SIMMONS FIRST NATIONAL CORP
Form 8-K
January 08, 2008

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

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Exchange Act of 1934

Date of Report (Date of earliest event reported) January 7, 2008

SIMMONS FIRST NATIONAL CORPORATION
(Exact name of registrant as specified in its charter)

Arkansas	0-6253	71-0407808
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

501 Main Street, Pine Bluff, Arkansas	71601
(Address of principal executive offices)	(Zip Code)

(870) 541-1000
(Registrant's telephone number, including area code)

Not Applicable
(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act(17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the ExchangeAct (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the ExchangeAct (17 CFR 240.13e-4(c))

ITEM: 5.02(d) DEPARTURE OF DIRECTORS OR PRINCIPAL OFFICERS; ELECTION OF DIRECTORS; APPOINTMENT OF PRINCIPAL OFFICERS

On Thursday, January 3, 2008, Simmons First National Corporation's (NASDAQ-GS: SFNC) Board of Directors announced the acceptance of election of William E. Clark II and Edward Drilling as directors of the Company.

Mr. Clark is Chairman and Chief Executive Officer of CDI contractors, LLC. Mr. Clark will serve on the Nominating Compensation and Corporate Governance and Audit Committees.

Mr. Drilling currently serves as President of AT&T Arkansas. Mr. Drilling will serve on the Nominating Compensation and Corporate Governance Committee.

ITEM: 9.01 STATEMENTS, PRO FORMA INFOMRATION AND EXHIBITS

Exhibit 99.1 Press Release of the Company dated January 7, 2008, announcing the appointments of William E. Clark II and Edward Drilling.

SIGNATURE

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

SIMMONS FIRST NATIONAL CORPORATION

/s/ Robert A. Fehlman

Date: January 7, 2008

Robert A. Fehlman, Executive Vice President
and Chief Financial Officer

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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) insurance covering the replacement of a damaged or lost device;

- Prepaid minutes – represents revenues recognized primarily from the usage and expiration of international prepaid minutes, net of chargebacks;

- 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; and

- Other revenues – represent primarily revenues from items we stopped selling, which included the sale of telecommunications hardware, proprietary software and related services, as well as other ancillary revenue sources. We stopped selling the aforementioned items in late 2012 as we discontinued efforts to acquire new customers for such products.

Components of Cost of Revenues

Our cost of revenues is comprised of the following components:

- Cost of magicJack devices sold – represent the costs of components and manufacturing of the magicJack devices, as well as broker commissions, production, packaging and other inventory-related costs. The cost of components and manufacturing of the magicJack devices is recognized from sales of the magicJack devices to retailers, wholesalers, or direct to customers over the period associated with the initial six or twelve months access right period.

- 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

- 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 sources we ceased selling. These sources included the sale of telecommunications hardware, proprietary software and related services. We stopped selling these items in late 2012 as we discontinued efforts to acquire new customers for such products.

YEAR ENDED DECEMBER 31, 2013 COMPARED TO YEAR ENDED DECEMBER 31, 2012

Net Revenues

Total net revenue was $143.5 million and $158.4 million for the years ended December 31, 2013 and 2012, respectively, representing a decrease of $14.9 million, or (9.4%). The decreases in the components of net revenues were primarily attributable to the following:

- a $19.3 million decrease in revenues recognized for the sale of magicJack devices, primarily as a result of: (i) the reduction in revenues recognized on sales of the magicJack PLUS due to the introduction of the New magicJack PLUS in June 2013, (ii) lower average unit prices of magicJack PLUS units as a result of holiday promotions, offset in part by the revenues from sales of the New magicJack PLUS being recognized over six months as opposed to twelve months for prior devices, and (iii) a lower proportionate number of magicJack devices being sold directly to consumers at retail prices as opposed to the number of units sold to retailers and distributors at wholesale prices;

- a $2.9 million decrease in revenues from prepaid minutes primarily as a result of the Company making an operational change in February 2012 which allowed it to identify the point in time when prepaid minutes expire under the terms of service, resulting in approximately $3.0 million attributable to prepaid minutes that expired between February 2008 and February 2012 being recognized as revenue in 2012;

- a $2.9 million decrease in revenues from access and wholesale charges;

- a $1.8 million decrease in non-core other revenues as a result of the Company no longer selling telecommunications hardware and the Company’s proprietary software in late 2012 as it discontinued efforts to acquire new customers for such products; and

- a $1.2 million decrease in shipping and handling revenues primarily as a result of the reduction in unit sales mentioned above, offset in part by the recognition of shipping and handling revenues related to the New magicJack PLUS over six months as opposed to twelve months for prior devices.

These decreases in components of net revenue were partially offset by a $13.2 million increase in renewal revenues as a result of an increase in customers on a renewal period and the impact of price increases effective in early 2012;

In the years ended December 31, 2013 and 2012, sales of the magicJack devices through retail outlets represented approximately 70% and 59%, respectively, of sales of all magicJack devices sold. For the same periods, direct sales represented approximately 30% and 41%, respectively, of magicJack devices sold.

For years ended December 31, 2013 and 2012, no retailer accounted for more than 10% of our total net revenues.

Cost of Revenues

Total cost of revenues was $49.1 million and $61.3 million for the years ended December 31, 2013 and 2012, respectively, representing a decrease of $12.2 million, or 19.9%. This decrease in cost of revenues was primarily attributable to:

- a $9.0 million combined decrease in costs related to the magicJack devices, shipping and handling and credit card processing fees driven by: (i) lower sales of the magicJack and magicJack PLUS as the Company only sold the magicJack through certain retailers since the launch of the magicJack PLUS in September 2011 and lower sales of the magicJack PLUS in the 12 months preceding December 2013, offset in part by costs related to the Company starting to sell the New magicJack PLUS in June 2013, and (ii) certain inventory write-downs in 2012; and

- a $5.8 million reduction in network and carrier charges as we stopped selling to certain high-cost wholesalers and continued effort to negotiate better rates with other carriers.

These decreases in cost of revenues were partially offset by $2.6 million increase in cost of other revenues primarily due to: (i) higher personnel-related costs attributable to a higher percentage allocation of costs to cost of revenues, (ii) higher amortization expense due to certain intangible assets purchased in mid 2012, offset in part by reduced costs of non-core other revenues as a result of no longer selling telecommunications hardware and our proprietary software in late 2012.

Operating Expenses

Total operating expenses were $47.0 million and $53.5 million for the years ended December 31, 2013 and 2012, respectively, representing a decrease of $6.5 million, or 12.2%. This decrease in operating expenses was primarily due to:

- an $8.9 million decrease in advertising-related expense driven by a reduction in long-form advertising for most of 2013 as the Company prepared to launch the New magicJack PLUS and its new advertising campaign and reduced sponsorship-related expenses, offset in part by costs associated with the brand refresh and new advertising campaign;

- a $0.7 million decrease in general & administrative expenses primarily due to lower employee bonus expense and reduced legal expenses driven by litigation and other disputes that ended in late 2012 and 2013, offset in part by professional fees, severance payments and other costs in part as a result of the Company reaching certain agreement with its founder and former chief executive officer, as well as other tax-related projects; and

- a $3.1 million increase in research and development costs due to higher professional fees and personnel-related costs allocated to research and development as a result of work related to the New magicJack PLUS and magicJack APP.

The Company's combined advertising-related expenses decreased by approximately 38.3% for the year ended December 31, 2013 as compared to December 31, 2012 primarily due to less advertising efforts as the Company geared up to launch the New magicJack PLUS and its new advertising campaign and brand refresh. Advertising-related expenses have varied, and may continue to vary from quarter to quarter.

The Company believes it will be able to reduce legal expenses related to litigation and certain tax-related projects in future periods as certain open legal cases and projects are resolved.

Other (Expense) Income

Total other (expense) income was $(0.3) million and $3.3 million for the years ended December 31, 2013 and 2012, respectively, representing a decrease of approximately $3.6 million. This decrease in other income was primarily due to changes in the item discussed below.

Fair Value (Loss) Gain on Common Equity Put Options

Fair value (loss) gain on common equity put options for years ended December 31, 2013 and 2012 was ($1.0) million and $3.7 million, respectively. We sold common equity put option contracts in connection with our share repurchase program in order to attempt to lower the average share price paid for ordinary shares we purchase. We do not expect to sell common equity put options in connection with our share repurchase program in the future.

Income Taxes

Total income benefit was $23.2 million and $9.0 million for the years ended December 31, 2013 and 2012, respectively. The principal components of the Company's income taxes for the years ended December 31, 2013 and 2012 are the following (in thousands):

	Year Ended December 31,	
	2013	2012

Income before taxes	$ 47,148	$ 46,890
Income tax benefit	(23,163)	(8,961)
Effective income tax rate	(49.13)%	(19.11)%

The Company recorded an income tax benefit of $23.2 million and $9.0 million for the years ended December 31, 2013 and 2012, respectively, primarily related to the release of $40.5 million and $10.9 million of our valuation allowance in those years. Prior to 2012, we provided a full valuation allowance related to our net deferred tax assets as we then believed the objective and verifiable evidence of our historical pre-tax losses outweighed the existing positive evidence regarding our ability to realize our deferred tax assets. During 2012, we reassessed the need for a valuation allowance against our net deferred tax assets and concluded that it was more-likely-than-not that we would be able to recover certain deferred tax assets by generating taxable income, and again reevaluated our position in the fourth quarter of 2013, and accordingly, we released additional amounts of our valuation allowance. As of December 31, 2013, we determined that a valuation allowance of $17.6 million was required to reduce certain deferred tax assets to their net recoverable amounts. Going forward, we expect that our income tax expense will increase in the future. The actual amount of the income tax expense in the future will be affected by various factors, including our future profitability and, potentially, the realization of previously unrecognized deferred tax assets recovered from future taxable income. We will continue to review our deferred tax valuation allowance on a quarterly basis. Refer to Note 14, "Income Taxes," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details, as well as a reconciliation of the statutory tax rate to our effective tax rate.

Net Income Attributable to Ordinary Shareholders and Income Per Share

As a result of the foregoing items, net income attributable to ordinary shareholders increased to $70.3 million in 2013 as compared to $55.9 million in 2012. Income per diluted share attributable to ordinary shareholders increased to $3.81 per ordinary share in 2013 as compared to $2.73 per ordinary share in 2012 primarily as a result of the aforementioned additional amounts of our valuation allowance, as well as a decrease of approximately 1.5 million (or 7.6%) in the weighted average number of ordinary shares outstanding in 2013 as compared to 2012 primarily due to the Company's share repurchase program.

YEAR ENDED DECEMBER 31, 2012 COMPARED TO YEAR ENDED DECEMBER 31, 2011

Net Revenues

Total net revenue was $158.4 million and $110.5 million for the years ended December 31, 2012 and 2011, respectively, representing an increase of $47.9 million, or 43.4%. The increases in the components of net revenues were primarily attributable to the following:

- a $29.3 million combined increase in revenues recognized for the sale of magicJack devices, primarily as a result of: (i) the recognition of revenues on sales of the magicJack PLUS, which started in September 2011, (ii) higher average unit prices of magicJack PLUS units, and (iii) a higher proportionate number of magicJack PLUS units being sold directly to consumers at retail prices as opposed to the number of units sold to retailers and distributors at wholesale prices;

- a $7.3 million increase in renewal revenues primarily as a result of the impact of price increases effective in early 2012;

- a $4.0 million increase in the sale of magicJack-related products, primarily driven by the increase in porting fees;

- a $3.9 million increase in revenues from prepaid minutes primarily as a result of the Company making an operational change in February 2012 which allowed it to identify the point in time when prepaid minutes expire under the terms of service, resulting in approximately $3.0 million attributable to prepaid minutes that expired between February 2008 and February 2012 being recognized as revenue;

- a $3.4 million increase in shipping and handling revenues primarily as a result of the Company commencing to sell the magicJack PLUS in September 2011; and

- a $5.5 million increase in revenues from access and wholesale charges.

These increases in components of net revenue were partially offset by a $5.5 million decrease in non-core other revenues as a result of reduced sales of telecommunications hardware and the Company's proprietary software as it discontinued efforts to acquire new customers for such products in order to focus on internal matters.

In the years ended December 31, 2012 and 2011, sales of the magicJack and magicJack PLUS units through retail outlets represented approximately 59% and 57%, respectively, of sales of all magicJack units sold. For the same periods, direct sales represented approximately 41% and 43%, respectively, of magicJack units sold.

For years ended December 31, 2012 and 2011, no retailer accounted for more than 10% of the Company's total net revenues.

Cost of Revenues

Total cost of revenues was $61.3 million and $51.2 million for the years ended December 31, 2012 and 2011, respectively, representing an increase of $10.1 million, or 19.8%. This increase in cost of revenues was primarily attributable to: (i) $9.1 million increase driven by a higher number of magicJack PLUS units sold with a higher unit cost, (ii) shipping and handling cost and credit card processing fees primarily as a result of an increase in direct sales of the magicJack PLUS units in 2012, and (iii) a $2.6 million increase in write-offs of obsolete raw materials inventory.

The increases in cost of revenues were partially offset by $1.6 million primarily due to: (i) a decrease in VocalTec US and Israel costs as a result of a lower hardware cost as we discontinued efforts to acquire new customers for such products, and (ii) a reduction in depreciation expense resulting from a change in estimated useful lives of certain servers effective January 1, 2012, offset in part by higher amortization expense as a result of certain intangible assets being purchased in 2012.

Operating Expenses

Total operating expenses were $53.5 million and $63.9 million for the years ended December 31, 2012 and 2011, respectively, representing a decrease of $10.4 million, or 16.3%. This decrease in operating expenses was primarily due to: (i) a $9.0 million decrease in advertising-related expense driven by a reduction in long-form advertising and sponsorship-related expenses, (ii) a $1.4 million decrease in general and administrative expenses resulting from a $2.2 million decrease in legal expenses as a result of fewer legal cases, offset in part by higher personnel related costs primarily as a result of higher bonuses to employees and outside consultants in 2012 because of successful 2012 results.

The Company's combined advertising-related expenses decreased by approximately 27.9% for the year ended December 31, 2012 as compared to December 31, 2011 because the legacy value of its short and long-form advertising did not require continued reinforcement.

Other Income

Total other income was $3.3 million and $3.9 million for the years ended December 31, 2012 and 2011, respectively, representing a decrease of approximately $0.6 million. This decrease in other income was due to changes in the item discussed below.

Fair Value Gain on Common Equity Put Options

Fair value gain on common equity put options for years ended December 31, 2012 and 2011 was $3.7 million and $2.2 million, respectively. The Company sold common equity put option contracts in connection with its share repurchase program in order to attempt to lower the average share price paid for ordinary shares purchased.

Income Taxes

Total income tax (benefit) expense was $(9.0) million and $61 thousand for the years ended December 31, 2012 and 2011, respectively. The principal components of the Company's income taxes for the years ended December 31, 2012 and 2011 are the following (in thousands):

	Year Ended December 31,	
	2012	2011
Income (loss) before taxes	$ 46,890	$ (775)
Income tax (benefit) expense	(8,961)	61
Effective income tax rate	(19.11)%	(7.88)%

The Company has had low income taxes because of the offset of operating loss carryovers from earlier years of operation against income (loss) before income taxes. The Company recorded an income tax benefit of $9.0 million for the year ended December 31, 2012, primarily related to the release of $10.9 million of its valuation allowance in the fourth quarter of 2012. As of December 31, 2011, the Company provided a full valuation allowance related to its net deferred tax assets as it then believed the objective and verifiable evidence of its historical pre-tax losses outweighed the existing positive evidence regarding its ability to realize its deferred tax assets. During the fourth quarter of 2012, the Company reassessed the need for a valuation allowance against its net deferred tax assets and concluded that it was more-likely-than-not that the Company would be able to recover certain deferred tax assets by generating taxable income. Accordingly, the Company released a portion of its valuation allowance in the fourth quarter of 2012. Going forward, the Company expects that its effective tax rate will increase in the future. The actual amount of the effective tax rate in the future will be affected by various factors, including its future profitability and the realization of previously unrecognized deferred tax assets recovered from future taxable income. The Company reviews its deferred tax valuation allowance on a quarterly basis. Refer to Note 14, "Income Taxes," in the Notes to the Consolidated Financial Statements included in Item 8 herein for further details, as well as a reconciliation of the statutory tax rate to the Company's effective tax rate.

Net Income (Loss) Attributable to Ordinary Shareholders and Income (Loss) Per Share

As a result of the foregoing items, net income (loss) attributable to ordinary shareholders increased to $55.9 million in 2012 as compared to ($1.8) million in 2011. Income (loss) per diluted share attributable to ordinary shareholders increased to $2.73 per ordinary share in 2012 as compared to ($0.08) per ordinary share in 2011 as a result of increased profitability in 2012 and a decrease of approximately 3.3 million (or 14%) in the weighted average number of ordinary shares outstanding in 2012 as compared to 2011 due to the Company's share repurchase program.

LIQUIDITY AND CAPITAL RESOURCES

The Company's primary sources of liquidity are cash generated from operations and cash on hand and investments. As of December 31, 2013, the Company had cash and cash equivalents of $46.0 million, available-for-sale marketable securities of $8.8 million and accounts receivables of $3.6 million. Accounts payable at December 31, 2013 was $3.0 million.

During the year ended December 31, 2013, the Company generated positive operating cash flows of $35.3 million, as compared to $65.3 million for year ended December 31, 2012. The $30.0 million decrease was primarily attributable to less magicJack devices sold and cash used to make estimated tax payments in 2013. Net income was $70.3 million for the year ended December 31, 2013 as compared to a $55.9 million for the year ended December 31, 2012. The Company currently believes that available funds and cash flows generated by operations will be sufficient to fund its working capital and capital expenditure requirements for at least the next twelve months. If the Company decides to make future acquisitions, it may require new sources of funding, including additional debt, equity financing or some combination thereof. There can be no assurances that the Company 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 $35.3 million, $65.3 million and $25.3 million for the years ended December 31, 2013, 2012 and 2011, respectively.

During the year ended December 31, 2013, net cash provided by operating activities was primarily attributable to $70.3 million net income, offset primarily by: (i) $15.0 million in non-cash items consisting of a $29.0 million deferred income tax benefit, offset in part by $4.9 million depreciation and amortization expense, $3.9 million increase in uncertain tax positions, $2.8 million in share-based compensation related primarily to ordinary share options and restricted stock units issued to executives, $1.8 million provision for billing adjustments, and $1.0 million fair value loss on common equity put options, (ii) $11.4 million increase in deposits and other current assets as a result of the Company making estimated federal and state income tax payments, (iii) $10.7 million decrease in deferred revenues as a result of less sales of magicJack devices, and (iv) $2.5 million decrease in accrued expenses and other current liabilities primarily attributable to common equity put options outstanding at December 31, 2012 being assigned to us in early 2013.

During the year ended December 31, 2012, net cash provided by operating activities was primarily attributable to: (i) $55.9 million net income, (ii) $2.4 million in non-cash items consisting of a $8.9 million provision for billing adjustments as a result of the aforementioned FCC Order of November 18, 2011, $3.3 million for depreciation and amortization expense, $3.2 million in share-based compensation related primarily to bonuses paid in ordinary shares of the Company, and $0.7 million loss on investments, offset in part by $10.9 million deferred income tax benefit and $3.7 million fair value gains on common equity put options, (iii) $7.4 million increase in deferred revenues attributable to strong sales of access right renewals, (iv) a $3.7 million increase in accrued expenses and other current liabilities, which include outstanding common equity put option contracts sold in connection to our share repurchase program, and (v) a $3.3 million decrease in inventories as a result of the Company writing off approximately $3.5 million in excess components considered obsolete due to starting to manufacture a new product. These items were partially offset by a $3.2 million decrease in accounts payable.

During the year ended December 31, 2011, net cash provided by operating activities was primarily attributable to: (i) $20.6 million in non-cash expenses primarily as a result of a $16.2 million provision for billing adjustments as a result of the aforementioned FCC Order of November 18, 2011, $4.2 million for depreciation and amortization expense and $2.4 million in share-based compensation related primarily to bonuses paid in ordinary shares of the Company, (ii) a

$25.6 million increase in deferred revenues attributable primarily to strong initial sales of the magicJack PLUS and access right renewals, and (iii) a $4.3 million increase in accounts payable primarily due to timing of payments to our vendors. These items were partially offset by: (i) a $14.9 million increase in accounts receivable primarily due to the strong sales of the magicJack PLUS to retailers in late 2011 and low collections associated with access fees charged to other carriers, (ii) a $5.7 million increase in inventories as a result of the Company building up inventory for the magicJack PLUS, which we started selling in September 2011, (iii) a $2.1 million decrease in accrued expenses and other current liabilities as a result of the 2010 bonuses being paid out in early 2011, and (iv) a $1.9 million increase in deferred costs.

Cash Flow – Investing Activities

Net cash provided by (used in) investing activities was $12.0 million, ($4.7) million, and ($9.0) million for the years ended December 31, 2013, 2012 and 2011, respectively.

Net cash provided by investing activities during the year ended December 31, 2013 was primarily attributable to $12.3 million net proceeds from the sale of investments, partially offset by $0.2 million used for purchases of property and equipment, and $0.1 million used for acquisition of certain intangible assets.

Net cash used in investing activities during the year ended December 31, 2012 was primarily attributable to: (i) $5.7 million used to purchase certain intangible assets and (ii) $0.2 million for purchases of property and equipment. These items were partially offset by $1.3 million net proceeds from sale of investments.

Net cash used in investing activities during the year ended December 31, 2011 was primarily attributable to: (i) $6.5 million net purchase of investments, (ii) $1.5 million primarily due to the first of five installment payments for the purchase of certain intangible assets, and (iii) $1.0 million for purchases of property and equipment, primarily comprised of servers.

Cash Flow –Financing Activities

Net cash used in financing activities was $20.2 million, $54.6 million and $32.0 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Net cash used in financing activities for the year ended December 31, 2013 consisted of: (i) $18.7 million in cash used to purchase treasury stock in a privately negotiated repurchase agreements with the independent trustees of two irrevocable trusts previously created by the Company's founder, Mr. Daniel Borislow, as well as through the Company's share repurchase program and (ii) payment of $1.5 million for the third of five installment payments for the purchase of certain intangible assets in 2011.

Net cash used in financing activities during the year ended December 31, 2012 primarily consisted of: (i) $66.5 million in cash used to purchase treasury stock as part of the Company's share repurchase program and (ii) payment of $1.5 million for the second of five installment payments for the purchase of certain intangible assets in 2011. These items were partially offset by: (i) $12.2 million in premiums received from the sale of common equity put options in connection with the share repurchase program, and (ii) $1.2 million in cash received from the exercise of ordinary share options.

Net cash used in financing activities during the year ended December 31, 2011 primarily consisted of: (i) $28.2 million in cash used to purchase treasury stock as part of the Company's share repurchase program and (ii) $8.7 million paid for the redemption of 566,668 redeemable ordinary shares from an affiliate of an unrelated multinational entertainment products and services retailer in an arm's length transaction as described in Note 11, "Redeemable Ordinary Shares," in Item 8 herein. These items were partially offset by: (i) $3.1 million in premiums received from the sale of common equity put options in connection with the share repurchase program, and (ii) $1.8 million in cash received from the exercise of ordinary share options. Refer to the section below for additional information on the Company's share repurchase program.

Stock Repurchase Program

The Company's Board of Directors authorized a stock repurchase program to enable it to purchase its ordinary shares at such times as management deems appropriate up to a maximum cumulative repurchase authority of $100.0 million as of December 31, 2013. The objective of the Company's stock repurchase program is to improve stockholders' returns. The Company expended $91.3 million under its repurchase program through December 31, 2013, and there was $8.7 million authorized to purchase ordinary shares pursuant to the stock repurchase program. All shares purchased, not yet retired, are recorded as treasury shares. The Company repurchased 6,143,731 ordinary shares under this program through December 31 2013.

The Company has bought call option contracts and has sold put option contracts in connection with its 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, 2013, and the Company does not expect to buy call options or sell common equity put options in the future as part of its share repurchase program. Taking into consideration the proceeds received from the sale of put option contracts exercised, put option contracts that expired unexercised and purchase price of call option contracts exercised during the year ended December 31, 2013, 2012 and 2011, the Company expended approximately (i) $3.3 million purchasing 190,000 shares of outstanding ordinary shares at an average price of $17.27 during the year ended December 31, 2013, (ii) $55.9 million purchasing 2,989,949 shares of outstanding ordinary shares at an average price of $18.69 during the year ended December 31, 2012, and (iii) $32.2 million purchasing 2,963,782 shares of outstanding ordinary shares at an average price of $10.85 during the year ended December 31, 2011.

Other Liabilities

As of December 31, 2013, the Company had outstanding indebtedness in connection with an agreement entered during June 2011 for the purchase of certain intangible assets, and secured only by such intangible assets, under which it is required to make two non-interest bearing future annual payments of $1.5 million beginning May 31, 2014. The liability for such payments has been discounted at a rate of 10% to a net present value of $2.8 million and $3.9 million at December 31, 2013 and 2012, respectively. Refer to Note 9, "Other Liabilities," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

RECENT ACCOUNTING PRONOUNCEMENTS

In February 2013, the Financial Accounting Standards Board issued ASU No. 2013-02, Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02"). ASU 2013-02 requires an entity to present, either on the face of the statement where net income is presented or in the notes to the financial statements, significant amounts reclassified out of accumulated other comprehensive income (loss) by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. Amounts that are not required to be reclassified in their entirety to net income must be cross-referenced to other disclosures that provide additional detail. This guidance was effective on a prospective basis for the annual and interim reporting periods for the Company beginning January 1, 2013. The Company's adoption of this standard did not have a significant impact on its consolidated financial statements. The Company's accumulated other comprehensive loss is comprised of one item pertaining to the Company's unrealized gains and losses on marketable securities. Reclassification of the gains or losses occurs when the specific investments are sold.

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

Contractual Obligations

The impact that the Company’s aggregate contractual obligations as of December 31, 2013 are expected to have on its liquidity and cash flow in future periods is as follows (in thousands):

	Payments Due by Period				
		Less Than			More Than
	Total	1 Year	1-3 Years	3-5 Years	5 Years
Intangible assets purchased	$ 3,000	$ 1,500	$ 1,500	$ -	$ -
Operating lease obligations	$ 2,152	$ 445	$ 828	$ 632	$ 247
Accrued severance pay *	$ 340	$ -	$ -	$ -	$ 340
Uncertain tax positions	$ 4,247	$ -	$ -	$ -	$ 4,247
Total contractual obligations	$ 9,739	$ 1,945	$ 2,328	$ 632	$ 4,834

* As of December 31, 2013, we had $0.2 million in severance pay funds in reserve to settle such liabilities.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements as of December 31, 2013.

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, 2013.

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, 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.

Exposure to Equity and Derivative Prices

Market prices for equity securities are subject to fluctuation and consequently the amount realized in the subsequent sale of an investment may significantly differ from the reported market value. Fluctuation in the market price of a security may result from perceived changes in the underlying economic characteristics of the investee, the relative price of alternative investments and general market conditions.

Our Investments

As a result of the Company investing its excess cash, it is also subject to equity price risk with respect to long or short positions in financial instruments such as equity securities, which include call option and put option contracts. While the Company's ultimate potential loss with respect to these contracts is determined from the movement of the underlying security or index between the contract inception date and expiration date, the change in fair value of the derivative contracts is also affected by changes in other factors such as interest rates, expected dividend rates and the remaining duration of the contract. As of December 31, 2013, the Company did not have any short positions in put option contracts or long positions in call option contracts.

Our Stock Repurchase Program

The Company has sold put option contracts in connection with its share repurchase program in order to lower the average price paid for ordinary shares it purchases. Option contracts are sensitive to expiration dates of contracts and fluctuations in the sale price of the Company's ordinary shares, which are in turn sensitive to various factors, including but not limited to: (i) the Company's financial performance and (ii) fluctuations in the overall U.S. and foreign stock markets and economies. At December 31, 2013, the Company did not have any outstanding put option contracts. At December 31, 2012, the Company had outstanding put option contracts covering the purchase of 190,000 ordinary shares for $5.7 million. The Company received $2.4 million in proceeds from the sale of these put option contracts. If all of these outstanding put option contracts had been exercised as of December 31, 2012, the Company would have purchased these shares at an average price of $17.25 per share.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
magicJack VocalTec Ltd. and Subsidiaries
Jerusalem, Israel

We have audited the accompanying consolidated balance sheets of magicJack VocalTec Ltd. and Subsidiaries (the “Company”) as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income (loss), capital equity (deficit) and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of magicJack VocalTec Ltd. and Subsidiaries at December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, 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), magicJack VocalTec Ltd.’s internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated March 12, 2014 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP
Certified Public Accountants
West Palm Beach, Florida

March 12, 2014

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

	December 31,	
	2013	2012
ASSETS		
Current assets:		
Cash and cash equivalents	$45,997	$18,959
Marketable securities, at fair value	8,782	19,390
Accounts receivable, net of allowance for doubtful accounts and billing adjustments of $3,912 and $20,498, respectively	3,626	6,004
Inventories	4,490	5,340
Deferred costs	4,662	7,066
Prepaid income taxes	11,956	98
Deferred tax assets, current	11,267	1,114
Deposits and other current assets	818	1,313
Total current assets	91,598	59,284
Property and equipment, net	1,959	2,348
Intangible assets, net	15,656	16,136
Goodwill	32,304	32,304
Deferred tax assets, non-current	29,684	9,831
Deposits and other non-current assets	693	864
Total assets	$171,894	$120,767
LIABILITIES AND CAPITAL EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$4,237	$3,651
Accrued expenses and other current liabilities	9,236	13,569
Deferred revenue, current portion	54,541	67,038
Total current liabilities	68,014	84,258
Deferred revenue, net of current portion	59,951	58,165
Other non-current liabilities	6,487	3,114
Total liabilities	134,452	145,537
Commitments and contingencies (Note 11)		
Capital equity (deficit):		
Ordinary shares, No par value; 100,000 shares authorized; 25,029 and 24,728 shares issued at December 31, 2013 and 2012, respectively	111,744	108,048
Additional paid-in capital	3,692	1,729
Accumulated other comprehensive loss	(642)	(1,494)
Treasury stock (7,202 and 6,018 shares at December 31, 2013 and 2012, respectively)	(108,151)	(93,541)
Retained earnings (accumulated deficit)	30,799	(39,512)
Total capital equity (deficit)	37,442	(24,770)
Total liabilities and capital equity (deficit)	$171,894	$120,767

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2013	2012	2011
Net revenues	$143,492	$158,362	$110,450
Cost of revenues	49,094	61,325	51,181
Gross profit	94,398	97,037	59,269
Operating expenses:			
Advertising	14,293	23,181	32,148
General and administrative	26,998	27,697	29,050
Research and development	5,661	2,594	2,716
Total operating expenses	46,952	53,472	63,914
Operating income (loss)	47,446	43,565	(4,645)
Other income (expense):			
Gains (losses) on investments	722	(738)	649
Interest and dividend income	318	783	1,271
Interest expense	(307)	(411)	(277)
Fair value (loss) gain on common equity put options	(1,047)	3,650	2,192
Other income, net	16	41	35
Total other (expense) income	(298)	3,325	3,870
Income (loss) before income taxes	47,148	46,890	(775)
Income tax (benefit) expense	(23,163)	(8,961)	61
Net income (loss)	70,311	55,851	(836)
Dividends on redeemable ordinary shares	-	-	(955)
Net income (loss) attributable to ordinary shareholders	$70,311	$55,851	$(1,791)
Income (loss) per ordinary share:			
Basic	$3.81	$2.80	$(0.08)
Diluted	$3.81	$2.73	$(0.08)
Weighted average ordinary shares outstanding:			
Basic	18,468	19,916	23,342
Diluted	18,476	19,985	23,342

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2013	2012	2011
Net income (loss)	$70,311	$55,851	$(836)
Other comprehensive income (loss):			
Reclassification of unrealized loss on marketable securities to realized (loss) gain on investments	420	783	257
Net unrealized gain (loss) on marketable securities	432	(1,494)	(2,029)
Comprehensive income (loss)	$71,163	$55,140	$(2,608)

See accompanying notes to consolidated financial statements.

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CAPITAL EQUITY (DEFICIT)
For the Years Ended December 31, 2013, 2012 and 2011
(in thousands)

	Common Stock			Accumulated Other	Treasury Stock			
	Number	Amount	Additional Paid-in Capital	Comprehensive Income (Loss)	Number	Amount	Retained Earnings (Accumulated Deficit)	Total Capital (Deficit) Equity
Balance, December 31, 2010	22,952	$91,527	$ 1,971	$ 989	(6)	$(81)	$ (94,527)	$(121)
Exercise of ordinary share options	532	1,774	-	-	-	-	-	1,774
Share-based compensation	193	2,223	224	-	-	-	-	2,447
Purchase of treasury stock	-	-	-	-	(2,597)	(27,537)	-	(27,537)
Contributed services	-	-	75	-	-	-	-	75
Reclassification of redeemable ordinary shares	100	1,366	-	-	-	-	-	1,366
Redemption of redeemable ordinary shares	567	7,740	(955)	-	(567)	(7,740)	-	(955)
Outstanding common equity call options	-	-	(85)	-	-	-	-	(85)
Unrealized loss on marketable securities	-	-	-	(1,772)	-	-	-	(1,772)
Adjustment of redemption value of redeemable ordinary shares	-	-	(733)	-	-	-	-	(733)
Net loss	-	-	-	-	-	-	(836)	(836)
Balance, December 31, 2011	24,344	$104,630	$ 497	$ (783)	(3,170)	$(35,358)	$ (95,363)	$(26,377)
Exercise of ordinary share options	270	1,230	-	-	-	-	-	1,230
Share-based compensation	29	531	651	-	133	2,008	-	3,190
Ordinary shares issued for purchase of								

intangible assets	85	1,657	-	-	-	-	-	1,657
Purchase of treasury stock	-	-	487	-	(2,990)	(60,327)	-	(59,840)
Contributed services	-	-	94	-	9	136	-	230
Unrealized loss on marketable securities	-	-	-	(711)	-	-	-	(711)
Net income	-	-	-	-	-	-	55,851	55,851
Balance, December 31, 2012	24,728	$108,048	$ 1,729	$ (1,494)	(6,018)	$(93,541)	$ (39,512)	$(24,770)
Exercise of ordinary share options	1	-	-	-	-	-	-	-
Share-based compensation	-	-	2,307	-	32	499	-	2,806
Issuance of ordinary shares	-	-	(428)	-	36	428	-	-
Ordinary shares issued for purchase of intangible assets	300	3,696	-	-	-	-	-	- 3,696
Purchase of treasury stock	-	-	84	-	(1,252)	(15,537)	-	(15,453)
Unrealized gain on marketable securities	-	-	-	852	-	-	-	852
Net income	-	-	-	-	-	-	70,311	70,311
Balance, December 31, 2013	25,029	$111,744	$ 3,692	$ (642)	(7,202)	$(108,151)	$ 30,799	$37,442

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Net income (loss)	$70,311	$55,851	$(836)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Provision for doubtful accounts and billing adjustments	1,799	9,148	16,434
Share-based issuances	2,806	3,190	2,447
Depreciation and amortization	4,858	3,302	4,160
Increase (decrease) of uncertain tax position	3,893	11	(75)
Deferred income tax (benefit) provision	(29,007)	(10,945)	93
Interest expense - non-cash	307	411	277
(Gains) losses on investments	(722)	738	(649)
Fair value loss (gain) on common equity put options	1,047	(3,650)	(2,192)
Contributed services	-	230	75
Change in operating assets and liabilities			
Accounts receivable	579	(6,366)	(14,884)
Inventories	850	3,336	(5,668)
Deferred costs	2,404	1,484	(1,935)
Deposits and other current assets	(11,435)	385	(184)
Other non-current assets	100	324	587
Accounts payable	586	(3,194)	4,255
Accrued expenses and other current liabilities	(2,495)	3,654	(2,132)
Deferred revenue	(10,711)	7,369	25,626
Other non-current liabilities	111	(16)	(69)
Net cash provided by operating activities	35,281	65,262	25,330
Cash flows from investing activities:			
Purchases of investments	(368)	(129,166)	(34,710)
Proceeds from sales of investments	12,622	130,462	28,192
Purchases of property and equipment	(176)	(217)	(974)
Acquisition of intangible assets	(117)	(5,749)	(1,548)
Net cash provided by (used in) investing activities	11,961	(4,670)	(9,040)
Cash flows from financing activities:			
Purchase of treasury stock	(18,704)	(66,509)	(28,182)
Redemption of redeemable ordinary shares	-	-	(8,695)
Proceeds from sale of common equity put options	-	12,185	3,146
Proceeds from exercise of ordinary share options	-	1,230	1,774
Payment of other non-current liabilities	(1,500)	(1,500)	-
Net cash used in financing activities	(20,204)	(54,594)	(31,957)
Net increase (decrease) in cash and cash equivalents	27,038	5,998	(15,667)
Cash and cash equivalents, beginning of year	18,959	12,961	28,628
Cash and cash equivalents, end of year	$45,997	$18,959	$12,961

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2013	2012	2011
Supplemental disclosures:			
Interest paid	$-	$-	$-
Income taxes paid	$12,578	$5	$17
Non-cash investing and financing activities:			
Reclassification of redeemable ordinary shares to ordinary shares	$-	$-	$1,366
Ordinary shares issued for purchase of intangible assets	$3,696	$1,657	$-
Intangible assets (acquired through financing)	$-	$-	$4,795
Adjustment to redemption value of redeemable ordinary shares	$-	$-	$733

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

magicJack VocalTec is a vertically integrated group of companies. The Company owns a micro-processor chip design company, an appserver and session border controller company, a wholesale provider of voice-over-Internet-Protocol ("VoIP") services, a softphone company, and the developer and provider of the magicJack product line. The Company also wholesales telephone service to VoIP providers and telecommunication carriers.

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

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"), are re-measured in dollars and any gains or losses are recognized in the Company's earnings in the period they occur.

The Company prepares its consolidated financial statements on the basis of being a single reporting entity. Approximately 90% of the Company's revenues in the years ended December 31, 2013, 2012 and 2011 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), and Predictive Marketing, LLC and B Kruse and Associates, LLC (collectively, "Dialmaxx"). 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.

NOTE 2 – SUMMARY OF ACCOUNTING POLICIES

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

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of 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 allowances for billing adjustments and doubtful accounts, 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.

Net Revenues

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

Revenue Recognition

magicJack Devices Revenue

The Company recognizes revenues from sales and shipping of direct sales of the magicJack devices over the period associated with the initial access right period. Customers may purchase access rights for continued use of its software to access the Company’s servers for additional years either when the original purchase is made, or at any time thereafter. The revenue associated with the access right for additional years is deferred and recognized ratably over the extended access right period.

Sales Return Policy

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

Returns from retailers are accepted on an authorized basis for devices deemed defective. The Company may offer certain retailers the limited right to return any unsold merchandise from their initial stocking orders. The Company estimates potential returns under these arrangements at point of sale and re-estimates potential returns on a quarterly basis. For the years ended December 31, 2013, 2012 and 2011, the Company’s estimates of returns and actual returns from initial stocking orders have not been materially different.

Prepaid Minutes and Access and Wholesale Charges

Revenue from prepaid minutes and access and wholesale charges are recognized as minutes are used. These revenues are generated from the usage of prepaid minutes, fees for origination of calls to 800-numbers, access fees charged to other telecommunication carriers on a per-minute basis for Interexchange Carriers (“IXC”) calls terminated on the Company’s servers. Revenues from access fee charges to other telecommunication carriers are recorded based on rates set forth in the respective state and federal tariffs or negotiated contract rates, less a provision for billing adjustments of $1.8 million, $8.9 million and $16.2 million for the years ended December 31, 2013, 2012 and 2011, respectively. The decreases in the provision for billing adjustments is primarily due to the Company reaching certain settlement with large carriers.

Deferred Revenues

Deferred revenues consist primarily of billings and payments for magicJack devices and sales of access rights received in advance of revenue recognition. The Company bills and collects in advance for magicJack devices, which include the access right for the software to access its servers for an initial access right period in order to obtain free domestic local and long distance broadband telephone 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.

Cost of Revenues

Cost of revenues includes 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, servers 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 $5.2 million, $5.7 million and $4.9 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Advertising Expenses

Advertising expenses of $14.3 million, $23.2 million and $32.1 million for the years ended December 31, 2013, 2012 and 2011, respectively, consist primarily of television infomercials and commercials, Internet advertising and print advertising. Advertising costs are expensed when incurred.

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 broadband 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 $5.7 million, $2.6 million and $2.7 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Earnings per Ordinary Share

Net Income (loss) per share attributable to the Company's shareholders – basic, is calculated by dividing net income (loss) attributable to shareholders by the weighted average number of ordinary shares outstanding during each period, including redeemable ordinary shares (if applicable). Income (loss) per share attributable to the Company's shareholders – diluted, is computed using the weighted average number of ordinary and potentially diluted ordinary share equivalents outstanding during the period, including redeemable ordinary shares (if applicable). Potentially dilutive ordinary share equivalents consist of shares issuable upon the exercise or settlement of options to purchase ordinary shares, restricted stock and outstanding put option contracts on the Company's own stock (if applicable).

Cash and Cash Equivalents

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

Allowance for Doubtful Accounts and Billing Adjustments

The Company maintains an allowance for doubtful accounts 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, 2013, 2012 and 2011 are as follows (in thousands):

	December 31,		
	2013	2012	2011
Balance, beginning of period	$ 20,498	$ 24,813	$ 8,498
Change in provision for doubtful accounts	(3)	(182)	235
Change in provision for billing adjustments	1,802	8,929	16,199
Write-offs	(18,385)	(13,062)	(119)
Balance, end of period	$ 3,912	$ 20,498	$ 24,813

The Company settled certain carrier receivable disputes during the years ended December 31, 2013 and 2012, which resulted in the write-offs of approximately $18.4 million and $13.1 million, respectively, of accounts receivables the Company had previously reserved.

Marketable Securities and Other Investments

Marketable securities are considered available-for-sale. Available-for-sale securities are recorded at fair value with any unrealized gains and losses reported in other comprehensive income (loss) and as a separate component of capital equity (deficit) in the consolidated balance sheets. Gains and losses are recorded based on specific identification by asset. The Company does not recognize changes in the fair value of its available-for-sale investments in income unless a decline in value is considered other-than-temporary in accordance with the authoritative guidance.

Common Equity Put Options

Common equity put option ("put option") contracts sold in connection with the Company's share repurchase program may expire unexercised or be assigned to the Company on or before the contract expiration date. Put option contracts exercised result in the Company purchasing its ordinary shares. Put option contracts outstanding at the end of a period are liabilities under ASC Subtopic 480-10, "Distinguishing Liabilities from Equity," and are included in accrued expenses and other current liabilities in the Company's consolidated balance sheet. These liabilities are marked-to-market at the unadjusted quoted prices in active markets for identical assets, which are Level 1 inputs. Any unrealized gains or losses are recognized as fair value gains (losses) on common equity put options in the Company's consolidated statements of operations.

Common Equity Call Options

Common equity call option ("call option") contracts exercised result in the Company purchasing its ordinary shares. The Purchase of call option contracts on the Company's own stock is accounted for as equity in accordance with ASC Subtopic 815-40, "Derivatives and Hedging." Outstanding call option contracts are included in additional paid-in capital in the Company's consolidated balance sheet at cost.

Interest and Dividend Income

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

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 and U.S. government notes. Marketable securities generally consist of equity and debt securities as well as a variety of mutual funds which primarily invest in government securities, debt, preferred stocks and equity securities.

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 Israeli bank are not insured. We have never experienced any losses related to these balances. At December 31, 2013, the Company had cash and cash equivalents totaling $46.0 million, which included (i) $45.6 million in U.S. banks, and (ii) $0.4 million in an Israeli financial institution.

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 $0.2 million that exceed insurance limits at December 31, 2013. The Company had money market accounts with a financial institution with balances totaling approximately $43.8

million.

One telecommunication carrier accounted for approximately 28% of gross accounts receivable at December 31, 2013. One telecommunication carrier accounted for approximately 63% of gross accounts receivable at December 31, 2012. For the years ended December 31, 2013, 2012 and 2011, no telecommunication carrier accounted for more than 10% of the Company’s total operating revenue.

One U.S. retail customer, Best Buy, accounted for approximately 10% of gross accounts receivable at December 31, 2013. No U.S. retail customer accounted for more than 10% of gross accounts receivable at December 31, 2012. For the years ended December 31, 2013, 2012 and 2011, no retailer accounted for more than 10% of the Company's total operating revenues.

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, time deposits and common equity put options in the Company's own stock. As of December 31, 2013 and 2012, 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.

In connection with the Company's purchase of certain intangible assets during June 2011, the Company made payments of $1.5 million in May 2011, May 2012 and May 2013, respectively, and is required to make non-interest bearing annual future payments of $1.5 million for each of the next two years, beginning May 31, 2014. The liability for such payments has been discounted at a rate of 10% to a total fair value of $2.8 and $3.9 million at December 31, 2013 and December 31, 2012, respectively, with $1.5 million included in accrued expenses and other current liabilities at December 31, 2013 and December 31, 2012, and $1.3 million and $2.4 million included in other non-current liabilities in the Company's December 31, 2013 and December 31, 2012 consolidated balance sheets, respectively. The Company believes that the $2.8 million carrying value approximates fair value based on observable market inputs other than quoted prices for similar traded debt securities, which are Level 2 instruments. The $0.2 million unamortized discount at December 31, 2013 is being amortized using the effective interest method and recorded as interest expense in the Company's consolidated statements of operations.

Any unrealized gains or losses related to put option contracts sold in connection with the Company's share repurchase program are recognized as fair value gains (losses) on common equity put options in the Company's consolidated statements of operations. These liabilities are marked-to-market at the unadjusted quoted prices in active markets for identical assets, which are Level 1 inputs. As of December 31, 2013, there were no common equity put options outstanding. At December 31, 2012, outstanding common equity put options had a fair value of $2.2 million, which is included in the consolidated balance sheet in accrued expenses and other current liabilities.

Inventories

Inventories are stated at the lower of cost or market, 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.

Property, Equipment and Depreciation Expense

Property and equipment consist primarily of servers, computer hardware, furniture, and leasehold improvements. Fixed assets, other than leasehold improvements, are stated at cost with depreciation provided using the straight-line method over the estimated useful lives of the related assets, which range from three to fifteen years. Leasehold improvements are stated at cost and amortized 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.

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. Amortization is computed on identified intangibles subject to amortization using the accelerated and straight-line methods over the estimated useful lives of such assets, which range from one to seventeen years. The costs of developing the Company's intellectual property rights, intellectual property right applications and technology are charged to research and development expense.

Long-lived Assets

The Company reviews long-lived assets subject to amortization and certain identified intangibles subject to amortization 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. Long-lived assets and certain identifiable intangible assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. In the years ended December 31, 2013, 2012 and 2011, there were no deemed impairments of long-lived assets.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the identifiable net assets acquired. Goodwill and other intangible assets with indefinite lives are not amortized to operations, but instead are reviewed for impairment at least annually, or when there is an indicator of impairment. The Company is currently defined as one reporting unit.

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.

If the two-step goodwill impairment test is required to be performed, under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, the Company proceeds to step two of the goodwill impairment test. Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. An impairment loss shall be recognized to the extent that the carrying amount of goodwill exceeds its implied fair value.

The Company evaluates the carrying value of its goodwill annually or more frequently if impairment indicators arise. 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.

In connection with the Company’s annual goodwill impairment analysis performed as of October 1, 2013, the annual measurement date, there is no impairment of such assets as of and for the years ended December 31, 2013, 2012 and 2011. There were no impairments at December 31, 2012 and 2011.

Share-based Compensation

Share-based compensation generally consists of option grants or ordinary share and restricted stock units awards to directors, officers, employees or consultants that are measured at grant date, based on the fair value of the award, and are recognized as an expense over the requisite service period.

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 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 there is greater than 50% likelihood 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 where there is 50% or less likelihood that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements.

Comprehensive Income (Loss)

Comprehensive income (loss), as defined, includes all changes in equity (net assets) during a period from non-owner sources. The difference between net income (loss) and comprehensive income (loss) is due to reclassification of unrealized gain or loss on marketable securities to realized gain or loss on investments and net unrealized gains or losses on marketable securities classified as available-for-sale.

Treasury Shares

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

Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board issued ASU No. 2013-02, Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02"). ASU 2013-02 requires an entity to present, either on the face of the statement where net income is presented or in the notes to the financial statements, significant amounts reclassified out of accumulated other comprehensive income (loss) by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. Amounts that are not required to be reclassified in their entirety to net income must be cross-referenced to other disclosures that provide additional detail. This guidance was effective on a prospective basis for the annual and interim reporting periods for the Company beginning January 1, 2013. The Company's adoption of this standard did not have a significant impact on its consolidated financial statements. The Company's accumulated other comprehensive loss is comprised of one item pertaining to the Company's unrealized gains and losses on marketable securities. Reclassification of the gains or losses occurs when the specific investments are sold.

NOTE 3 – MARKETABLE SECURITIES

The Company's marketable securities are classified as available-for-sale. As of December 31, 2013 and 2012, the available-for-sale securities consisted primarily of equity securities, debt securities and time deposits, which are invested in the following (in thousands):

	December 31, 2013		
	Fair	Unrealized	Unrealized Gains
	Value	Gains	(Losses)
Common equity securities	$ 8,415	$ -	$ (642)
Time deposits	367	-	-
Total	$ 8,782	$ -	$ (642)

	December 31, 2012		
	Fair Value	Unrealized Gains	Unrealized Losses
Common equity securities	$ 7,983	$ -	$ (1,074)
Debt securities	11,407	-	(420)
Total	$ 19,390	$ -	$ (1,494)

The fair market value of common equity securities at December 31, 2013 and 2012 was determined based on unadjusted quoted prices in active markets for identical assets, which are Level 1 inputs. The fair market value of time deposits at December 31, 2013 was determined based on its face value, which approximates its fair value and is a Level 1 input. The fair market value of debt securities at December 31, 2012 was determined based on valuations based on inputs other than quoted prices included within Level 1 that are directly observable for the asset, which are Level 2 inputs.

As of December 31, 2013, the Company considers the declines in market value of its marketable security to be temporary in nature and does not consider its investment in common equity securities other-than-temporarily impaired. Fair values were determined for each individual marketable security. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, and the Company's intent to sell, or whether it is more-likely-than-not it will be required to sell, the investment before recovery of the investment's cost basis. Management has determined there is no other-than-temporary impairment of marketable securities at December 31, 2013.

Gains (losses) on investments for the years ended December 31, 2013, 2012 and 2011 was $0.7 million, ($0.7) million and $0.6 million, respectively, and included reclassification of unrealized loss on marketable securities from other comprehensive loss to gains (losses) on investments of $0.4 million, $0.8 million and $0.3 million, respectively.

NOTE 4 – INVENTORIES

Inventories are comprised of the following (in thousands):

	December 31,	
	2013	2012
Raw materials	$ 1,266	$ 3,009

Finished goods	3,224	2,331
Total	$ 4,490	$ 5,340

Raw materials represent components used in the manufacturing of the magicJack devices, held by the Company or by a Chinese manufacturer on consignment. Finished products are comprised primarily of magicJack devices on hand or in transit to the Company's distribution center in the United States. There were no write-downs of obsolete inventory for the year ended December 31, 2013. The Company wrote-off approximately $3.5 million and $0.8 million of obsolete inventory during the years ended December 31, 2012 and 2011, respectively.

NOTE 5 – PROPERTY AND EQUIPMENT

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

	Estimated Useful Lives (in years)	December 31, 2013	December 31, 2012
Switches	3 - 15	$ 7,099	$ 7,099
Computers	3	2,370	2,194
Furniture	5	160	173
Leasehold-improvements	*	228	227
Accumulated depreciation and amortization		(7,898)	(7,345)
Total		$ 1,959	$ 2,348

* 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, 2013, 2012 and 2011 was $0.6 million, $0.5 million and $2.1 million, respectively. During the year ended December 31, 2012, the Company changed the estimated useful lives of some of its servers and other ancillary equipment from 3 years to either 10 or 15 years in order to more accurately reflect the expected useful lives of such equipment. This change in estimate was effective January 1, 2012 and was accounted on a prospective basis in accordance with ASC Subtopic 250-10, "Accounting Changes and Error." As a result of this change in estimate, the Company recorded $0.6 million and $1.0 million less depreciation expense for the years ended December 31, 2013 and 2012, respectively. This change in estimate resulted in a positive impact to net income and diluted earnings per share of $0.6 million and $0.03 per share, respectively for the years ended December 31, 2013, and $1.0 million and $0.05 per share, respectively, for the year ended December 31, 2012.

NOTE 6 – INTANGIBLE ASSETS

As of December 31, 2013 and 2012, the Company had intangible assets with carrying values of $15.7 million and $16.1 million, respectively. Identified intangible assets not subject to amortization at December 31, 2013 consisted of tradename and domain names with combined carrying value of $1.2 million. Identified intangible assets not subject to amortization at December 31, 2012 consisted of tradename, a purchased carrier interconnection agreement, and domain names with combined carrying value of $1.5 million. Identified intangible assets with finite lives subject to amortization consist of the following (in thousands):

Estimated	December 31, 2013	December 31, 2012

	Useful Lives (in years)	Gross Carrying Amount	Accumulated Amortization	Net	Weighted-Average Life	Gross Carrying Amount	Accumulated Amortization	Net	Weighted-Average Life
Technology	3 - 17	$5,221	$ (4,254)	$967	6.19	$5,221	$ (3,735)	$1,486	6.69
Intellectual property rights	3 - 17	14,161	(5,280)	8,881	5.69	14,161	(2,772)	11,389	6.23
Covenants not-to-compete and not-to-sue	2 - 5	5,781	(1,385)	4,396	1.97	2,085	(660)	1,425	3.42
Tradename	3 - 6	321	(274)	47	2.00	321	(250)	71	3.00
Customer relationships	5 - 7	750	(581)	169	3.58	750	(464)	286	4.55
Backlog	1	800	(800)	-	-	800	(800)	-	-
Total		$27,034	$ (12,574)	$14,460		$23,338	$ (8,681)	$14,657	

Amortization expense for years ended December 31, 2013, 2012 and 2011 were $4.3 million, $2.8 million and $2.1 million, respectively. Amortization expense for the year ended December 31, 2013 included (i) a $0.2 million impairment of certain technology and customer relationships related to the VocalTec legacy products, which the Company stopped selling in 2013, and (ii) a $0.4 million impairment of a carrier interconnection agreement as a result of more favorable rates that have become available to the Company. Based on the carrying value of identified intangible assets recorded at December 31, 2013, and assuming no subsequent impairment of the underlying assets, the amortization expense for the future fiscal years is expected to be as follows (in thousands):

Fiscal Year	Amortization Expense
2014	$ 5,100
2015	4,163
2016	1,564
2017	1,331
2018	854
Thereafter	1,448
	$ 14,460

NOTE 7 – GOODWILL

As of December 31, 2013 and 2012, the Company had goodwill with carrying values of $32.3 million. There were no changes in changes in goodwill during the years ended December 31, 2013 and 2012.

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, 2013 and 2012 (in thousands)

	December 31,	
	2013	2012
magicJack devices	$ 14,855	$ 31,481
Access right renewals	37,108	32,969
Prepaid minutes	2,578	2,588
Deferred revenue, current	54,541	67,038
Deferred revenue, non-current*	59,951	58,165
Total deferred revenues	$ 114,492	$ 125,203

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

Deferred revenues as of December 31, 2013 are expected to be recognized in future years as follows (in thousands):

Fiscal Year

	Estimated Recognition of Deferred Revenues
2014	$ 54,541
2015	22,212
2016	14,813
2017	11,312
2018	5,873
Thereafter	5,741
	$ 114,492

Costs necessary to fulfill the Company’s obligations to provide broadband telephone service to new and existing customers who have purchased magicJack devices or access rights to access the Company’s servers are expensed as incurred. Such costs were approximately $22.1 million, $27.9 million and $27.8 million for the years ended December 31, 2013, 2012 and 2011, respectively.

NOTE 9 – OTHER LIABILITIES

As of December 31, 2013 and 2012, the Company had outstanding indebtedness in connection with an agreement entered during June 2011 for the purchase of certain intangible assets, and secured only by such intangible assets, under which the Company is required to make two non-interest bearing future annual payments of $1.5 million beginning May 31, 2014. The liability for such payments has been discounted at a rate of 10% to a total net present value of $2.8 million and $3.9 million at December 31, 2013 and 2012, respectively, with $1.5 million included in accrued expenses and other current liabilities at December 31, 2013 and 2012, and $1.3 million and $2.4 million included in other non-current liabilities in the accompanying December 31, 2013 and 2012 consolidated balance sheet, 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 April 22, 2013, Arthur M. Bussel (a/k/a "Mel Arthur"), Lori A. Bussel and As Seen On TV.US, Inc. filed a lawsuit against Daniel M. Borislow, "magicJack VocalTec LLC," and YMax Corporation in Florida's Sixth Judicial Circuit Court, Pinellas County, for various claims including breach of contract. The suit is captioned Bussel v. Borislow, et al., Case No. 13-004178-CI. The Plaintiffs contend that the three Defendants were served with Summonses and Complaints on May 8, 2013; the three Defendants dispute that they were served. The three Plaintiffs filed a Motion for Default on May 29, 2013, and the Clerk of the Court entered Defaults against the three named Defendants on May 31, 2013. On June 4, 2013, the three Plaintiffs filed a Motion for Default Judgment, seeking, (i) approximately $5.9 million and interest in money damages judgment against all three named Defendants, and (ii) an Order awarding to the three Plaintiffs legal title to a 2009 Cadillac Escalade motor vehicle. No ruling has been made on Plaintiffs’ Motion for Default Judgment. On June 18, 2013, the Company and the other Defendants filed several Motions, including a Motion to Vacate Clerk’s Default, together with Motions seeking to Dismiss the Complaint, to Quash Service, and to Transfer or Dismiss the suit based on improper venue. The Company and the other Defendants also filed affidavits in support of their Motions. The Court has scheduled a hearing to address the merits of the various pending motions commencing on May 29, 2014. The Company believes it has raised multiple grounds that will result in the Default entered by the Clerk of the Court being vacated or set aside. The Company also believes that it has meritorious defenses to the claims asserted in the Plaintiffs’ Complaint. The Company intends to defend the litigation vigorously, and may have counterclaims against Arthur and Lori Bussel. However, the Company can provide no assurance as to the ultimate outcome of this matter and if the default judgment is upheld it could have a material adverse effect on the Company's financial condition, results of operation and cash flows.

The Company believes that it files all required tax returns and pays all required 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 strongly believes any possible claims are without merit and vigorously defends its rights. However, if a state or municipality 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 dollars.

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").

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 interstate, intrastate, and local traffic origination and termination services. 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 exchanged with 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’s Order, rates are lowered for the most common termination functions performed by regulated service providers when handling voice 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. The transition to new rates begins by capping rates that regulated service providers can charge service providers for a variety of functions performed to terminate voice traffic. Depending on the particular function performed and the type of regulated service provider, the rate gradually decreases until a unified rate for inter- and intrastate voice traffic of $0.0007 per minute is established by July 1, 2016 for the most common termination functions performed by price cap regulated service providers and their competitors when processing voice traffic, called end office switching. Beginning July 1, 2017, these regulated service providers must recover the costs associated with the provision of service from their customers and not other regulated service providers.

The 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 handling such traffic from their customers. But as part of the transition to that end point, the Order adopts a VoIP-PSTN specific framework for compensation between regulated service providers. The Order establishes 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 local rate associated with traditional telecommunications traffic. Further, the Order allows regulated service providers to tariff charges associated with handling VoIP-PSTN traffic in a manner consistent with the rates established by the Order. The VoIP-PSTN reforms became effective December 29, 2011.

The Order broadly reforms the system of default rates that apply to payments between regulated service providers going forward, but does 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 Company cannot predict the full impact of the FCC’s Order at this time.

The Order is now effective and may be subject to litigation. Because the FCC establishes default rates, it could also take some time for regulated service providers to invoke change in law clauses in contracts to implement the new rates.

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 may not now be required by the FCC to provide 911 services, 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 telecommunication 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. users who have 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. 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 requirement compelling the disclosure of network management policies. The Court struck down the first two requirements, 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 requirement. The Company cannot predict to what extent this decision may affect its business at this time. While the Company believes that interference with access to its products and services seems unlikely, such broadband Internet access provider interference has occurred, in very limited circumstances, in the U.S., and could result in a loss of existing users and increased costs, and could impair the Company's ability to attract new users, thereby harming its revenue and growth. On February 19, 2014, the Federal Communications Commission stated it won't appeal the aforementioned court decision regarding net neutrality rules and will try again to craft regulations to ensure open access to the Internet.

Universal Service Fund ("USF") and Other Funds - The FCC and many state public utility commissions ("PUCs") have established USF programs to ensure that affordable telecommunications services are widely available in high cost areas and for income-eligible telephone subscribers and to promote universal availability of modern networks capable of providing mobile 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 Fund. All telecommunications carriers are required to contribute to these funds, and the requirements have been expanded to include 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. Federal USF fees have to date only applied if a company bills for telecommunication services. magicJack LP does not bill for domestic local and long distance telecommunication calling services.

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.

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.

Number Portability - The FCC requires interconnected VoIP providers to comply with Local Number Portability ("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.

Outage Reporting - In July 2010, the FCC's Public Safety and Homeland Security Bureau sought comment on whether to extend the FCC's outage reporting rules to broadband Internet service providers and interconnected VoIP service providers. In a May 2011 rulemaking, the FCC proposed to extend the outage reporting requirements in Part 4 of the rules to interconnected VoIP and broadband service providers. On February 15, 2012, the FCC announced the adoption of a Report and Order requiring interconnected VoIP service 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.

Discontinuance of Service Reporting - The FCC requires interconnected VoIP providers to file an application with the Commission for the discontinuance, reduction or impairment of services, which includes the conversion of an interconnected VoIP service to a service that permits users to receive calls that originate on the public switched telephone network ("PSTN") but not terminate calls to the PSTN, or the converse. The Company believes it is not an interconnected VoIP provider as currently defined by the FCC.

Annual Traffic and Revenue Reports - In January of 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 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. 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.

Effects of State Regulations - The Company has 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.

State and Municipal Taxes - The Company believes that it files all required tax returns and pays all required taxes (such as sales, excise, utility, and ad valorem taxes), fees and surcharges. The Company believes that it is exempt from certain taxes, fees and surcharges because it does not charge for telephone services or render bills to its customers. The Company remits sales tax in Florida on sales of magicJack units because its magicJack LP subsidiary's personnel, property and activities are in Florida. Certain states and municipalities may disagree with the Company's policies 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 state. 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 may at some time be required to collect and remit sales taxes to states other than Florida. The Company 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 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 case by case bases 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, 2013 are as follows (in thousands):

Fiscal Year	Estimated Rent Expense
2014	$ 445
2015	482
2016	346
2017	313
2018	319
Thereafter	247
	$ 2,152

Rent expense for the Company's real property leases were $0.4 million, $0.5 million and $0.5 million for the years ended December 31, 2013, 2012 and 2011, respectively, and are included in selling, general and administrative expense in the accompanying Consolidated Statements of Operations.

NOTE 11 – REDEEMABLE ORDINARY SHARES

On December 30, 2011, the Company purchased 566,668 ordinary shares (previously classified as redeemable ordinary shares) from an unrelated multinational entertainment products and services retailer in an arm's length transaction for $8.7 million, or $15.35 per share, which exceeded the closing price on NASDAQ of $13.66 per share. The redemption price of $7.7 million representing the shares purchased at the closing price was recorded as a purchase of treasury shares. The $1.0 million excess of the redemption price paid over the closing price on NASDAQ was recorded as a reduction of additional paid-in capital and a dividend to the seller for purposes of computing earnings per share. Refer to Note 15, "Income (Loss) per Share" for further details of the impact of this item to the calculation of loss per share for the year ended December 31, 2011.

The changes in carrying value of the redeemable ordinary shares during the year ended December 31, 2011 was as follows (in thousands):

	Year Ended December 31,

	2011
Balance, beginning of period	$ 8,373
Adjustment of redemption value of redeemable ordinary shares	733
Redemption of 566,668 redeemable ordinary shares to treasury shares	(7,740)
Reclassification of 100,000 redeemable ordinary shares to ordinary shares	(1,366)
Balance, end of period	$ -

NOTE 12 – ORDINARY SHARES, TREASURY SHARES AND FAIR VALUE GAIN ON COMMON EQUITY PUT OPTIONS

Ordinary Shares

During the year ended December 31, 2013, the Company issued 300,000 ordinary shares valued at approximately $3.7 million based on the quoted market price of the Company's ordinary shares to the Company's founder, Mr. Daniel Borislow, as consideration for entering into in exchange for his obligations under an agreement, which provides, amongst other things, that: (i) Mr. Borislow will not have any ongoing involvement in the business or operations of the Company or any of its subsidiaries, (i) a standstill requirement under which Mr. Borislow has agreed, for a period of two years, to refrain from taking certain actions as a shareholder of the Company, (iii) an agreement not to compete with the Company or to solicit its employees without the Company's consent for two years, and (iv) the assignment of certain intellectual property rights by Mr. Borislow for the benefit of the Company. The Company recorded the consideration for the aforementioned agreement as an intangible asset and will amortize it over the two-year period covered under this agreement.

During the year ended December 31, 2012, the Company issued: (i) 10,000 ordinary shares valued at approximately $0.2 million to its new President for a sign-on bonus, (ii) 21,564 ordinary shares valued at approximately $0.4 million for the purchase of a carrier interconnection agreement, (iii) 19,350 ordinary shares valued at approximately $0.4 million for marketing-related sponsorships, and (iv) 62,563 ordinary shares valued at $1.3 million as consideration for the purchase or certain intangible assets.

During the year ended December 31, 2011, the Company issued 52,964 ordinary shares valued at approximately $0.7 million to members of its Board of Directors, employees and outside consultants for services rendered. Shares issued to members of its Board of Directors vest over a period of 3 years. On November 28, 2011, the Company issued 140,000 ordinary shares valued at approximately $1.5 million, after amounts for taxes withholdings, to settle the bonus liability to employees and outside consultants.

On December 1, 2011, the Company's Board of Directors approved a two-for-one stock split that was paid on December 16, 2011 in the form of a 100 percent stock dividend to shareholders of record as of December 12, 2011. All share and per share information has been retrospectively adjusted for the stock split.

Treasury Stock and Fair Value (Loss) Gain on Common Equity Put Options

The Company's Board of Directors authorized a stock repurchase program to enable it to purchase its ordinary shares at such times as management deems appropriate up to a maximum cumulative repurchase authority of $100.0 million as of December 31, 2013. The objective of the Company's stock repurchase program is to improve stockholders' returns. The Company expended $91.3 million under its repurchase program through December 31, 2013, and there was $8.7 million authorized to purchase ordinary shares pursuant to the stock repurchase program. All shares purchased, not yet retired, are recorded as treasury shares. The Company repurchased 6,143,731 ordinary shares under this program through December 31, 2013.

The Company has bought call option contracts and has sold put option contracts in connection with its 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, 2013. Taking into consideration the proceeds received from the sale of put option contracts exercised, put option contracts that expired unexercised and purchase price of call option contracts exercised during the year ended December 31, 2013, 2012 and 2011, the Company expended approximately (i) $3.3 million purchasing 190,000 shares of outstanding ordinary shares at an average price of $17.27 during the year ended December 31, 2013, (ii) $55.9 million purchasing 2,989,949 shares of outstanding ordinary shares at an average price of $18.69 during the year ended December 31, 2012, and (iii) $32.2 million purchasing 2,963,782 shares of outstanding ordinary shares at an average price of $10.85 during the year ended December 31, 2011.

On November 6, 2013, the Company repurchased 1,062,092 of its ordinary shares at $12.24 per share, for an aggregate purchase price of approximately $13.0 million (and fair value of $12.32 per share, or $13.1 million) in privately negotiated repurchase agreements with the independent trustees of two irrevocable trusts previously created by the Company's founder, Mr. Daniel Borislow.

On December 31, 2013, the Company issued 35,967 of its ordinary shares held as treasury shares with a cost of $0.4 million, $12.24 per share (and fair value of $0.4 million, $11.91 per share), to its executive officers as a result of restricted stock units, that were issued in mid-2013, vesting.

In March 2013, the Company issued 32,129 of its ordinary shares held as treasury stock with a cost of $0.2 million, $15.54 per share (and fair value of $0.5 million, $12.45 per share), to settle a liability.

The Company issued 133,178 of its ordinary shares held as treasury shares with a cost of $2.0 million, $15.08 per share (and a fair value of $2.5 million, $18.44 per share), to employees and outside consultants for services rendered in 2012. The Company also issued 8,787 of its ordinary shares held as treasury shares with a cost of $136 thousand, $15.48 per share (and a fair value of $150 thousand, $17.07 per share, to an outside consultant for contributed services in connection with the Company's purchase of certain intangible assets in 2012.

On December 30, 2011, the Company purchased 566,668 shares (previously classified as redeemable ordinary shares) from an affiliate of an unrelated multinational entertainment products and services retailer in an arm's length transaction for $8.7 million, or $15.35 per share. Refer to Note 11, "Redeemable Ordinary Shares," for further details on this transaction.

On October 7, 2011, the Company purchased 200,000 ordinary shares as a result of a legal settlement related to credit card processing, for $1.5 million in cash, or $7.50 per share. The fair value of the 200,000 ordinary shares on October 7, 2011 was $2.3 million based on closing market price on NASDAQ of the Company's ordinary shares of $11.33 per share. As a result, the Company recorded $2.3 million as the cost of treasury shares and a reduction in credit card processing fees of $0.8 million, which is included in cost of revenues.

The changes in treasury stock during the years ended December 31, 2013, 2012 and 2011 are as follows (in thousands, except for number of shares):

	Year Ended December 31,					
	2013		2012		2011	
	Number	Amount	Number	Amount	Number	Amount
Balance, beginning of period	6,018,246	$ 93,541	3,170,262	$ 35,358	6,480	$ 81
Ordinary shares purchased through the stock repurchase program	190,000	2,453	2,989,949	60,327	2,397,114	25,271
Purchase of treasury stock as a result of a legal settlement	-	-	-	-	200,000	2,266
Redemption of redeemable ordinary shares	-	-	-	-	566,668	7,740

Ordinary shares issued to settle liabiity	(32,129)	(499)	(133,178)	(2,008)	-	-
Ordinary shares issued for contributed services	-	-	(8,787)	(136)	-	-
Ordinary shares issued due to vesting of restricted stock units	(35,967)	(428)	-	-	-	-
Other purchases	1,062,092	13,084	-	-	-	-
Balance, end of period	7,202,242	$ 108,151	6,018,246	$ 93,541	3,170,262	$ 35,358

NOTE 13 – SHARE-BASED COMPENSATION

The Company has granted ordinary share options, issued restricted stock units and ordinary shares 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 stockholders. The Company is currently granting share-based awards under the magicJack Vocaltec Ltd. 2013 Stock Incentive Plan and the magicJack Vocaltec Ltd. 2013 Israeli Stock Incentive Plan (together, the "2013 Plans"). In July 2013, the shareholders approved the 2013 Plans at the annual general meeting of shareholders to allow grants of ordinary share options, restricted stock units and ordinary shares. The aggregate number of shares that may be subject to awards under the Plans is 2,250,000. The Company had previously granted shares under the VocalTec amended Master Stock Plan (the "2003 Plan") which expired in April 2013. Share-based awards are generally exercisable or issuable upon vesting. 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 ordinary share options, issued restricted stock units and ordinary shares for the years ended December 31, 2013, 2012, and 2011 was as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Ordinary share options	$ 1,685	$ 203	$ 224
Restricted stock units	721	-	-
Ordinary shares	400	2,987	2,223
	$ 2,806	$ 3,190	$ 2,447

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

	Year Ended December 31,		
	2013	2012	2011
Cost of revenues	$ -	$ 12	$ 39
Advertising	408	427	72
General and administrative	2,200	2,472	2,145
Research and development	198	279	191
	$ 2,806	$ 3,190	$ 2,447

Ordinary Share Options

Ordinary share options granted under the 2013 Plans have a five-year life and usually vest evenly over a three year period beginning at the date of grant. The 2013 Plans allow for a maximum term of ten years for awards granted. The following table provides additional information regarding ordinary share options issued, outstanding and exercisable for years ended December 31, 2013, 2012 and 2011 (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 *
January 1, 2011	849,478	$ 6.25	1.87	$ 6,319
Granted	-	$ -		
Exercised	(531,836)	$ 3.33		
Expired or cancelled	(27,410)	$ 33.13		
December 31, 2011	290,232	$ 4.86	1.66	$ 2,554
Granted	-	$ -		
Exercised	(270,088)	$ 4.54		
Expired or cancelled	(8,644)	$ 16.17		
December 31, 2012	11,500	$ 3.85	7.13	$ 165
Granted	1,274,607	$ 15.04		
Exercised	(900)	$ 0.45		
Expired or cancelled	-	$ -		
December 31, 2013	1,285,207	$ 14.95	4.41	$ -
Vested at December 31, 2013	336,911	$ 15.29	4.29	$ -

Exercisable at December 31, 2013 and expected to vest **	336,911	$ 15.29	4.29	$ -

* The aggregate intrinsic value is the difference between the estimated market value for the Company's common stock and the exercise price of the outstanding stock options.

** Options expeted to vest reflected
an estimated forfeiture rate.

Share-based compensation expense recognized for ordinary share options was approximately $1.7 million, $0.2 million and $0.2 million for the years ended December 31, 2013, 2012 and 2011, respectively. The total intrinsic value of ordinary share options exercised during the years ended December 31, 2013, 2012 and 2011 was $12 thousand, $3.8 million and $3.9 million, respectively. As of December 31, 2013, there was approximately $7.8 million of unrecognized share-based compensation expense related to unvested ordinary share options, which is expected to be recognized over a weighted average period of 1.30 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. As the Company does not have historical data available regarding employee exercise patterns, it did not anticipate any forfeiture of the ordinary share options granted and the expected term of the ordinary share options was calculated using the simplified method in accordance with SAB No. 107, "Share Based Payment." 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 Company did not issue ordinary shares options in 2012 and 2011. The weighted average fair value of ordinary share options granted during the year ended December 31, 2013 is $7.47, and was measured at the date of grant using the following assumptions:

	Year Ended December 31, 2013	
Expected term (in years)	3.4 - 3.6	
Dividend yield	0.00	%
Expected volatility	57.5% to 84.9%	
Risk free interest rate	1.42% to 1.55%	
Forfeiture rate	0.00	%

Restricted Stock Units

The Company may also award non-vested restricted stock units to its executives, employees, directors and outside consultants under the 2013 Plan, which may vest based on service or a combination or service and other conditions, such as market. The compensation expense for the award will be recognized assuming that the requisite service is rendered regardless of whether the market conditions are achieved. Each non-vested stock unit, upon vesting, represents the right to receive one ordinary share of the Company. During the year ended December 31, 2013, the Company granted certain officers and directors 190,713 restricted stock units under the 2013 Plans, comprised of 138,357 service-based restricted stock units and 52,356 market and service condition restricted stock units. The vesting of the market and service condition is based on the Company's ordinary shares being above $16.29 per share at the vesting dates, or closing at a five-day average above $16.29 per share after the vesting date.

The following table summarizes the Company's restricted stock unit activity for the year ended December 31, 2013:

	Number of Shares		Average Fair Value at Grant Date
January 1, 2013	-	$	-
Granted	190,713	$	14.15
Vested	(35,967)	$	14.42
Forfeited	-	$	-
Non-vested at December 31, 2013	154,746	$	14.08

During the year ended December 31, 2013, the Company recognized $0.7 million in share-based compensation expense related to restricted stock units. As of December 31, 2013, there was $2.0 million in unrecognized share-based compensation costs related to restricted stock units. The unrecognized share-based compensation expense is expected to be recognized over a weighted average period of 1.68 years.

The Company recorded share-based compensation costs from ordinary share options and restricted stock units, related deferred tax assets and tax benefits of $2.4 million, $0.3 million and $0.7 million, respectively, in 2013, $0.2 million, $0 and $50 thousand, respectively, in 2012 and $0.2 million, $0 and $56 thousand, respectively, in 2011.

NOTE 14 – 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.

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

	Year Ended December 31,		
	2013	2012	2011
United States	$ 13,808	$ 39,090	$ (12,442)
Foreign	33,340	7,800	11,667
	$ 47,148	$ 46,890	$ (775)

The components of the income tax provision (benefit) in 2013, 2012 and 2011 are as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Current:			
Federal	$ 769	$ 1,482	$ 20
State	(6)	502	1
Foreign	1,188	-	(53)
Current provision (benefit)	1,951	1,984	(32)
Deferred:			
Federal	(5,942)	(3,873)	-
State	(540)	(1,312)	93
Foreign	(22,525)	(5,760)	-
Deferred (benefit) provision	(29,007)	(10,945)	93
Uncertain tax positions	3,893	-	-
Total income tax (benefit) provision	$ (23,163)	$ (8,961)	$ 61

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, 2013, 2012 and 2011. Minimum income tax benefit has been recorded in prior years due to the Company's historical pre-tax losses (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Federal tax at statutory rate	35.00 %	34.00 %	34.00 %
State and local taxes, net of federal	3.18	3.60	3.60
Nondeductible compensation	0.00	0.00	(10.88)
Non taxable income	0.00	(2.93)	0.00
Foreign results at rates other than domestic	(9.31)	(1.11)	0.00
Uncertain tax positions	8.25	0.00	0.00
Other	(0.28)	0.81	12.75

Valuation allowance	(85.97)	(53.48)	(47.35)
Effective tax rate	(49.13) %	(19.11) %	(7.88) %

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 significant components of estimated deferred income tax assets and liabilities as of December 31, 2013 and 2012 are as follows (in thousands):

	December 31, 2013		December 31, 2012	
	Current	Non-Current	Current	Non-Current
Deferred tax assets:				
Deferred revenue, net of deferred costs	$ 2,860	$ 2,421	$ 3,926	$ 11,204
Domestic net operating loss carryforward	-	1,749	-	838
Foreign net operating loss carryforward	8,745	32,983	1,929	44,303
Basis difference in intangible assets	-	2,862	-	2,586
Allowance for doubtful accounts	171	-	180	-
Currently non-deductible expenses and other	3,714	2,866	1,750	-
Capital loss carryforwards	133	16	-	294
Total deferred tax assets	15,623	42,897	7,785	59,225
Deferred tax liabilities:				
Basis difference in goodwill	-	(532)	-	(501)
Basis difference in fixed assets	-	(466)	-	(456)
Total deferred tax liabilities	-	(998)	-	(957)
Valuation allowance	(4,356)	(13,213)	(6,671)	(48,718)
Net deferred taxes	$ 11,267	$ 28,686	$ 1,114	$ 9,550

A valuation allowance is required to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized. To assess the likelihood that deferred tax assets will be recoverable from taxable income, the Company considers all the evidence, both positive and negative that a valuation allowances is needed. At December 31, 2013 and 2012, the Company reassessed whether it could realize its deferred tax assets.

When assessing all available evidence, the Company considers an important piece of objective evidence the extent to which it has made pre-tax income or losses over the most recent three year period. Historically through 2011, the Company had maintained a full valuation allowance on its net deferred tax assets principally because it had been in a cumulative pre-tax loss position and also based on its deferred tax asset reversal pattern in the U.S. jurisdiction. In 2012, and then again in 2013, the Company experienced significant improvement in its operating results and generated strong pre-tax income in the U.S. and Israel, which limited the impact of this important piece of negative evidence from the Company’s evaluation. More broadly, the Company’s assessment for the year ended December 31, 2013 considered the following positive and negative evidence.

Positive evidence

The Company’s U.S. and Israeli operations generated $13.8 million and $33.3 million, respectively, of pre-tax income in 2013. In addition, the Company has now generated cumulative pre-tax income in the U.S and Israel of more than $40.5 million and $52.8 million, respectively, for the three year period ended December 31, 2013, 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 $29.8 million and $107.9 million in future taxable income, respectively, to realize the deferred tax assets at December 31, 2013. The Company’s Israeli net operating loss carryforwards are not subject to expiration and its financial performance has continued to improve despite challenging macroeconomic conditions.

Negative evidence

The negative evidence consists primarily of the Company's history of significant pre-tax losses dating back to years prior to the merger in 2010. In total, the U.S. group of companies has approximately $0.6 million of deferred tax assets related to $1.5 million of net operating losses that are limited to use against taxable income of specific subsidiaries. The Israeli group of companies has approximately $41.7 million of deferred tax assets related to $157.5 million of net operating loss carryforwards, which has accumulated over many years. Of the total Israeli group combined net operating losses, $55.0 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 losses incurred prior to the year ended December 31, 2012 would be repeated.

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 is strong. The improving financial performance in recent years 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.

In performing its analysis, the Company used the most updated plans and estimates that it currently uses to manage the underlying business. As a result, the Company released $40.5 million ($11.7 million in the U.S. and $29.8 million in Israel) and $10.9 million ($5.1 million in the U.S. and $5.8 million in Israel) of the valuation allowance recorded against its deferred tax assets at December 31, 2013 and 2012, respectively. The Company determined that a remaining valuation allowance estimated at $17.6 million and $55.4 million as of December 31, 2013 and 2012, respectively, was necessary to reduce the deferred tax assets to the amount that will more-likely-than-not be realized. In particular, the valuation allowance remaining as of December 31, 2013, primarily represents amounts related to net operating losses associated with specific subsidiary entities for which it is not more-likely-than-not to be realized.

The reconciliation of the valuation allowance for the years ended December 31, 2013 and 2012 is as follows (in thousands):

	December 31,	
	2013	2012
Balance, beginning of period	$ 55,389	$ 66,736
Changes to the valuation allowance	(37,820)	(11,347)
Balance, end of period	$ 17,569	$ 55,389

The Company files U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. During 2013, the Internal Revenue Service commenced an examination of the Company's U.S. income tax returns for 2010 and 2011, and several state examinations are also under way. The Company adopted the provisions of

ASC Subtopic 740-10, formerly FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes — an interpretation of SFAS No. 109” as of January 1, 2007 with no material impact to its consolidated financial position or its results of operations. The tax years 2005 – 2012 remain open to examination by the major taxing jurisdictions to which the Company is subject.

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 financial statements.

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

	December 31,		
	2013	2012	2011
Unrecognized tax benefits, opening balance	$ 354	$ 343	$ 418
Gross increases - tax positions in prior period	5,323	11	6
Gross decreases - tax positions in prior period	-	-	(81)
Lapse of statute of limitations	-	-	-
Unrecognized tax benefits, ending balance	$ 5,677	$ 354	$ 343

At December 31, 2013, 2012, and 2011, there are $5.3 million, $11 thousand, and $6 thousand of unrecognized tax benefits, respectively, that if recognized, would affect the Company's annual effective tax rate. 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 other non-current liabilities in its Consolidated Balance Sheets. The amount of interest and penalties recognized by the Company in the years ended December 31, 2013, 2012 and 2011 was $183 thousand, $140 thousand and $120 thousand, respectively.

NOTE 15 – INCOME (LOSS) PER SHARE

Net Income (loss) per share attributable to the Company's ordinary shareholders – basic, is calculated by dividing net income (loss) attributable to shareholders by the weighted average number of ordinary shares outstanding during each period, including redeemable ordinary shares (if applicable). Income (loss) per share attributable to the Company's ordinary shareholders – diluted, is computed using net income (loss) attributable to shareholders adjusted for gains or losses on in-the-money dilutive shares, and dividing it by the weighted average number of ordinary and potentially diluted ordinary share equivalents outstanding during the period, including redeemable ordinary shares (if applicable). Potentially dilutive ordinary share equivalents consist of shares issuable upon the exercise or settlement of options to purchase ordinary shares and outstanding put option contracts on the Company's own stock (if applicable).

Potentially dilutive securities, using the treasury stock method are set forth in the following table, which presents the computation of basic and diluted net income (loss) per ordinary share attributable to shareholders (in thousands, except for per share information):

	Year Ended December 31,		
	2013	2012	2011
Numerator:			
Net income (loss)	$ 70,311	$ 55,851	$ (836)
Dividends on redeemable ordinary shares	-	-	(955)
Net income (loss) attributable to ordinary shareholders	$ 70,311	$ 55,851	$ (1,791)
Gains on in-the-money common equity put options	$ -	$ (1,301)	$ -
Diluted net income (loss) attributable to ordinary shareholders	$ 70,311	$ 54,550	$ (1,791)
Denominator:			

Denominator for basic net income per share - weighted average ordinary shares outstanding		18,468		19,916		23,342	
Effect of dilutive options to purchase ordinary shares		8		9		-	
Effect of dilutive options exercised or expired during the year		-		49		-	
Effect of dilutive common equity put options outstanding		-		11		-	
Denominator for diluted net income per share - weighted average ordinary shares outstanding **		18,476		19,985		23,342	
Net income (loss) per ordinary share attributable to shareholders							
Basic	$	3.81	$	2.80	$	(0.08	)
Diluted	$	3.81	$	2.73	$	(0.08	)

* Due to the net loss for the year ended December 31, 2011, basic and diluted loss per ordinary share was the same, as the effect of potentially dilutive securities would have been anti-dilutive.

** Options to purchase 1,274,637 ordinary shares and 190,713 restricted stock units outstanding for part of the second half of the year ended December 31, 2013 were not included in the calculation of diluted earnings per share because their respective exercise prices were greater than the average market price of the ordinary shares and their inclusion in the calculation would be antidilutive. Options to purchase 30 ordinary shares outstanding during the year ended December 31, 2012 were not included in the calculation of diluted earnings per share because their respective exercise prices were greater than the average market price of the ordinary shares and their inclusion in the calculation would be antidilutive. Options to purchase 290,232 ordinary shares outstanding during the year ended December 31, 2011 were not included in the calculation of diluted earnings per share as the Company had a net loss for the year and their inclusion in the calculation would be antidilutive.

MAGICJACK VOCALTEC LTD. AND SUBSIDIARIES

SUPPLEMENTAL FINANCIAL INFORMATION

SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly financial results for the years ended December 31, 2013 and 2012 were as follows (in thousands, except per share data):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2013					
Net revenues	$36,877	$32,902	$35,533	$38,180	$143,492
Gross Profit	25,734	20,846	23,399	24,419	94,398
Operating income	15,240	9,639	12,651	9,916	47,446
Net income (1)	9,586	6,508	8,903	45,314	70,311
Earnings per ordinary share: (1) (2)					
Basic	0.51	0.35	0.48	2.51	3.81
Diluted	0.51	0.35	0.48	2.50	3.81

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2012					
Net revenues (3)	$37,587	$38,559	$40,789	$41,427	$158,362
Gross Profit	22,027	23,500	24,043	27,467	97,037
Operating income	5,831	10,318	11,186	16,230	43,565
Net income (4)	8,196	10,270	15,116	22,269	55,851
Earnings per ordinary share: (2) (3) (4)					
Basic	0.39	0.51	0.78	1.17	2.80
Diluted	0.39	0.50	0.77	1.17	2.73

(1) Material adjustments were made in the fourth quarter of 2013 to record $40.5 million of release of valuation allowance against deferred tax assets and record uncertain tax positions of $3.9 million.

(2) The sum of quarterly earnings (loss) per ordinary share amounts may not add to the annual earnings (loss) per ordinary share amount due to the weighting of ordinary shares and equivalent ordinary shares outstanding during each of the respective periods.

(3) Net revenues for the first quarter of fiscal year 2012 include the impact of an operational change which allowed the Company to identify the point in time when prepaid minutes expire under the terms of service, which resulted in approximately $3.0 million attributable to prepaid minutes that expired between February 2008 and February 2012 being recognized as revenue since such amounts were considered earned. As a result, our basic and diluted earnings per ordinary share for the first quarter of fiscal year 2012 were increased by approximately $0.14 and $0.15 per ordinary share, respectively.

(4) A material adjustment was made in the fourth quarter of 2012 to record $2.0 million of current income tax expense and $10.9 million of release of valuation allowance against deferred tax assets.

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

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of December 31, 2013, 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 Securities Exchange Act of 1934, as amended, or the Exchange Act. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of December 31, 2013, 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.

Remediation of Income Tax Material Weakness

During the year ended December 31, 2013, we completed our plan to remediate a material weakness in our internal controls over reviewing and monitoring the accuracy of our income tax provision and accounting for income taxes. As of December 31, 2013, management assessed and concluded that the internal controls over accounting for income taxes were effective. Therefore, the previously reported material weakness related to accounting for income taxes has been remediated as of December 31, 2013.

During 2013, we completed the following actions related to our remediation plan:

- engaged highly qualified tax professionals;
- retained and/or more fully utilized tax advisors with significant experience in domestic and multinational income taxes and tax-related issues;
- improved existing controls, as well as designed and implemented additional controls around our income tax processes; and
- expanded and improved the processes around the review and contemporaneous documentation of our ongoing income tax accounting procedures, tax positions and strategies.

We will continue to focus on maintaining the system of internal controls that was developed and implemented over the last three years and make enhancements when and where necessary. Additionally, we will continue to engage and consult with qualified tax professionals on our tax processes as required.

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, 2013. 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 COSO criteria). Based on our assessment we believe that, as of December 31, 2013, 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, 2013 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

To the Board of Directors and Stockholders
magicJack VocalTec Ltd. and Subsidiaries
Jerusalem, Israel

We have audited magicJack VocalTec Ltd.'s and Subsidiaries (the Company's) internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control – Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). magicJack VocalTec, Ltd.'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 Annual 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 conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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.

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.

In our opinion, magicJack VocalTec Ltd. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of magicJack VocalTec, Ltd. and Subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income (loss), capital equity (deficit), and cash flows for each of the three years in the period ended December 31, 2013 and our report dated March 12, 2014 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP
Certified Public Accountants

West Palm Beach, Florida

March 12, 2014

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

We refer you to our Proxy Statement for the 2014 Annual General Meeting of Shareholders under the captions "Corporate Governance," "Report of the Audit Committee," "Biographies of our Board Nominees." "Meetings and Committees of the Board," and "Section 16(a) Beneficial Ownership Reporting Compliance," which sections are incorporated by reference herein. Biographical information on our executive officers is contained in Part I of this Annual Report on Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

We refer you to our Proxy Statement for the 2014 Annual General Meeting of Shareholders under the captions "Executive Compensation and Related Matters," including "Compensation Discussion and Analysis" and "Management Planning and Development Committee Report," which sections are incorporated by reference herein.

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

We refer you to our Proxy Statement for the 2014 Annual General Meeting of Shareholders under the captions "Security Ownership of Certain beneficial Owners and Management," and "Approval Of Related Party Transactions Under Israeli Law," which sections are incorporated by reference herein.

We refer you to Item 5, "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" for information with respect to all of our equity compensation plans in effect as of December 31, 2013, which section is incorporated by reference herein.

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

We refer you to our Proxy Statement for the 2014 Annual General Meeting of Shareholders under the captions "Corporate Governance" and "Certain Relationships and Related Transactions," which sections are incorporated by reference herein.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

We refer you to our Proxy Statement for the 2014 Annual General Meeting of Shareholders under the caption "Ratification of Appointment of Independent Registered Public Accounting Firm," which section is incorporated by reference herein.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

2.1 Agreement and Plan of Merger, dated as of July 16, 2010, among YMax Corporation, the Company and VocalTec Merger Sub, Inc., filed with the SEC on July 19, 2010 as Exhibit 10.1 to Form 6-K and incorporated herein by reference.

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 Form of YMax indemnification undertaking between YMax Corporation and its directors,* filed with the SEC on November 18, 2010 as Appendix C to proxy statement submitted on Form 6-K and incorporated herein by reference.

10.8 Employment Offer Letter dated February 1, 2012, by and between magicJack VocalTec Ltd. and Andrew MacInnes,* filed with the SEC on March 15, 2012 as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q and incorporated herein by reference.

10.9 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.

10.10 Restricted Share Grant Letter Agreement, dated April 28, 2011, with Tal Yaron-Eldar,* 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.

10.12 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.

10.13 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.

10.14 Separation Agreement, dated May 10, 2013, by and between magicJack VocalTec Ltd. and Peter J. Russo*, filed with the SEC on May 13, 2013 as Exhibit 10.1 to the Company's Current Report on Form 8-K and incorporated herein by reference.

10.15 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.

10.16 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.

10.17 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.

10.18 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.

10.19 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.

10.20 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.

10.21 Omnibus Agreement, dated November 5, 2013, between magicJack VocalTec Ltd. and Daniel Borislow, filed with the SEC on November 12, 2013 as Exhibit 10.1 to the Company's Current Report on Form 8-K and incorporated herein by reference.

10.22 Letter of Intent, dated November 5, 2013, between magicJack VocalTec Ltd. and Daniel Borislow, filed with the SEC on November 12, 2013 as Exhibit 10.2 to the Company's Current Report on Form 8-K and incorporated herein by reference.

10.23 Private Placement Agreement, dated as of November 5, 2013, between magicJack Vocaltec Ltd. and Trustee of the DB April 2013 GRAT, filed with the SEC on November 12, 2013 as Exhibit 10.3 to the Company's Current Report on Form 8-K and incorporated herein by reference.

10.24 Private Placement Agreement, dated as of November 5, 2013, between magicJack Vocaltec Ltd. and Trustee of the DMB 2012 Family Trust, filed with the SEC on November 12, 2013 as Exhibit 10.4 to the Company's Current Report on Form 8-K and incorporated herein by reference.

10.25 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.

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

* Management contract or compensatory plan or arrangement.

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/ Gerald Vento	/s/ Jose Gordo
Gerald Vento President and Chief Executive Officer Date: March 12, 2014	Jose Gordo Chief Financial Officer Date: March 12, 2014

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/ Gerald Vento Gerald Vento	President & Chief Executive Officer and Director (principal executive officer)	March 12, 2014
/s/ Jose Gordo Jose Gordo	Chief Financial Officer (principal financial officer and principal accounting officer)	March 12, 2014
/s/ Donald A. Burns Donald A. Burns	Director	March 12, 2014
/s/ Yuen Wah Sing Dr. Yuen Wah Sing	Director	March 12, 2014
/s/ Tal Yaron-Eldar Tal Yaron-Eldar	Director	March 12, 2014
/s/ Yoseph Dauber Yoseph Dauber	Director	March 12, 2014
/s/ Richard Harris Richard Harris	Director	March 12, 2014