

MAGICJACK VOCALTEC LTD  
Form 10-K  
March 15, 2012

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-K

(MARK ONE)

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

For the fiscal year ended December 31, 2011

OR

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

For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-27648

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

STATE OF ISRAEL  
(State or Other Jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

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

(561) 771-2255  
(Registrant's telephone number, including area code)

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

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

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

NONE

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

Yes ☐ No ☒

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

Yes ☐ No ☒

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

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ☐ No ☐

---

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

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

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

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The aggregate market value of the ordinary shares held by non-affiliates of the registrant computed by reference to the price of the registrant's Ordinary Shares as of the last business day of the registrant's most recently completed second fiscal quarter (based on the last reported sale price on The Nasdaq Global Stock Market as of such date) was \$188,143,053.

The number of the registrant's ordinary shares outstanding as of February 29, 2012 was 21,018,254 shares, no par value.

#### DOCUMENTS INCORPORATED BY REFERENCE

Not applicable.

## TABLE OF CONTENTS

### PART I:

<u>ITEM 1. BUSINESS</u>	3
<u>ITEM</u>	
<u>1A. RISK FACTORS</u>	11
<u>ITEM</u>	
<u>1B. UNRESOLVED STAFF COMMENTS</u>	28
<u>ITEM 2. PROPERTIES</u>	28
<u>ITEM 3. LEGAL PROCEEDINGS</u>	28
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	29

### PART II:

<u>MARKET OF REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER</u>	
<u>ITEM 5. MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	29
<u>ITEM 6. SELECTED FINANCIAL DATA</u>	32
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND</u>	
<u>ITEM 7. RESULTS OF OPERATIONS</u>	34
<u>ITEM</u>	
<u>7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	46
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	48
<u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING</u>	
<u>ITEM 9. AND FINANCIAL DISCLOSURE</u>	82
<u>ITEM</u>	
<u>9A. CONTROLS AND PROCEDURES</u>	82
<u>ITEM</u>	
<u>9B. OTHER INFORMATION</u>	84

### PART III:

<u>ITEM</u>	
<u>10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	84
<u>ITEM</u>	
<u>11. EXECUTIVE COMPENSATION</u>	87
<u>ITEM</u>	
<u>12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT</u>	92
<u>AND RELATED STOCKHOLDER MATTERS</u>	93

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

ITEM

14. PRINCIPAL ACCOUNTING FEES AND SERVICES

94

PART IV:

ITEM

15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

95

SIGNATURES

96

---

## DEFINITIONS

In this annual report on Form 10-K, unless the context otherwise requires:

- references to “magicJack VocalTec,” the “Company,” “we,” “us” or “our” are to magicJack VocalTec Ltd., a company organized under the laws of the State of Israel (the “Registrant”), and its wholly-owned subsidiaries;
- references to “ordinary shares”, “our shares” and similar expressions refer to the Registrant’s Ordinary Shares, no par value;
- references to “\$” or “dollars” are to U.S. dollars and all references to “NIS” are to New Israeli Shekels. Except as otherwise indicated, financial statements of, and information regarding, magicJack VocalTec are presented in U.S. dollars;
- references to the “Companies Law” are to Israel’s Companies Law, 5759-1999, as currently amended;
- references to the “Exchange Act” are to the Securities Exchange Act of 1934, as amended;
- references to “NASDAQ” are to the NASDAQ Global Stock Market; and
- references to the “SEC” are to the United States Securities and Exchange Commission.

## USE OF TRADEMARKS

VocalTec, MAGICJACK, MAGICJACK & Design, MAGICJACK PLUS, MAGICJACK APP, MAGICJACK PC, MAGICIN, MAGICOUT, MAGICFIX, MAGIFIX & Design, MAGICPHONE, and MAGICPAGE are trademarks of magicJack LP. Trademark applications for the MAGICJACK mark are pending in certain foreign countries, including Mexico and Peru. Trademark applications for the MAGICJACK & Design mark are pending in Mexico. Applications for the MAGICJACK APP, MAGICJACK PC and MAGICJACK PLUS marks are pending in Canada. Outside the United States, trademark registrations for the MAGICJACK mark have been obtained in Canada, China, the European Union, El Salvador, and Mexico, for the MAGICJACK & Design mark in Canada and Mexico. These trademarks are important to our business. Although we have omitted the “®” and “tm” trademark designations for such trademarks in this annual report, all rights to such trademarks are nevertheless reserved.

## SHARE AND PER SHARE INFORMATION

All share and per share information in this annual report on Form 10-K has been adjusted for the 1-for-10 reverse stock split effected in connection with the merger of VocalTec Communications Ltd. and YMax Corporation in July, 2010, as well as a 2-for-1 stock split paid in the form of a 100 percent share dividend effective December 16, 2011, described in Note 15, “Ordinary Shares,” in the Notes to our Consolidated Financial Statements included in Item 8 herein.

## PART I

THIS ANNUAL REPORT ON FORM 10-K CONTAINS HISTORICAL INFORMATION AND FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE SET FORTH IN THESE FORWARD-LOOKING STATEMENTS. THE WORDS “ANTICIPATE,” “BELIEVE,” “ESTIMATE,” “EXPECT,”

“INTEND,” “MAY,” “PLAN,” “PROJECT,” “SHOULD” AND SIMILAR EXPRESSIONS, AS THEY RELATE TO MAGICJACK VOCALTEC OR ITS MANAGEMENT, ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. SUCH STATEMENTS REFLECT THE CURRENT VIEWS AND ASSUMPTIONS OF MAGICJACK VOCALTEC WITH RESPECT TO FUTURE EVENTS AND ARE SUBJECT TO RISKS AND UNCERTAINTIES. MANY FACTORS COULD CAUSE THE ACTUAL RESULTS, PERFORMANCE OR ACHIEVEMENTS TO BE MATERIALLY DIFFERENT FROM ANY FUTURE RESULTS, PERFORMANCE OR ACHIEVEMENTS THAT MAY BE EXPRESSED OR IMPLIED BY SUCH FORWARD-LOOKING STATEMENTS, BOTH REFERENCED AND NOT REFERENCED IN THIS ANNUAL REPORT. SUCH FACTORS INCLUDE, BUT ARE NOT LIMITED TO: THE COMPETITION WE FACE; OUR RELIANCE ON THE MAGICJACK PRODUCT AND RELATED SOFTWARE LICENSE FOR A SUBSTANTIAL PORTION OF OUR REVENUES; OUR ABILITY TO ATTRACT NEW CUSTOMERS AND RETAIN CURRENT CUSTOMERS; OUR ABILITY TO OBTAIN ENOUGH PHONE NUMBERS TO MEET OUR CUSTOMERS’ DEMANDS; OUR ABILITY TO SUCCESSFULLY PROTECT OUR PROPRIETARY RIGHTS OR DEFEND OURSELVES AGAINST CLAIMS OF INFRINGEMENT; OUR ABILITY TO DEVELOP AND DEPLOY NEW PRODUCTS; ABILITY TO COMPLY WITH DOMESTIC AND INTERNATIONAL REGULATIONS AND STANDARDS; THE ABILITY TO ANTICIPATE DEMAND FOR OUR PRODUCTS; DIFFERENCES BETWEEN OUR SERVICES AND TRADITIONAL PHONE SERVICES, INCLUDING 911 SERVICE; OUR ABILITY TO ADAPT TO RAPID CHANGES IN THE MARKET FOR VOICE SERVICES; OUR DEPENDENCE ON KEY SWITCHING ELEMENTS FROM COMPETITORS; UNCERTAINTIES RELATING TO REGULATION OF VOICE-OVER-INTERNET-PROTOCOL SERVICES; SERVER OR SYSTEM FAILURES THAT COULD AFFECT THE QUALITY OR DISRUPT THE SERVICES WE PROVIDE AND OUR ABILITY TO MAINTAIN DATA SECURITY.

CERTAIN FACTORS THAT MIGHT CAUSE SUCH ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE SET FORTH IN THESE FORWARD LOOKING STATEMENTS ARE INCLUDED AND FULLY DESCRIBED IN PART I, ITEM 1A, “RISK FACTORS.” SHOULD ONE OR MORE OF THESE RISKS OR UNCERTAINTIES MATERIALIZE, OR SHOULD UNDERLYING ASSUMPTIONS PROVE INCORRECT, ACTUAL RESULTS MAY VARY MATERIALLY FROM THOSE DESCRIBED HEREIN AS ANTICIPATED, BELIEVED, ESTIMATED, EXPECTED, INTENDED, PLANNED OR PROJECTED. MAGICJACK VOCALTEC DOES NOT INTEND OR ASSUME ANY OBLIGATION TO UPDATE THESE FORWARD-LOOKING STATEMENTS. ANY FORWARD-LOOKING STATEMENTS IN THIS ANNUAL REPORT ON FORM 10-K ARE MADE AS OF THE DATE HEREOF, AND WE UNDERTAKE NO OBLIGATION TO PUBLICLY UPDATE OR REVISE ANY FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE, EXCEPT AS REQUIRED BY LAW.

ITEM 1. BUSINESS

Merger

On July 16, 2010, VocalTec Communications Ltd. (“VocalTec”), an Israeli public company listed on NASDAQ, entered into and consummated a Merger Agreement (the “Merger Agreement”) with YMax Corporation (“YMax”, and together with VocalTec, the “Combined Company”). Under the terms of the Merger Agreement, each share of YMax common stock outstanding immediately prior to the consummation of the 2010 business combination was cancelled. YMax shareholders received 21,125,790 shares of VocalTec in total, representing in the aggregate approximately 90% of the outstanding shares of the Combined Company after the transaction. As a result, this transaction was accounted for as a reverse acquisition and YMax was the accounting acquirer. VocalTec became the continuing legal entity and parent, and YMax became a wholly owned subsidiary of VocalTec. At the April 28, 2011 shareholder meeting, the shareholders approved a change in the company’s name to magicJack VocalTec Ltd. (which including its subsidiaries, is also referred to as the “Company,” “We,” or “magicJack VocalTec”). The Company’s name changed following approval of the new name by the Israeli Registrar of Companies on May 15, 2011.

Business Overview

magicJack VocalTec is a cloud communications leader that is the inventor of voice-over-Internet-Protocol (“VoIP”), the softphone (“magicJack PC”) and the award winning magicJack products. 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. We charge as little as \$20 a year for a license renewal to access our servers, and our customers then continue to obtain free telephone services. During September 2011, we began providing additional products and services, which include voice apps on smart phones, as well as the magicJack PLUSTM, which is a standalone magicJack that has its own CPU and can connect a regular phone directly to the user’s broadband modem/router and function as a standalone phone without using a computer. Our products and services allow users to make and 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.

Following the 2010 business combination, magicJack VocalTec is a vertically integrated group of companies. We now own a micro processor chip design company, an appserver and session border controller company, a wholesale provider of VoIP services, a softphone company, and the developer and provider of the magicJack product line. We intend to soon expand these existing platforms to allow its customers to use search, shopping, click-to-call and other services via the Internet through intellectual property pending and proprietary technologies. We are now also wholesaling telephone service to VoIP providers and others telecommunication carriers.

During September 2011, we began promoting the magicJack PC, a softphone that can be used to make or receive telephone calls between two computers or between the customer’s computer and a public switch telephone network (“PSTN”). The customer can use a headphone or a computer’s speakers and microphone to make and receive telephone calls. In September 2011, the magicJack APPTM also became available for the iPhone, iPad and iPod Touch. It will be available for Android smart phones in the second quarter of 2012.



The magicJack PLUS' core technology and device is expected to have a long life as we are able to add Wi-Fi and 4G connection capabilities, as well as other functions by adding capabilities to the magicJack PLUS or developing very small modules that can connect to the magicJack PLUS in a daisy chain format. In the future, these other modules and the magicJack PLUS are expected to provide telephone service, video on demand and ISP along with the other features, hence Triple Play plus capabilities, in a device weighing just a few ounces. This can be accomplished in a number of ways and we plan to develop the most cost effective and highest quality alternatives for our customers. We intend to partner with a wireless 4G provider to be able to offer Triple Play services.

Our corporate name is magicJack VocalTec Ltd. for both legal and commercial purposes. We are located at 12 Benny Gaon Street, Building 2B, Poleg Industrial Area, Netanya, Israel 42504 (telephone number +972-9-970-3888). We were organized under the laws of the State of Israel in 1989 and are subject to the Israeli Companies Law, or the Companies Law. Our subsidiary, YMax, whose offices are at 5700 Georgia Avenue, West Palm Beach, Florida, 33405 (telephone number 561-771-2255) is our U.S. agent for service.

## Product and Service Offerings

### magicJack and magicJack PLUS

The magicJack and magicJack PLUS are VoIP devices weighing about one ounce and include an initial 12-month license period that enables customers to use our software to access our switches. Customers receive free VoIP phone service for their home, enterprise or while traveling. We started selling the magicJack in late 2007. In September 2011, we launched the magicJack PLUS, which contains a SoC (System on a Chip) that connects either to a computer USB like the original magicJack or directly to a broadband modem/router. Similar to the original magicJack, the magicJack PLUS also has a plug to which a regular phone can be connected. These features and capabilities allow users to replace their home or enterprise phone services with the magicJack PLUS, or simply use it as a second phone line.

### magicJack PC

The magicJack PC is a softphone that allows users to make and receive telephone calls through the computer using a headphone or the computer's speakers and microphone.

### magicJack APP

The magicJack APP is an application that allows users to make and receive telephone calls through their smart phones using their magicJack account. The magicJack APP is currently available for the iPhone, iPad and iPod Touch. It will be available for Android smart phones in the second quarter of 2012.

## License Renewals

Customers who own a magicJack, magicJack PLUS or magicJack service may purchase licenses for continued use of the software to access our switches for additional years. We offer users renewal service periods ranging from one to five years.

## Prepaid Minutes

Our customers can purchase minutes on a prepaid basis, including international minutes, through their magicJack accounts, and make domestic and international calls using their magicJack, magicJack PLUS, magicJack PC or magicJack APP.

#### Other magicJack-Related Products

We offer customers other products related to their magicJack devices and services, such as insurance, custom or vanity phone numbers, Canadian phone numbers, and the ability to port their existing phone numbers to a magicJack device.

#### Termination and Access Charges

We generate revenues from access and terminations fees charged to other carriers, as well as wholesaling telephone service to VoIP providers and others telecommunication carriers.

#### Telecommunication Hardware, Software and Services

We sell telecommunications hardware, proprietary software and service agreements to telecommunication carriers. Service agreements include maintenance, technical support, training and upgrades.

## Other Business Acquisitions

In November 2010, the Company acquired Predictive Marketing, LLC and B Kruse and Associates, LLC (collectively, “Dialmaxx”), which developed technology used in providing predictive calling services.

In January 2009, the Company acquired the tradename, technology, equipment, and assumed trade accounts and other payables of the telecommunications division of Stratus Technologies Bermuda Ltd., which developed and built the software the Company uses to maintain its servers and switches. As a result of this acquisition, the Company gained control of certain maintenance and technology related to its switches and software.

In June 2008, the Company acquired all of the outstanding capital stock of Tiger Jet Network, Inc. (“TigerJet”), a company that provides chip development for the magicJack® and other pending products, from the TigerJet stockholders. By acquiring TigerJet, the Company gained control of certain production and technology related to the magicJack. The Company was TigerJet’s primary customer in 2008. Subsequent to the closing of the acquisition, sales to TigerJet’s other customers have been immaterial.

In February 2007, the Company entered into an agreement, which was finalized in March 2007, to acquire all of the outstanding capital stock of SJ Labs, Inc. (“SJ Labs”), a telecommunications software company that developed our softphone platform and continues to develop other VoIP technology. The acquisition allowed us to acquire exclusive rights to the technology and insure exclusive access to SJ Labs’ computer programmers.

## Sources of Revenues

We generate revenues from the following sources: (i) the sales of the magicJack and magicJack PLUS to retailers, wholesalers or directly to customers, (ii) license renewal fees, (iii) fees charged for shipping the magicJack and magicJack PLUS to customers, (iv) sale of magicJack-related products, such as Canadian, vanity or custom phone numbers, among others, (v) sale of prepaid minutes, (vi) access and terminations fees charged to other carriers and wholesale of access to our telecommunication servers, and (vii) and sales of telecommunications hardware, software and related services. The following table presents a breakdown of our operating revenues the periods indicated (in thousands).

	Year Ended December 31,		
	2011	2010	2009
Operating Revenue			
Sale of magicJack and magicJack PLUS	\$ 44,552	\$ 65,025	\$ 80,046
License renewals	36,546	21,598	5,390
Shipping and handling	2,158	3,555	10,733
magicJack-related products	4,596	2,586	452
Prepaid minutes	11,634	10,542	6,584
Access and termination charges	3,607	8,993	7,967
Other	7,357	7,379	5,640
Total Operating Revenue	\$ 110,450	\$ 119,678	\$ 116,812

## Research and Development

The Company’s research and development activities consist primarily of the design and development of its proprietary software used in the magicJack, magicJack PLUS, magicJack APP and its switches, as well as the development of new products and applications for use in its broadband service offerings. Research and development expenses were

\$2.7 million, \$4.0 million and \$5.5 million for the years ended December 31, 2011, 2010 and 2009, respectively. We account for research and development costs in accordance with applicable accounting pronouncements describe in Note 3, "Summary of Accounting Policies," in the Notes to our Consolidated Financial Statements included in Item 8 herein for further details.

#### Markets Where We Compete

The primary markets in which we currently compete are in North America. Over 90% of all of the Company's revenues in 2011 and 2010, and 100% of the Company's revenues in 2009, were derived from sales to customers located in the United States. Approximately 90% of our property and equipment, net of depreciation, is located in the United States.

The majority of our revenues were generated from sales of the magicJack product line and from the software license that accompanies these products, which were \$87.9 million, \$92.8 million and \$96.6 million for the years ended December 31, 2011, 2010 and 2009, respectively. We also provide our customers the ability to make domestic and international calls using the magicJack, magicJack PLUS and magicJack APP by purchasing prepaid minutes. Revenues generated from the usage of prepaid minutes were \$11.6 million, \$10.5 million and \$6.6 million for the years ended December 31, 2011, 2010 and 2009, respectively.

#### Business Seasonality

Our revenues are not subject to seasonal fluctuations.

#### Manufacturing

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

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

#### Marketing, Sales and Distribution

We rely on various marketing methods to advertise our products, including Internet marketing and long and short form television commercials. We currently distribute the magicJack through retail outlets, including Walmart, Radio Shack, Best Buy, Office Depot, Staples, Walgreens, CVS, Fry's and others, as well as through direct sales.

In the years ended December 31, 2011, 2010 and 2009, sales of the magicJack and magicJack PLUS units through retail outlets represented approximately 57%, 73% and 65%, respectively, of sales of all magicJack and magicJack PLUS units sold. For the same periods, direct sales represented approximately 43%, 27% and 35%, respectively, of magicJack and magicJack PLUS units sold.

For year ended December 31, 2011, no retailer accounted for more than 10% of the Company's total operating revenues. For the years ended December 31, 2010 and 2009, one retailer, RadioShack, accounted for approximately 11% of the Company's total operating revenues.

#### Competition

We face competition from traditional telephone companies, wireless companies, cable companies and alternative voice communication providers. Some of our principal competitors are the traditional telephone service providers, such as AT&T, Inc., CenturyLink, Inc. and Verizon Communications Inc., which provide telephone service based on the public switched telephone network. Some of these traditional providers also have added or are planning to add broadband telephone services to their existing telephone and broadband offerings. We also face, or expect to face,

competition from cable companies, such as Cablevision Systems Corp., Charter Communications, Inc., Comcast Corporation, Cox Communications, Inc. and Time Warner Cable (a division of Time Warner Inc.), which have added or are planning to add broadband telephone services to their existing cable television, voice and broadband offerings. Further, wireless providers, including AT&T Mobility, Sprint Nextel Corporation, T-Mobile USA Inc., Verizon Wireless and Clearwire, offer services that some customers may prefer over wireline service. In the future, as wireless companies offer more minutes at lower prices, their services may become more attractive to customers as a replacement for wireline service. Some of these providers may be developing a dual mode phone that will be able to use broadband telephone service where broadband access is available and cellular phone service elsewhere, which will pose additional competition to our offerings.

We also compete against established alternative voice communication providers, such as Skype, which is a non-interconnected VoIP provider, and Vonage, and may face competition from other large, well-capitalized Internet companies, such as America Online, Inc., Google Inc., Microsoft Corporation, and Yahoo! Inc. In addition, we will compete with independent broadband telephone service providers.

Because most of our target customers are already purchasing communications services from one or more of these providers, success is dependent upon our ability to attract target customers away from their existing providers. We compete primarily through the quality and cost structure of our infrastructure and our low pricing.

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

### Our Competitive Positioning

We believe that the key competitive factors in our market include:

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

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

### Intellectual Property

We believe that the improvement of existing products, our technologies and the development of new products are important in establishing and maintaining a competitive advantage. We believe that the value of our products is dependent, to a certain extent, upon the maintenance of intellectual property rights, the license rights to use certain intellectual property rights, trade secrets or copyright protection of our proprietary software and technologies. We rely on a combination of trade secrets, copyright, trademark and patent law, together with non-disclosure and invention assignment agreements, to establish and protect the technology used in our products.

magicJack VocalTec and its wholly-owned subsidiaries have filed numerous intellectual property right applications in the United States and other countries with respect to certain technologies employed and to be employed in its products. Some of those applications have already been issued and VocalTec has the rights to use these registered intellectual property rights either under a non-exclusive license, or by owning these intellectual property rights. VocalTec received more than 20 intellectual property rights.

Our registered trademarks include VocalTec, MAGICJACK, MAGICJACK & Design, MAGICIN, MAGICOUT, MAGIC FIX, MAGICFIX & Design in the United States, trademark applications are pending for MAGICJACK PLUS, MAGICJACK APP, MAGICJACK PC, MAGICPHONE, and MAGICPAGE. Trademark applications for the MAGICJACK mark are pending in certain foreign countries, including Mexico and Peru. Trademark applications for the MAGICJACK & Design mark are pending in Mexico. Applications for the MAGICJACK APP, MAGICJACK PC, and MAGICJACK PLUS marks are pending in Canada. Outside the United States, trademark registrations for the MAGICJACK mark have been obtained in Canada, China, the European Union, El Salvador, and Mexico. All other trademarks or registered trademarks used in this Annual Report on Form 10-K are the property of their respective owners.

We rely on a combination of intellectual property rights, copyright, trademark and trade secret laws, as well as confidentiality agreements, to establish and protect our intellectual property worldwide. We have filed numerous foreign and domestic intellectual property right applications directed to our magicJack device with E911 capability,

emergency call routing, emergency call location determination, and related technologies. At present, we have seven pending utility intellectual property rights applications in the United States, nineteen pending foreign intellectual property rights applications, one issued foreign intellectual property rights, and one pending international intellectual property right application awaiting nationalization, directed to such technologies. We are also actively researching new technologies and improvements to our existing technologies and intend to pursue intellectual property right protection for these technologies to the extent permissible by law and prudent for our business. Currently, and if and when intellectual property rights are issued from our pending applications, those intellectual property rights will expire between February 2026 and May 2030. Two design intellectual property rights have also been issued by the United States Patent and Trademark Office. Many of our software and communication solutions have been developed internally and are proprietary.

Although we do not believe that our products infringe on any valid claim of a intellectual property rights owned by any third party, third parties have asserted infringement and other claims against us from time to time. These claims have been directed at certain basic and fundamental components of our products. There can be no assurance that third parties will not assert such claims against us in the future or that such claims will not be successful. Refer to Note 13, “Commitments and Contingencies,” in the Notes to our Conso