller	46	Executive Vice President and Chief Financial Officer
Dvir Salomon	39	Executive Vice President and Chief Technology Officer
Kristin Beischel	32	Executive Vice President and Chief Marketing Officer

IZHAK GROSS was appointed to the Board effective August 9, 2016. Mr. Gross co-founded four global companies in fields ranging from network messaging, web conferencing, VoIP systems and recyclable printed boards. From 2006 to 2010, Mr. Gross served as the co-founder, Chairman and Chief Executive Officer of Kroom Ltd., a company headquartered in Tel Aviv, Israel that designed and manufactured a wide range of products made out of laminated printed board. From 1996 to 2005, he served as the co-founder and Chairman of ArelNet Ltd., a company headquartered in Yavne, Israel that was publicly traded on the Israel Stock Exchange (TASE). ArelNet Ltd. was a pioneer of VoIP communications producing switching and delivery systems. From 1988 to 2005, Mr. Gross also served as co-founder and Chairman of Arel Communications and Software Ltd., a technology leader in interactive web communications headquartered in Yavne, Israel that was publicly traded on Nasdaq. From 1982 to 1988, he served as cofounder and Managing Director of Arel Computers and Software Ltd., a company headquartered in Yavne, Israel that marketed the ARCOM Value Added Network messaging transaction system, including fax, email, telex and telegraph systems deployed in more than 50 countries. From 1976 to 1979, Mr. Gross served as a Senior System Programmer for Granot Central Cooperating Ltd. in Emek Hefer, Israel, and from 1973 to 1986, he taught mathematics and physics at Kibutz Gan Shmuel High School in Gan Schmuel, Israel. Mr. Gross received a BSC in Theoretical Physics from Technion, Israel Institute of Technology in Haifa, Israel in 1973. Mr. Gross contributes to the mix of experience and qualifications the Board seeks to maintain primarily through his over 30 years of experience co-founding and managing global high-tech companies with a special focus on communications software and hardware.

TAL YARON-ELDAR was appointed to the Board in April 2011 and re-appointed in April 2014. In 2013, Ms. Yaron-Eldar founded Yaron-Eldar, Paller Schwartz and Co. From January 2004 until 2012, Ms. Yaron-Eldar served as the Chief Executive Officer of Arazim Investment Company, a publicly traded real estate investment company. She was a partner with the law firm Cohen, Yaron-Eldar & Co. from July 2004 to March 2007, when she became a partner with the law firm of Tadmor & Co. Ms. Yaron-Eldar has also served in a variety of public positions, including Chief Legal Advisor of the Customs and V.A.T. Department of the Finance Ministry of the State of Israel from 1998 to 2001 and as the Commissioner of Income Tax and Real Property Tax Authority of the State of Israel from 2002 to 2004. She currently serves as a director of Rosetta Genomics Ltd., a biotech company traded on Nasdaq Meditechnika Ltd., a medical appliances company traded on the Tel Aviv Stock Exchange Lodgia Rotex Investments Ltd., a real estate company traded on the Tel Aviv Stock Exchange Arko Investments, a venture capital firm traded on the Tel Aviv Stock Exchange and Tadea Investments, Postal Bank, and Galmed Pharmaceuticals. Ms. Yaron-Eldar holds an MBA, specializing in finance, and an LLB from Tel Aviv University, and is a member of the Israeli Bar Association. She contributes to the mix of experience and qualifications the Board seeks to maintain primarily through her legal, tax and finance experience.

ALAN B. HOWE was appointed to the Board on April 19, 2017. Mr. Howe has served as Co-Founder and Managing Partner of Broadband Initiatives, LLC, a boutique corporate advisory and consulting firm, since 2001, and provides various strategic and operational consulting services to multiple corporate clients in that role. He served as Vice President of Strategic and Wireless Business Development for Covad Communications, Inc., a national broadband telecommunications company, from May 2005 to October 2008, and as Chief Financial Officer and Vice President of Corporate Development for TELETRAC, Inc., a mobile data and location solutions provider, from April 1995 to April 2001. Previously, he held various executive management positions for Sprint and Manufacturers Hanover Trust Company. Mr. Howe is currently a member of the board of directors of Determine, Inc. (NASDAQ: DTRM), serving as Vice Chairman of the board, Data I/O Corporation (NASDAQ: DAIO), serving as Chairman of the board, and Urban Communications, Inc. (TSX-V: UBN). He previously served on the board of directors of Qualstar (NASDAQ: QBAK), Ditech Networks, Inc. (formerly, NASDAQ: DITC), Altigen Communications, Inc. (OTC: ATGN), Calloway’s Nursery, Inc. (OTC: CLWY), and Crossroads Systems, Inc. (NASDAQ: CRDS). Mr. Howe holds a B.S. in business administration and marketing from the University of Illinois and an M.B.A. from the Indiana University Kelley Graduate School of Business. Mr. Howe’s operational, corporate finance, business development and corporate governance experience qualify him to serve on the Company’s Board of Directors.

DR. YUEN WAH SING was appointed to the Board upon the consummation of the 2010 business combination between VocalTec Communications Ltd. ("VocalTec") and YMax on July 16, 2010. Dr. Sing served as the President of TigerJet Network, Inc. ("TigerJet"), currently a wholly owned subsidiary of YMax, from June 2008 through July 2016. Dr. Sing brings more than 30 years of semiconductor and VoIP communication industry experience to the Company. He has served as a director of YMax since 2008 and as its Chairman since October 2009. Prior to its acquisition by YMax in 2008, from 1998 to 2008, Dr. Sing founded and was the Chief Executive Officer of TigerJet. Prior to founding TigerJet, Dr. Sing was the founder of 8x8 Inc./Packet 8, a video conferencing and VoIP company and served as Executive Vice President and Vice Chairman from 1987 to 1997. Dr. Sing received a PhD and MS degree in electrical engineering from the University of California, Berkeley. We believe his experience, qualifications, attributes and skills, particularly in the telecommunications industry, qualify him to serve as a member of our Board.

RICHARD HARRIS was appointed to the Board on March 26, 2013. Mr. Harris is founder and president of Harris & Associates, a twenty-three year-old consulting firm specializing in financial, operational and strategic consulting services to start-up and high growth telecommunications and technology firms. Mr. Harris' experience includes strategic planning, capital formation, corporate valuations, litigation support and expert testimony. He has served as Chief Financial Officer for Independent Wireless One as Vice President of Operations, Finance and Administration for Horizon Cellular Telephone Company as Vice President and Chief Financial Officer for Metrophone Cellular Communications Company as Chief Financial Officer for Nobel Learning Centers as Controller for Harrah's Atlantic City and as Audit Manager for Coopers and Lybrand. He served on the Board of Directors and as Chairman of the Finance Committee of Amtrol Inc. from 2007 to 2017. Mr. Harris holds an MBA in Finance from the Wharton School in Philadelphia, a BS in Accounting from the Pennsylvania State University and has CPA licenses in Pennsylvania and New Jersey. Mr. Harris contributes to the mix of experience and qualifications the Board seeks to maintain primarily through his consulting work in the telecommunications industry and his experience as a Chief Financial Officer for public companies.

DON C. BELL III was appointed to the Company's Board on December 29, 2016, and was appointed Chief Executive Officer by the Board on March 9, 2017. Prior to joining the Company, he was the owner and general partner of Tidal Capital LLC since April 2011, and President of Trigg Partners since August 2014. He was President and Principal Owner of Tidal Research, LLC from 2007 to 2011. From 2003 to 2006, he served as Senior Vice President of Marketing and Corporate Development at IPC Systems, Inc. From 2001 to 2003, he was Vice President of Clearwire Technologies. From 1998 to 2001, he was an Investment Banker in the Mergers and Strategic Advisory Department of Goldman Sachs. Mr. Bell holds a Master's Degree in Business Administration from The Wharton School, University of Pennsylvania, and graduated from St. John's College with a BA in Classics. Mr. Bell's operating, finance and public director experience in the telecom and technology industry qualify him to serve on the Company's Board of Directors.

THOMAS FULLER joined magicJack VocalTec in March 2017 as EVP Finance and transitioned to CFO in May of 2017 immediately following the filing of the Form 10-Q for the quarter ended March 31, 2017. Mr. Fuller is co-founder of Echo Financial Business Consulting, a consulting firm providing financial and operational consulting and transaction support to companies predominantly in the telecommunications industry. From 2003 to 2014 Mr. Fuller served in various capacities at IPC Systems Inc. including EMEA Finance Director, VP Business Development & Operations and most recently as SVP Marketing & Sales Support. Prior to IPC, Mr. Fuller served as the Finance Director for two Benchmark Capital funded start-ups, and as the UK Finance Director for Sterling Software Inc. Mr. Fuller began his career at Ernst & Young where he worked as an audit manager and within the Due Diligence practice.

DVIR SALOMON joined magicJack VocalTec in 2010, initially leading all research and development and now serving as EVP & Chief Technology Officer. Mr. Salomon has over 17 years of experience in complex communication systems, including VoIP, wireless service networks, and QoS. In 2008, Mr. Salomon co-founded CityOnHand, a GPS-based multimedia tour guide for smartphones, leading all technology and business development while also co-founding CrosIT Solutions, a consulting and information technology provider. Prior to founding the technology startups, Mr. Salomon was a manager at Airspan Ltd. and Arelnet Ltd. where he developed his VoIP and wireless service provider expertise. Mr. Salomon holds a BSc in Technology Management from HIT.

KRISTIN BEISCHEL joined magicJack VocalTec in March 2017 as EVP & Chief Marketing Officer. Ms. Beischel brings over 10 years of experience building large-scale customer acquisition programs for public and private organizations looking to drive an immediate increase in sales. From 2007 to 2015, Ms. Beischel was employee #2 at IMM, a full-service digital agency, where she helped build the business over 8 years to a 9-figure revenue organization. She held multiple senior management and operating roles at IMM, most recently as VP & Group Partnership Director, where she consulted with CMO-level clients, managed client services teams, led business development, and built out the agency's media capabilities and services. Her clients included AT&T, Sprint, and T-Mobile among others. From 2015 to 2017, Ms. Beischel served as Senior Advisor to Boulder Heavy Industries, a private investment and adtech incubator firm, where she led business due diligence and advised portfolio companies on sales, marketing and operations while also founding Bake Like A Champ, a digital learning platform. Ms. Beischel holds a BS in Business Administration with an emphasis in Marketing from the University of Colorado-Boulder.

CORPORATE GOVERNANCE

Code of Ethics

We have adopted a written code of ethics that applies to our directors, officers (including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions) and other employees. A copy of our code of ethics is available on the Company's website: www.vocaltec.com under the "Corporate Governance - Governance Documents" tab. Amendments to and waivers from the code of ethics, as applicable, will be disclosed on the Company's website.

Audit Committee

The membership of the Audit Committee consists of at least three directors, all of whom meet the independence requirements established by the Board and applicable laws, regulations, and listing requirements. Each member has the ability to read and understand fundamental financial statements and otherwise meets the financial sophistication standard established by the requirements of the Nasdaq rules. At least one member of the Audit Committee is an "audit committee financial expert" as defined by the rules and regulations of the SEC.

The purpose of our Audit Committee is to provide assistance to our Board in fulfilling its legal and fiduciary obligations with respect to matters involving the oversight of the quality and integrity of the accounting, auditing, financial reporting and internal control functions of the Company and its subsidiaries as well as complying with the legal requirements under Israeli law, the rules and regulations of the SEC and Nasdaq. The following are examples of functions within the authority of the Audit Committee:

- to recommend to the Board and the shareholders the appointment, termination and approval of the compensation of, and oversee, the Company's independent auditor;
- to communicate on a regular basis with the Company's outside auditors and review their operation and remuneration;
- to assess the Company's internal audit system and the performance of its independent auditor and if the necessary resources have been made available to the independent auditor considering the Company's needs and size;
- to determine arrangements for handling complaints of employees in relation to suspected flaws in the business management of the Company and the protection of the rights of such employees;
- to discuss with management and the Company's independent auditor significant risks or exposures and assess the steps management has taken to minimize such risks to the Company; and
- to decide whether to approve acts or transactions involving directors, executive officers, controlling shareholders and third parties in which directors, executive officers or controlling shareholders have an interest.

During the 2017 fiscal year, our Audit Committee was comprised of Alan Howe, Tal Yaron-Eldar and Richard Harris (chairman), each of whom meets the independence requirements of the Nasdaq Listing Standards and the enhanced independence standards for Audit Committee members required by the SEC. Our Board has determined that Tal Yaron-Eldar and Richard Harris qualify as "audit committee financial experts" as defined by Item 407(d) of Regulation S-K.

Section 16(a) Beneficial Ownership Reporting Compliance

Based solely upon a review of Section 16 filings furnished to us during the fiscal year ended December 31, 2017, we believe that each of our officers and directors and any other person subject to Section 16 of the Exchange Act with respect to the Company reported on a timely basis all transactions required to be reported by Section 16(a) during fiscal year 2017.

Family Relationships

There are no family relationships among any of the Company's directors or executive officers.

ITEM 11. EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

The following discussion and analysis contains statements regarding individual and Company performance targets and goals used in setting compensation for our Named Executive Officers. These targets and goals are disclosed in the limited context of the Company's compensation programs and should not be understood to be statements of management's future expectations or estimates of future results or other guidance. The Company specifically cautions investors not to apply these statements to other contexts.

Compensation Philosophy and Objectives

The goals of our executive officer compensation program are to attract, retain, and reward executive officers who contribute to our success, to align executive officer compensation with our performance, and to motivate executive officers to achieve our business objectives. We compensate our senior management through a mix of base salary, bonus, and equity compensation designed to align management's incentives with the long-term interests of our shareholders. In addition, we provide our Named Executive Officers ("NEOs") with benefits that are generally available to all employees of the Company. Compensation paid to our executive officers is made under the terms of an employment agreement, if applicable, and on a discretionary basis by our Board following approval by the Compensation Committee. In addition, shareholders must approve certain executive compensation, as described in more detail below.

Our Named Executive Officers in 2017 were Gerald Vento, former Chief Executive Officer, President and Director; Jose Gordo, former Chief Financial Officer; Don Carlos Bell III, the Company's current President and Chief Executive Officer; Thomas Fuller, the Company's current Executive Vice President and Chief Financial Officer; Kristin Beischel, the Company's current Executive Vice President and Chief Marketing Officer; and Dvir Salomon, the Company's current Executive Vice President and Chief Technology Officer.

Setting Executive Compensation

At the 2013 annual general meeting of shareholders held on July 3, 2013, our shareholders approved the compensation policy that we submitted to the shareholders for their approval (the "Compensation Policy"). Under Amendment No. 20 to the Companies Law, which came into effect in December 2012 ("Amendment No. 20"), public companies were required to adopt a compensation policy with respect to the terms of service and employment of their directors and officers no later than September 2013. The Companies Law requires that a compensation policy be reviewed and approved every three years. Accordingly, on March 9, 2017, following the recommendation of the Compensation Committee, the Company's Board approved the Amended Compensation Policy for a three-year term (the "First Amended Compensation Policy"). The First Amended Compensation Policy amended, among other things, certain caps on the amount of sales commissions and bonuses paid to any officer, specified the measurable criteria framework for the payment of bonuses, the factors the Compensation Committee will consider when awarding a sign-on bonus, and amended the maximum severance payment payable to an officer in the event of a changes of control, all as specified in the Company's definitive proxy statement for the 2016 annual general meeting, filed with the SEC on March 15, 2017. Shareholder approval for the First Amended Compensation Policy was obtained at the 2016 annual general meeting of shareholders held on April 19, 2017.

On May 22, 2017, following the recommendation of the Compensation Committee, the Company's Board approved additional changes to the First Amended Compensation Policy to accommodate an update to non-employee director compensation. The changes provided for non-employee director compensation as follows:

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- Annual cash compensation for each non-employee director in the amount of $50,000 or, in the case of the non-employee Chairman of the Board, $100,000, paid quarterly;
- Annual equity-based compensation valued at $60,000 per year for each non-employee director, which will fully vest on the first anniversary of the date of grant;
- Annual cash compensation of $10,000 for service on each of the Company's Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee; and
- Annual cash compensation of $10,000 for service on a "special committee" of the Board, intended to cover up to four meetings per year, with additional cash compensation of $1,000 for each additional meeting thereafter.

Shareholder approval for the above amendments to the First Amended Compensation Policy was obtained at a special meeting of the Company's shareholders held on July 31, 2017. The First Amended Compensation Policy, as amended by the amendments described above, is referred to herein as the "Amended Compensation Policy".

Amendment No. 20 to the Companies Law provides that the compensation policy shall be based, among other parameters, on promoting the company's objectives, its work plan and long term strategy, creating appropriate incentives for the company's directors and officers, considering, among other factors, the risk management of the company, the company's size and nature of its operations and, with respect to terms of service and employment that include non-fixed compensation, the contribution of the director or officer to achievement of corporate goals and increased profits, all with a long term view and taking into account the officer's position.

The Amended Compensation Policy includes both long term and short term compensation elements and is to be reviewed from time to time by the Company's Compensation Committee and Board as required by the Companies Law. In general, the compensation package for officers will be examined while taking into consideration, amongst others, the following parameters: (i) the education, qualifications, expertise, seniority (in the Company in particular, and in the officer's profession in general), professional experience and achievements of the officer; (ii) the officer's position, the scope of his responsibility and previous wage agreements that were signed with him; (iii) the officer's contribution to the Company's business, profits and stability; (iv) the degree of responsibility imposed on the officer; and (v) the Company's need to retain officers who have skills, know-how or unique expertise. Additionally, prior to the approval of a compensation package for an officer, the Company will conduct a wage survey that compares and analyzes the level and cost of the compensation package offered to an officer of the Company with the compensation packages offered to officers in similar positions in other companies of the same type and/or financial structure. The surveys are to be conducted internally or through an external consultant recommended by the Compensation Committee.

As provided in the Amended Compensation Policy, the Company is entitled to grant to officers a compensation package which may include a base salary, commissions, signing bonus, annual cash bonus and share-based compensation, or any combination thereof, and additional standard benefits. The Amended Compensation Policy also specifies the cash and share-based compensation to be paid to non-employee directors, as well as reimbursement of out-of-pocket expenses incurred in connection with fulfillment of their duties as directors, all subject to applicable law.

An engagement with an officer who is not a director, controlling shareholder (or relative thereof), or the Chief Executive Officer regarding his or her service and terms of employment must be approved by the Compensation Committee and the Board, provided that the compensation is approved in accordance with the Company's compensation policy. Other approval requirements apply if the engagement is not in accordance with the Company's compensation policy. An engagement with the Chief Executive Officer regarding his or her service and terms of employment must be approved by our Compensation Committee, our Board of Directors, and by a special majority of our shareholders as provided under Israeli law. In special cases, the compensation of a nominee for service as the Chief Executive Officer may be approved without shareholder approval, subject to meeting certain conditions under the Companies Law. Arrangements between the Company and a director as to the terms of his office or regarding compensation for non-directorial duties requires the approval of the Compensation Committee, the Board and shareholders.

The Compensation Committee has from time to time retained the services of independent compensation consulting firms to provide information in accordance with the requirements of our Amended Compensation Policy. In 2017, the Compensation Committee selected and directly retained the services of Meridian Compensation Consultants, LLC ("Meridian"), an independent compensation consulting firm, to provide a peer group analysis and a compensation benchmarking study related to director compensation as well as related to compensation of Don Carlos Bell III, the Company's President and Chief Executive Officer; Thomas Fuller, the Company's Executive Vice President and Chief Financial Officer; Kristin Beischel, the Company's Executive Vice President and Chief Marketing Officer; and Dvir Salomon, the Company's Executive Vice President and Chief Technology Officer.

Meridian developed a peer group analysis for the purpose of comparing and analyzing the level and cost of the compensation package to be offered to the Company's President and Chief Executive Officer, Executive Vice President and Chief Financial Officer, Executive Vice President and Chief Marketing Officer and Executive Vice President and Chief Technology Officer. The peer group companies considered by Meridian and approved by the Compensation Committee in connection with 2017 compensation include companies of similar size, as measured by trailing twelve months revenue, market capitalization and enterprise value, that operated in the same or complimentary industries as the Company and are as follows:

- GTT Communications Inc.
- Shenandoah Telecommun Co
- Cogent Communications Hldgs
- Iridium Communications Inc.
- Atn International Inc.
- Hawaiian Telcom Holdco Inc.
- Inteliquent Inc.
- LogMeIn Inc.
- Incontact Inc.
- Demandware Inc.
- 8x8 Inc.
- LivePerson Inc.
- Alaska Communications Sys Gp
- Lumos Networks Corp
- ORBCOMM Inc.
- Spok Holdings Inc.
- Limelight Networks Inc.
- Five9 Inc.
- Boingo Wireless Inc.
- Brightcove Inc.
- Synacor Inc.
- Fusion Telecommunications
- Ooma Inc.

The Compensation Committee considered the data and analyses prepared by Meridian that included the appropriateness of: (i) the amount of base salary, (ii) the annual incentive bonus potential and the performance metrics for achieving such bonus, (iii) the existence and amount of a signing bonus, (iv) the mix and vesting schedule for equity compensation, and (v) market practice with respect to other employment terms, with respect to each of the officers reviewed compared to that of the peer group companies listed above. The peer group data was collected primarily from proxy filings reflecting the most recently disclosed compensation as of the time Meridian compiled the data in 2017.

Meridian reviewed with the Compensation Committee Meridian's analysis of the (1) base salaries, (2) bonus, (3) total cash compensation (salary plus annual bonus opportunity), (4) long-term incentive awards and (5) total direct compensation (salary plus annual bonus opportunity plus value of long-term incentives payable to each named executive officer) to the 25th percentile, the 50th percentile and 75th percentile target opportunity of the peer group. The Compensation Committee used this peer group data to obtain a general understanding of current compensation practices consistent with our Amended Compensation Policy, to ensure that the Committee was acting in an informed and responsible manner and to make sure our executive compensation program is competitive. The Compensation Committee did not seek to set any elements of compensation at a specific percentile of the relevant peer group but it did want to understand and be cognizant of the divergence of any of the compensation elements from the 25th percentile, 50th percentile and 75th percentile. The Compensation Committee and Board determined that the compensation packages proposed for Mr. Bell, Mr. Fuller, Ms. Beischel and Mr. Salomon were consistent with the compensation paid to similarly situated name executive officers by the Company's peer group as presented by Meridian.

A description of Meridian's analysis and recommendations with respect to the 2017 changes to compensation for non-employee directors is set forth below under "2017 Director Compensation," below.

Compensation Program

The primary components of the executive compensation program of our Company consist of base salary, bonuses, grants of restricted stock and options, and health benefits. In connection with the Company's formal process to review and evaluate strategic alternatives to enhance stockholder value, including a possible sale of the Company, the Company also provided a special transaction bonus opportunity for Messrs. Bell, Fuller, Salomon and Ms. Beischel.

Base Salary

In accordance with our Amended Compensation Policy, the base salary of a new officer in the Company was determined based on the parameters set forth in the Amended Compensation Policy and discussed above. The Compensation Committee and the Board had authority to update the base salary of the officers (other than (i) officers who are controlling shareholders or their relatives or other officers' compensation in which the controlling shareholder has a personal interest and (ii) officers who serve as directors) consistent with the terms of the Compensation Policy including the parameters specified above, provided that the Compensation Committee alone had authority to approve an amendment to an officer's base salary that does not increase such base salary by more than 15% on an aggregate basis during the term of the officer's employment agreement and, with respect to the annual base salary of the CEO, such change does not materially change the structure of the incentives provided thereto, even if the total value of the compensation package remains unchanged .

Mr. Vento's base salary in 2017 for his service as then Chief Executive Officer of the Company was $500,000. He resigned from this position effective March 9, 2017 and, as a result, received $94,872 in base salary for 2017.
Mr. Gordo's base salary for 2017 for his service as then Chief Financial Officer of the Company was $350,000 but he resigned from this position effective May 25, 2017 and, as a result, received $132,436 in base salary for 2017. Keith Reed's base salary in 2017 for his service as the former General Manager - Senior Vice President Enterprise was $350,000 but he resigned from this position effective February 3, 2017 and, as a result, received $33,205 in base

salary for 2017. Accordingly, although a named executive officer for 2016, Mr. Reed is not among the named executive officers for 2017. The 2017 annual base salary amounts for Mr. Vento, Mr. Gordo and Mr. Reed were at the same amount as their 2016 annual base salary levels.

Mr. Bell was hired as the Company’s President and Chief Executive Officer effective March 9, 2017 at a base salary of $500,000, resulting in base salary of $405,449 paid to Mr. Bell in 2017. Mr. Fuller was hired as the Company’s Executive Vice President of Finance effective March 13, 2017, transitioning to the role of Executive Vice President and Chief Financial Officer on May 11, 2017, at a base salary of $275,000, resulting in base salary of $220,882 paid to Mr. Fuller in 2017. Ms. Beischel was hired as the Company’s Executive Vice President and Chief Marketing Officer effective March 9, 2017 at a base salary of $225,000, resulting in base salary of $182,590 paid to Ms. Beischel in 2017. Mr. Salomon was employed as the Company’s Chief Technology Officer under the terms of an Employment Agreement dated October 14, 2016 at a base salary of $300,000. He executed an Amended and Restated Employment Agreement on June 23, 2017, under which his base salary was reduced to $275,000, resulting in base salary of $287,500 paid to Mr. Salomon in 2017.

We believe we provided the above Named Executive Officers with a level of base salary that recognized appropriately each individual officer’s scope of responsibility, role in the organization, experience, contributions to the success of our Company and the results of peer group surveys.

Signing Bonus

Under our Amended Compensation Policy, we may grant a signing bonus to an officer, which may not exceed the officer’s initial annual base salary and will be subject to the limitations in the Amended Compensation Policy. A signing bonus will not be considered in calculating the maximum amount of the bonus (described below) payable to an officer following his initial year of employment. In 2017, Mr. Bell received a signing bonus of $500,000, Mr. Fuller received a signing bonus of $275,000 and Ms. Beischel received a signing bonus of $150,000. No other signing bonuses were awarded to our Named Executive Officers during 2017.

Annual Cash Incentive Bonus

Under the terms of our Amended Compensation Policy, our annual cash incentive bonus will be based mainly (at least 80%) on measurable criteria, and, with respect to its less significant part (up to 20%), at the Board and management’s discretion, based on non-measurable criteria. Measurable criteria may include financial targets, meeting sales and marketing objectives, productivity indices and growth in the volume of activity, cost savings, implementation and promotion of planned projects, promoting strategic targets, promoting innovation in the Company and/or success in raising capital.

The remaining portion of the annual cash bonus (not exceeding 20% of the annual cash bonus) will be determined according to non-measurable criteria, such as the contribution of the officer to the Company’s business, its profitability and stability, the need for the Company to retain an officer with skills, know-how, or unique expertise, the responsibility imposed on the officer, changes that occurred in the responsibility imposed on the officer during the year, satisfaction with the officer’s performance, assessing the officer’s ability to work in coordination and cooperation with other employees of the Company, the officer’s contribution to an appropriate control environment and ethical environment and such other elements as recommended by the Compensation Committee and approved by the Board. Based on our Amended Compensation Policy and the peer group survey conducted in 2017, the Compensation Committee established the following annual cash incentive bonus structure for Messrs. Bell, Fuller and Salomon and Ms. Beischel applicable for each of them during the year ended December 31, 2017 under the terms of their employment agreements:

Executive	Target/Maximum Annual Bonus	Bonus Milestones:	Bonus Payout Levels
Don Carlos Bell III	Target of $500,000	50% based on meeting at least 80% and up to 120% of target revenue for the year 50% based on meeting at least 80% and up to 120% of target EBITDA for the year	Revenue: Range from 35% to 200% of the target annual bonus. EBITDA: Range from 35% to 200% of the target annual bonus.

Thomas Fuller	Target of $206,250	50% based on meeting at least 80% and up to 120% of target revenue for the year	Revenue: Range from 35% to 200% of the target annual bonus.
		50% based on meeting at least 80% and up to 120% of target EBITDA for the year	EBITDA: Range from 35% to 200% of the target annual bonus.
Kristin Beischel	Target of $112,500	50% based on meeting at least 80% and up to 120% of target revenue for the year	Revenue: Range from 35% to 200% of the target annual bonus.
		50% based on meeting at least 80% and up to 120% of target EBITDA for the year	EBITDA: Range from 35% to 200% of the target annual bonus.
Dvir Salomon	Target of $137,500	50% based on meeting at least 80% and up to 120% of target revenue for the year	Revenue: Range from 35% to 200% of the target annual bonus.
		50% based on meeting at least 80% and up to 120% of target EBITDA for the year	EBITDA: Range from 35% to 200% of the target annual bonus.

The term "EBITDA" when used to describe the financial performance measure for the annual cash incentive bonus means earnings before interest expense, income taxes, depreciation and amortization.

The following table sets forth the awards to the NEOs determined by the Compensation Committee at its meeting held on March 8, 2018:

Name and Position	Target Bonus	Minimum* Annual Bonus	Maximum Annual Bonus	Actual Annual Bonus	Actual Annual Bonus as a Percentage of Target Annual Bonus	Actual Annual Bonus as a Percentage of Maximum Annual Bonus
Don Carlos Bell, III	$500,000.00	$87,500.00	$1,000,000.00	$497,750.00	99.550 %	49.775 %
Thomas Fuller	$206,250.00	$36,093.75	$412,500.00	$205,322.00	99.550 %	49.775 %
Dvir Salomon	$137,500.00	$24,062.50	$275,000.00	$136,881.00	99.550 %	49.775 %
Kristin Beischel	$112,500.00	$19,687.50	$225,000.00	$111,995.00	99.551 %	49.776 %

* Minimum Annual Bonus is based upon hitting minimum target in only one category (revenue or EBITDA) which is possible.

Messrs. Vento, Gordo and Reed were not eligible to participate in the annual cash incentive bonus program described above due to their respective resignations prior to December 31, 2017.

Sales Commissions

Under our Amended Compensation Policy, we may pay our officers sales and other commissions based on a pre-determined commission plan, which commissions will be considered part of the officer's aggregate compensation package subject to limitations in the Amended Compensation Policy. None of our Named Executive Officers will receive commissions for the year ended December 31, 2017.

Grants of Restricted Stock and Ordinary Share Options

Equity compensation consists of periodic grants of restricted stock and options exercisable for ordinary shares to certain of our executives under our Amended and Restated magicJack VocalTec Ltd. 2013 Stock Incentive Plan, and our Amended and Restated magicJack VocalTec Ltd. 2013 Israeli Stock Incentive Plan, (together the "2013 Plans"), to provide additional incentive to work to maximize long-term total return to shareholders. Award levels are determined based on market data and may vary among participants based on their positions within the Company, assessment of job performance, and other factors, including the terms of their employment agreements with the Company. A committee appointed by the Board is specified to act as the plan administrator. In 2017, our Compensation Committee administered the plan.

Based on the recommendation of the Compensation Committee and findings of the Board, on May 8, 2017, the Board approved and the Company entered into a Restricted Stock Agreement and an Option Agreement with Mr. Bell in connection with his services as the new Chief Executive Officer of the Company. Mr. Bell was awarded 149,068 shares of restricted stock under the terms of his Restricted Stock Agreement and 1,883,165 ordinary share options under the terms of his Option Agreement at a strike price of $9.51. These agreements were subject to the approval of the Company's shareholders as required under Israeli law. At a Special Meeting of Shareholders held on July 31, 2017, the required shareholder vote approving these agreements with Mr. Bell was obtained. See "Employment

Agreements for Current Named Executive Officers," below.

Also on May 8, 2017, upon the recommendation of the Compensation Committee and findings of the Board, the Board approved, and the Company entered into a Restricted Stock Agreement and an Option Agreement with, Mr. Fuller in connection with his services as Executive Vice President Finance and, commencing May 11, 2017, Executive Vice President and Chief Financial Officer. Mr. Fuller was awarded 37,267 shares of restricted stock under the terms of his Restricted Stock Agreement and 470,791 ordinary share options under the terms of his Option Agreement at a strike price of $9.51. Mr. Fuller's Option Agreement was subject to approval of amendments to our magicJack VocalTec Ltd. 2013 Stock Incentive Plan by the Company's shareholders to increase the number of the Company's ordinary shares available for grant under the plan. At a Special Meeting of Shareholders held on July 31, 2017, the required shareholder vote approving the amendments was obtained. See "Employment Agreements for Current Named Executive Officers," below.

Also on May 8, 2017, upon the recommendation of the Compensation Committee and findings of the Board, the Board approved, and the Company entered into a Restricted Stock Agreement and Option Agreement with, Ms. Beischel in connection with her services as Executive Vice President and Chief Marketing Officer. Ms. Beischel was awarded 21,118 shares of restricted stock under the terms of her Restricted Stock Agreement and 266,782 ordinary share options under the terms of her Option Agreement at a strike price of $9.51. Ms. Beischel's Option Agreement was subject to approval of amendments to our magicJack VocalTec Ltd. 2013 Stock Incentive Plan by the Company's shareholders to increase the number of the Company's ordinary shares available for grant under the plan. At a Special Meeting of Shareholders held on July 31, 2017, the required shareholder vote approving the amendments was obtained. See "Employment Agreements for Current Named Executive Officers," below.

On June 23, 2017, upon the recommendation of the Compensation Committee and findings of the Board, the Board approved, and the Company entered into an Option Agreement with Mr. Salomon in connection with his services as Executive Vice President and Chief Technology Officer. Mr. Salomon was awarded 175,566 ordinary share options under the terms of his Option Agreement at a strike price of $9.51. Mr. Salomon's Option Agreement was subject to approval of amendments to our magicJack VocalTec Ltd. 2013 Stock Incentive Plan by the Company's shareholders to increase the number of the Company's ordinary shares available for grant under the plan. At a Special Meeting of Shareholders held on July 31, 2017, the required shareholder vote approving the amendments was obtained. See "Employment Agreements for Current Named Executive Officers," below.

No grants of restricted stock or options were made to Messrs. Vento or Gordo during 2017.

Benefits

We provide various employee benefit programs to our executive officers, including: (i) medical and dental insurance benefits for our U.S. based employees, and (ii) a defined contribution retirement plan for our Israeli employees. These benefits are generally available to all full-time employees of our Company based on their location.

Special Transaction Bonus

Upon the recommendation of the Compensation Committee and findings of the Board, the Board approved provisions in the employment agreements for Messrs. Bell, Fuller and Salomon and Ms. Beischel providing for a special transaction bonus if the closing of a transaction resulting in a “change of control” (as defined in the respective agreements) occurs before the one-year anniversary of the execution date of the agreements (the “Transaction Deadline”) and the applicable executive is still employed by the Company on the closing date. The bonus is based on the sales price or Company valuation in the change of control transaction. Upon the recommendation of the Compensation Committee and findings of the Board, the Board provided for this special transaction bonus in recognition that none of the long-term equity incentives granted to Messrs. Bell or Fuller or Ms. Beischel on May 8, 2017 will vest as a result of a change of control occurring before the one-year anniversary of the grant on May 8, 2018. The special transaction bonus for Mr. Salomon will be reduced by the value of restricted stock which accelerates in connection with a change of control. On November 8, 2017, in consideration of the fact that the Merger might not be consummated on or before the one-year anniversary of the Bell, Fuller and Beischel Agreements, the Board approved an amendment to each of those executive employment agreements to allow each of these executives to receive the special transaction bonus in connection with the Merger, regardless of when the Merger is consummated. The Board also approved amendments to the restricted stock agreements pursuant to which the vesting of their restricted stock awards will be delayed and forfeited immediately prior to and contingent upon the consummation of the Merger.

Compensation Committee Report

Our Compensation Committee has reviewed and discussed with management the Compensation Discussion and Analysis included in this annual report and, based on such review and discussions, the Compensation Committee recommended to our Board that the Compensation Discussion and Analysis be included in this annual report.

Respectfully submitted,
The Compensation Committee
Tal Yaron-Eldar
Izhak Gross
Richard Harris

2017 Summary Compensation Table

The table below summarizes the total compensation earned by each of our Named Executive Officers for the fiscal years ended December 31, 2017, 2016 and 2015.

Name and Principal Position (a)	Year (b)	Salary ($) (c)	Bonus ($) (d)	Stock Awards ($)[1] (e)	Option Awards ($)[1] (f)	Non-Equity Incentive Plan Compensation ($)[2] (g)	All Other Compensation ($) (i)	Total ($) (j)
Don Carlos Bell III								
Chief	2017	405,449	-	1,244,718	4,003,029	497,750	500,000	(3) 6,650,946
Executive Officer,	2016	-	-	-	-	-	-	-
and President	2015	-	-	-	-	-	-	-
Thomas Fuller								
Chief	2017	220,882	-	311,179	1,000,757	205,322	275,000	(4) 2,013,140
Financial	2016	-	-	-	-	-	-	-
Officer and EVP	2015	-	-	-	-	-	-	-
Dvir Salomon								
Chief	2017	287,500	-	-	373,199	161,881	93,681	(5) 916,261
Technology	2016	25,000	-	607,000	-	125,000	225,000	(5) 982,000
Officer and EVP	2015	-	-	-	-	-	-	-
Kristen Beischel								
Chief	2017	182,590	-	176,335	567,096	111,995	151,400	(6) 1,189,416
Marketing	2016	-	-	-	-	-	-	-
Officer and EVP	2015	-	-	-	-	-	-	-
Gerald Vento								
Former Chief	2017	94,872	-	-	-	-	820,591	(7) 915,463
Executive Officer,	2016	500,000	-	-	-	406,500	-	906,500
and President[3]	2015	500,000	-	-	-	706,063	-	1,206,063
Jose Gordo								
Former Chief	2017	132,436	-	-	-	-	525,796	(8) 658,232
Financial	2016	350,000	-	-	-	142,275	4,269	(8) 496,544
Officer[4]	2015	325,000	-	1,800,000	1,801,138	211,819	-	4,137,957

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(1) The amounts in these columns reflect the aggregate grant date fair value of the stock awards computed based on the closing adjusted price as of the grant date and for option awards computed based on the Black-Scholes value as of the grant date in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718, "Stock-based Compensation." For additional information, see note 12 to the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

(2) The amounts in 2016 and 2015 represent the annual cash incentive bonuses paid in 2017 and 2016, respectively, to Messrs. Vento, Gordo and Salomon based on the bonus milestones achieved during the years ended December 31, 2016 and 2015, respectively. There were no annual cash incentive bonuses paid to Messrs. Vento and Gordo for the year ended December 31, 2017. The amounts in 2017 represent the annual cash incentive bonus to be paid to Messrs. Bell, Fuller and Salomon and Ms. Beischel for the year ended December 31, 2017, based on the March 8, 2018 Compensation Committee meeting.

(3) Mr. Bell received a signing bonus of $500,000 in 2017.

(4) Mr. Fuller received a signing bonus of $275,000 in 2017.

(5) Mr. Salomon received $8,829 in health-related benefits in 2017 as well as $84,852 in expense reimbursements related to his relocation to the United States from Israel. In 2016 Mr. Salomon received $225,000 in indirect compensation from our Israeli parent to the consulting company which employed Mr. Salomon before we acquired that consulting company and Mr. Salomon became an employee of magicJack in the United States.

(6) Ms. Beischel received a signing bonus of $150,000 in 2017 as well as $1,400 in health-related benefits.

(7) Mr. Vento retired as President and Chief Executive Office of the Company effective March 9, 2017, and resigned from the Board of Directors on June 17, 2017. Mr. Vento received $800,000 in consulting fees and $20,591 in non-employee Director fees in 2017.

(8) Mr. Gordo left the Company effective May 25, 2017. In connection with his departure, he executed a separation agreement and received $525,000 in severance. Additionally, Mr. Gordo received $796 and $4,269 in health-related benefits in 2017 and 2016 respectively.

2017 Pay Ratio Disclosure

For purposes of calculating the 2017 ratio of the median annual total compensation of all Company employees to the total annual compensation of the Company's chief executive officer, the Company included in its calculation of compensation: base salary, commissions, annual bonus amounts, stock-based compensation (based on the grant date fair value of awards granted during 2017) and other incentive payments (including sign-on bonuses for the new executive officers). The Company used December 31, 2017 as its measurement date. Base salary amounts were annualized for any employee who had less than a full year of service during 2017, including the Chief Executive Officer. Total compensation for Don Carlos Bell III, the Company's Chief Executive Officer was determined to be $6,792,747 and was approximately 85 times the median annual compensation of all Company employees excluding the chief executive officer of $79,919. If stock based compensation amounts are excluded from the calculation, Mr. Bell's annual compensation is approximately $1,545,000, or 19 times the median employee compensation of $79,919. For purposes of this calculation, the Company had 135 employees worldwide, excluding the chief executive officer.

2017 Grants of Plan-Based Awards

The table below sets forth information regarding grants of plan-based awards made to our Named Executive Officers during the year ended December 31, 2017.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards[1] Threshold ($)	Target ($)	Maximum ($)	All Other Stock Awards: Number of Shares of Stock or Stock Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards ($)	Grant Date Fair Value of Stock and Option Awards ($)
Don Carlos Bell III	05/08/17	175,000	500,000	1,000,000	149,068	1,883,165	9.51	5,247,747
Thomas Fuller	05/08/17	72,188	206,250	412,500	37,267	470,791	9.51	1,311,936
Dvir Salomon	05/08/17	-	125,000	-	-	175,566	9.51	373,199
Kristen Beischel	05/08/17	39,375	112,500	225,000	21,118	266,782	9.51	743,432
Gerald Vento	-	-	-	-	-	-	-	-
Jose Gordo	-	-	-	-	-	-	-	-

(1) These columns reflect the threshold, target and maximum amounts that Messrs. Bell, Fuller and Salomon and Ms. Beischel were eligible to receive under our annual cash incentive bonus plan with respect to fiscal year 2017. Messrs. Vento and Gordo were not eligible to receive an award under the annual cash incentive bonus plan for fiscal year 2017. Awards paid for 2016 are reflected in the Summary Compensation Table, above.

2017 Outstanding Equity Awards and Stock Vesting
Outstanding Equity Awards at 2017 Fiscal Year End

The following table sets forth certain information regarding equity-based awards held by our Named Executive Officers as of December 31, 2017.

Name	Option Award: Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Stock Awards: Number of Shares or Units of Stock That Have Not Vested (#)(1)	Market Value of Shares or Units of Stock That Have Not Vested ($)(2)
Don Carlos Bell III	-	1,883,165	9.51	05/08/22	149,068	1,259,625
Thomas Fuller	-	470,791	9.51	05/08/22	37,267	314,906
Dvir Salomon	-	175,566	9.51	05/08/22	16,666	140,828
Kristen Beischel	-	266,782	9.51	05/08/22	21,118	178,447
Gerald Vento(3)	-	-	-	-	-	-
Jose Gordo(4)	-	-	-	-	-	-

(1) All shares in this column consist of restricted stock awards. The awards granted to Messrs. Bell and Fuller and to Ms. Beischel are scheduled to vest in one-third increments on each of May 8, 2018, March 9, 2019 and March 9, 2020. If the contemplated change-in-control event is culminated, none of these awards will vest. The awards for Mr. Salomon are scheduled to vest on December 31, 2018. The vesting would be accelerated if the contemplated change-in-control is approved and the transaction completed.

(2) Amounts in this column have been calculated using an assumed stock price of $8.45, the closing price of our ordinary shares on December 29, 2017, the last business day of our fiscal year 2017.

(3) On June 18, 2017, Mr. Vento and the Company entered into an agreement to amend his Consulting Agreement. In connection with that amendment, Mr. Vento surrendered to the Company the options to purchase 722,782 shares at an exercise price of $14.95 per share. Accordingly, the option was terminated effective June 18, 2017, and excluded from this schedule.

(4) In connection with Mr. Gordo’s departure from the Company, 106,907 options with a strike price of $9.33 vested in May 2017, and were scheduled to expire on November 25, 2017 absent a change-in-control event. Additionally, 225,964 remaining unvested stock options that were originally scheduled to vest in annual increments on December 31, 2017 and 2018 were forfeited, unless there was a Change of Control within 180 days of his termination date. Furthermore, 87,310 shares underlying a restricted stock award made in 2015 remained unvested and were not scheduled to vest, unless there was a Change of Control within 180 days of Mr. Gordo’s termination. The contemplated transaction qualifies as a Change of Control, and if finalized will trigger the vesting of these awards. As the options are at a strike price higher than the proposed purchase price, Mr. Gordo’s options have no value. The 87,310 shares that would vest upon a change-in-control have a market value of $737,770 at December 31, 2017. In connection with his termination, Mr. Gordo surrendered to the Company options originally granted on

May 8, 2013 covering 296,031 shares at an exercise price of $17.63.

Option Exercises and Stock Vested in 2017

The Named Executive Officers did not exercise any stock options during the year ended December 31, 2017. The following table sets forth certain information regarding the vesting of shares of our restricted stock for each of our Named Executive Officers during 2017.

	Stock Awards	
Name	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)(1)
Don Carlos Bell III	-	-
Thomas Fuller	-	-
Dvir Salomon	16,667	140,836
Kristen Beischel	-	-
Gerald Vento	-	-
Jose Gordo	76,211	495,372

(1) The aggregate dollar amount realized by the Named Executive Officer upon the vesting of shares of our restricted stock was computed by multiplying the number of shares of our restricted stock that vested by the market value of the underlying shares on the last date the market was open prior to the vesting date. The amount for Mr. Salomon was calculated using an assumed stock price of $8.45, the closing price of our ordinary shares on December 29, 2017, the last business day prior to the vesting date of December 31, 2017. The amount for Mr. Gordo was calculated using an assumed stock price of $6.50, the closing price on the vesting date of May 25, 2017, the date of his separation.

Pension Benefits and Nonqualified Deferred Compensation

None of our Named Executive Officers participate in or have account balances in qualified or non-qualified defined benefit plans sponsored by us, neither do any of our Named Executive Officers participate in or have account balances in non-qualified defined contribution plans or other deferred compensation plans maintained by us.

Employment Agreements and Potential Payments Upon Termination or Change of Control for Named Executive Officers

Vento Agreement

On April 2, 2013, the Company entered into a definitive employment agreement and compensation arrangement with Gerald Vento (the “Vento Agreement”), in connection with his services as President and Chief Executive Officer of the Company. Under the terms of the Vento Agreement, Mr. Vento’s compensation was retroactive to January 1, 2013 to coincide with Mr. Vento’s start date as Chief Executive Officer.

The term of employment was initially for three years, beginning on January 1, 2013, but it was extended for an additional year through December 31, 2016 as recommended by the Compensation Committee and Board and approved by the Company’s shareholders at its 2015 annual general meeting of shareholders. Additionally, as recommended by the Compensation Committee and the Board and approved by the Company’s shareholders at its

2016 annual meeting, the Company entered into the Second Amendment to Mr. Vento's term of employment through the earlier of June 30, 2017 or the date the Company hired a new President and Chief Executive Officer to replace Mr. Vento.

Mr. Vento was paid an annual base salary of $500,000, subject to review each calendar year and possible increases in the sole discretion of the Board. Mr. Vento also received a signing bonus of $500,000 in 2013. For each fiscal year of employment during which the Company employed Mr. Vento, he was eligible to receive a bonus based on the Company meeting certain performance criteria. Mr. Vento's target annual bonus equaled his annual base salary (the "Target Annual Bonus"). The annual bonus ranged from 35% to 200% of the Target Annual Bonus. The annual bonus formula and performance criteria for each fiscal year were based: (i) 50% on the Company meeting at least 80% and up to 120% of its target revenue for the fiscal year; and (ii) 50% on the Company meeting at least 80% and up to 120% of its target EBITDA for the fiscal year.

Except as described below, Mr. Vento was only entitled to receive an annual bonus if he was employed by the Company pursuant to the Vento Agreement at the close of business on the last day of the applicable fiscal year with respect to the annual bonus.

Mr. Vento was granted stock options to purchase an aggregate of 722,782 shares of the Company's ordinary shares at an exercise price of $14.95, which was the fair market value of the Company's ordinary shares on the date of grant (the "Vento Options"). In addition, Mr. Vento was granted 80,267 shares of restricted stock (the "Vento Restricted Stock"). All of the Vento Options and Vento Restricted Stock were fully vested as of December 31, 2015. The Vento Options will expire immediately upon termination of Mr. Vento's employment for Cause, and six months after termination of Mr. Vento's service (including service as a Board member or consultant to the Company) for any reason other than Cause. The Vento Restricted Stock and any shares acquired through exercise of the Vento Options are subject to sale restrictions, as more particularly set forth in the agreements granting those equity interests. Mr. Vento did not receive any equity compensation when the term of the Vento Agreement was extended through December 31, 2016 nor when the term of the Vento Agreement was extended through the earlier of June 30, 2017 or the date the Company hired the new President and Chief Executive Officer to replace Mr. Vento.

On December 31, 2016, either Mr. Vento or the Company could have terminated Mr. Vento's employment under the Vento Agreement for any reason upon not less than 30 days prior written notice:

(i) Upon termination of Mr. Vento's employment prior to a Change of Control, by Mr. Vento for Good Reason or by the Company without Cause (as defined in the Vento Agreement), Mr. Vento will be entitled to a termination payment equal to the sum of (a) Mr. Vento's annual base salary at the time of such termination and (b) Mr. Vento's Target Annual Bonus for the fiscal year in which his employment is terminated (as if the applicable performance criteria have been met at the level that would result in payment of the Target Annual Bonus at the 100% level irrespective of whether or not that is the case);

(ii) Upon termination of Mr. Vento's employment by the resignation of Mr. Vento without Good Reason or by the Company with Cause, death or disability or for any other reason except as provided in the immediately preceding paragraph above or the immediately following paragraphs below, Mr. Vento will be due no further compensation other than what is due and owing through the effective date of Mr. Vento's resignation or termination (including any Annual Bonus that may be due and payable to Mr. Vento);

(iii) If upon or within six months subsequent to a Change of Control, Mr. Vento's employment is terminated by Mr. Vento for Good Reason or by the Company without Cause, Mr. Vento will be entitled to and paid a termination payment equal to three times the sum of (a) Mr. Vento's annual base salary at the time of such termination and (b) Mr. Vento's Target Annual Bonus for the fiscal year in which his employment is terminated (as if the applicable performance criteria have been met at the level that would result in payment of the Target Annual Bonus at the 100% level irrespective of whether or not that is the case); or

(iv) If Mr. Vento's employment is terminated by Mr. Vento for Good Reason or by the Company without Cause 180 days prior to the Company's execution of an agreement which, if consummated, would constitute a Change of Control, then upon consummation of such Change of Control, Mr. Vento will receive an additional payment equal to the difference between (a) the change of control termination payment described in clause (iii) and (b) any termination payment previously provided to Mr. Vento as described in clause (i).

Mr. Vento agreed during the term of his employment and until two years after termination of employment, (A) he will not engage in any business or activity which is the same as or competitive with any business or activity conducted by the Company or any of its majority owned subsidiaries or (B) become an officer, employee or consultant of or otherwise assume a substantial role or relationship with, any governmental entity, agency or political subdivision that is a client or customer of the Company or any subsidiary or affiliate of the Company, provided that Mr. Vento may invest in securities of any public company so long as he does not beneficially own more than 5% of the class of public securities. During the period of Mr. Vento's employment and until three years after the termination of employment, Mr. Vento will not, without the Company's prior written consent, seek to employ or otherwise seek the services of any employee or consultant of the Company or any of its majority-owned subsidiaries. Mr. Vento also agreed to restrictive covenants with respect to confidentiality and work product.

In connection with the Second Amendment, the Board of Directors also proposed that the Company enter into the Consulting Agreement with Mr. Vento effective as of March 10, 2017, the date following the separation date under the Vento Employment Agreement as extended by the Second Amendment in lieu of any severance to be provided to Mr. Vento on the separation date, as an inducement for Mr. Vento to execute the Second Amendment, for Mr. Vento to continue to serve as the Company's President and CEO through the separation date and to smoothly transition Mr. Vento's duties to the Company's new President and CEO. The Company entered into the Consulting Agreement with Mr. Vento on March 10, 2017.

The Consulting Agreement provides that Mr. Vento will perform certain professional consulting services for the Company. In consideration for Mr. Vento's professional consulting services, the Company will pay Mr. Vento a consulting fee of $83,333.33 per month. The term of the Consulting Agreement will commence on the separation date under the Second Amendment and originally contemplated a one-year term. On June 18, 2017, Mr. Vento and the Company entered into an agreement to amend his Consulting Agreement to shorten the term by approximately two months and to similarly reduce the aggregate amount payable under the Consulting Agreement by $200,000. Accordingly, the Consulting Agreement, as amended, will continue until December 26, 2017. The term of the Consulting Agreement may be terminated by Mr. Vento or the Company upon 30 days advance written notice or by the Company immediately for cause as defined in the Consulting Agreement. If the Consulting Agreement is terminated by the Company without cause, Mr. Vento will be entitled to a termination payment equal to the full amount payable under the Consulting Agreement as if the agreement was not terminated. If the Consulting Agreement is terminated by the Company for cause, by Mr. Vento for any reason, or upon his death or disability, Mr. Vento will be due no further compensation other than what is due and owing through the effective time of the termination.

Gordo Agreement

On May 8, 2013, the Company entered into an executive employment agreement with Jose Gordo, effective as of May 10, 2013 relating to his service as Chief Financial Officer of the Company. The term of employment under the executive employment agreement with Mr. Gordo was from May 10, 2013 through December 31, 2015.

Mr. Gordo entered into a new Employment Agreement with the Company on December 1, 2015 with an effective date of January 1, 2016 through December 31, 2018 under which he would continue to serve as the Company's Chief Financial Officer (the "2016 Gordo Agreement"). Pursuant to the 2016 Gordo Agreement, Mr. Gordo was to receive an annual base salary in the amount of $350,000 subject to review each calendar year and possible increases in the sole discretion of the Board. For each fiscal year of employment under the 2016 Gordo Agreement, Mr. Gordo was eligible to receive an Annual Bonus based on the Company meeting certain performance criteria. Mr. Gordo's Target Annual Bonus was $175,000, subject to review each calendar year and possible increase in the sole discretion of the Board. The Annual Bonus ranged from 35% to 200% of the Target Annual Bonus. The Annual Bonus formula and performance criteria for each fiscal year were based: (i) 50% on the Company meeting at least 80% and up to 120% of its target revenue for the fiscal year; and (ii) 50% on the Company meeting at least 80% and up to 120% of its target EBITDA for the fiscal year.

Except as described below, Mr. Gordo was only entitled to receive an Annual Bonus if he was employed by the Company pursuant to the 2016 Gordo Agreement at the close of business on the last day of the applicable fiscal year with respect to the Annual Bonus.

Mr. Gordo was granted stock options to purchase 499,307 shares of the Company's ordinary shares at an exercise price of $9.33, which was the fair market value of the Company's ordinary shares on December 1, 2015, the date of grant (the "2015 Options"). In addition, Mr. Gordo was granted 192,926 shares of restricted stock (the "2015 Restricted Stock") on December 1, 2015. The 2015 Options and 2015 Restricted Stock are scheduled to vest as follows: one-third of the 2015 Options and 2015 Restricted Stock vested on December 31, 2016, and one-third would vest on each of December 31, 2017 and December 31, 2018, respectively, subject to Mr. Gordo's continued employment by the Company. In the event that Mr. Gordo's employment is terminated by the Company without "Cause" or by Mr. Gordo for "Good Reason" (as such terms are defined in the agreements granting those equity interests), Mr. Gordo would be credited with service through the date that is three months after the termination date (the "Final Vesting Date"), and the 2015 Restricted Stock and 2015 Options would vest on a pro-rata basis through the Final Vesting Date. In addition, all unvested 2015 Options and 2015 Restricted Stock in the Company would immediately become 100% vested upon a Change of Control (as defined in the 2016 Gordo Agreement). The 2015 Options will expire immediately upon termination of Mr. Gordo's employment for Cause, or six months after termination of Mr. Gordo's service (including service as a consultant to the Company) for any reason other than Cause. The 2015 Restricted Stock and any shares purchased through exercise of the 2015 Options are subject to sale restrictions as more particularly set forth in the agreements granting those equity interests.

Mr. Gordo was also granted stock options to purchase 256,151 shares of the Company's ordinary shares at an exercise price of $17.63, which was the fair market value of the Company's ordinary shares on July 3, 2013, the date of grant (the "2013 Options"). In addition, Mr. Gordo was granted 27,634 shares of restricted stock (the "2013 Restricted Stock") on July 3, 2013. The 2013 Options and 2013 Restricted Stock were fully vested as of December 31, 2015. Furthermore, Mr. Gordo was granted 39,880 ordinary share options at an exercise price of $17.63 (the "Prior Service Options") and 52,356 shares of restricted stock for services provided to the Company prior to his employment by the Company (the "Prior Service RSUs") on July 3, 2013. The Prior Service Options were fully vested as of December 31, 2015. The Prior Service RSUs were scheduled to vest in full on December 31, 2015, however, the shares have a vesting schedule based on the Company's stock price reaching certain targets. In the event that the targets are not met, the vesting is deferred until the targets are reached. In the event that Mr. Gordo's employment is terminated by the Company without "Cause" or by Mr. Gordo for "Good Reason," or the Company experiences a Change of Control prior to termination of Mr. Gordo's employment (as such terms are defined in Mr. Gordo's Restricted Stock Agreement), the

Prior Service RSUs will fully vest. The 2013 Options and Prior Service Options will expire immediately upon termination of Mr. Gordo's employment for Cause, six months after termination of Mr. Gordo's service (including service as a consultant to the Company) for any reason other than Cause. The 2013 Restricted Stock, the Prior Services RSUs and any shares purchased through exercise of the 2013 Options or Prior Service Options are subject to sale restrictions as more particularly set forth in the agreements granting those equity interests.

Either Mr. Gordo or the Company could terminate Mr. Gordo's employment under the 2016 Gordo Agreement for any reason upon not less than 30 days prior written notice:

(i) Upon termination prior to a Change of Control by the Company without Cause or by Mr. Gordo for Good Reason, each as defined in the Gordo Agreement, Mr. Gordo will be entitled to a termination payment equal to the sum of (a) Mr. Gordo's annual base salary at the time of such termination and (b) Mr. Gordo's Target Annual Bonus for the fiscal year in which his employment is terminated (as if the applicable performance criteria have been met at the level that would result in payment of the Target Annual Bonus at the 100% level irrespective of whether or not that is the case);

(ii) Upon termination of Mr. Gordo's employment by the resignation of Mr. Gordo without Good Reason or by the Company with Cause, death or disability or for any other reason except as provided in the immediately preceding paragraph above or the immediately following paragraphs below, Mr. Gordo will be due no further compensation other than what is due and owing through the effective date of Mr. Gordo's resignation or termination (including any Annual Bonus that may be due and payable to Mr. Gordo);

(iii) If upon or within six months subsequent to a Change of Control, Mr. Gordo's employment is terminated by Mr. Gordo for Good Reason or by the Company without Cause, Mr. Gordo will be entitled to and paid a termination payment equal to three times the sum of (a) Mr. Gordo's annual base salary at the time of such termination and (b) Mr. Gordo's Target Annual Bonus for the fiscal year in which his employment is terminated (as if the applicable performance criteria have been met at the level that would result in payment of the Target Annual Bonus at the 100% level irrespective of whether or not that is the case); or

(iv) If Mr. Gordo's employment is terminated by Mr. Gordo for Good Reason or by the Company without Cause 180 days prior to the Company's execution of an agreement which, if consummated, would constitute a Change of Control, then upon consummation of such Change of Control, Mr. Gordo will receive an additional payment equal to the difference between (a) the change of control termination payment described in clause (iii) and (b) any termination payment previously provided to Mr. Gordo as described in clause (i).

Mr. Gordo agreed that during the term of his employment and until two years after termination of employment, (A) he would not engage in any business or activity which is the same as or competitive with any business or activity conducted by the Company or any of its majority owned subsidiaries or (B) he would not become an officer, employee or consultant of or otherwise assume a substantial role or relationship with, any governmental entity, agency or political subdivision that is a client or customer of the Company or any subsidiary or affiliate of the Company, provided that Mr. Gordo could invest in securities of any public company so long as he did not beneficially own more than 5% of the class of public securities. During the period of Mr. Gordo's employment and until three years after the termination of employment, Mr. Gordo will not, without the Company's prior written consent, seek to employ or otherwise seek the services of any employee or consultant of the Company or any of its majority-owned subsidiaries. Mr. Gordo also agreed to restrictive covenants with respect to confidentiality and work product.

On May 25, 2017, Mr. Gordo's employment with the Company terminated. Pursuant to the terms of his employment agreement, he was paid a severance payment of $525,000 and executed a Separation and Release Agreement. Because of the provision of his Employment Agreement described in paragraph (iv) above, Mr. Gordo will be entitled to an additional payment upon the consummation of the Merger in the amount of $907,725.

Bell Agreement

On May 8, 2017, the Company entered into an Executive Employment Agreement with Mr. Bell, which we refer to in this annual report as the "Bell Agreement", retaining him as President and Chief Executive Officer of the Company for a three-year term with retroactive effect to March 9, 2017. Mr. Bell will be paid an annual base salary of $500,000, subject to review each calendar year and possible increases in the sole discretion of the Board, subject to the compensation policy of the Company then in effect. Mr. Bell received a signing bonus of $500,000.

The Bell Agreement provides for a special transaction bonus if the closing of a transaction resulting in a "change of control" (as defined in the Bell Agreement) occurs before the one-year anniversary of the execution date of the Bell Agreement (the "Transaction Deadline") and Mr. Bell is still employed by the Company on the closing date. A bonus is based on the sales price or Company valuation in the change of control transaction. The Board provided for this special transaction bonus in recognition that none of Mr. Bell's long-term equity incentives (see below) will vest as a result of a change of control occurring before the one-year anniversary of the grant on May 8, 2018. An amendment to the Bell Agreement was entered into on November 9, 2017, to push out the Transaction Deadline for the Transaction to allow Mr. Bell to receive the special transaction bonus in connection with the Transaction.

Also pursuant to the Bell Agreement, for each fiscal year of employment during which the Company employs Mr. Bell, he is be eligible to receive a bonus based on the Company meeting certain performance criteria. Mr. Bell's target annual bonus will equal his annual base salary (the "Target Annual Bonus"). The annual bonus will range from 35% to 200% of the Target Annual Bonus. The bonus formula and performance criteria for fiscal year 2017 are based: (i) 50% on the Company meeting at least 80% and up to 120% of its target revenue for the fiscal year; and (ii) 50% on the Company meeting at least 80% and up to 120% of its target EBITDA for the fiscal year. The Company's target revenue and target EBITDA were set by the Compensation Committee and communicated to Mr. Bell in May 2017. The annual bonus formula and performance criteria for calendar years 2018 and 2019 will be based: (i) one-third on the Company meeting at least 80% and up to 120% of its target revenue for the applicable fiscal year; (ii) one-third on the Company meeting at least 80% and up to 120% of its target EBITDA for the applicable fiscal year, and (iii) one-third on the Company meeting at least 80% and up to 120% of another objective Key Performance Indicator (the “KPI Target”) for the applicable fiscal year to be determined by the Board, or the Compensation Committee of the Board, after consultation with Mr. Bell. For purposes of the Bell Agreement, “EBITDA” means earnings before interest, taxes, depreciation and amortization calculated in accordance with generally accepted accounting principles consistent with the application of such concepts in developing the Company’s annual budget, subject to adjustments for one-time occurrences outside the ordinary course of business as deemed appropriate by the Company’s Compensation Committee.

If the Company’s financial statements are restated for a period for which an Annual Bonus has been paid under the terms of the Agreement, the Annual Bonus amount for such period will be re-calculated by the Company (the “Recalculated Bonus Amount”). In any such event, the difference between the Annual Bonus in question and the Recalculated Bonus Amount will be paid to or refunded by Mr. Bell, as applicable, not later than 60 days after the restatement, provided that no such adjustments will be made at any time after the second anniversary of the Annual Bonus payment in question.

Except as described below under "Termination", Mr. Bell will be entitled to receive an Annual Bonus only if he is employed by the Company pursuant to the Bell Agreement at the close of business on the last day of the applicable fiscal year with respect to the Annual Bonus.

Mr. Bell is entitled to 20 paid-time-off days per fiscal year. Mr. Bell is eligible to participate in, without action by the Board or any committee thereof, any benefits and perquisites available to the executive officers of the Company, including any group health, dental, life insurance, disability, or other form of executive benefit plan or program of the Company now existing or that may be later adopted by the Company. The Company will reimburse Mr. Bell for all ordinary and necessary business expenditures made by him in connection with, or in furtherance of, his employment upon presentation by him of supporting information as may from time to time be reasonably requested by the Board.

Also in connection with his hiring, Mr. Bell was granted an option to purchase 1,883,165 of the Company's ordinary shares at an exercise price of $9.51, representing approximately 118% of the fair market value of the Company's shares on the date of grant (the "Option"), pursuant to a Stock Option Agreement dated May 8, 2017 (the "Bell Option Agreement"). In addition, on May 8, 2017, Mr. Bell was granted 149,068 restricted shares (the "Restricted Stock") pursuant to a Restricted Stock Agreement dated May 8, 2017 (the "Bell Restricted Stock Agreement"). The Restricted Stock was granted under the terms of the Company's 2013 Stock Incentive Plan. The Option was granted under the terms of the Company's Amended 2013 Stock Incentive Plan (the "Amended Plan"), subject to the approval of the Amended Plan by the Company's shareholders which was obtained in July of 2017. Both grants were also subject to shareholder approval at the July 2017 shareholder meeting, and shareholder approval was obtained.

The Option and Restricted Stock, as originally granted, were to vest as follows: one-third of the Options and Restricted Stock would vest on each of May 8, 2018, March 9, 2019 and March 9, 2020, subject to Mr. Bell's continued employment by the Company. After the one year anniversary of their respective grant dates, both equity grants were subject to partial accelerated vesting in the event of Mr. Bell's termination without "cause" or for "good reason" (as each is defined in the Bell Agreement) or in the event of his termination as a result of his death or disability, and full accelerated vesting under certain circumstances related to a change of control of the Company. If a change of control of the Company occurs before the one-year anniversary of the grant (i.e., before May 8, 2018), there was to be no accelerated vesting of these grants.

Either Mr. Bell or the Company may terminate Mr. Bell's employment under the Bell Agreement for any reason upon not less than 30 days prior written notice.

(i) Upon termination of Mr. Bell's employment prior to a change of control by Mr. Bell for good reason or by the Company without cause (as each term is defined in the Bell Agreement), Mr. Bell will be entitled to a termination payment equal to two times Mr. Bell's annual base salary at the time of such termination (the "Termination Payment").

(ii) Upon termination of Mr. Bell's employment by the resignation of Mr. Bell without good reason or by the Company with cause or by reason of death or disability or for any other reason except as provided in the immediately preceding paragraph above or the immediately following paragraph below, Mr. Bell will be due no further compensation other than what is due and owing through the effective date of Mr. Bell's resignation or termination (including any Annual Bonus that may be due and payable to Mr. Bell).

(iii) If upon or within six months subsequent to a change of control, Mr. Bell's employment is terminated by Mr. Bell for good reason or by the Company without cause, Mr. Bell will be entitled to and be paid a termination payment (the "Change of Control Payment") equal to two times the sum of (a) Mr. Bell's annual base salary at the time of such termination and (b) Mr. Bell's Target Annual Bonus for the fiscal year in which his employment is terminated (as if the applicable performance criteria have been met at the level that would result in payment of the Target Annual Bonus at the 100% level irrespective of whether or not that is the case); provided, however, that the Change of Control Payment will only be paid to Mr. Bell if the change of control closes after the six month anniversary of the execution date of the Bell Agreement and the change of control transaction meets a per share threshold price that is greater than or equal to $9.51 per share. In the event a change of control transaction closes in the first six months following the execution date of the Bell Agreement, or closes pursuant to an agreement entered into in the first six months following the execution date of the Bell Agreement, Mr. Bell will not be entitled to the Change of Control Payment upon his termination.

The Bell Agreement provides for a payment reduction to avoid imposition of the excise tax imposed under Section 4999 of the Internal Revenue Code.

Mr. Bell will not be entitled to any severance payment unless Mr. Bell executes and delivers to the Company a general release of claims on terms described in the Bell Agreement.

Mr. Bell has agreed that during the term of his employment and until one year after termination of employment, (A) he will not engage in any business or activity which is the same as or competitive with any business or activity conducted by the Company or any of its majority owned subsidiaries or (B) become an officer, employee or consultant of or otherwise assume a substantial role or relationship with, any governmental entity, agency or political subdivision that is a client or customer of the Company or any subsidiary or affiliate of the Company, provided that Mr. Bell may invest in securities of any public company so long as he does not beneficially own more than 5% of the class of publicly traded securities. During the period of Mr. Bell’s employment and until one year after the termination of employment, Mr. Bell will not, without the Company’s prior written consent, seek to employ or otherwise seek the services of any employee or consultant of the Company or any of its majority-owned subsidiaries. Mr. Bell also agreed to restrictive covenants with respect to confidentiality and work product.

Fuller Agreement

On May 8, 2017, the Company entered into an Executive Employment Agreement with Mr. Fuller, which we refer to in this annual report as the “Fuller Agreement”, retaining him as Executive Vice President Finance and, effective May 11, 2017, Executive Vice President and Chief Financial Officer of the Company for a three-year term with retroactive effect to March 13, 2017. Mr. Fuller will be paid an annual base salary of $275,000, subject to review each calendar year and possible increases in the sole discretion of the Board, subject to the compensation policy of the Company then in effect. Mr. Fuller received a signing bonus of $275,000.

The Fuller Agreement provides for a special transaction bonus if the closing of a transaction resulting in a “change of control” (as defined in the Fuller Agreement) occurs before the one-year anniversary of the execution date of the Fuller Agreement (the “Transaction Deadline”) and Mr. Fuller is still employed by the Company on the closing date. The bonus is based on the sales price or Company valuation in the change of control transaction. The Board provided for this special transaction bonus in recognition that none of Mr. Fuller’s long-term equity incentives (see below) will vest as a result of a change of control occurring before the one-year anniversary of the grant on May 8, 2018. In connection with the approval of the Merger Agreement, the Board approved and on November 9, 2017, the Company entered into an amendment to the Fuller Agreement to push out the Transaction Deadline for the Transaction to allow Mr. Fuller to receive the special transaction bonus in connection with the Transaction.

Also pursuant to the Fuller Agreement, for each fiscal year of employment during which the Company employs Mr. Fuller, he is be eligible to receive a bonus based on the Company meeting certain performance criteria. Mr. Fuller’s target annual bonus will equal 75% of his annual base salary (the “Target Annual Bonus”). The annual bonus will range from 35% to 200% of the Target Annual Bonus. The bonus formula and performance criteria for fiscal year 2017 are based: (i) 50% on the Company meeting at least 80% and up to 120% of its target revenue for the fiscal year; and (ii) 50% on the Company meeting at least 80% and up to 120% of its target EBITDA for the fiscal year. The Company’s target revenue and target EBITDA were set by the Compensation Committee and communicated to Mr. Fuller in May 2017. The annual bonus formula and performance criteria for calendar years 2018 and 2019 will be based: (i) one-third on the Company meeting at least 80% and up to 120% of its target revenue for the applicable fiscal year; (ii) one-third on the Company meeting at least 80% and up to 120% of its target EBITDA for the applicable fiscal year, and (iii) one-third on the Company meeting at least 80% and up to 120% of another objective Key Performance Indicator (the “KPI Target”) for the applicable fiscal year to be determined by the Board, or the Compensation Committee of the Board, after consultation with the Company’s Chief Executive Officer and Mr. Fuller. For purposes of the Fuller Agreement, “EBITDA” means earnings before interest, taxes, depreciation and amortization calculated in accordance with generally accepted accounting principles consistent with the application of such concepts in developing the Company’s annual budget, subject to adjustments for one-time occurrences outside the ordinary course of business as deemed appropriate by the Company’s Compensation Committee. The Fuller Agreement also provides for long-term equity incentives, including a restricted stock grant of 37,267 shares and the grant of an option to purchase 470,791 shares.

Mr. Fuller is entitled to 20 paid-time-off days per fiscal year. Mr. Fuller is eligible to participate in, without action by the Board or any committee thereof, any benefits and perquisites available to the executive officers of the Company, including any group health, dental, life insurance, disability, or other form of executive benefit plan or program of the Company now existing or that may be later adopted by the Company. The Company will reimburse Mr. Fuller for all ordinary and necessary business expenditures made by him in connection with, or in furtherance of, his employment upon presentation by him of supporting information as may from time to time be reasonably requested by the Board.

Mr. Fuller’s restricted stock grant was granted under the terms of the Company’s 2013 Stock Incentive Plan pursuant to a Restricted Stock Agreement dated May 8, 2017 (the “Fuller Restricted Stock Agreement”). Mr. Fuller’s option was granted under the terms of the Company’s Amended 2013 Stock Incentive Plan and pursuant to an Option Agreement dated May 8, 2017, as amended by Amendment to Option Agreement dated July 27, 2017 (the “Options”). The Options have an exercise price equal to $9.51 per share and will vest over thirty-four (34) months commencing on the one year anniversary of the date of grant, May 8, 2018. The restricted stock would similarly vest over a period of thirty-four (34) months commencing on the one year anniversary of the date of grant. After the one year anniversary of their respective grant dates, both equity grants are subject to partial accelerated vesting in the event of Mr. Fuller's termination without "cause" or for "good reason" (as each is defined in the Fuller Agreement) or in the event of his termination as a result of his death or disability, and full accelerated vesting under certain circumstances related to a change of control of the Company.

Also in connection with the approval of the Merger Agreement, the Board approved, and the Company entered into, an amendment to the Fuller Restricted Stock Agreement to delay the vesting of the restricted stock and to provide for the restricted stock to be forfeited immediately prior to and contingent upon the consummation of the Merger.

Pursuant to the Fuller Agreement, either the Company or Mr. Fuller may terminate Mr. Fuller's employment for any reason upon not less than 30 days prior written notice.

(i) Upon termination of Mr. Fuller's employment prior to a change of control by Mr. Fuller for good reason or by the Company without cause (as each term is defined in the Fuller Agreement), Mr. Fuller will be entitled to a termination payment equal to one times the sum of (a) Mr. Fuller's annual base salary at the time of such termination and (b) Mr. Fuller's target annual bonus for the fiscal year in which his employment is terminated.

(ii) Upon termination of Mr. Fuller's employment by the resignation of Mr. Fuller without good reason or by the Company with cause or by reason of death or disability or for any other reason except as provided in the immediately preceding paragraph above or the immediately following paragraph below, Mr. Fuller will be due no further compensation other than what is due and owing through the effective date of Mr. Fuller's resignation or termination (including any annual bonus that may be due and payable to Mr. Fuller).

(iii) If upon or within six months subsequent to a change of control, Mr. Fuller's employment is terminated by him for good reason or by the Company without cause, Mr. Fuller will be entitled to and be paid a termination payment (the "Change of Control Payment") equal to one and one-half times the sum of (a) Mr. Fuller's annual base salary at the time of such termination and (b) Mr. Fuller's target annual bonus for the fiscal year in which his employment is terminated (as if the applicable performance criteria have been met at the level that would result in payment of the target annual bonus at the 100% level irrespective of whether or not that is the case); provided, however, that the Change of Control Payment will only be paid to Mr. Fuller if the change of control closes after the six month anniversary of the execution date of the Fuller Agreement and the change of control transaction meets a per share threshold price that is greater than or equal to $9.51 per share. In the event a change of control transaction closes in the first six months following the execution date of the Fuller Agreement, or closes pursuant to an agreement entered into in the first six months following the execution date of the Fuller Agreement, Mr. Fuller will not be entitled to the Change of Control Payment upon his termination.

Mr. Fuller will not be entitled to any severance payment unless he executes and delivers to the Company a general release of claims on terms described in the agreement.

Mr. Fuller has agreed that during the term of his employment and until one year after termination of employment, (A) he will not engage in any business or activity which is the same as or competitive with any business or activity conducted by the Company or any of its majority owned subsidiaries or (B) become an officer, employee or consultant of or otherwise assume a substantial role or relationship with, any governmental entity, agency or political subdivision that is a client or customer of the Company or any subsidiary or affiliate of the Company, provided that Mr. Fuller may invest in securities of any public company so long as he does not beneficially own more than 5% of the class of publicly traded securities. During the period of Mr. Fuller's employment and until three years after the termination of employment, Mr. Fuller will not, without the Company's prior written consent, seek to employ or otherwise seek the services of any employee or consultant of the Company or any of its majority-owned subsidiaries. Mr. Fuller also agreed to restrictive covenants with respect to confidentiality and work product.

Beischel Agreement

On May 8, 2017, the Company entered into an Executive Employment Agreement with Ms. Beischel, as amended by amendment to Executive Employment Agreement dated August 16, 2017, which we refer to in this annual report as the "Beischel Agreement", retaining her as Executive Vice President and Chief Marketing Officer of the Company for a three-year term with retroactive effect to March 9, 2017. Ms. Beischel will be paid an annual base salary of $225,000, subject to review each calendar year and possible increases in the sole discretion of the Board, subject to the compensation policy of the Company then in effect. Ms. Beischel received a signing bonus of $150,000.

The Beischel Agreement provides for a special transaction bonus if the closing of a transaction resulting in a "change of control" (as defined in the Beischel Agreement) occurs before the one-year anniversary of the execution date of the Beischel Agreement (the "Transaction Deadline") and Ms. Beischel is still employed by the Company on the closing date. The bonus is based on the sales price or Company valuation in the change of control transaction. The Board provided for this special transaction bonus in recognition that none of Ms. Beischel's long-term equity incentives (see below) will vest as a result of a change of control occurring before the one-year anniversary of the grant on May 8, 2018. In connection with the approval of the Merger Agreement, the Board approved and on November 9, 2017, the Company entered into an amendment to the Beischel Agreement to push out the Transaction Deadline for the Transaction to allow Ms. Beischel to receive the special transaction bonus in connection with the Transaction.

Also pursuant to the Beischel Agreement, for each fiscal year of employment during which the Company employs Ms. Beischel, she is be eligible to receive a bonus based on the Company meeting certain performance criteria. Ms. Beischel’s target annual bonus will equal 50% of her annual base salary (the “Target Annual Bonus”). The annual bonus will range from 35% to 200% of the Target Annual Bonus. The bonus formula and performance criteria for fiscal year 2017 are based: (i) 50% on the Company meeting at least 80% and up to 120% of its target revenue for the fiscal year; and (ii) 50% on the Company meeting at least 80% and up to 120% of its target EBITDA for the fiscal year. The Company’s target revenue and target EBITDA were set by the Compensation Committee and communicated to Ms. Beischel in May 2017. The annual bonus formula and performance criteria for calendar years 2018 and 2019 will be based: (i) one-third on the Company meeting at least 80% and up to 120% of its target revenue for the applicable fiscal year; (ii) one-third on the Company meeting at least 80% and up to 120% of its target EBITDA for the applicable fiscal year, and (iii) one-third on the Company meeting at least 80% and up to 120% of another objective Key Performance Indicator (the “KPI Target”) for the applicable fiscal year to be determined by the Board, or the Compensation Committee of the Board, after consultation with the Company’s Chief Executive Officer and Ms. Beischel. For purposes of the Beischel Agreement, “EBITDA” means earnings before interest, taxes, depreciation and amortization calculated in accordance with generally accepted accounting principles consistent with the application of such concepts in developing the Company’s annual budget, subject to adjustments for one-time occurrences outside the ordinary course of business as deemed appropriate by the Company’s Compensation Committee. The Beischel Agreement also provides for long-term equity incentives, including a restricted stock grant of 21,118 shares and the grant of an option to purchase 266,782 shares.

Ms. Beischel is entitled to 20 paid-time-off days per fiscal year. Ms. Beischel is eligible to participate in, without action by the Board or any committee thereof, any benefits and perquisites available to the executive officers of the Company, including any group health, dental, life insurance, disability, or other form of executive benefit plan or program of the Company now existing or that may be later adopted by the Company. The Company will reimburse Ms. Beischel for all ordinary and necessary business expenditures made by her in connection with, or in furtherance of, her employment upon presentation by her of supporting information as may from time to time be reasonably requested by the Board.

Ms. Beischel's restricted stock grant was granted under the terms of the Company's 2013 Stock Incentive Plan pursuant to a Restricted Stock Agreement dated May 8, 2017 (the "Beischel Restricted Stock Agreement"). Ms. Beischel's option was granted under the terms of the Company's Amended 2013 Stock Incentive Plan and pursuant to an Option Agreement dated May 8, 2017, as amended by Amendment to Option Agreement dated July 27, 2017 (the "Options"). The Options have an exercise price equal to $9.51 per share and will vest over thirty-four (34) months commencing on the one year anniversary of the date of grant, May 8, 2018. The restricted stock would similarly vest over a period of thirty-four (34) months commencing on the one year anniversary of the date of grant. After the one year anniversary of their respective grant dates, both equity grants are subject to partial accelerated vesting in the event of Ms. Beischel's termination without "cause" or for "good reason" (as each is defined in the Beischel Agreement) or in the event of her termination as a result of her death or disability, and full accelerated vesting under certain circumstances related to a change of control of the Company.

Also in connection with the approval of the Merger Agreement, the Board approved, and the Company entered into, an amendment to the Beischel Restricted Stock Agreement to delay the vesting of the restricted stock and to provide for the restricted stock to be forfeited immediately prior to and contingent upon the consummation of the Merger.

Pursuant to the Beischel Agreement, either the Company or Ms. Beischel may terminate Ms. Beischel's employment for any reason upon not less than 30 days prior written notice.

(i) Upon termination of Ms. Beischel's employment by Ms. Beischel for good reason or by the Company without cause (as each term is defined in the Beischel Agreement), Ms. Beischel will be entitled to a termination payment equal to one times the sum of (a) Ms. Beischel's annual base salary at the time of such termination and (b) Ms. Beischel's target annual bonus for the fiscal year in which her employment is terminated. The termination payment will be paid in a lump sum.

(ii) Upon termination of Ms. Beischel's employment by the resignation of Ms. Beischel without good reason or by the Company with cause or by reason of death or disability or for any other reason except as provided in the immediately preceding paragraph above, Ms. Beischel will be due no further compensation other than what is due and owing through the effective date of Ms. Beischel's resignation or termination (including any annual bonus that may be due and payable to Ms. Beischel).

Ms. Beischel will not be entitled to any severance payment unless she executes and delivers to the Company a general release of claims on terms described in the agreement.

Ms. Beischel has agreed that during the term of her employment and until one year after termination of employment, (A) she will not engage in any business or activity which is the same as or competitive with any business or activity conducted by the Company or any of its majority owned subsidiaries or (B) become an officer, employee or consultant of or otherwise assume a substantial role or relationship with, any governmental entity, agency or political subdivision that is a client or customer of the Company or any subsidiary or affiliate of the Company, provided that Ms. Beischel may invest in securities of any public company so long as she does not beneficially own more than 5% of the class of publicly traded securities. During the period of Ms. Beischel's employment and until one year after the termination of employment, Ms. Beischel will not, without the Company's prior written consent, seek to employ or otherwise seek the services of any employee or consultant of the Company or any of its majority-owned subsidiaries. Ms. Beischel also agreed to restrictive covenants with respect to confidentiality and work product.

Salomon Agreement

On June 23, 2017, the Company entered into an Amended and Restated Executive Employment Agreement with Mr. Salomon, as amended by amendment to Executive Employment Agreement dated August 16, 2017, which we refer to in this annual report as the "Salomon Agreement". The Salomon Agreement amended and restated the terms of an Employment Agreement executed by Mr. Salomon and the Company on October 14, 2016, prior to Mr. Salomon becoming a Named Executive Officer of the Company, and provided that Mr. Salomon would serve as the Company's Executive Vice President and Chief Technology Officer through March 9, 2020. Pursuant to the Salomon Agreement, Mr. Salomon will be paid an annual base salary of $275,000, subject to review each calendar year and possible increases in the sole discretion of the Board, subject to the compensation policy of the Company then in effect.

The Salomon Agreement provides for a special transaction bonus if the closing of a transaction resulting in a "change of control" (as defined in the Salomon Agreement) occurs before the one-year anniversary of the execution date of the Salomon Agreement (the "Transaction Deadline") and Mr. Salomon is still employed by the Company on the closing date. The bonus is based on the sales price or Company valuation in the change of control transaction and is subject to reduction by an amount equal to the value of shares of restricted stock that are accelerated and cashed out immediately before and contingent upon the consummation of the Merger.

Also pursuant to the Salomon Agreement, for each fiscal year of employment during which the Company employs Mr. Salomon, he is be eligible to receive a bonus based on the Company meeting certain performance criteria. Mr. Salomon's target annual bonus will equal 50% of his annual base salary (the "Target Annual Bonus"). The annual bonus will range from 35% to 200% of the Target Annual Bonus. The bonus formula and performance criteria for fiscal year 2017 are based: (i) 50% on the Company meeting at least 80% and up to 120% of its target revenue for the fiscal year; and (ii) 50% on the Company meeting at least 80% and up to 120% of its target EBITDA for the fiscal year. The Company's target revenue and target EBITDA were set by the Compensation Committee and communicated to Mr. Salomon in May 2017. The annual bonus formula and performance criteria for calendar years 2018 and 2019 will be based: (i) one-third on the Company meeting at least 80% and up to 120% of its target revenue for the applicable fiscal year; (ii) one-third on the Company meeting at least 80% and up to 120% of its target EBITDA for the applicable fiscal year, and (iii) one-third on the Company meeting at least 80% and up to 120% of another objective Key Performance Indicator (the "KPI Target") for the applicable fiscal year to be determined by the Board, or the Compensation Committee of the Board, after consultation with the Company's Chief Executive Officer and Mr. Salomon. For purposes of the Salomon Agreement, "EBITDA" means earnings before interest, taxes, depreciation and amortization calculated in accordance with generally accepted accounting principles consistent with the application of such concepts in developing the Company's annual budget, subject to adjustments for one-time occurrences outside the ordinary course of business as deemed appropriate by the Company's Compensation Committee. The Salomon Agreement also provides for long-term equity incentives in the form of a grant of an option to purchase 175,566 shares at a strike price equal to $9.51 per share.

Mr. Salomon is entitled to 20 paid-time-off days per fiscal year. Mr. Salomon is eligible to participate in, without action by the Board or any committee thereof, any benefits and perquisites available to the executive officers of the Company, including any group health, dental, life insurance, disability, or other form of executive benefit plan or program of the Company now existing or that may be later adopted by the Company. The Company will reimburse Mr. Salomon for all ordinary and necessary business expenditures made by his in connection with, or in furtherance of, his employment upon presentation by his of supporting information as may from time to time be reasonably requested by the Board.

Mr. Salomon's option was granted under the terms of the Company's Amended 2013 Stock Incentive Plan and pursuant to an Option Agreement dated June 23, 2017, as amended by Amendment to Option Agreement dated July 27, 2017 (the "Options"). The Options have an exercise price equal to $9.51 per share and will vest over thirty-two and one-half (32.5) months commencing on the one year anniversary of the date of grant, June 23, 2018. After the one year anniversary of the grant date, the Options are subject to partial accelerated vesting in the event of Mr. Salomon's termination without "cause" or for "good reason" (as each is defined in the Salomon Agreement) or in the event of his termination as a result of his death or disability, and full accelerated vesting under certain circumstances related to a change of control of the Company.

Pursuant to the Salomon Agreement, either the Company or Mr. Salomon may terminate Mr. Salomon's employment for any reason upon not less than 30 days prior written notice.

(i) Upon termination of Mr. Salomon's employment by Mr. Salomon for good reason or by the Company without cause (as each term is defined in the Fuller Agreement), Mr. Salomon will be entitled to a termination payment equal to one times the sum of (a) Mr. Salomon's annual base salary at the time of such termination and (b) Mr. Salomon's target annual bonus for the fiscal year in which his employment is terminated. The termination payment will be paid in a lump sum.

(ii) Upon termination of Mr. Salomon's employment by the resignation of Mr. Salomon without good reason or by the Company with cause or by reason of death or disability or for any other reason except as provided in the immediately preceding paragraph above, Mr. Salomon will be due no further compensation other than what is due and owing through the effective date of Mr. Salomon's resignation or termination (including any annual bonus that may be due and payable to Mr. Salomon).

Mr. Salomon will not be entitled to any severance payment unless he executes and delivers to the Company a general release of claims on terms described in the agreement.

Mr. Salomon has agreed that during the term of his employment and until six months after termination of employment, (A) he will not engage in any business or activity which is the same as or competitive with any business or activity conducted by the Company or any of its majority owned subsidiaries or (B) become an officer, employee or consultant of or otherwise assume a substantial role or relationship with, any governmental entity, agency or political subdivision that is a client or customer of the Company or any subsidiary or affiliate of the Company, provided that Mr. Salomon may invest in securities of any public company so long as he does not beneficially own more than 5% of the class of publicly traded securities. During the period of Mr. Salomon's employment and until one year after the termination of employment, Mr. Salomon will not, without the Company's prior written consent, seek to employ or otherwise seek the services of any employee or consultant of the Company or any of its majority-owned subsidiaries. Mr. Salomon also agreed to restrictive covenants with respect to confidentiality and work product.

Compensation Committee Interlocks and Insider Participants

From January 1, 2017 through December 31, 2017, our Compensation Committee consisted of Tal Yaron-Eldar, Richard Harris (Chairman) and Izhak Gross.

During 2017, none of the members of our Compensation Committee was an employee or officer of the Company. Further, during 2017, no Compensation Committee member had any relationship requiring disclosure under Item 404 of Regulation S-K promulgated by the SEC. None of our executive officers serves on the board of directors or compensation committee of a company that has an executive officer that serves on our Board or our Compensation Committee.

2017 Director Compensation

During 2017, Meridian developed a peer group analysis for the purpose of comparing and analyzing the level and cost of the compensation package to be offered to the Company's non-executive directors. The peer group companies considered by Meridian and approved by the Compensation Committee in connection with 2017 compensation include companies of similar size, as measured by trailing twelve months revenue, market capitalization and enterprise value, that operated in the same or complimentary industries as the Company and are as follows:

- 8x8 Inc.
- Alaska Communications Sys Gp
- Atn International Inc.
- Boingo Wireless Inc.
- Brightcove Inc.
- Cogent Communications Hldgs
- Demandware Inc.
- Five9 Inc.
- Fusion Telecommunications
- GTT Communications Inc.
- Hawaiian Telcom Holdco Inc.
- Incontact Inc.
- Inteliquent Inc.
- Iridium Communications Inc.
- Limelight Networks Inc.
- LivePerson Inc.
- LogMeIn Inc.
- Lumos Networks Corp
- Ooma Inc.
- ORBCOMM Inc.
- Shenandoah Telecommun Co
- Spok Holdings Inc.
- Synacor Inc.

The Compensation Committee considered the data and analyses prepared by Meridian that included the appropriateness of: (i) total annual compensation, (ii) annual retainer and Board meeting fees, (iii) committee fees (including committee retainers, meeting fees and chair fees), (iv) equity compensation, and (v) leadership fees (i.e., lead director and non-executive chairman). The peer group data was collected primarily from proxy filings reflecting the most recently disclosed compensation as of the time Meridian compiled the data in 2017.

Meridian reviewed with the Compensation Committee its analysis of the above referenced elements of compensation in comparison to the 25th percentile, the 50th percentile and 75th percentile target opportunity of the peer group. The Compensation Committee used this peer group data to obtain a general understanding of current compensation practices consistent with our Amended Compensation Policy, to ensure that it was acting in an informed and responsible manner and to make sure our non-executive director compensation program is competitive. The Compensation Committee did not seek to set any elements of compensation at a specific percentile of the relevant peer group but, it did want to understand and be cognizant of the divergence of any of the compensation elements from the 25th percentile, 50th percentile and 75th percentile. The Compensation Committee and Board determined that the compensation packages proposed for non-executive directors in the Company's Amended Compensation Policy was consistent with the compensation paid to non-executive directors by the Company's peer group presented by Meridian. The Amended Compensation Policy, including the terms of non-executive director compensation, was presented to and approved by the Company's shareholders at the Company's special meeting held on July 31, 2017.

121

The following table sets forth information with respect to compensation for the non-employee directors listed during the fiscal year ended December 31, 2017.

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	All Other Compensation ($)	Total ($)
Richard Harris[(1)]	102,000	60,000	-	162,000
Donald A. Burns[(2)]	38,904	-	-	38,904
Alan Howe[(3)]	71,096	60,000	-	131,096
Tal Yaron-Eldar[(4)]	70,000	60,000	-	130,000
Izhak Gross[(5)]	106,429	111,800	-	218,229
Dr. Yuen Wah Sing[(6)]	50,000	60,000	-	110,000

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(1) Mr. Harris served on the Audit Committee and Compensation Committee for all of fiscal year 2017. Additionally, Mr. Harris earned $32,000 serving on Special Committees during 2017. Mr. Harris had 8,108 unvested stock awards at December 31, 2017.

(2) Mr. Burns served as Chairman of the Board from January 1, 2013 until his resignation from the Board on May 22, 2017. As Chairman, Mr. Burns received $38,904 for his partial year of service during the year ended December 31, 2017. Mr. Burns had no outstanding stock awards or options awards at December 31, 2017.

(3) Mr. Howe was appointed to the Board of Directors on April 19, 2017, and served on the Audit and Nominating and Governance Committees. Mr. Howe also earned $22,000 during 2017 for his service on Special Committees. Mr. Howe had 8,108 unvested stock awards at December 31, 2017.

(4) Ms. Yaron-Eldar served on the Audit Committee and Compensation Committee for all of fiscal year 2017. Ms. Yaron-Eldar had 8,108 unvested stock awards at December 31, 2017.

(5) Mr. Gross was appointed to the Board of Directors on August 9, 2016 to fill a vacancy caused by a Board member's retirement. He served on the Audit Committee and Compensation Committee from the date of his appointment until the appointment of Mr. Howe in April 2017. He thereafter served on the Nominations and Corporate Governance Committee and the Compensation Committee. Upon the resignation of Mr. Burns, Mr. Gross was appointed chairman of the Board and he served as the Chairman for the remainder of 2017. Additionally, Mr. Gross earned $25,333 during 2017 for his service on Special Committees. Mr. Gross had 15,108 stock awards unvested at December 31, 2017.

(6) Dr. Sing had had 8,108 unvested stock awards at December 31, 2017.

During fiscal year 2017, the Company's non-employee directors received the following compensation:

· A fixed annual payment of $50,000 (to be paid quarterly) for service as a member of the Board, and $100,000 for the Chairman of the Board, plus, if applicable, a fixed annual payment of $10,000 (to be paid quarterly) for service as a member of each committee of the Board on which the director serves (the standing committees of our Board are the Audit Committee, Compensation Committee, and the Nomination and Governance Committee). Additionally, Board members received $10,000 for service on a "Special Committee" plus $1,000 per meeting for each meeting in excess of three meetings.

- Reimbursement of business expenses and travel and accommodation expenses incurred in the performance of duties as a member of the Board and/or any Board committee, including, for illustration purposes, business class flying tickets for overseas travels, suitable hotel accommodation, taxi and/or leased vehicles.

122

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth, as of March 12, 2018, the number of our ordinary shares, which constitute our only voting securities, beneficially owned by (i) all shareholders known to us to own more than five percent of our outstanding ordinary shares, (ii) each of our directors, (iii) each of our named executive officers, and (iv) by all of our current executive officers and directors as a group as of March 12, 2018. The data presented is based on information provided to us by the holders or disclosed in public filings with the SEC. The percentage of outstanding ordinary shares is based on 16,189,794 ordinary shares outstanding plus, with respect to each director and executive officer with options or restricted share awards which are currently exercisable (in the case of options) or which may be acquired by such director or executive officer within 60 days of March 12, 2018.

Except where otherwise indicated, and except pursuant to community property laws, we believe, based on information furnished by such owners, that the beneficial owners of the shares listed below have sole investment and voting power with respect to such shares. The shareholders listed below do not have any different voting rights from any of our other shareholders.

	Ordinary Shares Beneficially Owned		
Name of Beneficial Owner	Number[1]	Percent	
Adams Street Partners, LLC [2] One North Wacker Drive, Suite 2200 Chicago, IL 60606	1,976,861	12.21	%
B. Riley FBR, Inc. [3] 11100 Santa Monica Boulevard, Suite 800 Los Angeles, CA 90025	1,249,600	7.72	%
Renaissance Technologies LLC [4] 800 Third Avenue New York, NY 10022	1,048,000	6.47	%
The Goldman Sachs Group, Inc. [5]	840,329	5.20	%
Don Carlos Bell III [6]	-	-	
Izhak Gross	2,333	*	
Richard Harris	13,046	*	
Alan Howe	-	-	
Dr. Yuen Wah Sing [7]	293,684	1.80	%
Gerald Vento (former executive officer) [8]	217,167	1.34	%
Tal Yaron-Eldar	17,000	*	
Thomas Fuller [9]	-	-	
Jose Gordo (former executive officer) [10]	301,844	1.85	%
Dvir Salomon [11]	83,334	*	
Kristen Beischel [12]	-	-	
Directors and current executive officers as a group (9 persons) [13]	409,397	2.51	%

* Represents less than 1% of the outstanding ordinary shares.

(1) Beneficial ownership is determined in accordance with the rules of the SEC and includes voting or investment power with respect to ordinary shares. Unless otherwise indicated below, to our knowledge, all persons included in this table have sole voting and investment power with respect to their ordinary shares, except to the extent

authority is shared by spouses under applicable law. Pursuant to the rules of the SEC, the number of ordinary shares deemed outstanding includes shares issuable upon settlement of restricted ordinary shares held by the respective person or group that will vest within 60 days of November 30, 2017 and pursuant to ordinary share options held by the respective person or group that are currently exercisable or may be exercised within 60 days of the date hereof, which we refer to as presently exercisable ordinary share options.

(2) Information based on the Schedule 13G Amendment filed with the SEC on February 13, 2017 by Adams Street Partners, LLC.

(3) Information based on the Schedule 13G filed with the SEC on January 3, 2018 by B. Riley FBR, Inc.

(4) Information based on the Schedule 13G/A filed with the SEC on February 14, 2018 by Renaissance Technologies LLC ("RTC") and Renaissance Technologies Holdings Corporation ("RTHC"). RTC and RTHC have sole voting power over 782,038 shares, sole dispositive power over 917,200 shares, and shared voting and dispositive power over 131,000 shares.

(5) Information based on the Schedule 13G filed with the SEC on January 26, 2018 by The Goldman Sachs Group, Inc. and Goldman Sachs & Co. LLC, each of whom report shared voting and shared dispositive power over all shares reported on the Schedule 13G.

(6) Mr. Bell was appointed President and Chief Executive Officer on March 9, 2017 and was elected to the Board by the shareholders on April 19, 2017. He currently owns no shares.

(7) Includes 100,000 shares subject to currently exercisable options with an exercise price of $19.23 per share.

(8) Mr. Vento served as President and Chief Executive Officer through the 2016 fiscal year and until March 9, 2017. He resigned from the Board on June 17, 2017 and is no longer with the Company.

(9) Mr. Fuller was appointed Executive Vice President and Chief Financial Officer effective May 11, 2017. He currently owns no shares.

(10) Mr. Gordo served as Chief Financial Officer through the 2016 fiscal year and until May 11, 2017. Mr. Gordo is no longer with the Company. Reported beneficial ownership includes 166,436 shares subject to currently exercisable options with an exercise price of $9.33 per share.

(11) Mr. Salomon was appointed Executive Vice President and Chief Technology Officer effective May 8, 2017. He currently owns 83,334 shares.

(12) Ms. Beischel was appointed Executive Vice President and Chief Marketing Officer effective May 8, 2017. She currently owns no shares.

(13) Includes 100,000 shares subject to currently exercisable options.

We refer you to Item 5, "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" above for information with respect to our equity compensation plans, which information is incorporated by reference herein.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Certain Relationships and Related Party Transactions

In our fiscal year ended December 31, 2017, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or are to be a party in which the amount involved exceeds $120,000 and in which any of our directors, executive officers, holders of more than 5% of our ordinary shares or any members of the immediate family of any of the foregoing persons, had or will have a direct or indirect material interest. The Merger Agreement with B.Riley predated B.Riley's acquisition of our ordinary shares.

Approval of Related Party Transactions under Israeli Law

Under the Companies Law, an engagement by the Company with an officer who is not a director, controlling shareholder or the chief executive officer regarding his or her service and terms of employment, including an undertaking to indemnify, exculpate or insure such officer, must be approved by the Compensation Committee and the Board, provided that the compensation is approved in accordance with the Company's compensation policy adopted under the Companies Law. If the engagement is not in accordance with the Company's compensation policy, approval of the engagement by the general meeting of the shareholders, requires one of the following: (i) the majority of shareholder votes counted at the general meeting including the majority of all of the votes of those shareholders who are not controlling shareholders and do not have a Personal Interest in the approval of the compensation policy, who participate at the meeting (excluding abstentions) or (ii) the total number of votes against the proposal among the shareholders mentioned in paragraph (i) does not exceed 2% of the voting rights in the Company (a "Special Majority"). In special cases, the Compensation Committee and the Board may decide to adopt the terms of such an engagement despite the objection of the shareholders, so long as such decision is based on detailed reasons and after discussing again such engagement and reexamining it in light of the shareholder objection.

An engagement with the chief executive officer of the Company regarding his or her service and terms of employment must be approved by our Compensation Committee, our Board of Directors, and by a Special Majority. In special cases, the compensation of the chief executive officer may be approved without shareholder approval if the candidate for chief executive officer is independent and the Compensation Committee determines, on the basis of detailed reasons, that convening a shareholder meeting to approve the engagement will frustrate the engagement, but only if the engagement complies with the compensation policy adopted under the Companies Law. The renewal or extension of the engagement with a company's chief executive officer need not be approved by the shareholders of the Company if the terms and conditions of such renewal or extension are no more beneficial than the previous engagement or there is no substantial difference in the terms and conditions under the circumstances, and the terms and conditions of such renewal or extension are in accordance with the Company's compensation policy.

For all other transactions between an officer and the Company (or Company transactions in which the officer has a Personal Interest), the Companies Law requires Audit Committee approval followed by board of director approval if the transaction is deemed to be extraordinary, and only board of director approval if the transaction is not deemed to be extraordinary. Under the Companies Law, an "extraordinary transaction" is a transaction:

- other than in the ordinary course of business;
- that is not on market terms; or
- that is likely to have a material impact on a company's profitability, assets or liabilities.

A "Personal Interest" is defined under the Companies Law as the personal interest of a person in an action or in a transaction of the Company, including the personal interest of such person's relative or the interest of any other corporate body in which the person or such person's relative is a director or general manager, a 5% shareholder or holds 5% or more of the voting rights, or has the right to appoint at least one director or the general manager, but excluding a personal interest stemming solely from the fact of holding shares in the Company. A personal interest also includes (1) a personal interest of a person who votes according to a proxy of another person, including in the event that the other person has no personal interest, and (2) a personal interest of a person who gave a proxy to another person to vote on his or her behalf regardless of whether the discretion of how to vote lies with the person voting or not.

Under the Companies Law, an engagement by the Company with a director regarding the terms of service as a director and other positions of employment (if employed) requires the approval of the Compensation Committee, the Board of Directors and a regular majority of the shareholders, provided that such terms of employment are in accordance with the Company's compensation policy. Such an engagement that is not in accordance with the Company's compensation policy may be obtained in special cases but only if approved by a Special Majority. The engagement with a company's directors need not be approved by the shareholders of the Company with respect to the period from the commencement of the engagement until the next shareholder meeting convened by the Company, if the terms and conditions of such engagement were approved by the Compensation Committee and the Board of Directors of the Company, the terms and conditions of such engagement are in accordance with the Company's compensation policy approved in accordance with the Companies Law, and if the terms and conditions of such engagement are no more beneficial than the terms and conditions of the person previously serving in such role or there is no substantial difference in the terms and conditions of the previous engagement versus the new one under the circumstances, including the scope of engagement.

A person who has a Personal Interest in the approval of a transaction that is submitted to approval of the Audit Committee or the Board of Directors generally may not be present during the deliberations and shall not take part in the voting of the Audit Committee or of the Board of Directors on such transaction. However, such person may be present at the meeting for the purpose of presenting the transaction if the chairman of the Board of Directors or the chairman of the Audit Committee, as the case may be, has determined that the presence of such director is required for presenting the transaction. Notwithstanding the above, a director may be present at a deliberation of the Audit Committee and the Board of Directors and may take part in the voting, if the majority of the members of the Audit Committee or the Board of Directors, as the case may be, have a Personal Interest in the approval of the transaction, in which case the transaction shall also require the approval of the shareholders of the Company.

In addition, under the Companies Law, extraordinary transactions of a public company with a controlling shareholder or in which a controlling shareholder has a Personal Interest, and the terms of engagement of the Company, directly or indirectly, with a controlling shareholder or his or her relative regarding the receipt by the Company of services from the controlling shareholder, require the approval of the Audit Committee (or the Compensation Committee, if the engagement is related to the terms of service and employment), the Board of Directors and a Special Majority, in that order. In addition, any such extraordinary transaction with a term of more than three years requires the abovementioned approval every three years unless, with respect to transactions not involving the receipt of services or compensation, the Audit Committee determines that a longer term is reasonable under the circumstances.

Director Independence

The Board makes an annual determination of independence as to each board member under the current standards for “independence” established by Nasdaq and the SEC. The Board determined that all of its directors, except Mr. Bell, are independent under these standards.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table sets forth fees for professional services provided by BDO, the Company's current independent registered public accountant, for the audit of the Company's consolidated financial statements for fiscal years 2017 and 2016, and fees billed for audit-related and other services (in thousands):

	Year Ended December 31, 2017	Year Ended December 31, 2016
Audit fees (1)	$1,038	$844
Audit-related fees (2)	26	215
Tax fees (3)	147	196
Total fees	$1,211	$1,255

(1) Represents aggregate fees for professional services provided in connection with the audits of our annual consolidated financial statements and effectiveness of internal control over financial reporting as promulgated by Section 404 of the Sarbanes-Oxley Act, reviews of our quarterly financial statements and audit services provided in connection with the filings of Form 8-K, and other statutory or regulatory filings.

(2) Represents fees for professional services provided by BDO in connection with diligence work performed on behalf of the Company.

(3) Represents aggregate fees for professional services provided in connection with tax compliance, tax planning and tax advice.

Audit Committee Pre-Approval Policies and Procedures

Our Audit Committee is responsible for the oversight of our independent registered public accountants' work. The Audit Committee's policy is to preapprove all audit and non-audit services provided by the Company's independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year, and any pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. Additional services may be pre-approved by the Audit Committee on an individual basis. The Audit Committee has delegated pre-approval authority to its chairman when necessary due to timing considerations. Any services approved by the chairman must be reported to the full Audit Committee at its next scheduled meeting. The independent registered public accounting firm and management are required to periodically report to the full Audit Committee regarding the extent of services provided by the independent registered public accounting firm in accordance with the pre-approval policies and the fees for the services performed to date. Our Audit Committee pre-approved all audit and non-audit services provided by our independent accountants during 2016 and 2017 and the fees paid for such services.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

2.1	Asset Purchase Agreement, dated as of March 15, 2016, by and among Todd A. Correll, Thomas J. Tharrington, North American Telecommunications Corporation, and magicJack Business Subsidiary, Inc., a subsidiary of the Company and the Company (solely as guarantor of the obligations of magicJack Business Subsidiary, Inc.), filed with the SEC on May 12, 2016 as Exhibit 2.1 to the Company's Amendment No. 1 to the Quarterly Report on Form 10-Q/A and incorporated herein by reference.[1]
3.1	Amended and Restated Articles of Association, filed with the SEC on April 2, 2013 as Exhibit 3.1 to the Company's Annual Report on Form 10-K and incorporated herein by reference.
4.1	Form of Share Certificate of the Company, filed with the SEC on January 12, 2011 as Exhibit 4.2 to the Company's Amendment No. 1 to Registration Statement on Form F-3 (File No. 333-169659) and incorporated herein by reference.
10.1*	2003 Amended Master Stock Option Plan, filed with the SEC on January 19, 2011 as Exhibit 99.1 to the Company's registration statement on Form S-8 (File Number 333-171771) and incorporated herein by reference.
10.2*	Amended and Restated Appendix to Stock Option Plan – U.S.A. Employees, filed with the SEC on January 19, 2011 as Exhibit 99.2 to the Company's registration statement on Form S-8 (File Number 333-171771) and incorporated herein by reference.
10.3*	Amended and Restated Appendix to Stock Option Plan – Non-U.S. and Non-Israeli Employees and Consultants, filed with the SEC on January 19, 2011 as Exhibit 99.3 to the Company's registration statement on Form S-8 (File Number 333-171771) and incorporated herein by reference.
10.4*	Form of indemnification and release undertaking between the Company and its officers and directors, filed with the SEC on November 18, 2010 as Appendix B to proxy statement submitted on Form 6-K and incorporated herein by reference.
10.5*	Restricted Share Grant Letter Agreement, dated April 28, 2011, with Yoseph Dauber, filed with the SEC on March 15, 2012 as Exhibit 10.11 to the Company's Annual Report on Form 10-K and incorporated herein by reference.
10.6*	Restricted Share Grant Letter Agreement, dated April 28, 2011, with Tal Yaron-Eldar, filed with the SEC on March 15, 2012 as Exhibit 10.12 to the Company's Annual Report on Form 10-K and incorporated herein by reference.
10.7*	Executive Employment Agreement, effective January 1, 2013, by and between MagicJack VocalTec Ltd and Gerald Vento, filed with the SEC on April 8, 2013 as Exhibit 10.1 to the Company's Current Report on Form 8-K and incorporated herein by reference.
10.8*	Form of Restricted Stock Agreement, filed with the SEC on April 8, 2013 as Exhibit 10.4 to the Company's Current Report on Form 8-K and incorporated herein by reference.
10.9*	Consulting Agreement, dated May 11, 2013, by and between magicJack VocalTec Ltd. and Peter J. Russo, filed with the SEC on May 13, 2013 as Exhibit 10.2 to the Company's Current Report on Form 8-K and incorporated herein by reference.
10.10*	Executive Employment Agreement, dated May 8, 2013 by and between magicJack VocalTec Ltd. and Jose Gordo, filed with the SEC on May 13, 2013 as Exhibit 10.3 to the Company's Current Report on Form 8-K and incorporated herein by reference.
10.11*	

	Form of Stock Option Agreement, filed with the SEC on May 13, 2013 as Exhibit 10.5 to the Company's Current Report on Form 8-K and incorporated herein by reference.
10.12*	magicJack VocalTec Ltd. Compensation Policy, filed with the SEC on June 3, 2013 as Appendix B to the Company's proxy statement and incorporated herein by reference.
10.13*	magicJack VocalTec Ltd. 2013 Stock Incentive Plan, filed with the SEC on June 3, 2013 as Appendix C to the Company's proxy statement and incorporated herein by reference.
10.14*	magicJack VocalTec Ltd. 2013 Israeli Stock Incentive Plan, filed with the SEC on June 3, 2013 as Appendix D to the Company's proxy statement and incorporated herein by reference.
10.15*	Amendment to magicJack VocalTec Ltd. 2013 Stock incentive Plan, filed with the SEC on March 21, 2014 on the Company's Definitive Additional Materials on Schedule 14A and incorporated herein by reference.
10.16*	Amendment to magicJack VocalTec Ltd. 2013 Israeli Stock incentive Plan, filed with the SEC on March 21, 2014 on the Company's Definitive Additional Materials on Schedule 14A and incorporated herein by reference.
10.17*	Executive Employment Agreement, dated December 13, 2013, by and between magicJack VocalTec Ltd. and Timothy R. McDonald, filed with the SEC on December 17, 2013 as Exhibit 10.1 to the Company's Current Report on Form 8-K and incorporated herein by reference.
10.18*	Amendment to Executive Employment Agreement, dated as of July 15, 2015, by and between the Company and Gerald T. Vento, filed with the SEC on August 10, 2015 as Exhibit 10.1 to the Company's Annual Report on Form 10-K and incorporated herein by reference.
10.19*	Separation Agreement, dated as of June 5, 2015, by and between the Company and Timothy McDonald, filed with the SEC on August 10, 2015 as Exhibit 10.2 to the Company's Annual Report on Form 10-K and incorporated herein by reference.

10.20*	Consulting Agreement, dated as of June 6, 2015, by and between the Company and Timothy McDonald, filed with the SEC on August 10, 2015 as Exhibit 10.3 to the Company's Annual Report on Form 10-K and incorporated herein by reference.
10.21*	Executive Employment Agreement, dated as of December 1, 2015, between the Company and Jose Gordo, filed with the SEC on December 7, 2015 as Exhibit 10.1 to the Company's Current Report on Form 8-K and incorporated herein by reference.
10.22*	Executive Employment Agreement, dated as of December 1, 2015, between the Company and Keith Reed, filed with the SEC on December 7, 2015 as Exhibit 10.2 to the Company's Current Report on Form 8-K and incorporated herein by reference.
10.23*	Executive Employment Agreement, dated as of March 17, 2016, between magicJack Business Subsidiary, Inc., a subsidiary of the Company, the Company (as guarantor of the obligations and agreements of magicJack Business Subsidiary, Inc.) and Todd A. Correll, filed with the SEC on May 12, 2016 as Exhibit 10.22 to the Company's Amendment No. 1 to the Quarterly Report on Form 10-Q/A and incorporated herein by reference.
10.24*	Executive Employment Agreement, dated as of March 17, 2016, between magicJack Business Subsidiary, Inc., a subsidiary of the Company, the Company (as guarantor of the obligations and agreements of magicJack Business Subsidiary, Inc.) and Thomas J. Tharrington, filed with the SEC on May 12, 2016 as Exhibit 10.23 to the Company's Amendment No. 1 to the Quarterly Report on Form 10-Q/A and incorporated herein by reference.
10.25*	Second Amendment to Executive Employment Agreement, effective as of December 31, 2016, by and between magicJack VocalTec Ltd. and Gerald Vento (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 5, 2017, Commission File No. 000-27648).
10.26	Settlement Agreement, dated January 31, 2017, entered into between the Company, David L. Kanen and Kanen Wealth Management LLC, (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 2, 2017, Commission File No. 000-27648).
10.27*	Employment Agreement, dated May 8, 2017, between the Company and Don Carlos Bell, III (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 7, 2017, Commission File No. 000-27648).**
10.28*	Stock Option Agreement, dated May 8, 2017, between the Company and Don Carlos Bell, III (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on June 7, 2017, Commission File No. 000-27648).
10.29*	Restricted Stock Agreement, dated May 8, 2017, between the Company and Don Carlos Bell, III (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on June 7, 2017, Commission File No. 000-27648).
10.30*	Employment Agreement, dated May 8, 2017, between the Company and Thomas Fuller (incorporated herein by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2017, Commission File No. 000-27648).**
10.31*	Stock Option Agreement, dated May 8, 2017, between the Company and Thomas Fuller (incorporated herein by reference to Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2017, Commission File No. 000-27648).
10.32*	Restricted Stock Agreement, dated May 8, 2017, between the Company and Thomas Fuller (incorporated herein by reference to Exhibit 10.8 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2017, Commission File No. 000-27648).

10.33*	Amendments to Independent Contractor and Stock Option Agreements and Releases of Claims, dated June 17, 2017, between the Company and Gerald Vento (incorporated herein by reference to Exhibit 10.11 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2017, Commission File No. 000-27648).
10.34*	Amended and Restated magicJack VocalTec Ltd. 2013 Stock Incentive Plan (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 1, 2017, Commission File No. 000-27648).
10.35*	Amended and Restated magicJack VocalTec Ltd. 2013 Israeli Stock Incentive Plan (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on August 1, 2017, Commission File No. 000-27648).
10.36	Agreement and Plan of Merger, dated as of November 9, 2017, by and among magicJack VocalTec Ltd., B. Riley Financial, Inc. and B. R. Acquisition Ltd. (incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on November 9, 2017, Commission File No. 000-27648). [2]
10.37*	Amendment to Executive Employment Agreement, dated November 9, 2017, between the Company and Don Carlos Bell, III (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 16, 2017, Commission File No. 000-27648).

10.38*	Amendment to Executive Employment Agreement, dated November 9, 2017, between the Company and Thomas E.D. Fuller (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on November 16, 2017, Commission File No. 000-27648).
10.39*	Amendment to magicJack VocalTec Ltd. 2013 Stock Incentive Plan Restricted Stock Agreement, dated November 9, 2017, between the Company and Don Carlos Bell, III (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on November 16, 2017, Commission File No. 000-27648).
10.40*	Amendment to magicJack VocalTec Ltd. 2013 Stock Incentive Plan Restricted Stock Agreement, dated November 9, 2017, between the Company and Thomas E.D. Fuller (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on November 16, 2017, Commission File No. 000-27648).
10.41*	Equity Rights Contingent Cancellation Agreement, dated November 9, 2017, between the Company and Don Carlos Bell, III (incorporated herein by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on November 16, 2017, Commission File No. 000-27648).
10.42*	Amended and Restated Employment Agreement, dated June 23, 2017, by and between YMax Communications Corp and Dvir Salomon (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 14, 2018, Commission File No. 000-27648).
10.43*	Amendment to Amended and Restated Employment Agreement, dated August 16, 2017, by and between YMax Communications Corp and Dvir Salomon (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on March 14, 2018, Commission File No. 000-27648).
10.44*	Executive Employment Agreement, dated May 8, 2017, by and between the Company and Kristin Beischel (incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on March 14, 2018, Commission File No. 000-27648).
10.45*	Restricted Stock Agreement, dated May 8, 2017, between the Company and Kristin Beischel
10.46*	Stock Option Agreement, dated May 8, 2017, between the Company and Kristin Beischel
10.47*	Amendment to Option Agreement, dated July 27, 2017, between the Company and Kristin Beischel
10.48*	Amendment to Executive Employment Agreement, dated August 16, 2017, by and between magicJack VocalTec Ltd. and Kristin Beischel (incorporated herein by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on March 14, 2018, Commission File No. 000-27648).
10.49*	Amendment to Executive Employment Agreement, dated November 9, 2017, by and between magicJack VocalTec Ltd. and Kristin Beischel (incorporated herein by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on March 14, 2018, Commission File No. 000-27648).
21.1	List of Subsidiaries
23.1	Consent of BDO USA, LLP.
31.1	Certification of CEO of magicJack VocalTec Ltd. required by Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of CFO of magicJack VocalTec Ltd. required by Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934.
32.1	Certification of CEO of magicJack VocalTec Ltd. required by Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934.
32.2	

Certification of CFO of magicJack VocalTec Ltd. required by Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934.

Financial statement schedules have been omitted as they are not required under the related instructions or are inapplicable.

* Management contract or compensatory plan or arrangement.
** Confidential treatment requested and granted for portions of this agreement.

[1] –	The exhibits and schedules to the Asset Purchase Agreement have been omitted pursuant to Item 601 (b)(2) of Regulation S-K. We agree to furnish supplementally to the SEC, upon request, a copy of the omitted exhibits and schedules.
[2] –	The exhibits and schedules to the Agreement and Plan of Merger have been omitted pursuant to Item 601 (b)(2) of Regulation S-K. We agree to furnish supplementally to the SEC,

upon request, a copy of the omitted exhibits and schedules.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MAGICJACK VOCALTEC LTD.
(Registrant)

By: /s/ Don C. Bell III	/s/ Thomas Fuller
Don C. Bell III	Thomas Fuller
President and Chief Executive Officer	Executive Vice President and Chief Financial Officer
Date: March 16, 2018	Date: March 16, 2018

Pursuant to the requirements of the Securities and Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Don C. Bell III Don C. Bell III	President & Chief Executive Officer and Director (principal executive officer)	March 16, 2018
/s/ Thomas Fuller Thomas Fuller	Executive Vice President and Chief Financial Officer (principal financial officer and principal accounting officer)	March 16, 2018
/s/ Izhak Gross Izhak Gross	Director, Chairman of the Board	March 16, 2018
/s/ Yuen Wah Sing Dr. Yuen Wah Sing	Director	March 16, 2018
/s/ Tal Yaron-Eldar Tal Yaron-Eldar	Director	March 16, 2018
/s/ Richard Harris Richard Harris	Director	March 16, 2018
/s/ Alan B. Howe Alan B. Howe	Director	March 16, 2018

EXHIBIT INDEX

Exhibit Number	Description
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32.2	Certification of CFO of magicJack VocalTec Ltd. required by Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934.

* Denotes management contract or compensatory plan or arrangement.