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

# FORM 10-K

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

For the fiscal year ended December 31, 2022:

Or

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

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

| Nevada | 001-32277 | 87-0591719 |
|---|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (Commission File Number) | (I.R.S. Employer Identification No.) |

**1615 South 52nd Street, Tempe, AZ 85281**
(Address of Principal Executive Office) (Zip Code)

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

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

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, par value $0.001 per share | The Nasdaq Stock Market |

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

Indicate by check mark if 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 Exchange 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, a smaller reporting company, or an emerging growth company.

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

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

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of December 31, 2022 was approximately $24,250,036.

The number of shares of the registrant's common stock outstanding as of February 28, 2023 was 25,697,115.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Registrant's 2023 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

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## PART I

Throughout this Annual Report, we refer to Crexendo, Inc., together with its subsidiaries, as “we,” “us,” “our Company,” “Crexendo®” or “the Company.” As used in this Annual Report, “Ride The Cloud™” is a registered trademark of our Company in the United States and other countries. All other product names are or may be trademarks of, and are used to identify the products and services of, their respective owners.

THIS ANNUAL REPORT ON FORM 10-K CONTAINS FORWARD-LOOKING STATEMENTS. THESE STATEMENTS RELATE TO FUTURE EVENTS OR OUR FUTURE FINANCIAL PERFORMANCE. IN SOME CASES, YOU CAN IDENTIFY FORWARD-LOOKING STATEMENTS BY TERMINOLOGY SUCH AS “MAY,” “WILL,” “SHOULD,” “EXPECT,” “PLAN,” “INTEND,” “ANTICIPATE,” “BELIEVE,” “ESTIMATE,” “PROJECT,” “PREDICT,” “POTENTIAL” OR “CONTINUE” (INCLUDING THE NEGATIVE OF SUCH TERMS), OR OTHER SIMILAR TERMINOLOGY. THESE STATEMENTS ARE ONLY ESTIMATIONS, AND ARE BASED UPON VARIOUS ASSUMPTIONS THAT MAY NOT BE REALIZED. ACTUAL EVENTS OR RESULTS MAY DIFFER MATERIALLY. IN EVALUATING THESE STATEMENTS, YOU SHOULD SPECIFICALLY CONSIDER VARIOUS FACTORS, INCLUDING, BUT NOT LIMITED TO, THE RISKS OUTLINED BELOW UNDER ITEM 1A. THESE FACTORS MAY CAUSE OUR ACTUAL RESULTS TO DIFFER MATERIALLY FROM ANY FORWARD-LOOKING STATEMENT.

ALTHOUGH WE BELIEVE THAT THE ESTIMATIONS REFLECTED IN THE FORWARD-LOOKING STATEMENTS ARE REASONABLE, WE CANNOT GUARANTEE FUTURE RESULTS, LEVELS OF ACTIVITY, PERFORMANCE OR ACHIEVEMENTS. MOREOVER, NEITHER WE NOR ANY OTHER PERSON ASSUMES RESPONSIBILITY FOR THE ACCURACY AND COMPLETENESS OF THE FORWARD-LOOKING STATEMENTS. WE DO NOT INTEND TO UPDATE ANY OF THE FORWARD-LOOKING STATEMENTS AFTER THE DATE OF THIS ANNUAL REPORT TO CONFORM SUCH STATEMENTS TO ACTUAL RESULTS OR TO CHANGES IN OUR EXPECTATIONS, UNLESS REQUIRED BY LAW.

### ITEM 1. BUSINESS

### OVERVIEW

Crexendo, Inc. is an award-winning premier provider of cloud communication platform and services, video collaboration and managed IT services designed to provide enterprise-class cloud solutions to any size business. Our solutions currently support over three million end users globally. By providing a variety of comprehensive and scalable solutions, we are able to cater to businesses of all sizes on a monthly subscription basis without the need for expensive capital investments, regardless of where their business is in its lifecycle. Our products and services can be categorized in the following offerings:

*Cloud Telecommunications Services* – Our cloud telecommunications services transmit calls using IP or cloud technology, which converts voice signals into digital data packets for transmission over the Internet or cloud. Each of our calling plans provides a number of basic features typically offered by traditional telephone service providers, plus a wide range of enhanced features that we believe offer an attractive value proposition to our customers. This platform enables a user, via a single “identity” or telephone number, to access and utilize services and features regardless of how the user is connected to the Internet or cloud, whether it’s from a desktop device or an application on a mobile device.

We generate recurring revenue from our cloud telecommunications services, broadband Internet services, managed IT services, software license sales, and infrastructure as a service. Our cloud telecommunications contracts typically have a thirty-six to sixty month term. We may also charge activation and flash fees and the Company generally allocates a portion of the activation fees to the desktop devices, which is recognized at the time of the installation or customer acceptance, and a portion to the service, which is recognized over the contract term using the straight-line method. We also charge other various contracted and non-contracted fees.

We generate product revenue, equipment financing revenue, and device as a service revenue from the sale and lease of our cloud telecommunications equipment. Revenues from the sale of equipment, including those from sales-type leases, are recognized at the time of sale or at the inception of the lease, as appropriate.

*Software Solutions* – Our software solutions segment derives revenues from three primary sources: software licenses, software maintenance support and professional services. Software and services may be sold separately or in bundled packages. Generally, contracts with customers contain multiple performance obligations, consisting of software and services. For bundled packages, the Company accounts for individual products and services separately if they are distinct – i.e. if a product or service is separately identifiable from other items in the bundled package and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The consideration is allocated between separate products and services in a bundle based on their relative stand-alone selling prices. The stand-alone selling prices are determined based on the prices at which the Company separately sells the software licenses and professional services. For items that are not sold separately (e.g. additional features) the Company estimates stand-alone selling prices using the adjusted market assessment approach. When we provide a free trial period, we do not begin to recognize recurring revenue until the trial period has ended and the customer has been billed for the services.

We generate software license revenue from the sale of perpetual software licenses, term-based software licenses that expire, and Software-as-a-Service ("SaaS") based software which are referred to as subscription arrangements. The Company does not recognize software revenue related to the renewal of subscription software licenses earlier than the beginning of the subscription period.

We generate subscription and maintenance support revenue from customer support and other supportive services. The Company offers warranties on its products. The warranty period for our licensed software is generally 90 days. Certain of the Company's warranties are considered to be assurance-type in nature and do not cover anything beyond ensuring that the product is functioning as intended. Based on the guidance in ASC 606, assurance-type warranties do not represent separate performance obligations. The Company also sells separately-priced maintenance service contracts, which qualify as service-type warranties and represent separate performance obligations. The Company does not typically allow and has no history of accepting material product returns. Customer support includes software updates on a when-and-if-available basis, telephone support, integrated web-based support and bug fixes or patches. Subscription and maintenance support revenue is recognized ratably over the term of the customer support agreement, which is typically one year.

We generate professional services and other revenue from consulting, technical support, resident engineer services, design services and installation services. Revenue for professional services and other is recognized when the performance obligation is complete and the customer has accepted the performance obligation.

**OUR SERVICES AND PRODUCTS**

Our solutions currently support over three million end users globally and was recently recognized as the fastest growing UCaaS platform in the United States. By providing a variety of comprehensive and scalable solutions, we are able to cater to businesses of all sizes on a monthly subscription basis without the need for expensive capital investments, regardless of where their business is in its lifecycle. Our products and services can be categorized in the following offerings:

**Cloud Telecommunications Services** – Our cloud telecommunications service offering includes hardware, software, and unified ng IP or cloud technology over any high-speed Internet connection. These services are rendered through a variety of devices and communication solutions for businesses using user interfaces such as a Crexendo branded desktop phones and/or mobile and desktop applications. Some examples of mobile devices are Android cell phones, iPhones, iPads or Android tablets. These services enable our customers to seamlessly communicate with others through phone calls that originate/terminate on our network or PSTN networks. Our cloud telecommunications services are powered by our proprietary implementation of standards based Web and VoIP cloud technologies. Our services use our highly scalable complex infrastructure that we build and manage based on industry standard best practices to achieve greater efficiencies, better quality of service (QoS) and customer satisfaction. Our infrastructure comprises of compute, storage, network technologies, 3rd party products and vendor relationships. We also develop end user portals for account management, license management, billing and customer support and adopt other cloud technologies through our partnerships.

Crexendo's cloud telecommunication service offers a wide variety of essential and advanced features for businesses of all sizes. Many of these features included in the service offering are:

- Business Productivity Features such as dial-by extension and name, transfer, conference, call recording, Unlimited calling to anywhere in the US and Canada, International calling, Toll free (Inbound and Outbound)
- Individual Productivity Features such as Caller ID, Call Waiting, Last Call Return, Call Recording, Music/Message-On-Hold, Voicemail, Unified Messaging, Hot-Desking

- Group Productivity Features such as Call Park, Call Pickup, Interactive Voice Response (IVR), Individual and Universal Paging, Corporate Directory, Multi-Party Conferencing, Group Mailboxes, Web and mobile devices based collaboration applications
- Call Center Features such as Automated Call Distribution (ACD), Call Monitor, Whisper and Barge, Automatic Call Recording, One way call recording, Analytics
- Advanced Unified Communication Features such as Find-Me-Follow-Me, Sequential Ring and Simultaneous Ring, Voicemail transcription
- Mobile Features such as extension dialing, transfer and conference and seamless hand-off from WiFi to/from 3G and 4G, LTE, as well as other data services. These features are also available on CrexMo, an intelligent mobile application for iPhones and Android smartphones, as well as iPads and Android tablets
- Traditional PBX Features such as Busy Lamp Fields, System Hold. 16-48 Port density Analog Devices
- Expanded Desktop Device Selection such as Entry Level Phone, Executive Desktop, DECT Phone for roaming users
- Advanced Faxing solution such as Cloud Fax (cFax) allowing customers to send and receive Faxes from their Email Clients, Mobile Phones and Desktops without having to use a Fax Machine simply by attaching a file
- Web based online portal to administer, manage and provision the system.
- Asynchronous communication tools like SMS/MMS, chat and document sharing to keep in pace with emerging communication trends.

Many of these services are included in our basic offering to our customers for a monthly recurring fee and do not require a capital expense. Some of the advanced features such as Automatic Call Recording and Call Center Features require additional monthly fees. Crexendo continues to invest and develop its technology and CPaaS offerings to make them more competitive and profitable.

**Software Solutions** – Our software solutions offering provides a comprehensive suite of unified communications (UC), video conferencing, collaboration & contact center solutions to over 215 service providers, servicing over three million users around the globe. Our platform enables service providers to customize packages with unprecedented levels of flexibility, profitability, and ease of use.

Our software solutions offering are as follows:

- *SNAPsolution®* - a comprehensive, IP-based platform that provides a broad suite of UC services including hosted Private Branch Exchange (PBX), auto-attendant, call center, conferencing, and mobility. The platform includes a broad range of feature-sets, custom-built to provide unprecedented levels of flexibility, making the solution competitive with the market's leading players. SNAPsolution includes a full suite of Voice over Internet Protocol (VoIP)/UC features with one low cost universal license, as opposed to pricing each feature individually. The Company licenses its platform based on concurrent sessions, not per seat/per feature. This allows service providers to oversubscribe their networks, driving down the cost per seat as volume increases. As the service provider increases their customer base, they only have to ensure they have sufficient concurrent call licenses to support users across the network.
- *SNAPaccel* – a Software-as-a-Service ("SaaS") based software license referred to as subscription arrangements.
- *Subscription Maintenance and Support* - The Company also sells separately-priced maintenance service contracts, which qualify as service-type warranties and represent separate performance obligations and customer support. Customer support includes software updates on a when-and-if-available basis, telephone support, integrated web-based support and bug fixes or patches.
- *Professional Services and Other* - The Company's professional services include consulting, technical support, resident engineer services, design services and installation services.

**SEGMENT INFORMATION**

The Company has two operating segments, which consist of cloud telecommunications services and software solutions. The information below is organized in accordance with our two reportable segments. Segment operating income is equal to segment net revenue less segment cost of service revenue, cost of product revenue, sales and marketing, research and development, and general and administrative expenses. Segment revenue and income/(loss) before income tax benefit/(provision) was as follows (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Revenue: | | |
| Cloud telecommunications services | $ 22,406 | $ 19,426 |
| Software solutions | 15,148 | 8,666 |
| Consolidated revenue | $ 37,554 | $ 28,092 |

| | Year Ended December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Loss before income tax benefit: | | |
| Cloud telecommunications services | $ (3,948) | $ (2,713) |
| Software solutions | (32,227) | (197) |
| Loss before income tax | $ (36,175) | $ (2,910) |

**TECHNOLOGY**

We believe our proprietary implementation of standard Web, IP, Cloud, Mobile and Internet technologies represent a key component of our business model. We believe these technologies and how we deliver them to our customers distinguish our services and products from the services and products offered by our competitors. Our technology infrastructure and virtual network operation center, all of which is built and managed on industry standard computers, storage, network, data and platforms offers us greater efficiencies while maintaining scalability and redundancy. The synergies between Web and Telecommunication protocols such as TCP/IP, HTTP, XML, SIP and innovations in computing, load balancing, redundancy and high availability of Web and Telecommunications technologies offers us a unique advantage in delivering these services to our customers seamlessly from our data center.

Our Cloud Telecommunications technology is continuously being enhanced with additional features and software functionality. Our current functionality includes:

- High-end desktop telephony devices such as Gigabit, PoE, 6 Line Color Phone with 10 programmable buttons and lower end Monochrome 2 Line wall mountable device.
- Basic Business Telephony Features such as those offered in a traditional PBX systems like extension dialing, Direct Inward Dialing (DID), Hold/Resume, Music-On-Hold, Call Transfer(Attended and Unattended), Conferencing, Local, Long Distance, Toll-Free and International Dialing, Voicemail, Auto-Attendant and traditional faxing.
- Advanced telephony features such as Call Park, Call Pickup, Paging (through the phones), Overhead paging, Call Recording.
- Call Center Functionality such as Agent Log In/Log Out, Whisper, Barge and Call center reporting.
- Unified Communications features like Simultaneous Ring, Sequential Ring, Status based Routing (Find-Me-Follow-Me), 10-party instant conference, and Mobile application (CrexMo).
- Crexendo Mobile Application (CrexMo), which allows users to place and receive extension calls using Crexendo's network, transfer and conference other users right from their mobile deviceas if they were in the office. It also provided users instant access to visual voicemail and call logs.
- End User Portal and Unified Messaging with Voicemail, Call Recording and eFax inbox.
- Collaboration products like group chat, SMS/MMS, document sharing, video and web conferencing.

Our Software Solutions technology includes a full suite of Voice over Internet Protocol (VoIP)/UC features with one low cost universal license, built out either in a client's own data centers, or on our Managed Infrastructure as a Service. Our current functionality includes:

- Carrier Grade with Geo-Redundant Reliability
- Scalability to support communications service providers of all sizes
- Video Conferencing and Collaboration
    - Webinars
    - Scheduling
    - Meeting Recordings
    - Content/Screen Sharing
    - Chat
- Multi Tenant Architecture to support multiple resellers, agents and retail clients
- Contact Center as a Service (CCaaS)
    - All-in-One Cloud Native Contact Center
    - Workforce Engagement
    - Call Recording
    - Employee Performance Management
    - Quality Assurance & Monitoring
    - Reporting, Analytics & Insights
- Unified Communications as a Service (UCaaS)
    - PBX functionality in the Cloud
    - Natively integrated with messaging, team collaboration, meetings and contact center
    - Unified mobile and device experience
    - Full integration with Microsoft Teams
    - HD Audio
    - Call Transcription
    - Sentiment Analysis
    - Customizable Emergency Notifications
    - E911 Dynamic Routing
    - Cradle to Grave Reporting
- Infrastructure as a Service
    - Eliminate CAPEX and startup costs
    - Slash time to market with immediacy of HW, resources, and expertise
    - Client's own SNAPsolution running in redundant Top-tier data centers both in the US and Europe
    - Public vs Private Network Separation
    - Multi-Layer Network Security
    - Access Control Tracking and Change Control Procedures
    - Offloads operations, upgrade and maintenance to Crexendo
    - Disaster recovery and business continuity
    - Operational flexibility with on-demand scaling
    - 4 "9"s service uptime reliability

**RESEARCH AND DEVELOPMENT**

We invested $3,955,000 and $1,396,000 for the years ended December 31, 2022 and 2021, respectively, in the research and development of our technologies and data centers. The majority of these expenditures were for enhancements to our cloud telecommunications products and services and continued development of our software solutions products.

## COMPETITION

The market for cloud business communications services is large and increasingly competitive. We expect competition to continue to increase in the future. Some of these competitors include:

- traditional on-premise, hardware business communications providers such as Alcatel-Lucent, Avaya Inc., Cisco Systems, Inc., Mitel, NEC, and Siemens Enterprise Networks, LLC, any of which may now or in the future also host their solutions through the cloud;
- software providers such as Microsoft Corporation (Microsoft Teams (formerly Skype for Business)) and BroadSoft, Inc. (acquired by Cisco Systems, Inc.) that generally license their software and may now or in the future also host their solutions through the cloud, and their resellers including major carriers and cable companies;
- established communications providers that resell on-premise hardware, software, and hosted solutions, such as AT&T, Verizon Communications Inc., CenturyLink, Cox, Charter and Comcast Corporation in the United States, TELUS and others in Canada, and BT, Vodafone, and others in the United Kingdom, all of whom have significantly greater resources than us and do now or may in the future also develop and/or host their own or other solutions through the cloud;
- other cloud companies such as 8x8, Inc., RingCentral, Inc., Amazon.com, Inc., DialPad, Inc., Fusion, Fuze (formerly Thinking Phone Networks), StarBlue (merger of Star2Star and BlueFace), Intermedia.net, Inc., J2 Global, Inc., Jive Communications, Inc. (acquired by LogMeIn, Inc.), Microsoft Corporation (Microsoft Teams (formerly Skype for Business)), Mitel, Nextiva, Inc., Slack Technologies, Inc., Vonage Holdings Corp., and West Corporation;
- other large internet companies such as Alphabet Inc., Facebook, Inc., Oracle Corporation, Zoom, and Salesforce.com, Inc., any of which might launch its own cloud-based business communication services or acquire other cloud-based business communications companies in the future; and
- established contact center providers such as Amazon.com, Inc., Aspect Software, Inc., Avaya Inc., Five9, Inc., Genesys Telecommunications Laboratories, Inc., and NewVoiceMedia.

The competitive landscape for our software solutions fall into two main categories, (1) other third party UCaaS platform vendors, such as Cisco, Mitel and Microsoft, and (2) third-party platforms hosted on service provider networks, e.g. 3CX, Ribbon, Avaya, NEC, Unify and Vodia.

Additionally, should we determine to pursue acquisition opportunities, we may compete with other companies with similar growth strategies. Some of these competitors may be larger and have greater financial resources than we do. Competition for these acquisition targets could also result in increased prices of acquisition targets and a diminished pool of companies available for acquisition.

There are relatively low barriers to entry into our business. Our proprietary technology does not preclude or inhibit competitors from entering our markets. In particular, we anticipate new entrants will attempt to develop competing products and services or new forums for conducting e-commerce and telecommunications services which could be deemed competition. Additionally, if telecommunications service providers with more resources and name recognition were to enter our markets, they may redefine our industry and make it difficult for us to compete.

Expected technology advances associated with the Cloud, increasing use of the Cloud, and new software products are welcome advancements that we believe will broaden the Cloud's viability. We anticipate that we can compete successfully by relying on our infrastructure, marketing strategies and techniques, systems and procedures, and by adding additional products and services in the future. We believe we can continue the operation of our business by periodic review and revision to our product offerings and marketing approach.

## INTELLECTUAL PROPERTY

Our success depends in part on using and protecting our proprietary technology and other intellectual property. Furthermore, we must conduct our operations without infringing on the proprietary rights of third parties. We also rely upon trade secrets and the know-how and expertise of our key employees. To protect our proprietary technology and other intellectual property, we rely on a combination of the protections provided by applicable copyright, trademark and trade secret laws, as well as confidentiality procedures and licensing arrangements. Although we believe we have taken appropriate steps to protect our intellectual property rights, including requiring employees and third parties who are granted access to our intellectual property to enter into confidentiality agreements, these measures may not be sufficient to protect our rights against third parties. Unauthorized parties may still copy or otherwise obtain and use our software and technology, despite our efforts to protect our trade secrets and proprietary rights through intellectual property rights, licenses and confidentiality agreements. Others may independently develop or otherwise acquire unpatented technologies or products similar or superior to ours.

We license from third parties certain software and Internet tools, which we include in our services and products. If any of these licenses were terminated, we could be required to seek licenses for similar software and Internet tools from other third parties or develop these tools internally. We may not be able to obtain such licenses or develop such tools in a timely fashion, on acceptable terms, or at all.

Companies participating in the software, Internet technology, and telecommunication industries are frequently involved in disputes relating to intellectual property. We may be required to defend our intellectual property rights against infringement, duplication, discovery and misappropriation by third parties or to defend against third-party claims of infringement. Likewise, disputes may arise in the future with respect to ownership of technology developed by employees who were previously employed by other companies. Any such litigation or disputes could be costly and divert our attention from our business. An adverse determination could subject us to significant liabilities to third parties, require us to seek licenses from, or pay royalties to, third parties, or require us to develop appropriate alternative technology. Some or all of these licenses may not be available to us on acceptable terms, or at all. In addition, we may be unable to develop alternate technology at an acceptable price, or at all. Any of these events could have a material adverse effect on our business prospects, financial position, or results of operations.

**EMPLOYEES**

As of December 31, 2022, we had 181 employees; 176 full-time and 5 part-time, including 10 executives, 45 sales representatives and sales management, 8 in marketing, 29 engineers and IT support, 73 in operations and customer support, 16 in accounting, finance, and legal.

**CORPORATE INFORMATION**

Crexendo, Inc. was incorporated as a Nevada corporation under the name "Netgateway, Inc." on April 13, 1995. In November 1999, we were reincorporated under the laws of Delaware. In July 2002, we changed our corporate name to "iMergent, Inc." In May 2011, our stockholders approved an amendment to our Certificate of Incorporation to change our name from "iMergent, Inc." to "Crexendo, Inc." The name change was effective May 18, 2011. Our ticker symbol "IIG" on the New York Stock Exchange was changed to "EXE" on May 18, 2011. On January 13, 2015, the Company moved to the OTCQX Marketplace and our ticker symbol was changed to "CXDO". In November 2016, we were reincorporated as a Nevada corporation. On July 8, 2020, the Company up listed to The Nasdaq Capital Market keeping our ticker symbol "CXDO".

Our principal executive offices are located at 1615 S. 52nd Street, Tempe, AZ 85281. The telephone number of our principal executive offices is (602) 714-8500, and our main corporate website is www.crexendo.com. Information contained on, or that can be accessed through, our website, does not constitute part of this Annual Report on Form 10-K and inclusion of our website address in this Annual Report on Form 10-K is an inactive textual reference only.

We make available our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended, free of charge on our website, www.crexendo.com/why-crexendo/sec-filings/ as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission, or the "SEC". In addition, the SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

The Company announces material information to the public about the Company, its products and services and other matters through a variety of means, including the Company's website (www.crexendo.com), the investor relations section of its website (www.crexendo.com/company/investors), press releases, filings with the SEC, and public conference calls, in order to achieve broad, non-exclusionary distribution of information to the public. The Company encourages investors and others to review the information it makes public in these locations, as such information could be deemed to be material information. Please note that this list may be updated from time to time.

## GOVERNMENTAL REGULATION

As a provider of Internet communications services, we are subject to regulation in the U.S. by the FCC. Some of these regulatory obligations include contributing to the Federal Universal Service Fund, Telecommunications Relay Service Fund and federal programs related to number administration; providing access to E-911 services; protecting customer information; and porting phone numbers upon a valid customer request. We are also required to pay state and local 911 fees and contribute to state universal service funds in those states that assess Internet voice communications services. We are a competitive local exchange carrier (CLEC) in forty-seven states. We are subject to the same FCC regulations applicable to telecommunications companies, as well as regulation by the public utility commission in these states. Specific regulations vary on a state-by-state basis, but generally include the requirement to register or seek certification to provide its services, to file and update tariffs setting forth the terms, conditions and prices for our intrastate services and to comply with various reporting, record-keeping, surcharge collection, and consumer protection requirements.

We are subject to regulations generally applicable to all businesses. We are also subject to an increasing number of laws and regulations directly applicable to telecommunication, internet access and commerce. The adoption of any such additional laws or regulations may decrease the rate of growth of the Internet, which could in turn decrease the demand for our products and services. Such laws may also increase our costs of doing business or otherwise have an adverse effect on our business prospects, financial position or results of operations. Moreover, the applicability to the Internet of existing laws governing issues such as property ownership, libel, and personal privacy is uncertain. Future federal or state legislation or regulation could have a material adverse effect on our business prospects, financial condition and results of operations.

## ITEM 1A. RISK FACTORS.

***The adverse impacts of the COVID-19 pandemic may continue to impact our business there is also the potential of other pandemics which may cause some adverse effects on our business and may continue to have increased adverse effects our business, results of operations, and financial condition.***

Since early 2020, the world has been and continues to be impacted by COVID-19 and its variants. COVID-19 and measures to prevent its spread have impacted our business in a number of ways, and it and other potential pandemics may continue to impact the business. Effects of the COVID-19 pandemic have negatively impacted the global economy and may continue to cause negative impacts. The effects of COVID-19 as well as potential future pandemics may continue to impact our business as well as those of the third-parties we rely upon for our manufacturing, shipping and other operations particularly in China. Among other things a new outbreak of a pandemic, the remaining effects of COVID-19 or the continuation of the COVID-19 pandemic may result in:

- a decrease in demand and/or prices for our products and services;
- a prolonged economic recession or depression that could significantly reduce demand and/or prices for our products and services;
- reduced productivity in our product development, operations, marketing, sales and other activities;
- disruptions to our supply chain;
- increased costs resulting from our efforts to mitigate the impact of the COVID-19 pandemic;
- reduced access to financing to fund our operations due to a deterioration of credit and financial markets; or
- higher rate of losses on our accounts receivables due to credit defaults.

The economic stimulus and the resulting inflation, supply chain issues and potential recession which is related to the response to COVID-19 has also caused significant uncertainty and volatility in global and domestic financial markets and the trading prices for the common stock of technology companies, including us. Due to such volatility, we may not be able to raise additional capital, if needed, on favorable terms, or at all. Further adverse economic events resulting from the COVID-19 pandemic, including a sustained economic downturn, could materially and adversely affect our business, access to capital markets and the value of our common stock.

We believe the production capabilities of our suppliers have been, and may continue to be, impacted as a result of quarantines, closures of production facilities, lack of supplies, or delays caused by both COVID-19 and post pandemic issues discussed herein. The continued disruption in the manufacture, shipment and sales of telephones and ancillary equipment may negatively and materially impact our operating and financial operating results, including revenue, gross margins, operating margins, cash flows and other operating results.

***A continued downturn in the worldwide or domestic economy may harm our business.***

There is currently a downturn in the worldwide and domestic economy caused by inflation, reduced demand and a potential recession. As the economic uncertainty prolongs, this may continue to reduce demand for our products or our customers' products, which could result in significant decreases in sales and margins for our products. In addition, the deterioration in credit markets could limit our ability to obtain external financing to fund our operations and capital expenditures. We may experience losses on our holdings of cash and investments due to failures of financial institutions and other parties. Adverse economic conditions may also result in a higher rate of losses on our accounts receivables due to credit defaults. As a result, a continued downturn in the worldwide or domestic economy could have a material adverse effect on our business, results of operations, or financial condition.

***The US economy has started to recover from the pandemic but the bounce back in demand has stressed supply chains and caused inflation to rise sharply. The economy is expected to slow, as the Federal Reserve continues to tighten monetary policy these factors may negatively affect our business.***

The economy is uncertain, there is rising interest and there is a risk of a recession which may cause substantial disruption in our sales and results. Of particular concern is (1) Impact of Market Downturn on Sales; (2) Impact of Uncertain Capital Markets; (3) Rising Interest Rates and the (4) Impact of Inflation; Those issues, together with other uncertainties based on the economy may cause customers to cease operations, reduce spending by our customers, have customers defer purchase decisions and or reduce spending. All of those factors may have a material adverse effect on our business, results of operations, or financial condition.

***Our quarterly and annual results of operations have fluctuated in the past and may continue to do so in the future. As a result, we may fail to meet or to exceed the expectations of research analysts or investors, which could cause our stock price to fluctuate and impair our ability to raise capital.***

Our quarterly and annual results of operations have varied historically from period to period, and we expect that they will continue to fluctuate due to a variety of factors (including but not limited to inflation, economic uncertainty, potential recession and COVID-19), some of which are outside of our control, including:

- our ability to retain existing customers and resellers, expand our existing customers' user base, and attract new customers;
- our ability to introduce new solutions;
- the actions of our competitors, including pricing changes or the introduction of new solutions;
- our ability to effectively manage our growth;
- our ability to successfully penetrate the market for larger businesses;
- the mix of annual and multi-year subscriptions at any given time;
- the timing, cost, and effectiveness of our advertising and marketing efforts;
- the timing, operating cost, and capital expenditures related to the operation, maintenance and expansion of our business;
- service outages or information security breaches and any related impact on our reputation;
- our ability to accurately forecast revenues and appropriately plan our expenses;
- our ability to realize our deferred tax assets;
- costs associated with defending and resolving intellectual property infringement and other claims;
- changes in tax laws, regulations, or accounting rules;
- the timing and cost of developing or acquiring technologies, services or businesses, and our ability to successfully manage any such acquisitions;
- adverse weather conditions;
- the impact of worldwide economic, political, industry, and market conditions; and,
- our ability to maintain compliance with all regulatory requirements.

Any one of the factors above, or the cumulative effect of some or all of the factors referred to above, may result in significant fluctuations in our quarterly and annual results of operations. This variability and unpredictability could result in our failure to meet the expectations of research analysts or investors for any period, which could cause our stock price to decline. We sustained operating losses in 2022 and 2021 and may experience losses in the future. In addition, a significant percentage of our operating expenses is fixed in nature and is based on forecasted revenues trends. Accordingly, in the event of revenue shortfalls, we may not be able to mitigate the negative impact on net income/(loss) and margins in the short term. If we fail to meet or exceed the expectations of research analysts or investors, the market price of our shares could fall substantially, and we could face costly lawsuits, including securities class-action suits. This may also impair our ability to raise capital, should we seek to do so.

***Our growth and the evolving markets in which we operate make it difficult to evaluate our current business and future prospects, which may increase the risk of investing in our stock.***

We have encountered and expect to continue to encounter risks and uncertainties as a growing company, the market for our products changes frequently. If our assumptions regarding these uncertainties are incorrect or change in reaction to changes in our markets, or if we do not manage or address these risks successfully, our results of operations could differ materially from our expectations, and our business could suffer.

***We may not remain profitable, and results may fluctuate.***

We have in the past sustained losses and may have losses again in the future. We expect to invest in sales and marketing, and in research and development, among other areas of our business, in order to compete more successfully for the business of companies that are transitioning to cloud communications and otherwise position ourselves to take advantage of long-term revenue-generating opportunities.

The investments we have made and will continue to make may not generate the returns that we anticipate, which could adversely impact our financial condition and make it more difficult for us to grow revenue and/or return to GAAP profitability. In order to continue and maintain profitability, we will need to manage our cost structure more efficiently, not incur significant liabilities, while continuing to grow our revenues. Despite these efforts, our revenue growth may slow, revenues may decline, or we may incur significant losses in the future due to economic and world conditions downturn in general economic conditions, increasing competition (including competitive pricing pressures), decrease in the adoption or sustained use of cloud communications market, exiting lines of business, or our inability to execute on business opportunities. We cannot be certain that we will be able to achieve or maintain operating profitability in the future.

We expect to undertake additional acquisitions the cost of which may affect profitability in certain quarters and for periods after the closing of the acquisition.

Our future operating results, including revenues, expenses, losses and profits, may vary substantially from period to period and may be difficult to predict.

***We have been paying a quarterly dividend and there is no guarantee that dividends will continue to be paid***

We may not be able to maintain paying dividends at current rates or at all. We have been paying a quarterly dividend. Any determination to pay dividends to the Company’s stockholders in the future will be at the discretion of the board of directors and will depend on the Company’s results of operations, financial condition and other factors deemed relevant by the board of directors. The ability to pay dividends depends largely on results of operations. In addition, the Company may choose to retain capital to support growth or further mitigate risk instead of returning capital to its shareholders. As a result, there can be no assurance that we will be able to maintain paying dividends.

***We expect to undertake acquisitions, mergers or change to our capital structure to expand our business, which may pose risks to our business and dilute the ownership of our existing stockholders. We may be required to acquire debt to fund acquisitions or mergers.***

As part of a potential growth strategy, we expect to attempt to acquire or merge with certain businesses. Whether we realize benefits from any such transactions will depend in part upon the integration of the acquired businesses, the performance of the acquired products, services and capacities of the technologies acquired, as well as the personnel hired in connection therewith. Accordingly, our results of operations could be adversely affected from transaction-related charges, amortization of intangible assets, and charges for impairment of long-term assets including goodwill and intangible assets. While we believe that we have established appropriate and adequate procedures and processes to mitigate these risks, there can be no assurance that any potential transaction will be successful.

In addition, the financing of any acquisition may require us to raise additional funds through public or private sources. Additional funds may not be available on terms that are favorable to us and, in the case of equity financings, may result in dilution to our stockholders. Future acquisitions by us could also result in large and immediate write-offs or assumptions of debt and contingent liabilities, any of which may have a material adverse effect on our consolidated financial position, results of operations, and cash flows.

Acquiring debt to finance acquisitions would require paying down of principal and payment of interest, which requires the use of cash, and we may not have sufficient cash flow from our business to pay down substantial debt. The ability to make scheduled payments of principal or to pay interest on debt will depend on our future performance, which is subject to economic, financial, competitive, and other factors beyond our control. Our business may not generate cash flow from operations to service any acquired debt, including paying off the principal when due, and make necessary capital expenditures.

***We may not be able to secure financing on favorable terms, or at all, to meet future needs.***

We may need to pursue financing in the future to make expenditures or investments to support the growth of our business (whether through acquisitions or otherwise) and may require additional capital to pursue our business objectives, respond to new competitive pressures, service our debt, pay extraordinary expenses, or fund growth, including through acquisitions, among other potential uses. Additional funds, however, may not be available when we need them on terms that are acceptable to us, or at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to grow and support our business and to respond to business challenges could be significantly limited.

***Our strategy to expand through acquisitions or investments in, other companies, may divert our management's attention, increase expenses, disrupt our operations and harm our results of operations.***

Our business strategy may, from time to time, include acquiring or investing in complementary services, technologies or businesses. We cannot assure you that we will successfully identify suitable acquisition candidates, integrate or manage disparate technologies, lines of business, personnel and corporate cultures, realize our business strategy or the expected return on our investment, or manage a geographically dispersed company. Our inability to successfully operate and integrate newly acquired businesses appropriately, effectively, and in a timely manner could impair our ability to take advantage of future growth opportunities and other advances in technology, as well as on our revenues, gross margins and expenses. Any such acquisition or investment could materially and adversely affect our results of operations. Acquisitions and other strategic investments involve significant risks and uncertainties, including: the potential failure to achieve the expected benefits of the combination or acquisition; unanticipated costs and liabilities; difficulties in integrating new products and services; software, businesses; operations and technology infrastructure in an efficient and effective manner; difficulties in maintaining customer relations; the potential loss of key employees of the acquired businesses; the diversion of the attention of our senior management from the operation of our daily business; the potential adverse effect on our cash position to the extent that we use cash for the purchase price; the potential significant increase of our interest expense, leverage, and debt service requirements if we incur additional debt to pay for an acquisition; the potential to incur large and immediate write-offs and restructuring and other related expenses; and the inability to maintain uniform standards, controls, policies and procedures.

Further, any acquisition may affect our ability to adequately maintain our internal control over financial reporting. If our internal control over financial reporting is not effective, it may adversely affect investor confidence in the Company.

***Our ability to use our net operating loss carry-forwards may be reduced in the event of an ownership change and could adversely affect our financial results.***

As of December 31, 2022, we had net operating loss ("NOL") carry-forwards of approximately $26,892,000. Section 382 of the Internal Revenue Code, as amended (the "Code") imposes limitations on a corporation's ability to utilize its NOL carry-forwards. In general terms, an ownership change results from transactions increasing the ownership of certain stockholders in the stock of a corporation by more than 50% over a three-year period. Any limited amounts may be carried over into later years, and the amount of the limitation may, under certain circumstances, be increased by the "recognized built-in gains" that occur during the five-year period after the ownership change (the recognition period). Future changes in ownership of more than 50% may also limit the use of these remaining NOL carry-forwards. Our earnings, if any, and cash resources would be materially and adversely affected if we cannot receive the full benefit of the remaining NOL carry-forwards. An ownership change could occur as a result of circumstances that are not within our control.

***The telecommunications industry is highly competitive. We face intense competition from traditional telephone companies, wireless companies, cable companies and alternative voice communication providers and other VoIP companies.***

Our Cloud telecommunications services compete with other voice over internet protocol (“VoIP”) providers. In addition, we also compete with traditional telephone service providers which provide telephone service based on the public switched telephone network (“PSTN”). Our VoIP offering is not fully compatible with such customers. Some of these traditional providers have also added VoIP services. There is also competition from cable providers, which have added VoIP service offerings in bundled packages to their existing cable customers. The telecommunications industry is highly competitive. We face intense competition from traditional telephone companies, wireless companies, cable companies, and alternative voice communication providers.

Most traditional wire line and wireless telephone service providers, cable companies, and some VoIP providers are substantially larger and better capitalized than we are and have the advantage of a large existing customer base. Because most of our target customers are already purchasing communications services from one or more of these providers, our success is dependent upon our ability to attract target customers away from their existing providers.

The markets for our products and services are continuing to evolve and are increasingly competitive. Demand and market acceptance for recently introduced and proposed new products and services and sales of such products and services are subject to a high level of uncertainty and risk. Our business may suffer if the market develops in an unexpected manner, develops more slowly than in the past or becomes saturated with competitors, if any new products and services do not sustain market acceptance. A number of very large, well-capitalized, high-profile companies serve the e-commerce, VoIP and Cloud technology markets. If any of these companies entered our markets in a focused and concentrated fashion, we could lose customers, particularly more sophisticated and financially stable customers.

***Our VoIP or cloud telecommunications service competes against established well financed alternative voice communication providers (such as 8x8 and Ring Central), who may provide comparable services at comparable or lower pricing.***

Pricing in the telecommunications industry is very fluid and competitive. Price is often a substantial motivation factor in a customer’s decision to switch to our telephony products and services. Our competitors may reduce their rates, which may require us to reduce our rates, which would affect our margins and revenues, or otherwise make our pricing non-competitive. We may be at a disadvantage compared with those competitors who have substantially greater resources than us or may otherwise be better positioned to withstand an extended period of downward pricing pressure.

Many of our current and potential competitors have longer operating histories, significantly greater resources and brand awareness, and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers. Our competitors may also offer bundled service arrangements that present a more differentiated or better integrated product to customers. Announcements, or expectations, as to the introduction of new products and technologies by our competitors or us could cause customers to defer purchases of our existing products, which also could have a material adverse effect on our business, financial condition or operating results.

Our Software Solutions division competes against numerous competitors including established well financed competitors.

The success of our Software Solutions division depends on a number of factors, including but not limited to acceptance of the functions and features we provide. We face numerous start up’s as well as well-established well financed competitors. Those competitors may disrupt the pricing structure we have in place and or offer additional features which we do not provide. Competitors may also provide new technologies such AI and bot, that we have not yet been able to provide. Such completion may affect our results, sales, margins, operating efficiencies and price of our common stock.

***The Managed Service Provider Industry is highly competitive. We face intense competition from both large and regional providers.***

We purchased Allegiant Networks, LLC (“Allegiant”) on November 1, 2022. In addition to telecommunications services, Allegiant provides Managed IT Services and Support. While those revenues do not represent a significant portion of our overall revenues, the managed services market is a highly competitive industry. Managed Service contains the same risks as detailed in the risk factors including the additional risks detailed herein.

Managed service is the practice of outsourcing on a proactive basis certain processes and functions intended to improve operations and cut expenses. It simplifies IT operations, increases user satisfaction, and improves service quality while reducing operating costs. Industry requirements, standards, applications, automation, and client needs are changing daily. These ever-changing factors and our ability to quickly adapt and meet those demands could negatively impact our ability to retain and attract clients. In addition, the rapid adoption of digital transformation and the rush of both large and midmarket providers to address this massive market opportunity creates risk and significant competition. We have no control on the outsourced services and a catastrophic failure on the part of one of the outsourced services could cause a loss of customers, loss of revenue, potential liability and a decline in our stock price.

As a small regional provider, many of Allegiant's current and potential MSP competitors have longer operating histories providing managed services, significantly greater resources and brand awareness, and a larger base of customers than we have. As a result, these competitors may have greater credibility with our existing and potential customers.

***Errors in our technology or technological issues outside our control could cause delays or interruptions to our customers.***

Our services (including cloud telecommunications, software solutions, managed services and e-commerce) can be disrupted by problems with our technology and systems such as malfunctions in our servers, processes, software or facilities. In addition, there may be service interruptions for reasons outside our control. Our customers and potential customers subscribing to our services have experienced such interruptions in the past and may experience such interruptions in the future as a result of these types of problems or others which may or may not be in our control. Such Interruptions cause us to lose customers and offer customer credits, which could adversely affect our revenue and profitability. Network and telecommunication interruptions may also impair our ability to sign-up new customers. In addition, since our systems and our customers' ability to use our services are Internet-dependent, our services may be subject to "cyber-attacks" from the Internet, which could have a significant impact on our systems and services.

***If we do not successfully maintain our physical infrastructure and maintain sufficient diverse geo redundant locations, which require large investments, we may be unable to substantially increase our sales and retain customers.***

Our ability to provide cloud telecommunications services is dependent upon on our physical and cloud-based infrastructure. While our physical equipment required for providing these services is redundant in nature, certain types of failures or malfunctioning of critical hardware/software equipment, including but not limited to fire, water or other physical damage may impact our ability to deliver continuous service to our customers, while there are redundancies, there is no guarantee that the system will operate as planned to provide back up in the event of an outage. Act of God or terrorism or vandalism or negligence or gross negligence including failure to properly update and maintain infrastructure may result in loss of revenue, profitability and failure to retain and acquire new customers.

Our ability to recover from disasters or failures, if and when they occur, is paramount to offering continued service to our existing customers. We maintain a redundant physical infrastructure for disaster recovery. This system does not guarantee continued reliability if a catastrophic event occurs. Despite implementation of network security measures, our servers may be vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering with our computer systems including, but not limited to, denial of service attacks. In addition, if there is a breach or alleged breach of security or privacy involving our services including but not limited to data loss, or if any third party undertakes illegal or harmful actions using our communications or e-commerce services, our business and reputation could suffer substantial adverse publicity and impairment. We have experienced interruptions in service in the past. We have taken and continue to take steps to improve our infrastructure to prevent service interruptions.

In addition to our physical infrastructures, we have a cloud infrastructure deployment with Amazon Web Services ("AWS") which is intended to provide continuous service to our customers in the event of a disaster or failure of our physical infrastructures. If we fail to properly maintain our infrastructure or our third-party service providers fail to maintain these facilities properly, or fail to respond quickly to problems, our customers may experience service interruptions. The failure to properly maintain services may result in negative consequences to us including but not limited to: (i) cause a material loss of customers, (ii) adversely affect our reputation, (iii) cause negative publicity, (iv) negatively impact our ability to acquire customers, (v) negatively impact our revenue and profitability, (vi) potential law suits for not reaching E-911 services, and (vii) potential law suits for loss of business and loss of reputation.

***Failure in our data centers or services could lead to significant costs and disruptions.***

All data centers, including ours, are subject to various points of failure. Problems with cooling equipment, generators, uninterruptible power supply, routers, switches, or other equipment, whether or not within our control, could result in service interruptions for our customers as well as equipment damage. Any failure or downtime could affect a significant percentage of our customers. The total destruction or severe impairment of our data center facilities could result in significant downtime of our services and the loss of customer data.

***We depend on our senior management and other key personnel, and a loss of these individuals could adversely impact our ability to execute our business plan and grow our business.***

We depend on the continued services of our key personnel, including our officers and certain engineers. Each of these individuals has acquired specialized knowledge and skills with respect to our operations. The loss of one or more of these key personnel could negatively impact our performance. In addition, we expect to hire additional personnel as we continue to execute our strategic plan, particularly if we are successful in expanding our operations. Competition for the limited number of qualified personnel in our industry is intense. At times, we have experienced difficulties in hiring personnel with the necessary training or experience.

***Changes or the termination of our web hosting model may negatively affect our business***

The Company shifted away from selling web hosting in 2011. The Company is not actively marketing its website development software or website hosting services and may decide to terminate. Our website hosting revenue represents less than 1% of our total revenue for the year ended December 31, 2022 and will continue to decline. In addition, the Company may determine that it will discontinue its web hosting functions as the cost to provide services may exceed any revenue received from those services. The failure to provide hosting may cause disruptions to customers who may attempt to claim that the Company is required to continue to host active websites and seek legal redress for such claims.

***We have targeted sales to mid-market and larger enterprise customers. Not properly managing these customers could negatively affect our business, margins, cash flow and operations.***

Selling to larger enterprise customers contains inherent risks and uncertainties. Our sales cycle has become more time-consuming and expensive. The delays associated with closing and installing larger customers may impact results on a quarter-to-quarter basis. There may be additional pricing pressure in this market which may affect margins and profitability. Revenue recognition may be delayed for some complex transactions, all of which could harm our business and operating results. The loss of a large customer may have a material negative impact on quarterly or annual results.

Multi-location users require additional and expensive customer service which may require additional expense and impact margins on enterprise sales. Enterprise customers may demand more features, integration services and customization which require additional engineering and operational time which could impact margins on an enterprise sale. Multi-location enterprise customer sales may have different requirement in different locations which may be difficult to fulfill or satisfy various interests which could result in cancellations.

Enterprise customers might demand we provide service locations internationally where we may encounter technical, logistical, infrastructure and regulatory limitations on our ability to implement or deliver our services. Our inability to provide service in certain international locations may result in a cancellation of the entire contract. Further with larger enterprise customer sales, the risk of customers transporting desktop devices internationally without our knowledge may increase.

We have a limited history of selling our services to larger businesses and may experience challenges in configuring and providing ongoing support for the solutions we sell to large customers. Larger customers' networks are often more complex than those of smaller customers, and the configuration of our services for these customers usually requires customer assistance. There is no guarantee that the customer will make available to us the necessary personnel and other resources for a successful configuration of services. Lack of assistance from the customers or lack of local resources may prevent us from properly configuring our services for the customers, which can in turn adversely impact the quality of services that we deliver over our customers' networks, and/or may result in delays in the implementation of our services and impact the quality and ability to continue to provide the services. This could also create a public perception that we are unable to deliver high quality of service to our customers, which could harm our reputation. In addition to the foregoing, larger customers tend to require higher levels of customer service and individual attention, which may increase our costs for implementing and delivering services.

***Sales to small and medium-sized businesses face risks as they may have fewer financial resources to weather an economic downturn.***

A substantial percentage of our revenues come from small and medium-sized businesses. These customers may be more adversely affected by economic downturns than larger, more established businesses. Weakness in certain segments of the credit markets and in the U.S. and global economies may result in customers reducing size or terminating their business, which could negatively affect our business. If small and medium-sized businesses experience financial hardship as a result of a weak economy, industry consolidation, or any other reason, the overall demand for our subscriptions could be materially and adversely affected.

***We must acquire new customers on an ongoing basis to maintain and increase our customers and revenues while the significant costs to acquire new customers may reduce our profitability.***

We will have to acquire new customers in order to increase revenues. We incur significant costs to acquire new customers, and those costs are an important factor in determining our profitability. Therefore, if we are unsuccessful in retaining customers or are required to spend significant amounts to acquire new customers beyond those budgeted, our revenue could decrease, which could prevent us from reaching profitability and have our net loss increase. Marketing expenditures are an ongoing requirement and will become a larger ongoing requirement of our business as we strive for acquiring new customers.

***If we do not successfully expand our sales, including our partner channel program and direct sales, we may be unable to increase our sales and that may affect our stock price.***

We sell our products and services primarily through direct sales and our partner channel, and we must substantially expand the number of partners and producing direct sales personnel to increase organic revenue substantially. If we are unable to expand our partner channel network and hire and retain qualified sales personnel, our ability to increase our organic revenue and grow our business could be compromised. The challenge of attracting, training, and retaining qualified candidates, may make it difficult to grow revenue. Our direct sales are driven largely by inside sales who sell our services and products to customers. Our future growth depends on our ability to develop and maintain a successful direct sales organization that identifies and closes a significant portion of sales. If we or the agents fail to do so, we may be unable to meet our revenue growth targets. Our partner sales are generated through indirect channel sales. These channels consist of master agents' independent agents (including master agents), value-added resellers, and service providers. We contract directly with the end customer. We may or may not have active involvement in the sale or may use these channel partners to identify, qualify and manage prospects throughout the sales cycle. These channels may generate an increasing portion of our revenue in the future. Our continued success requires continuing to develop and maintain successful relationships with these partners. If we fail to properly select and manage our partners, or they are not successful in their sales efforts, we may be unable to meet our revenue growth targets.

A substantial portion of our sales is dependent on our partner channel (including but not limited to, resellers, and master agents) to sell our products and services; our failure to effectively develop, manage, and maintain our indirect sales channels could materially and adversely affect our revenues.

Our success depends on our continued ability to establish and maintain a network of channel relationships, including but not limited to strategic partners, agents, and master agents. We need to properly manage and expand these relationships. These relationships are essential both in targeting our strategic base and expanding into the enterprise market. We believe we will need to expand our network in order to grow our business. An increasing portion of our revenues are and maybe derived from our network of resellers. We do not have long-term contracts with these resellers, nor do most of our contracts require minimum commitments on the part of resellers. The loss of or reduction in sales through these third parties could materially reduce our revenues. Many of our competitors also rely on resellers and there may be intense completion regarding their sales, attention, and commitment. Competitors may be able to transition some or all of those customers onto their competing solutions, which could materially and adversely affect our revenues.

Acquiring new resellers and retaining current resellers requires substantial training in our technology and subscription offerings which necessitates time and resources. To maintain and expand our indirect sales, we must continue to scale and improve our processes and procedures to support these agents, including investment in systems and training.

***Our churn rate may increase in future periods due to customer cancellations or other factors, which may adversely impact our revenue or require us to spend more money to grow our customer base.***

Our customers generally have initial service periods of between three and five years and may discontinue their subscriptions for our services after the expiration of their initial subscription period. In addition, our customers may renew for lower subscription amounts or for shorter contract lengths. We may not accurately predict cancellation rates for our customers. Our cancellation rates may increase or fluctuate because of a number of factors, including customer usage, pricing changes, number of applications used by our customers, customer satisfaction with our service, the acquisition of our customers by other companies and deteriorating general economic conditions. If our customers do not renew their subscriptions for our service or decrease the amount they spend with us, our revenue will decline, and our business will suffer.

Our rate of customer cancellations we believe has increased and may increase in future periods due to many factors, some of which are beyond our control, such as the financial condition of our customers or the state of credit markets, especially given the current economic uncertainty, inflation and supply issue and their impact on the economy. In addition, a single protracted service outage or a series of service disruptions, whether due to our services or those of our bandwidth carriers, may result in a sharp increase in customer cancellations.

***We may not be able to scale our business efficiently or quickly enough to meet our customers' growing needs, in which case our operating results could be harmed.***

As usage of our cloud telecommunications services by mid-market and larger distributed enterprises expands and as customers continue to integrate our services across their enterprises, we are required to devote additional resources to improving our application architecture, integrating our products and applications across our technology platform as well as expanding integration and performance. We will need to appropriately scale our internal business systems and our services organization, including customer support and services and regulatory compliance, to serve a growing customer base. Any failure of or delay in these efforts could impair our systems' performance and reduce customer satisfaction, which could result in decreased sales to new customers and lower renewal rates by existing customers and eventually hurt our revenue growth and our reputation. We cannot guarantee that the expansion and improvements to our infrastructure and systems will be fully or effectively implemented on a timely basis, if at all, which failure may reduce revenue and our margins and adversely impact our financial results.

***Our success depends in part upon our ability to provide customer service that effectively supports the needs of our customers.***

Providing customer services effectively requires that our customer support personnel have industry-specific technical knowledge and expertise. It may be difficult and costly for us to hire qualified personnel. Our support personnel require extensive training on our products and services, which may make it difficult to scale up our support operations rapidly or effectively. The importance of high-quality customer support will increase as we expand our business and pursue new customers. If we do not help our customers quickly resolve post-implementation issues and provide effective ongoing support, our ability to sell additional features and services to existing customers will suffer and our reputation may be harmed.

***Our telecommunications and managed services success depends in part upon the capacity, reliability, and performance of our several third-party providers and their network infrastructure, the failure of which could cause delays or interruptions of our service and impact our revenue and profitability. Our Software Solutions Division relies on outside contractors and service providers, the failure of which could impact servie and profitability.***

We depend on several third-party providers to provide uninterrupted and error-free service to maintain our operations and to provide managed services. We do not have control over these providers, and some of these providers may be our competitors. We may be subject to interruptions or delays in their service and our reputation and business may be harmed. The failure of any of these third party service providers to properly maintain services may result in negative consequences to us including but not limited to: (i) cause a loss of customers, (ii) adversely affect our reputation, (iii) cause negative publicity, (iv) negatively impact our ability to acquire customers, (v) negatively impact our revenue and profitability, (vi) potential law suits for not reaching E-911 services, and (vii) potential law suits for loss of business and loss of reputation. These third-party providers include:

- *Internet Bandwidth Providers.* We may be subject to interruptions or delays in network service. If we fail to maintain reliable bandwidth or performance that could significantly reduce customer demand for our services and damage our business. Our cloud telecommunications service (and to a lesser extent our e-commerce services) requires our customers to have an operative broadband Internet connection and an electrical power supply, which are provided by the customer's Internet service provider and electric utility company and not by us. The quality of some broadband Internet connections may be too poor for customers to use our services properly. In addition, if there is any interruption to a customer's broadband Internet service or electrical power supply, that customer will be unable to make or receive calls, including emergency calls (our E-911 service), using our service. In addition, internet backbone providers may be able to block, degrade or charge for access to, or the bandwidth use of certain of our products and services which could have a negative effect on our services and could lead to additional expenses and the loss of users. Our products and services depend on the ability of our users to access the Internet, and many of our services require significant bandwidth to work effectively. Further, customers who access our mobile application Crexmo© (or future application) through their smartphones must have a high-speed connection, to use our services. This access is provided by companies that have significant and increasing market power in the broadband and Internet access marketplace some of these providers offer products and services that directly compete with our own offerings, which give them a significant competitive advantage.

- Tier 1 and non-Tier 1 Telecom suppliers for Telecom Origination and Termination Services. We depend on these companies to provide service telecom services, sourcing of Direct Inward Dialing (DID), porting of numbers and delivering telephone calls from and to endpoints and devices on our network. If we fail to maintain reliable connectivity or performance with our upstream carriers it could then significantly reduce customer demand for our services and damage our business.

- A portion of our customer service responses, delivery of calls to and from PSTN and other public telephone VoIP/Wireless service providers and provision of aspects of our E-911 service. We offer our cloud telecommunications customers support 24 hours a day, seven days a week. We may rely on third parties (sometimes outside of the U.S) to respond to customer inquiries. These third-party providers generally represent us without identifying themselves as independent parties. The ability of third-party providers to provide these representatives may be disrupted due to issues outside our control. We also maintain an agreement with an E-911 provider to assist us in routing emergency calls directly to an emergency service dispatcher at the public-safety answering point ("PSAP") in the area of the customer's registered location and terminating E-911 calls. We also contract with a provider for the national call center that operates 24 hours a day, seven days a week to receive certain emergency calls and with several companies that maintain PSAP databases for the purpose of deploying and operating E-911 services. The dispatcher will have automatic access to the customer's telephone number and registered location information. If a customer moves their Crexendo service to a new location, the customer's registered location information must be updated and verified by the customer. Until that takes place, the customer will have to verbally advise the emergency dispatcher of his or her actual location at the time of an emergency 9-1-1 call. This can lead to delays in the delivery of emergency services. Interruptions in service from these vendors could also cause failures in our customers' access to E-911 services and expose us to liability.

- Our services providers and partners may experience service interruptions or degradation because of hardware and software defects or malfunctions, computer denial-of-service and other cyberattacks, human error, natural disasters, power losses, disruptions in services, bankruptcy, fraud, military or political conflicts, terrorist attacks, computer viruses or other malware, or other events. Their systems also may be subject to break-ins, sabotage and intentional acts of vandalism. Some of our provider systems may not be fully redundant, and their disaster recovery planning may not be sufficient for all eventualities.

- Outside contractors and third-party agents for fulfillment of certain items and critical manufacturing services. We outsource the manufacturing of certain products we sell and provide. We submit purchase orders to agents or the companies that manufacture the products. We describe, among other things, the type and quantities of products or components to be supplied or manufactured and the delivery date and other terms applicable to the products or components. Our suppliers or manufacturers potentially may not accept any purchase order that we submit. Our reliance on outside parties involves a number of potential risks, including: (i) the absence of adequate capacity, (ii) the unavailability of, or interruptions in access to, production or manufacturing processes, (iii) reduced control over delivery schedules, (iv) errors in the product, and (v) claims of third-party intellectual infringement or defective merchandise. If delays, problems or defects were to occur, it could adversely affect our business, cause claims for damages to be filed against us, and negatively impact our consolidated operations and cash flows.

***We depend upon industry standard protocols, best practices, solutions, third-party software, technology, and tools, including but not limited to Open Source software.***

We rely on non-proprietary third-party licensing and software, some of which may be Open Source and protected under various licensing agreements. We may be subject to additional royalties, license or trademark infringement costs or other unknown costs when one or more of these third-party technologies are affected or need to be replaced due to end-of-support or end-of-sale of such third parties.

***Changes to rates by our suppliers and increasing regulatory charges or tariffs may require us to raise prices, which could impact results.***

Our upstream carriers, suppliers and vendors may increase their rates thus directly impacting our cost of sales, which would affect our margins. Interconnected VoIP traffic may be subject to increased charges. Should this occur, the rates paid to our underlying carriers may increase which could reduce our profitability. Future changes in tariffs by regulatory agencies or application of tariff requirements to currently un-tariffed products or services could affect the price and sales of our products for certain classes of customers. Changes in our underlying costs of sales may increase rates we charge our customers which could make us less competitive and impact our sales and retention of existing customers.

***Changes in laws and regulations and the interpretation and enforcement of such laws and regulations could adversely impact our financial results or ability to conduct business.***

We are subject to a variety of federal and state laws and regulations as well as oversight from a variety of governmental agencies and public service commissions. The laws governing our business may change in ways that harm our business. Federal or state governmental agencies administering and enforcing such laws may also choose to interpret and apply them in ways that harm our business. These interpretations are also subject to change. Regulatory action could materially impair or force us to change our business model and may adversely affect our revenue, increase our compliance costs, and reduce our profitability. In addition, governmental agencies such as the Securities and Exchange Commission ("SEC"), Internal Revenue Service ("IRS"), Federal Trade Commission ("FTC"), Federal Communication Commission ("FCC") and state taxing authorities may conclude that we have violated federal laws, state laws or other rules and regulations, and we could be subject to fines, penalties or other actions that could adversely impact our financial results or our ability to conduct business.

***Our telecommunications services are required to comply with industry standards, FCC regulations, privacy laws as well as certain state and local jurisdiction specific regulations. Failure to comply with existing laws and any new laws that may become applicable to us may subject us to penalties, increase our operation costs, and may also require us to modify existing products and/or service.***

The acceptance of telecommunications services is dependent upon our meeting certain industry standards. We are required to comply with certain rules and regulations of the FCC regarding safety standards. Standards are continuously being modified and replaced. As standards evolve, we may be required to modify our existing products or develop and support new versions of our products. We must comply with certain federal, state, and local requirements regarding how we interact with our customers, including marketing practices, consumer protection, privacy, and billing issues, the provision of 9-1-1 emergency service and the quality of service we provide to our customers. The failure of our products and services to comply, or delays in compliance, with various existing and evolving standards could delay future offerings and impact our sales, margins, and profitability. Changes to the Universal Service Funds by the FCC or various states may require us to increase our costs which could negatively affect revenue and margins.

We are subject to Federal laws and FCC regulations that require us to protect customer information. While we have protections in place to protect customer information there is no assurance that our systems will not be subject to failure or intentional fraudulent attack. The failure to protect required information could subject us to penalties and diminish the confidence our customers have in our systems, which could negatively affect results. While we try to comply with all applicable data protection laws, regulations, standards, and codes of conduct, as well as our own posted privacy policies and contractual commitments to the extent possible, any failure by us to protect our users' privacy and data, including as a result of our systems being compromised by hacking or other malicious or surreptitious activity, could result in a loss of user confidence in our services and ultimately in a loss of users, which could materially and adversely affect our business as well as subject us to law suits, civil fines and criminal penalties.

Governmental entities, class action lawyers and consumer advocates are reviewing the data collection and use by companies that must maintain such data. Our own requirements as well as regulatory codes of conduct, enforcement actions by regulatory agencies, and lawsuits by other parties could impose additional compliance costs on us as well as subject us to unknown potential liabilities. These evolving laws, rules and practices may also curtail our current business activities, which may delay or affect our ability to become profitable as well as affect customers and other business opportunities.

In addition, several foreign countries and governmental bodies, including the E.U., Brazil and Canada, have laws and regulations concerning the collection and use of personally identifiable information obtained from their residents, including payment card information, which are often more restrictive than those in the U.S. Laws and regulations in these jurisdictions apply broadly to the collection, use, storage, disclosure and security of personally identifiable information, including payment card information identifying, or which may be used to identify, an individual, such as names, email addresses and, in some jurisdictions, Internet Protocol (IP) addresses, device identifiers and other data. Our phones may be moved to locations which could potentially subject us to jurisdiction. Also, websites we host may be available in these locations. As we conduct business or become deemed to conduct business in those foreign jurisdictions, we may become subject to those laws.

We are also subject to the privacy and data protection-related obligations in our contracts with our customers and other third parties. Any failure, or perceived failure, to comply with federal, state, or international laws, or to comply with our contractual obligations related to privacy, could result in proceedings or actions against us which could result in significant liability to us as well as harm to our reputation. Additionally, third parties with whom we contract may violate or appear to violate laws or regulations which could subject us to the same risks. Any new laws, regulations, other legal obligations or industry standards, or any changed interpretation of existing laws, regulations or other standards may require us to incur additional costs and restrict our business operations.

***Our collection, processing, storage, use, and transmission of personal data could give rise to liabilities as a result of governmental regulation, conflicting legal requirements, differing views on data privacy, or security breaches.***

We collect, process, store, use, and transmit personal data on a daily basis. Personal data is increasingly subject to legal and regulatory protections around the world, which vary widely in approach and which possibly conflict with one another. In recent years, for example, U.S. legislators and regulatory agencies, such as the Federal Trade Commission, as well as U.S. states have increased their focus on protecting personal data by law and regulation and have increased enforcement actions for violations of privacy and data protection requirements. California recently enacted legislation, the California Consumer Privacy Act ("CCPA") that will, among other things, require covered companies to provide new disclosures to California consumers, and afford such consumers new abilities to opt-out of certain sales of personal information, which became effective January 1, 2020. While we believe that we are not a covered entity under the law, the effects of the CCPA potentially are significant, however, and may require us to modify our data processing practices and policies and to incur substantial costs and expenses in an effort to comply. We may also from time to time be subject to, or face assertions that we are subject to, additional obligations relating to personal data by contract or due to assertions that self-regulatory obligations or industry standards apply to our practices. Washington and Massachusetts have also introduced significant privacy bills and Congress is debating federal privacy legislation, which if passed, may restrict our business operations and require us to incur additional costs for compliance.

The European Commission also approved and adopted the General Data Protection Regulation ("GDPR"), its data protection law, which took effect in May 2018. A Data Protection Act substantially implementing the GDPR was enacted in the U.K., effective in May 2018. These data protection laws and regulations are intended to protect the privacy and security of personal data, including credit card information that is collected, processed, and transmitted in or from the relevant jurisdiction. We stopped hosting websites in GDPR-complaint countries or countries from which the bulk of business came from countries subject to GDPR. We also took steps to block those countries from accessing any other sites we host. While we do not currently provide services in countries where compliance would be required and are therefore not required to be compliant, if we did provide those services or otherwise were required to become complaint, implementation of and compliance with these laws and regulations may be more costly or take longer than we anticipate, or could otherwise adversely affect our business operations, which could negatively impact our financial position or cash flows.

Additionally, media coverage of data breaches has escalated, in part because of the increased number of enforcement actions, investigations, and lawsuits. As this focus and attention on privacy and data protection increases, we also risk exposure to potential liabilities and costs resulting from compliance with or any failure to comply with applicable legal requirements, conflicts among these legal requirements, or differences in approaches to privacy.

***We face risks in our sales to certain market segments including, but not limited to, sales subject to HIPAA Regulations.***

We have sold and will continue to attempt to sell to certain customer segments which may have requirements for additional privacy or security. In addition, sales may be made to customers that are subject to additional security requirements. Selling into segments with additional requirements increases potential liability which in some instances may be unlimited. While the Company believes it meets or exceeds all requirements for sales into such segments, there is no assurance that the Company systems fully comply with all requirements. Our customers can use our services to store contact and other personal or identifying information, and to process, transmit, receive, store and retrieve a variety of communications and messages, including information about their own customers and other contacts. In addition, customers may use our services to store protected health information, or PHI, that is protected under the Health Insurance Portability and Accountability Act, or HIPAA. Noncompliance with laws and regulations relating to privacy and HIPAA may lead to significant fines, penalties or civil liability.

***We could be liable for breaches of security on our website, fraudulent activities of our users, or the failure of third-party vendors to deliver credit card transaction processing services.***

We engage in electronic billing and processing of our customers using secure transmission of sometimes confidential information over public networks. We have systems and processes in place that we deem sufficient and industry standard that are designed to protect consumer information and prevent fraudulent credit card transactions and other security breaches. However, there is no guarantee that such systems and processes will not experience a failure. Our failure to protect against fraud or breaches may subject us to costly breach notification and other mitigation obligations, class action lawsuits, investigations, fines, forfeitures, or penalties from governmental agencies that could adversely affect our operating results. We may be unable to prevent our customers from fraudulently receiving goods and services. Our liability could also increase if a large fraction of transactions using our services involve fraudulent or disputed credit card transactions. We may also experience losses due to customer fraud and theft of service. Customers have, in the past, obtained access to our service without paying for monthly service and international toll calls by unlawfully using fraudulently obtained codes. If our existing anti-fraud procedures are not adequate or effective, consumer fraud and theft of service could have a material adverse effect on our business, financial condition, and operating results.

***We could experience security breaches in the transmission and analysis of confidential and proprietary information of the consumer, the merchant, or both, as well as our own confidential and proprietary information.***

Anyone able to circumvent security measures could misappropriate proprietary information or cause interruptions in our operations, as well as the operations of the merchant. We may be required to expend significant capital and other resources to protect against security breaches or to minimize problems caused by security breaches. To the extent that we experience breaches in the security of proprietary information which we store and transmit, our reputation could be damaged, and we could be exposed to a risk of loss or litigation.

***We collect personal and credit card information from our customers and employees could misuse this information.***

The PCI Data Security Standard ("PCI DSS") is a specific set of comprehensive security standards required by credit card brands for enhancing payment account data security, including but not limited to requirements for security management, policies, procedures, network architecture, and software design. We maintain credit card and other personal information in our systems. Due to the sensitive nature of retaining such information we have implemented policies and procedures to preserve and protect our data and our customers' data against loss, misuse, corruption, misappropriation caused by systems failures, unauthorized access, or misuse. Notwithstanding these policies, we could be subject to liability claims by individuals and customers whose data resides in our databases for the misuse of that information. While the Company believes its systems meet or exceed industry standards, the Company does not believe it is required to meet PCI level 1 compliance and has not certified under that level. Failure to meet PCI compliance levels could negatively impact the Company's ability to collect and store credit card information which could cause substantial disruption to our business. Notwithstanding the results of this assessment there can be no assurance that payment card brands will not request further compliance assessments or set forth additional requirements to maintain access to credit card processing services, which could incur substantial additional costs and could have a material adverse effect on our business.

***Our ability to offer services outside the U.S. is subject to different regulations which may be unknown and uncertain.***

Regulatory treatment of VoIP providers outside the United States varies from country to country, and local jurisdictions. Many times, the laws are vague, unclear and regulations are not enforced uniformly. We are licensed as a VoIP seller in Canada and are considering expanding to other countries. We also cannot control if our customers take their devices out of the United States and use them abroad. Our resellers may sell to customers who maintain facilities outside the United States. The failure by us or our customers and resellers to comply with laws and regulations could reduce our revenue and profitability. As we expand to additional countries there may be additional regulations that we are required to comply with, the failure to comply or properly assess regulations may subject us to penalties, fines and other actions which could materially affect our business.

***Examinations by relevant tax authorities may result in material changes in related tax reserves for tax positions taken in previously filed tax returns or may impact the valuation of certain deferred income tax assets, such as net operating loss carry-forwards.***

Based on the outcome of examinations by relevant tax authorities, or as a result of the expiration of statutes of limitations for specific jurisdictions, it is reasonably possible that the related tax reserves for tax positions taken regarding previously filed tax returns will materially change from those recorded in our financial statements. In addition, the outcome of examinations may impact the valuation of certain deferred income tax assets (such as NOL carry-forwards) in future periods. It is not possible to estimate the impact of the amount of such changes, if any, to previously recorded uncertain tax positions.

***The FCC net neutrality rules have changed. There may be a negative effect to our business going forward as a consequence of those changes.***

On January 4, 2018, the FCC, released an order that largely repeals rules that the FCC had in place which prevented broadband internet access providers from degrading or otherwise disrupting a broad range of services provisioned over consumers' and enterprises' broadband internet access lines. There are efforts in Congress to prevent the order from becoming effective and a number of state attorneys general have filed an appeal of the FCC's January 4, 2018 order. Many of the largest providers of broadband services, like cable companies and traditional telephone companies, have publicly stated that they will not degrade or disrupt their customers" use of applications and services, like ours. However, there is not guarantee that they will continue to do such. If such providers were to degrade, impair, or block our services, it would negatively impact our ability to provide services to our customers, likely result in lost revenue and profits, and we would incur legal fees in attempting to restore our customers' access to our services. Broadband internet access providers may also attempt to charge us or our customers additional fees to access services like ours that may result in the loss of customers and revenue, decreased profitability, or increased costs to our offerings that may make our services less competitive. Following the adoption of the January 4, 2018 order, a number of states have passed laws establishing rules similar to those that existed prior to the effective date of the January 4, 2018 order. States have adopted a variety of approaches in attempting to preserve the rules in place prior to the order. We however cannot rely on those laws as there is legal uncertainty as to whether states that have passed such laws have the authority to do so if such laws as they could be interpreted to conflict with the January 4, 2018 order. The U.S. Department of Justice has taken the position that local authorities do not have the authority to contradict the FCC's January 4, 2018 order. We cannot predict the ultimate outcome of these disputes. President Biden and numerous Senators have criticized the current status of net neutrality, at this time we are not aware if there will be legislation that might reimpose the prior regulations.

***States are adding regulation for VoIP providers which could increase our costs and change certain aspects of our service.***

Certain states take the position that offerings by VoIP providers are intrastate and therefore subject to state regulation. We have registered as a competitive local exchange carrier ("CLEC") in most states; however, our rates are not regulated in the same manner as traditional telephone service providers. Some states are also requiring that we register as a seller of VoIP services even though we have registered as a CLEC. Some states argue that if the beginning and desktop devices of communications are known, and if some of these communications occur entirely within the boundaries of a state, the state can regulate that offering and may therefore add additional taxes or surcharges or regulate rates in a similar matter to traditional telephone service providers. We believe that the FCC has pre-empted states from regulating VoIP providers in the same manner as providers of traditional telecommunications services. We cannot predict how this issue will be resolved or its impact on our business at this time.

***Taxing authorities may successfully assert that we should have collected or in the future should collect sales and use, value added, or similar taxes, and any such assessments could adversely affect our business, financial condition, and results of operations.***

Jurisdictions in which we do not collect sales, use, value added, or similar taxes on VoIP services or other products may assert that such taxes are applicable, which could result in tax assessments, penalties, and interest, and we may be required to collect such taxes in the future. Such tax assessments, penalties, interest, or future requirements would adversely affect our financial condition and results of operations. Further, in June 2018, the Supreme Court held in *South Dakota v. Wayfair, Inc.* that states could impose sales tax collection obligations on out-of-state sellers even if those sellers lack any physical presence within the states imposing the sales taxes. Under *Wayfair*, a person requires only a "substantial nexus" with the taxing state before the state may subject the person to sales tax collection obligations therein. An increasing number of states (both before and after the publication of *Wayfair*) have considered or adopted laws that attempt to impose sales tax collection obligations on out-of-state sellers. The Supreme Court's *Wayfair* decision has removed a significant impediment to the enactment and enforcement of these laws, and it is possible that states may seek to tax out-of-state sellers on sales that occurred in prior tax years, which could create additional administrative burdens for us, put us at a competitive disadvantage if such states do not impose similar obligations on our competitors, and decrease our future sales, which would adversely impact our business, financial condition, and results of operations.

***We incur increased costs and demands on management as a result of compliance with laws and regulations applicable to public companies, which could harm our future operating results.***

As a public company we incur significant legal, accounting, and other expenses, including costs associated with public company reporting requirements. Our management team and other personnel devote a substantial amount of time complying with SEC, Nasdaq and other public company requirements.

The growth of our business may require that we strengthen our financial reporting systems and infrastructure if we fail to do so we may not remain in compliance with Section 404 of the Sarbanes-Oxley Act over internal control over financial reporting. If we fail to maintain compliance, we could be unable to report our financial results timely and accurately or prevent fraud. We may to incur significant expense and devote substantial management effort toward strengthening our systems.

***From time to time we had been the subject of governmental inquiries and investigations related to our discontinued seminar sales model and business practices that could require us to pay refunds, damages or fines, which could negatively impact our financial results or ability to conduct business. We have received customer complaints and civil actions.***

From time to time, we received inquiries from federal, national, state, city and local government officials in the various jurisdictions in which we operated. These inquiries had historically been related to our discontinued seminar sales practices. There is still the potential of review of past sales and sales of our current web and telecom services. We respond to these inquiries and have generally been successful in addressing the concerns of these persons and entities, without a formal complaint or charge being made, although there is often no formal closing of the inquiry or investigation. If the ultimate resolution of these or other inquiries or investigations is not in our favor, this may have a material adverse effect on our business or operations, or a formal complaint could be initiated. During the ordinary course of business, we also receive a number of complaints and inquiries from customers, governmental and private entities. In some cases, these complaints and inquiries from agencies and customers have ended up in civil court. We may continue to receive customer and agency claims and actions.

***We may incur substantial expenses in defending against third-party patent and trademark infringement claims regardless of their merit.***

From time to time, parties may assert patent infringement claims against us in the form of letters, lawsuits, and other forms of communication. Third parties may also assert claims against us alleging infringement of copyrights, trademark rights, trade secret rights or other proprietary rights or alleging unfair competition. If there is a determination that we have infringed third-party proprietary rights, we could incur substantial monetary liability and be prevented from using the rights in the future.

## Risks Related to Our Common Stock

***Our stock price may be volatile and may decline,***

The trading price and volume of our common stock is likely to be volatile and could fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

- actual or anticipated fluctuations in our results of operations due to, among other things, changes in customer demand, pricing, ordering patterns, and unforeseen operating costs;
- developments, status, and impact on us, our competitors, our constituents, and our suppliers related to supply chain disruptions;
- failure of research analysts to maintain coverage or the ability to get additional coverage, changes in financial estimates or ratings by any research analysts who follow us, or our failure to meet these estimates or the expectations of investors;
- announcements by us or our competitors of significant technical innovations, substantial promotions, price reductions, acquisitions, strategic partnerships, or joint ventures;
- changes in operating performance and stock market valuations of other competitive companies generally, or those in the telecommunication and related services industry;
- cyclical fluctuations;
- price and volume fluctuations in the overall stock market from time to time, including as a result of trends in the economy as a whole;
- actual or anticipated developments in our business or our competitors' businesses or the competitive landscape generally;
- new laws or regulations or new interpretations of existing laws, or regulations applicable to our business;
- any major change in our management;
- lawsuits threatened or filed against us; and
- other events or factors, including those resulting from war, incidents of terrorism, the COVID-19 pandemic or responses to these events.

In addition, the market for telecommunication stocks and the stock markets in general have experienced extreme price and volume fluctuations. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. The COVID-19 pandemic has also caused significant uncertainty and volatility in global and domestic financial markets and the trading prices for the common stock of technology companies, including us. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business and adversely affect our business, financial condition, and results of operations.

***Our securities have been thinly traded. An active trading market in our equity securities may cease to exist, which would adversely affect the market price and liquidity of our common stock, in addition our stock price has been subject to fluctuating prices. Our stock price may also be affected by any merger, acquisition, or need for future sales of our common stock or equity-linked securities in the public market.***

Our common stock is currently traded on the Nasdaq Capital Market. We cannot predict the actions of market makers, investors or other market participants, and can offer no assurances that the market for our securities will be stable. If there is no active trading market in our equity securities, the market price and liquidity of the securities will be adversely affected.

The market price of our common stock could decline as a result of a merger, acquisition, or sales of a large number of shares of our common stock in the market or the perception that these sales could occur. Such sales or offerings could lower the market price for our common stock and may make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. We may issue shares as part of a merger transaction, an acquisition or otherwise sell additional shares of our common stock or equity-linked securities to raise capital. A substantial number of shares of our common stock could be registered and issued. Furthermore, there are substantial amounts of vested stock options which are "in the money" which could be exercised and sold in public markets. The Company continues to expect to issue stock options as part of compensation. The Company further expects to request a new equity incentive plan be to accommodate additional stock options to allow the Company to properly incorporate any mergers or acquisitions. There may be further effect on our stock price upon the vesting and settlement of restricted stock units and performance units. We cannot predict the size of future issuances or the effect, if any, that they may have on the market price for our common stock. The issuance and sale of substantial amounts of common stock or equity-linked securities as in this offering, or the perception that such issuances and sales may occur, could adversely affect the trading price of our common stock and impair our ability to raise capital through the sale of additional equity or equity-linked securities. Additional dilution will also result as a consequence of shares of common stock sold pursuant to this offering and potential future offerings as well as if outstanding options to acquire shares of our common stock are exercised.

***We are a "smaller reporting company," and the reduced disclosure requirements applicable to us as such may make our common shares less attractive to our stockholders and investors.***

We are a "smaller reporting company" under the federal securities laws and, as such, are subject to scaled disclosure requirements afforded to such companies. For example, as a smaller reporting company, we are subject to reduced executive compensation disclosure requirements. Our stockholders and investors may find our common shares less attractive as a result of our status as a "smaller reporting company" and our reliance on the reduced disclosure requirements afforded to these companies. If some of our stockholders or investors find our common shares less attractive as a result, there may be a less active trading market for our common shares and the market price of our common shares may be more volatile.

***Our actual operating results may not meet expectations, which could likely cause our stock price to decline.***

We have historically not provided guidance in our earnings releases, earnings conference calls, or otherwise. Management in the future may change this policy and provide future guidance. If given, this guidance, which will include forward-looking statements, will be based on projections prepared by our management. Projections are based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic, and competitive uncertainties and contingencies, many of which are beyond our control. With or without our guidance, analysts, and other third parties may publish expectations regarding our business, financial condition, and results of operations. We do not accept any responsibility for any projections or reports published by any such third parties. Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions of the guidance furnished by us will not materialize or will vary significantly from actual results. If our actual performance does not meet or exceed our guidance or expectations, the trading price of our common stock is likely to decline.

***Our stock price, volatility and acceptance of our securities may be influenced by the research and reports that securities or industry analysts may publish about us or our business.***

The Company cannot guarantee if there will be research reports written on the Company. Our stock price may be affected by the ability to get coverage and/or sufficient coverage. If coverage is initiated and/or if one or more of current or future analysts who cover us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts after issuing coverage ceases coverage of the Company or fails to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline. Furthermore, such analysts publish their own projections regarding our actual results. These projections may vary widely from one another and may not accurately predict the results we actually achieve. Our stock price may decline if we fail to meet analysts' projections.

***Lack of sufficient stockholder equity or continued losses from operations could subject us to fail to comply with the listing requirements of the Nasdaq Capital Market, if that occurred, the price of our common stock and our ability to access the capital markets could be negatively impacted, and our business will be harmed.***

Our common stock is currently listed on the Nasdaq Capital Market. Our stock was previously traded in the over-the-counter market prior to which it was traded on the New York Stock Exchange and failed to maintain the continued listing qualifications. We cannot guarantee that we will always meet Nasdaq listing qualifications. There remains the possibility of future losses. It is possible we may not remain in compliance with the minimum conditions of Nasdaq listing qualifications. Delisting from the Nasdaq Capital Market could negatively affect the trading price of our stock and could also have other negative results, including the potential loss of confidence by suppliers and employees, the failure to attract the interest of institutional investors, and fewer business development opportunities.

***We may invest or spend the proceeds of our cash both from operations and from past and future offerings in ways with which you may not agree or in ways which may not yield a favorable return.***

Our management will have considerable discretion in the application of the net proceeds of this offering, and you will not have the opportunity, as part of your investment decision, to assess whether the proceeds are being used appropriately. The net proceeds may be used for corporate purposes that do not increase the value of our business, which could cause our stock price to decline. See the section of this prospectus titled “Use of Proceeds.”

***Future offerings, acquisitions or mergers could cause substantial dilution of their ownership interest.***

If the Company undertakes future offerings, or the Company issues stock compensation in an acquisition or merger stockholders will have a dilution in their ownership percentage of stock which may be substantial depending upon the amount of shares which may be required.

***Our Chairman of the Board owns a significant amount of our common stock and could exercise substantial corporate control. There may be limited ability to sell the Company absent the consent of the Chairman.***

Steven G. Mihaylo, who has recently retired as Chief Executive Officer, but remains Chairman of the Board of Crexendo, Inc., owns approximately 44% of the outstanding shares of our common stock based on the number of shares outstanding as of December 31, 2022. Mr. Mihaylo has the ability to determine the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, amalgamation, consolidation or sale of all or substantially all of our assets. Mr. Mihaylo may have the ability to control the management and affairs of our Company. As a “control company” it may not be required that the Company maintains a board comprising a majority of independent directors. As a director, Mr. Mihaylo owes a fiduciary duty to our stockholders. As a stockholder, Mr. Mihaylo is entitled to vote his shares, in his own interests, which may not always be in the interests of our stockholders generally. Accordingly, even though certain transactions may be in the best interests of other stockholders, this concentration of ownership may harm the market price of our common stock by, among other things, delaying, deferring or preventing a change in control of our Company, impeding a merger, amalgamation, consolidation, takeover or other business combination involving our Company, or discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of our Company.

In addition, sales or other dispositions of our shares by Mr. Mihaylo may depress our stock price. Sales of a significant number of shares of our common stock in the public market could harm the market price of our common stock. As additional shares of our common stock become available for resale in the public market, the supply of our common stock will increase, which could result in a decrease in the market price of our common stock.

Some of the provisions of our articles of incorporation and bylaws could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders by providing them with the opportunity to sell their shares at a premium to the then market price. Our bylaws contain provisions regulating the introduction of business at annual stockholders’ meetings by anyone other than the board of directors. These provisions may have the effect of making it more difficult, delaying, discouraging, preventing or rendering costlier an acquisition or a change in control of our Company.

As part of our recent acquisitions there are certain employees who own substantial amounts of our common stock which is subject to sale on the open market.

The substantial purchase price of our acquisition of both NetSapiens and Allegiant involved the issuing of our common stock. The lock up period for the purchase of NetSapiens has ended, and there is a rolling two year lock up of the stock that was part of the consideration for the purchase of Allegiant. These employees who acquired the stock may sell their shares on the open market which may depress our stock price. Sales of a significant number of shares of our common stock in the public market could harm the market price of our common stock.

***There is no guarantee that Crexendo and recently acquired companies will fully integrate operations or. failure to properly manage the acquisitions could impact our stock price and our future business and financial results.***

The success of the Allegiant acquisition and future acquisitions will depend, in part, on our ability to successfully integrate the business and operations and fully realize the anticipated benefits and synergies from combining the businesses. However, to realize these anticipated benefits and synergies, the businesses must be successfully combined. If we are not able to achieve these objectives, the anticipated benefits and synergies may not be realized fully or at all or may take longer to realize than expected. Any failure to timely realize these anticipated benefits could have a material adverse effect on our revenues, expenses and operating results. We have integrated most of the operations from the NetSapiens acquisition, we are beginning to see the efficiencies from combining the operations, there is no guarantee however that those efficiencies will fully materialize.

***We are planning to migrate most of Crexendo's customers to the Crexendo Software Solutions Communication Platform, the failure to do that efficiently and properly may impact our business revenue and stock price.***

We are continuing process of moving certain Crexendo customers to the Crexendo Software Solutions communication platform while retaining some customers on the Crexendo Ride the Cloud® system. There can be significant cost savings associated with consolidating all customers on one communication platform. The failure to properly migrate customers could cause customer service issues which could cause cancellations and loss of revenue. There may be expenses and other difficulties involved in migrating customers, which may cause substantial short-term expenses prior to realizing the anticipated cost savings from primarily operating one system. We may be unable to realize efficiencies of primarily maintaining one communication platform.

***We have incurred and still have some continuing transaction costs in connection with Acquisitions.***

We have incurred significant costs in connection with the recent acquisitions including legal, accounting, financial consulting, and related fees. There will be costs associated with combining accounting systems with the Allegiant system. We may also incur fees and costs related to these integration plans. We may be unable to realize efficiencies that would allow us, over time, to offset the costs incurred in connection with acquisitions.

***Crexendo may have difficulty attracting, motivating and retaining executives and other key employees.***

Crexendo may have difficulty in attracting, retaining and motivating key personnel. Executives from acquired companies own substantial shares of our common stock and/or have stock option grants, the payment from which could provide sufficient financial incentive for certain officers and employees to no longer pursue employment. If key employees depart, we may have to incur significant costs in identifying, hiring and retaining replacements for departing employees, which could reduce our ability to realize the anticipated benefits of the Merger.

***Crexendo's business relationships, including customer relationships, may be subject to disruption due to Acquisitions.***

Parties with which Crexendo does business with may experience uncertainty associated with acquisitions and business relationships may be subject to disruption as customers and others may attempt to negotiate changes in existing business relationships or consider entering into business relationships with parties other than Crexendo. These disruptions could have an adverse effect on the businesses, financial condition, results of operations or prospects of the combined business.

***The market price of our Common Stock after recent and future acquisitions may be affected by factors different from those affecting our Common Stock currently. The market price of our Common Stock may decline as a result of acquisitions.***

The businesses of Crexendo and NetSapiens differ, the business of Allegiant differs as they are a MSP, and provide cabling services, future acquisitions may have different lines of business and, accordingly, the results of operations and the market price of our Common Stock following the acquisitions and the combination of the businesses may be affected by factors different from those currently affecting the independent results of operations and market prices of common stock of each of the parties if they were stand alone. The market price of our Common Stock may decline as a result of the acquisitions if, among other things, we are unable to achieve growth in earnings or, if we incur expenses in excess of what is anticipated, or we otherwise fail to achieve anticipated operational efficiencies. The market price also may decline if we do not achieve the perceived benefits of the acquisitions as rapidly or to the extent anticipated by the investment community or if the effect of the acquisitions on our financial results is not consistent with the expectations of the investment community. There may be substantial selling of stock by shareholders who received shares of Crexendo stock in the acquisitions.

***We expect to continue to undertake acquisitions, mergers or change to our capital structure to expand our business, which may pose risks to our business and dilute the ownership of our existing stockholders.***

As part of a potential growth strategy, we expect to continue to attempt to acquire or merge with certain businesses. Whether we realize benefits from any such transactions will depend in part upon the integration of any acquired businesses, the performance of the acquired products, services and capacities of the technologies acquired, as well as the personnel hired in connection therewith. Accordingly, our results of operations could be adversely affected from transaction-related charges, amortization of intangible assets, and charges for impairment of long-term assets. While we believe that we have established appropriate and adequate procedures and processes to mitigate these risks, there can be no assurance that any potential transaction will be successful.

In addition, the financing of any acquisition may require us to raise additional funds through public or private sources. Additional funds may not be available on terms that are favorable to us and, in the case of equity financings, may result in dilution to our stockholders. Future acquisitions by us could also result in large and immediate write-offs or assumptions of debt and contingent liabilities, any of which may have a material adverse effect on our consolidated financial position, results of operations, and cash flows.

## ITEM 2. PROPERTIES

Our corporate office consists of approximately 22,000 square feet of office space located at 1615 South 52nd Street, Tempe, Arizona 85281. We also have offices located in San Diego, California, Overland Park, Kansas and Reston, Virginia. Our San Diego office space is located at 8910 University Center Lance, Suite 400, San Diego, CA 92122, our Overland Park, Kansas office space is located at 10983 Granada Lane, Suite 300, Overland Park, KS 66211, and our Virginia office space is located at 1875 Campus Commons Drive, Reston, Virginia 20191. We maintain property insurance on the corporate office building and tenant fire and casualty insurance on our assets located in the building in an amount that we deem adequate.

## ITEM 3. LEGAL PROCEEDINGS

From time to time, we receive inquiries from federal, state, city and local government officials as well as the FCC and taxing authorities in the various jurisdictions in which we operate. These inquiries and investigations related primarily to our discontinued seminar operations and concern compliance with various city, county, state, and/or federal regulations involving sales, representations made, customer service, refund policies, services and marketing practices. We respond to these inquiries and have generally been successful in addressing the concerns of these persons and entities, without a formal complaint or charge being made, although there is often no formal closing of the inquiry or investigation. There can be no assurance that the ultimate resolution of these or other inquiries and investigations will not have a material adverse effect on our business or operations, or that a formal complaint will not be initiated. We also receive complaints and inquiries in the ordinary course of our business from both customers and governmental and non-governmental bodies on behalf of customers, and in some cases these customer complaints have risen to the level of litigation. There can be no assurance that the ultimate resolution of these matters will not have a material adverse effect on our business or results of operations.

## ITEM 4. MINE SAFETY DISCLOSURES

The disclosure required by this item is not applicable

## PART II

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

### Market Information

Our common stock began trading on the NYSE - MKT on August 16, 2004 under the symbol "IIG." In May 2011, our stockholders approved an amendment to our Certificate of Incorporation to change our name from "iMergent, Inc." to "Crexendo, Inc." The name change was effective May 18, 2011. Our ticker symbol "IIG" on the New York Stock Exchange was changed to "EXE" on May 18, 2011. On January 13, 2015, the Company moved to the OTCQX Marketplace and our ticker symbol was changed to "CXDO". On July 8, 2020, the Company up listed to The Nasdaq Stock Market keeping our ticker symbol "CXDO". The following table sets forth the range of high and low sales prices as reported on the OTCQX Marketplace or The Nasdaq Stock Market for the periods indicated.

| | High | Low |
|---|---|---|
| Year Ended December 31, 2022 | | |
| October to December 2022 | $ 2.83 | $ 1.61 |
| July to September 2022 | 3.28 | 2.23 |
| April to June 2022 | 3.71 | 2.10 |
| January to March 2022 | 5.18 | 3.55 |
| Year Ended December 31, 2021 | | |
| October to December 2021 | $ 6.20 | $ 4.39 |
| July to September 2021 | 7.20 | 5.35 |
| April to June 2021 | 6.93 | 4.90 |
| January to March 2021 | 8.38 | 5.51 |

### Security Holders

As of December 31, 2022, there were 177 shareholders of record of our common stock. The majority of the shares are held by DTC FAST, a nominee of The Depository Trust Company. This number of record holders does not include beneficial holders whose shares are held in "street name," meaning that the shares are held for their accounts by brokers or other nominees. In these instances, the brokers or other nominees are included in the number of record holders, but the underlying beneficial holders of the common stock held in "street name" are not.

### Dividends

Our Board of Directors declared the following dividends payable in 2022 and 2021 (in thousands):

| Date Declared | Record Date | Dividend Per Share | Total Amount | Payment Date |
|---|---|---|---|---|
| February 8, 2022 | February 14, 2022 | $ 0.005 | $ 111 | February 28, 2022 |
| May 18, 2022 | May 30, 2022 | 0.005 | 112 | June 10, 2022 |
| August 12, 2022 | August 23, 2022 | 0.005 | 113 | September 2, 2022 |
| November 17, 2022 | November 28, 2022 | 0.005 | 126 | December 8, 2022 |

The declaration of dividends is solely at the discretion of our Board of Directors, which may change or terminate our dividend practice at any time for any reason without prior notice. On March 14, 2023, our Board of Directors declared a quarterly cash dividend of $0.005 per share.

### ISSUER PURCHASES OF EQUITY SEQURITIES

None

### RECENT SALES OF UNREGISTERED SECURITIES

None

## ITEM 6. SELECTED FINANCIAL DATA

Not required.

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

## SAFE HARBOR

*In addition to historical information, this Annual Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, risks and uncertainties, including the risk factors set forth in Item 1A. above and the risk factors set forth in this Annual Report. Generally, the words "anticipate", "expect", "intend", "believe" and similar expressions identify forward-looking statements. The forward-looking statements made in this Annual Report are made as of the filing date of this Annual Report with the SEC, and future events or circumstances could cause results that differ significantly from the forward-looking statements included here. Accordingly, we caution readers not to place undue reliance on these statements. We expressly disclaim any obligation to update or alter our forward-looking statements, whether, as a result of new information, future events or otherwise after the date of this document.*

### Overview

Crexendo, Inc. an award-winning premier provider of cloud communication platform and services, video collaboration and managed IT services designed to provide enterprise-class cloud solutions to any size business. Our solutions currently support over three million end users globally. The Company has two operating segments, which consist of Cloud Telecommunications Services and Software Solutions.

*Cloud Telecommunications Services* – Our cloud telecommunications services transmit calls using IP or cloud technology, which converts voice signals into digital data packets for transmission over the Internet or cloud. Each of our calling plans provides a number of basic features typically offered by traditional telephone service providers, plus a wide range of enhanced features that we believe offer an attractive value proposition to our customers. This platform enables a user, via a single "identity" or telephone number, to access and utilize services and features regardless of how the user is connected to the Internet or cloud, whether it's from a desktop device or an application on a mobile device.

We generate recurring revenue from our cloud telecommunications services, broadband Internet services, managed IT services, software license sales, and infrastructure as a service. Our cloud telecommunications contracts typically have a thirty-six to sixty month term. We also charge other various contracted and non-contracted fees.

We generate product revenue, equipment financing revenue, and device as a service revenue from the sale and lease of our cloud telecommunications equipment. Revenues from the sale of equipment, including those from sales-type leases, are recognized at the time of sale or at the inception of the lease, as appropriate.

Our Cloud Telecommunications service revenue increased 14% or $2,413,000 to $19,515,000 for the year ended December 31, 2022 as compared to $17,102,000 for the year ended December 31, 2021. Our Cloud Telecommunications product revenue increased 24% or $567,000 to $2,891,000 for the year ended December 31, 2022 as compared to $2,324,000 for the year ended December 31, 2021.

*Software Solutions* – Our software solutions segment derives revenues from three primary sources: software licenses, software maintenance support and professional services. Software and services may be sold separately or in bundled packages. Generally, contracts with customers contain multiple performance obligations, consisting of software and services. For bundled packages, the Company accounts for individual products and services separately if they are distinct – i.e. if a product or service is separately identifiable from other items in the bundled package and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The consideration is allocated between separate products and services in a bundle based on their relative stand-alone selling prices. The stand-alone selling prices are determined based on the prices at which the Company separately sells the software licenses and professional services. For items that are not sold separately (e.g. additional features) the Company estimates stand-alone selling prices using the adjusted market assessment approach. When we provide a free trial period, we do not begin to recognize recurring revenue until the trial period has ended and the customer has been billed for the services.

We generate software license revenue from the sale of perpetual software licenses, term-based software licenses that expire, and Software-as-a-Service ("SaaS") based software which are referred to as subscription arrangements. The Company does not recognize software revenue related to the renewal of subscription software licenses earlier than the beginning of the subscription period.

We generate subscription and maintenance support revenue from customer support and other supportive services. The Company offers warranties on its products. The warranty period for our licensed software is generally 90 days. Certain of the Company's warranties are considered to be assurance-type in nature and do not cover anything beyond ensuring that the product is functioning as intended. Based on the guidance in ASC 606, assurance-type warranties do not represent separate performance obligations. The Company also sells separately-priced maintenance service contracts, which qualify as service-type warranties and represent separate performance obligations. The Company does not typically allow and has no history of accepting material product returns. Customer support includes software updates on a when-and-if-available basis, telephone support, integrated web-based support and bug fixes or patches. Subscription and maintenance support revenue is recognized ratably over the term of the customer support agreement, which is typically one year.

We generate professional services and other revenue from consulting, technical support, resident engineer services, design services and installation services. Revenue for professional services and other is recognized when the performance obligation is complete and the customer has accepted the performance obligation.

Our Software Solutions revenue increased 75%, or $6,482,000 to $15,148,000 for the year ended December 31, 2022 as compared to $8,666,000 for the year ended December 31, 2021. The year ended December 31, 2021 includes only seven months of revenue from the NetSapiens acquisition date of June 1, 2021.

**Results of Consolidated Operations**

The following discussion of financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto and other financial information included herein this Annual Report.

**Results of Consolidated Operations (in thousands, except for per share amounts)**

| | Year Ended December 31, | |
|---|---|---|
| **Consolidated** | **2022** | **2021** |
| Service revenue | $ 19,515 | $ 17,102 |
| Software solutions revenue | 15,148 | 8,666 |
| Product revenue | 2,891 | 2,324 |
| Total revenue | 37,554 | 28,092 |
| Loss before income taxes | (36,175) | (2,910) |
| Income tax benefit | 762 | 465 |
| Net loss | (35,413) | (2,445) |
| Basic earnings per common share | $ (1.54) | $ (0.12) |
| Diluted earnings per common share | $ (1.54) | $ (0.12) |

| | For the three months ended | | | |
|---|---|---|---|---|
| **Consolidated** | **March 31, 2022** | **June 30, 2022** | **September 30, 2022** | **December 31, 2022** |
| Service revenue | $ 4,398 | $ 4,556 | $ 4,473 | $ 6,088 |
| Software solutions revenue | 3,268 | 3,598 | 3,875 | 4,407 |
| Product revenue | 492 | 692 | 760 | 947 |
| Total revenue | 8,158 | 8,846 | 9,108 | 11,442 |
| Loss before income taxes | (1,421) | (978) | (728) | (33,048) |
| Income tax benefit | 201 | 82 | 32 | 447 |
| Net loss | (1,220) | (896) | (696) | (32,601) |
| Basic earnings per common share (1) | $ (0.05) | $ (0.04) | $ (0.03) | $ (1.33) |
| Diluted earnings per common share (1) | $ (0.05) | $ (0.04) | $ (0.03) | $ (1.33) |

| Consolidated | For the three months ended March 31, 2021 | June 30, 2021 | September 30, 2021 | December 31, 2021 |
|---|---|---|---|---|
| Service revenue | $ 4,139 | $ 4,327 | $ 4,325 | $ 4,311 |
| Software solutions revenue | - | 1,012 | 3,784 | 3,870 |
| Product revenue | 368 | 440 | 701 | 815 |
| Total revenue | 4,507 | 5,779 | 8,810 | 8,996 |
| Income/(loss) before income taxes | (839) | (1,263) | 12 | (820) |
| Income tax benefit/(provision) | 124 | 260 | (137) | 218 |
| Net loss | (715) | (1,003) | (125) | (602) |
| | | | | |
| Basic earnings per common share (1) | $ (0.04) | $ (0.05) | $ (0.01) | $ (0.03) |
| Diluted earnings per common share (1) | $ (0.04) | $ (0.05) | $ (0.01) | $ (0.03) |

(1) Earnings per common share is computed independently for each of the quarters presented. Therefore, the sums of quarterly earnings per common share amounts do not necessarily equal the total for the twelve month periods presented.

**Year Ended December 31, 2022 Compared to Year Ended December 31, 2022**

*Total Revenue*

Total revenue consists of service revenue, software solutions revenue and product revenue. The following table reflects our total revenue for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, 2022 | 2021 | Dollar Change | Percent Change |
|---|---|---|---|---|
| Total revenue | $ 37,554 | $ 28,092 | $ 9,462 | 34% |

The increase in total revenue for the year is mainly driven by an additional $6,482,000 contributed from our software solutions segment for a full year compared to only seven months of revenue in the prior year resulting from the June 1, 2021 acquisition of NetSapiens, Inc., an increase in service revenue and product revenue of $1,755,000 contributed from our November 1, 2022 acquisition of Allegiant Networks, LLC , and an increase in organic service and product revenue of $1,225,000 for the year compared to 2021.

*Loss Before Income Taxes*

The following table reflects our income/(loss) before income taxes for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, 2022 | 2021 | Dollar Change | Percent Change |
|---|---|---|---|---|
| Loss before income taxes | $ (36,175) | $ (2,910) | $ (33,265) | 1143% |

The increase in loss before income tax is primarily due to an increase in operating expenses of $44,044,000, offset by an increase in revenue of $9,462,000 and an increase in other income, net of $1,317,000. The increase in operating expenses is primarily related to goodwill and long-lived asset impairment, increases in salaries and benefits, stock compensation expense, twelve months of software solutions operating expenses compared to only seven months in the prior year, and two months of Allegiant Networks operating expenses. The increase in revenue is primarily related to organic growth, twelve months of software solutions revenue compared to only seven months in the prior year, and two months of Allegiant Networks revenue. The increase in other income, net is primarily related to releasing a sales tax accrual.

*Income Tax Benefit*

The following table reflects our income tax benefit/(provision) for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Income tax benefit | $ 762 | $ 465 | $ 297 | 64% |

We had pre-tax loss for the year ended December 31, 2022 and 2021 of $(36,175,000) and $(2,910,000), respectively. For the year ended December 31, 2022, we recorded additional valuation allowance of $1,681,000 and for the year ended December 31, 2021, we recorded additional valuation allowance of $1,437,000.

**Use of Non-GAAP Financial Measures**

To evaluate our business, we consider and use non-generally accepted accounting principles ("Non-GAAP") net income and Adjusted EBITDA as a supplemental measure of operating performance. These measures include the same adjustments that management takes into account when it reviews and assesses operating performance on a period-to-period basis. We consider Non-GAAP net income to be an important indicator of overall business performance because it allows us to evaluate results without the effects of share-based compensation, acquisition related expenses, changes in fair value of contingent consideration, amortization of intangibles, and goodwill and long-lived asset impairment. We define EBITDA as U.S. GAAP net income/(loss) before interest expense, interest income and other expense/(income), goodwill and long-lived asset impairments, provision/(benefit) for income taxes, and depreciation and amortization. We believe EBITDA provides a useful metric to investors to compare us with other companies within our industry and across industries. We define Adjusted EBITDA as EBITDA adjusted for acquisition related expenses, changes in fair value of contingent consideration and share-based compensation. We use Adjusted EBITDA as a supplemental measure to review and assess operating performance. We also believe use of Adjusted EBITDA facilitates investors' use of operating performance comparisons from period to period, as well as across companies.

In our March 14, 2023 earnings press release, as furnished on Form 8-K, we included Non-GAAP net income, EBITDA and Adjusted EBITDA. The terms Non-GAAP net income, EBITDA, and Adjusted EBITDA are not defined under U.S. GAAP, and are not measures of operating income, operating performance or liquidity presented in analytical tools, and when assessing our operating performance, Non-GAAP net income, EBITDA, and Adjusted EBITDA should not be considered in isolation, or as a substitute for net income/(loss) or other consolidated income statement data prepared in accordance with U.S. GAAP. Some of these limitations include, but are not limited to:

- EBITDA and Adjusted EBITDA do not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- they do not reflect changes in, or cash requirements for, our working capital needs;
- they do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt that we may incur;
- they do not reflect income taxes or the cash requirements for any tax payments;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will be replaced sometime in the future, and EBITDA and Adjusted EBITDA do not reflect any cash requirements for such replacements;
- while share-based compensation is a component of operating expense, the impact on our financial statements compared to other companies can vary significantly due to such factors as the assumed life of the options and the assumed volatility of our common stock; and
- other companies may calculate EBITDA and Adjusted EBITDA differently than we do, limiting their usefulness as comparative measures.

We compensate for these limitations by relying primarily on our U.S. GAAP results and using Non-GAAP net income, EBITDA, and Adjusted EBITDA only as supplemental support for management's analysis of business performance. Non-GAAP net income, EBITDA and Adjusted EBITDA are calculated as follows for the periods presented.

**Reconciliation of Non-GAAP Financial Measures**

In accordance with the requirements of Regulation G issued by the SEC, we are presenting the most directly comparable U.S. GAAP financial measures and reconciling the unaudited Non-GAAP financial metrics to the comparable U.S. GAAP measures.

**Reconciliation of U.S. GAAP Net Income to Non-GAAP Net Income (Unaudited)**

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| | 2022 | 2021 | 2022 | 2021 |
| | (In thousands) | | (In thousands) | |
| U.S. GAAP net loss | $ (32,601) | $ (602) | $ (35,413) | $ (2,445) |
| Share-based compensation | 1,612 | 478 | 4,374 | 1,628 |
| Acquisition related expenses | 24 | (28) | 55 | 1,037 |
| Change in fair value of contigent consideration | - | 126 | - | 126 |
| Goodwill and long-lived asset impairment | 32,678 | - | 32,678 | - |
| Amortization of intangible assets | 786 | 618 | 2,435 | 1,391 |
| Non-GAAP net income | $ 2,499 | $ 592 | $ 4,129 | $ 1,737 |
| Non-GAAP net income per common share: | | | | |
| Basic | $ 0.10 | $ 0.03 | $ 0.18 | $ 0.09 |
| Diluted | $ 0.09 | $ 0.02 | $ 0.16 | $ 0.07 |
| Weighted-average common shares outstanding: | | | | |
| Basic | 24,423,030 | 21,792,137 | 22,939,514 | 20,275,691 |
| Diluted | 26,633,630 | 26,068,825 | 25,783,179 | 23,408,162 |

**Reconciliation of U.S. GAAP Net Income to EBITDA to Adjusted EBITDA (Unaudited)**

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| | 2022 | 2021 | 2022 | 2021 |
| | (In thousands) | | (In thousands) | |
| U.S. GAAP net loss | $ (32,601) | $ (602) | $ (35,413) | $ (2,445) |
| Depreciation and amortization | 885 | 695 | 2,747 | 1,626 |
| Interest expense | 21 | 20 | 78 | 84 |
| Interest income and other expense/(income) | (1,576) | 3 | (1,295) | 16 |
| Goodwill and long-lived asset impairment | 32,678 | - | 32,678 | - |
| Income tax benefit | (447) | (218) | (762) | (465) |
| EBITDA | (1,040) | (102) | (1,967) | (1,184) |
| Acquisition related expenses | 24 | (28) | 55 | 1,037 |
| Change in fair value of contingent consideration | - | 126 | - | 126 |
| Share-based compensation | 1,612 | 478 | 4,374 | 1,628 |
| Adjusted EBITDA | $ 596 | $ 474 | $ 2,462 | $ 1,607 |

**Critical Accounting Policies and Estimates**

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The following accounting policies are the most critical in understanding our consolidated financial position, results of operations or cash flows, and that may require management to make subjective or complex judgments about matters that are inherently uncertain.

*Revenue Recognition*

Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services and excludes any amounts collected on behalf of third parties. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the timing of revenue recognized but does not change the total revenue recognized on any agreement.

The consideration (including any discounts) is allocated between separate products and services in a bundle based on their relative stand-alone selling prices. The stand-alone selling prices are determined based on the prices at which the Company separately sells the products and services. For items that are not sold separately (e.g. additional features) the Company estimates stand-alone selling prices using the adjusted market assessment approach. Professional services revenue includes activation fees and any professional installation services. Installation services are recognized as revenue when the services are completed. The Company generally allocates a portion of the activation fees to the desktop devices, which is recognized at the time of the installation or customer acceptance, and a portion to the service, which is recognized over the contract term using the straight-line method. Our telecommunications services contracts typically have a term of thirty-six to sixty months. When we provide a free trial period, we do not begin to recognize recurring revenue until the trial period has ended and the customer has been billed for the services.

*Goodwill*

We have recorded goodwill related to various business acquisitions. Goodwill is recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. In each of our acquisitions, the objective of the acquisition was to expand our product offerings and customer base and to achieve synergies related to cross selling opportunities, all of which contributed to the recognition of goodwill. We test goodwill for impairment on an annual basis or more frequently if events or changes in circumstances indicate that goodwill might be impaired. The estimated fair value of the reporting unit is determined using our market capitalization as of our annual impairment assessment date or more frequently if circumstances indicate the goodwill might be impaired. Items that could reasonably be expected to negatively affect key assumptions used in estimating fair value include but are not limited to: sustained decline in our stock price due to a decline in our financial performance due to the loss of key customers, loss of key personnel, emergence of new technologies or new competitors; and decline in overall market or economic conditions leading to a decline in our stock price.

The process of estimating the fair value of goodwill is subjective and required the Company to make estimates that may significantly impact the outcome of the analysis. A qualitative assessment considers events and circumstances such as macroeconomic conditions, industry and market conditions, cost factors and overall financial performance, as well as company specifications. If after performing this assessment, the Company concluded it is more likely than not that the fair value of the reporting unit is less than its carrying amount, then the Company performed the quantitative test.

Under the quantitative test, a goodwill impairment is identified by comparing the fair value of the reporting unit to the carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds the fair value of the reporting unit, goodwill is considered impaired and an impairment charge is recognized in an amount equal to the excess, not to exceed the carrying amount of goodwill.

The Company estimated the fair value of the reporting unit with an income approach using the discounted cash flow ("DCF") analysis and the Company also considered a market-based valuation methodology using comparable public company trading values and the Company's market capitalization. Determining fair value requires the exercise of significant judgments, including the amount and timing of expected future cash flows, long-term growth rates, the discount rate and relevant comparable public company earnings multiples. The cash flows employed in the DCF analysis are based on the Company's best estimate of future sales, earnings and cash flows after considering factors such as general market conditions and recent operating performance. The discount rate utilized in the DCF analysis is based on the reporting unit's weighted-average cost of capital, which takes into account the relative weights of each component of capital structure (equity and debt) and represents the expected cost of new capital, adjusted as appropriate to consider the risk inherent in future cash flows of the Company's reporting unit.

Impairment assessment inherently involves management judgments regarding a number of assumptions described above. The reporting unit fair value also depends on the future strength of the U.S. economy. New and developing competition as well as technological change could also adversely affect future fair value estimates. Due to the many variables inherent in the estimation of a reporting unit's fair value and the relative size of the Company's recorded goodwill, differences in assumptions could have a material effect on the estimated fair values. For further information, see Note 8 (Intangible Assets and Goodwill).

*Intangible Assets*

Our intangible assets consist of customer relationships, developed technologies, trademark and trade names. The intangible assets are amortized following the patterns in which the economic benefits are consumed or straight-line over the estimated useful life. We periodically review the estimated useful lives of our intangible assets and review these assets for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The determination of impairment is based on estimates of future undiscounted cash flows. If an intangible asset is considered to be impaired, the amount of the impairment will be equal to the excess of the carrying value over the fair value of the asset.

Amortizable intangible assets are amortized over the estimated useful lives as follows:

| | |
|---|---|
| Customer relationships | 6 to 16 years |
| Developed technologies | 2 to 6 years |
| Trademark and trade names | 4 years |

*Valuation of Long-Lived Assets.*

The Company reviews the carrying amount of long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Once an indicator of potential impairment has occurred, the impairment test is based on whether the intent is to hold the asset for continued use or to hold the asset for sale. If the intent is to hold the asset for continued use, the impairment test first requires a comparison of projected undiscounted future cash flows against the carrying amount of the asset group. If the carrying value of the asset group exceeds the estimated undiscounted future cash flows, the asset group would be deemed to be potentially impaired. The impairment, if any, would be measured based on the amount by which the carrying amount exceeds the fair value. Fair value is determined primarily using the projected future undiscounted cash flows. Losses on long-lived assets to be disposed of are determined in a similar manner, except that fair values are reduced for the cost to dispose. We recognized impairment losses of $69,000 and $0 in the Consolidated Statements of Operations for the years ended December 31, 2022 and 2021, respectively.

*Deferred Taxes*

Our provision for income taxes is comprised of a current and a deferred portion. The current income tax provision is calculated as the estimated taxes payable or refundable on tax returns for the current year. The deferred income tax provision is calculated for the estimated future tax effects attributable to temporary differences and carryforwards using expected tax rates in effect during the years in which the differences are expected to reverse or the carryforwards are expected to be realized.

We currently have net deferred tax assets consisting of net operating loss carryforwards, tax credit carryforwards and deductible temporary differences. Management periodically weighs the positive and negative evidence to determine if it is more likely than not that some or all of the deferred tax assets will be realized. As of December 31, 2022, we have three years of cumulative pretax losses and the weight of all other positive and negative evidence, such as forecasts and projections of future pretax income are inherently subjective and require management to make assumption or complex judgments about matters that are inherently uncertain and therefore are not sufficient to overcome the significant negative evidence of a three year lookback cumulative loss position. Therefore, management determined that it is not more likely than not that we will be able to realize our deferred tax assets, and we have recorded a valuation allowance of $3,179,000 at December 31, 2022.

*Product Warranty*

We provide for the estimated cost of product warranties at the time we recognize revenue. We evaluate our warranty obligations on a product group basis. Our standard product warranty terms generally include post-sales support and repairs or replacement of a product at no additional charge for a specified period of time. We base our estimated warranty obligation upon warranty terms, ongoing product failure rates, and current period product shipments. If actual product failure rates, repair rates or any other post-sales support costs were to differ from our estimates, we would be required to make revisions to the estimated warranty liability. Warranty terms generally last for the duration that the customer has service. Some third-party equipment vendors offer extended warranties. These extended warranties are sold separately and provide services in addition to assurance that the product will function as expected, including updates and patches. The Company is arranging for these services to be provided by the third-party and is acting as an agent in the transaction and records revenue on a net basis at the time of sale.

*Contingent Liabilities*

Contingent liabilities require significant judgment in estimating potential payouts. Contingent considerations arising from business combinations and asset acquisitions require management to estimate future payouts based on forecasted results, which are highly sensitive to the estimates of discount rates and future revenues. These estimates can change significantly from period to period and are reviewed each reporting period to establish the fair value of the contingent liability.

*Share-Based Compensation*

We account for our share-based compensation awards using the fair-value method. The grant date fair value was determined using the Black-Scholes-Merton pricing model. The Black-Scholes-Merton valuation calculation requires us to make key assumptions such as future stock price volatility, expected terms, risk-free rates, and dividend yield. Our expected volatility is derived from our volatility rate as a publicly traded company. The expected term is based on our historical experience. The risk-free interest factor is based on the United States Treasury yield curve in effect at the time of the grant for zero coupon United States Treasury notes with maturities of approximately equal to each grant's expected term. For the year ended December 31, 2022, quarterly dividends of $0.005 were declared and paid, however we have assumed a 0% dividend yield for the year ended December 31, 2022. For the years ended December 31, 2021, no dividends were declared or paid, therefore we have assumed a 0% dividend yield.

We develop an estimate of the number of share-based awards that will be forfeited due to employee turnover. We will continue to use judgment in evaluating the expected term, volatility, and forfeiture rate related to our own share-based awards on a prospective basis, and in incorporating these factors into the model. If our actual experience differs significantly from the assumptions used to compute our share-based compensation cost, or if different assumptions had been used, we may have recorded too much or too little share-based compensation cost.

For additional information on use of estimates, see summary of Significant Accounting Policies in the notes to the Consolidated Financial Statements.

**Segment Operating Results**

The Company has two operating segments, which consist of Cloud Telecommunications Services and Software Solutions. The information below is organized in accordance with our two reportable segments. Segment operating income is equal to segment net revenue less segment cost of service revenue, cost of software solution revenue, cost of product revenue, sales and marketing, research and development, and general and administrative expenses.

**Operating Results of our Cloud Telecommunications Services Segment (in thousands):**

| Cloud Telecommunications Services | Year Ended December 31, 2022 | Year Ended December 31, 2021 |
|---|---|---|
| Service revenue | $ 19,515 | $ 17,102 |
| Product revenue | 2,891 | 2,324 |
| Total revenue | 22,406 | 19,426 |
| Operating expenses: | | |
| Cost of service revenue | 6,711 | 5,104 |
| Cost of product revenue | 1,637 | 1,525 |
| Selling and marketing | 7,234 | 5,915 |
| General and administrative | 9,366 | 8,129 |
| Research and development | 1,266 | 1,396 |
| Long-lived asset impairment | 69 | - |
| Total operating expenses | 26,283 | 22,069 |
| Operating loss | (3,877) | (2,643) |
| Other expense | (71) | (70) |
| Loss before tax benefit | $ (3,948) | $ (2,713) |

*Quarterly Financial Information*

| Cloud Telecommunications Services | For the three months ended March 31, 2022 | June 30, 2022 | September 30, 2022 | December 31, 2022 |
|---|---|---|---|---|
| Service revenue | $ 4,398 | $ 4,556 | $ 4,473 | $ 6,088 |
| Product revenue | 492 | 692 | 760 | 947 |
| Total revenue | 4,890 | 5,248 | 5,233 | 7,035 |
| Operating expenses: | | | | |
| Cost of service revenue | 1,436 | 1,438 | 1,375 | 2,462 |
| Cost of product revenue | 317 | 372 | 453 | 495 |
| Selling and marketing | 1,581 | 1,678 | 1,704 | 2,271 |
| General and administrative | 2,306 | 1,993 | 2,056 | 3,011 |
| Research and development | 304 | 310 | 284 | 368 |
| Long-lived asset impairment | - | - | - | 69 |
| Total operating expenses | 5,944 | 5,791 | 5,872 | 8,676 |
| Operating loss | (1,054) | (543) | (639) | (1,641) |
| Other expense | (18) | (17) | (17) | (19) |
| Loss before tax benefit | $ (1,072) | $ (560) | $ (656) | $ (1,660) |

| Cloud Telecommunications Services | For the three months ended March 31, 2021 | June 30, 2021 | September 30, 2021 | December 31, 2021 |
|---|---|---|---|---|
| Service revenue | $ 4,139 | $ 4,327 | $ 4,325 | $ 4,311 |
| Product revenue | 368 | 440 | 701 | 815 |
| Total revenue | 4,507 | 4,767 | 5,026 | 5,126 |
| Operating expenses: | | | | |
| Cost of service revenue | 1,259 | 1,347 | 1,210 | 1,288 |
| Cost of product revenue | 225 | 286 | 461 | 553 |
| Selling and marketing | 1,279 | 1,508 | 1,487 | 1,641 |
| General and administrative | 2,216 | 2,167 | 1,763 | 1,983 |
| Research and development | 350 | 388 | 358 | 300 |
| Total operating expenses | 5,329 | 5,696 | 5,279 | 5,765 |
| Operating loss | (822) | (929) | (253) | (639) |
| Other expense | (17) | (19) | (22) | (12) |
| Loss before tax benefit/(provision) | $ (839) | $ (948) | $ (275) | $ (651) |

**Year Ended December 31, 2022 Compared to Year Ended December 31, 2021**

*Service Revenue*

Cloud telecommunications service revenue consists primarily of fees collected for cloud telecommunications services, professional services, interest from sales-type leases, reselling broadband Internet services, managed IT service, administrative fees, and website hosting services. The following table reflects our service revenue for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Service revenue | $ 19,515 | $ 17,102 | $ 2,413 | 14% |

The increase in service revenue is due to an increase in organic telecommunications services of $517,000, an increase in fees, commissions, and other, recognized over time of $45,000, an increase in one-time fees, commissions and other of $255,000, an increase in sales-type lease interest of $69,000, and two months of service revenue of $1,527,000 contributed by our acquisition of Allegiant Networks, LLC on November 1, 2022. A substantial portion of Cloud Telecommunications service revenue is generated through thirty-six to sixty months service contracts.

*Product Revenue*

Product revenue consists primarily of fees collected from the sale of desktop phone devices, third-party equipment, and device as a service. The following table reflects our product revenue for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Product revenue | $ 2,891 | $ 2,324 | $ 567 | 24% |

Product revenue fluctuates from one period to the next based on timing of installations. Our typical customer installation is complete within 30-60 days. However, larger enterprise customers can take multiple months, depending on size and the number of locations. Product revenue is recognized when products have been installed and services commence. Additionally, product revenue can fluctuate due to the allocation of discounts or sales promotions across the performance obligations. Our November 1, 2022 acquisition of Allegiant Networks, LLC contributed $228,000 of the increase in product revenue.

*Backlog*

Backlog represents the total contract value of all contracts signed, less revenue recognized from those contracts as of December 31, 2022 and 2021. Backlog increased 6%, or $1,826,000 to $32,016,000 as of December 31, 2022 as compared to $30,190,000 as of December 31, 2021. Below is a table which displays the Cloud Telecommunications segment revenue backlog as of December 31, 2022 and 2021, which we expect to recognize as revenue within the next thirty-six to sixty months (in thousands):

| | |
|---|---|
| Cloud Telecommunications Services backlog as of December 31, 2022 | $ 32,016 |
| Cloud Telecommunications Services backlog as of December 31, 2021 | $ 30,190 |

*Cost of Service Revenue*

Cost of service revenue consists primarily of fees we pay to third-party telecommunications carriers, broadband Internet providers, software providers, costs related to installations, customer support salaries and benefits, and share-based compensation. The following table reflects our cost of service revenue for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Cost of service revenue | $ 6,711 | $ 5,104 | $ 1,607 | 31% |

The increase in cost of service revenue was primarily due to an increase in salaries, wages and benefits of $681,000 as a result of an increase in customer support and implementation specialist headcount, an increase in professional consulting services of $201,000, an increase in other cost of service revenue of $49,000, and additional cost of service revenue of $1,003,000 contributed by our November 1, 2022 acquisition of Allegiant Networks, LLC, offset by a $327,000 decrease in third-party telecommunications carrier costs.

*Cost of Product Revenue*

Cost of product revenue consists of the costs associated with desktop phone devices and third-party equipment. The following table reflects our cost of product revenue for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Cost of product revenue | $ 1,637 | $ 1,525 | $ 112 | 7% |

The increase is primarily related to the increase in product revenue and an increase in device costs, and additional cost of product revenue of $105,000 contributed by our November 1, 2022 acquisition of Allegiant Networks, LLC.

*Selling and Marketing*

Selling and marketing expenses consist primarily of direct and channel sales representative salaries and benefits, share-based compensation, partner channel commissions, amortization of costs to acquire contracts, travel expenses, lead generation services, trade shows, internal and third-party marketing costs, the production of marketing materials, and sales support software. The following table reflects our selling and marketing expenses for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Selling and marketing | $ 7,234 | $ 5,915 | $ 1,319 | 22% |

The increase in selling and marketing expense is due to an increase in salaries, wages and benefits of $437,000 related to expansion of our sales team, an increase in commission expense of $223,000 directly related to the increase in revenue, an increase in travel related costs and tradeshows of $185,000, and additional selling and marketing expense of $540,000 contributed by our November 1, 2022 acquisition of Allegiant Networks, LLC, offset by a decrease in sales leads and marketing material costs of $48,000 and a decrease in other sales and marketing expense of $18,000.

*General and Administrative*

General and administrative expenses consist of salaries, benefits and stock compensation for executives, administrative personnel, legal, rent, equipment, accounting and other professional services, investor relations, depreciation, amortization of intangibles, and other administrative corporate expenses. The following table reflects our general and administrative expenses for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| General and administrative | $ 9,366 | $ 8,129 | $ 1,237 | 15% |

The increase in general and administrative expenses is primarily due to an increase in administrative salaries, wages and benefits of $1,959,000 as a result of an increase in headcount, increase in stock compensations, and company-wide salary increases. There were additional general and administrative expenses of $382,000 contributed by our November 1, 2022 acquisition of Allegiant Networks, LLC. This was offset by a decrease in acquisition related legal, accounting, and other professional services of $982,000 in connection with the 2021 NetSapiens acquisition. Additionally, there was a decrease in corporate insurance costs of $91,000 and a decrease in other general and administrative expenses of $31,000.

*Research and Development*

Research and development expenses primarily consist of salaries and benefits, share-based compensation, and outsourced engineering services related to the development of new cloud telecommunications features and products. The following table reflects our research and development expenses for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Research and development | $ 1,266 | $ 1,396 | $ (130) | -9% |

The decrease in research and development expenses is primarily related to a decrease in costs for maintenance on our mobile applications and other development costs of $117,000 and a decrease in salaries, wages and benefits of $13,000.

*Other Expense*

Other expense primarily relates to interest expense and net foreign exchange gains or losses, offset by credit card cash back rewards. The following table reflects our other expense for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Other expense | $ (71) | $ (70) | $ (1) | 1% |

**Operating Results of our Software Solutions Segment (in thousands):**

| | Year Ended December 31, | |
|---|---|---|
| **Software Solutions** | 2022 | 2021 |
| Software solutions revenue | $ 15,148 | $ 8,666 |
| Operating expenses: | | |
| Cost of software solutions revenue | 5,336 | 4,031 |
| Selling and marketing | 4,491 | 2,345 |
| General and administrative | 3,538 | 2,457 |
| Research and development | 2,689 | - |
| Goodwill impairment | 32,609 | - |
| Total operating expenses | 48,663 | 8,833 |
| Operating loss | (33,515) | (167) |
| Other income/(expense) | 1,288 | (30) |
| Loss before tax benefit | $ (32,227) | $ (197) |

*Quarterly Financial Information*

| | For the three months ended | | | |
|---|---|---|---|---|
| **Software Solutions** | March 31, 2022 | June 30, 2022 | September 30, 2022 | December 31, 2022 |
| Software solutions revenue | $ 3,268 | $ 3,598 | $ 3,875 | $ 4,407 |
| Operating expenses: | | | | |
| Cost of software solutions revenue | 1,661 | 1,131 | 1,141 | 1,403 |
| Selling and marketing | 1,003 | 1,093 | 1,028 | 1,367 |
| General and administrative | 943 | 764 | 744 | 1,087 |
| Research and development | - | 919 | 867 | 903 |
| Goodwill impairment | - | - | - | 32,609 |
| Total operating expenses | 3,607 | 3,907 | 3,780 | 37,369 |
| Operating income/(loss) | (339) | (309) | 95 | (32,962) |
| Other income/(expense) | (10) | (109) | (167) | 1,574 |
| Loss before tax benefit | $ (349) | $ (418) | $ (72) | $ (31,388) |

| Software Solutions | For the three months ended | | | |
|---|---|---|---|---|
| | March 31, 2021 | June 30, 2021 | September 30, 2021 | December 31, 2021 |
| Software solutions revenue | $ - | $ 1,012 | $ 3,784 | $ 3,870 |
| Operating expenses: | | | | |
| Cost of software solutions revenue | - | 526 | 1,675 | 1,830 |
| Selling and marketing | - | 389 | 798 | 1,158 |
| General and administrative | - | 412 | 1,005 | 1,040 |
| Research and development | - | - | - | - |
| Total operating expenses | - | 1,327 | 3,478 | 4,028 |
| Operating income/(loss) | - | (315) | 306 | (158) |
| Other expense | - | - | (19) | (11) |
| Income/(loss) before tax benefit/(provision) | $ - | $ (315) | $ 287 | $ (169) |

**Year Ended December 31, 2022 Compared to Year Ended December 31, 2021**

*Software Solutions Revenue*

Software solutions revenue consists primarily of software license fees, subscription maintenance and support, and professional services. Software licenses are billed by the number of concurrent sessions a Partner has purchased or subscribes to. Subscription maintenance and support is ongoing and provides for software updates and improvements, support for add-on modules, bug fixes, and other general maintenance items. Professional services and other revenues consist of professional services such as the installation of software and integration of other modules, training and implementation as well as custom mobile branding. The following table reflects our service revenue for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Software solutions revenue | $ 15,148 | $ 8,666 | $ 6,482 | 75% |

The increase in software solutions revenue is primarily related to comparing twelve months of operating activity for the year ended December 31, 2022 to seven months of operating activity for the year ended December 31, 2021, from the acquisition date of June 1, 2021.

*Cost of Software Solutions Revenue*

Cost of software solutions revenue consists primarily of salaries and benefits, amortization expense related to the technology, cost of Data Center hosting, third-party software modules and outsourced services required to install and support software solutions. The following table reflects our cost of service revenue for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2022 | 2021 | Dollar Change | Percent Change |
| Cost of software solutions revenue | $ 5,336 | $ 4,031 | $ 1,305 | 32% |

The increase in cost of software solutions revenue is primarily related to comparing twelve months of operating activity for the year ended December 31, 2022 to seven months of operating activity for the year ended December 31, 2021, from the acquisition date of June 1, 2021 and the reclassification of expenses from cost of service revenue to research and development after carefully reviewing expenses that qualify as research and development operating expenses.

*Backlog*

Backlog represents the total contract value of all contracts signed, less revenue recognized from those contracts as of December 31, 2022 and 2021. Backlog increased 29%, or $3,302,000 to $14,830,000 as of December 31, 2022 as compared to $11,528,000 as of December 31, 2021. Below is a table which displays the Software Solutions segment revenue backlog as of December 31, 2022 and 2021, which we expect to recognize as revenue within the next thirty-six months (in thousands):

| | |
|---|---|
| Software Solutions backlog as of December 31, 2022 | $ 14,830 |
| Software Solutions backlog as of December 31, 2021 | $ 11,528 |

*Selling and Marketing*

Selling and marketing expenses consist primarily of sales and marketing salaries and benefits, commissions, share-based compensation, travel expenses, lead generation services, trade shows, third-party marketing services, the production of marketing materials, and sales support software. The following table reflects our selling and marketing expenses for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | **2022** | **2021** | **Dollar Change** | **Percent Change** |
| Selling and marketing | $ 4,491 | $ 2,345 | $ 2,146 | 92% |

The increase in selling and marketing expenses is primarily related to comparing twelve months of operating activity for the year ended December 31, 2022 to seven months of operating activity for the year ended December 31, 2021, from the acquisition date of June 1, 2021.

*General and Administrative*

General and administrative expenses consist of salaries and benefits for executives, administrative personnel, amortization of intangible asset related to customer lists, legal, rent, equipment, accounting and other professional services, and other administrative corporate expenses. The following table reflects our general and administrative expenses for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | **2022** | **2021** | **Dollar Change** | **Percent Change** |
| General and administrative | $ 3,538 | $ 2,457 | $ 1,081 | 44% |

The increase in general and administrative expenses is primarily related to comparing twelve months of operating activity for the year ended December 31, 2022 to seven months of operating activity for the year ended December 31, 2021, from the acquisition date of June 1, 2021 and the reclassification of expenses from general and administrative to research and development after carefully reviewing expenses that qualify as research and development operating expenses.

*Research and Development*

Research and development expenses primarily consists of salaries, wages and benefits, share-based compensation, and outsourcing engineering services related to the development of our software solutions. The following table reflects our research and development expense for the year end December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | **2022** | **2021** | **Dollar Change** | **Percent Change** |
| Research and development | $ 2,689 | $ - | $ 2,689 | - |

The increase in research and development expenses is primarily related to the reclassification of research and development expenses out of cost of service revenue and general and administrative expenses after carefully reviewing operating expenses that qualify as research and development operating expenses.

## LIQUIDITY AND CAPITAL RESOURCES

Liquidity is a measure of our ability to access sufficient cash flows to meet the short-term and long-term cash requirements of our business operations. We finance our operations primarily through services, software solutions, and product sales to our customers. As of December 31, 2022 and 2021, we had cash and cash equivalents of $5,475,000 and $7,468,000, respectively. Changes in cash and cash equivalents are dependent upon changes in, among other things, working capital items such as contract liabilities, contract costs, accounts payable, accounts receivable, prepaid expenses, and various accrued expenses, as well as purchases of property and equipment, asset acquisitions, business combinations, and changes in our capital and financial structure due to debt repayments and issuances, stock option exercises, sales of equity investments and similar events. We believe that our operations along with existing liquidity sources will satisfy our cash requirements for at least the next 12 months.

On November 1, 2022, the Company acquired 100% of the issued and outstanding shares of Allegiant Networks, LLC., a provider of telecommunications products, services, and solutions in Kansas and Missouri. The aggregate purchase price of $9.4 million consisted of $2.0 million of cash paid at closing, 2,461,538 shares of our common stock with an estimated fair value of $6.3 million issued at closing, and a three-year promissory note for $1.1 million.

*Operating Activities*

Cash provided by or used in operating activities is driven by our net loss, adjustments to reconcile to net cash provided by or used in operating activities, the timing of customer collections, as well as the amount and timing of disbursements to our vendors, the amount of cash we invest in personnel, marketing, and infrastructure costs to support the anticipated growth of our business. The following table reflects our net cash provided by/(used in) operating activities for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | **2022** | **2021** | **Dollar Change** | **Percent Change** |
| Net cash used in operating activities | $ (411) | $ (1,006) | $ 595 | -59% |

The net cash used in operations was primarily driven by our net loss for the year ended December 31, 2022 of $(35,413,000), an increase in contract costs, an increase in equipment financing receivables, an increase in other assets, a decrease in contract liabilities, and non-cash other income related to the release of a sales tax accrual, offset by non-cash expenses for impairment, depreciation, amortization, and share-based compensation.

*Investing Activities*

Cash provided by or used in investing activities is driven by the purchase of property and equipment, business combinations, and asset acquisitions. The following table reflects our net cash provided by/(used in) investing activities for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | **2022** | **2021** | **Dollar Change** | **Percent Change** |
| Net cash used in investing activities | $ (1,703) | $ (9,867) | $ 8,164 | -83% |

During the year ended December 31, 2022, the Company acquired 100% of the issued and outstanding shares of Allegiant Networks, LLC., a provider of telecommunications products, services, and solutions in Kansas and Missouri. Of the aggregate purchase price of $9.4 million, the Company paid $2.0 million of cash at closing, net of cash acquired of $586,000. Additionally, during the year ended December 31, 2022, we purchased $289,000 of property and equipment.

During the year ended December 31, 2021, the Company acquired 100% of the issued and outstanding shares of Centric Telecom, Inc., a provider of telecommunications products, services, and solutions in Northern Virginia. The aggregate purchase price of $3,255,000 consisted of $2,163,000 of cash paid at closing, 46,662 shares of our common stock with an estimated fair value of $346,000 issued at closing, and $746,000 of contingent consideration, which was paid out after the completion of the earn-out period in the fourth quarter of 2021. On June 1, 2021, the Company acquired 100% of the issued and outstanding shares of NetSapiens, Inc. ("NetSapiens"), a provider of a comprehensive suite of unified communications (UC), video conferencing, collaboration & contact center solutions to service providers, servicing over two Million end users around the globe. The aggregate purchase price was approximately $49.1 million, consisting of $10 million in cash, and approximately $39 million in common stock and stock options. In connection with the closing of the Merger, the Company issued 3,097,309 shares of the Company's common stock valued at $5.47 per share for common stock consideration of approximately $16.9 million, and 4,482,328 options under the Crexendo, Inc. 2021 Equity Incentive Plan with an aggregate value of $22.1 million, net of the aggregate exercise price of $5.6 million.

*Financing Activities*

Cash provided by or used in financing activities is driven by the proceeds from the exercise of options, taxes paid on the net settlement of stock options and RSUs, payment of contingent consideration, proceeds from finance leases and notes payable, repayments made on finance leases and notes payable, proceeds and repayments on line of credit, and proceeds from the issuance of common stock in connection with an offering. The following table reflects our net cash provided by financing activities for the year ended December 31, 2022, compared to the year ended December 31, 2021:

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | **2022** | **2021** | **Dollar Change** | **Percent Change** |
| Net cash provided by/(used in) financing activities | $ (54) | $ 650 | $ (704) | -108% |

Net cash used in financing activities in the year ended December 31, 2022, primarily relates to cash proceeds from the exercise of stock options of $816,000 and proceeds from the line of credit of $82,000, offset by dividend payments of $462,000, payments of employee tax withholdings related to the net settlement of stock options and RSUs of $290,000, and repayments made on finance leases and notes payable of $200,000.

Net cash provided by financing activities in the year ended December 31, 2021, primarily relates to cash proceeds from the exercise of stock options of $1,729,000 offset by the payments of employee tax withholdings related to the net settlement of stock options and RSUs of $163,000, and contingent consideration payment of $746,000 related to the Centric business acquisition.

## OFF BALANCE SHEET ARRANGEMENTS

As of December 31, 2022, we are not involved in any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

## RELATED PARTY TRANSACTIONS

None

## RECENT ACCOUNTING PRONOUNCEMENTS

For a summary of recent accounting pronouncements and the anticipated effects on our consolidated financial statements, see Note 1 to the consolidated financial statements, which is incorporated by reference herein.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

*Foreign Currency Risk*

For all periods presented, our sales and operating expenses were predominately denominated in U.S. dollars. We therefore have not had material foreign currency risk associated with sales and cost-based activities. The functional currency of our material operating entities is the U.S. dollar.

For the periods presented, we believe the exposure to foreign currency fluctuation from operating expenses is immaterial as the related costs do not constitute a significant portion of our total expenses. As we grow operations, our exposure to foreign currency risk may become more significant.

*Inflation Risk*

We do not believe that inflation has had a material effect on our business, financial condition, or results of operations. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### CREXENDO, INC. AND SUBSIDIARIES
### INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE


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**Report of Independent Registered Public Accounting Firm**

Stockholders and Board of Directors
Crexendo, Inc. and Subsidiaries
Tempe, AZ

**Opinion on the Consolidated Financial Statements**

We have audited the accompanying consolidated balance sheets of Crexendo, Inc. and subsidiaries (the "Company") as of December 31, 2022 and 2021, the related consolidated statements of operations and comprehensive loss, stockholders' equity, and cash flows for the years then ended, and the related notes and financial statement schedule (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2022 and 2021, and the results of its operations for the periods then ended, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

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

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

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

**Critical Audit Matters**

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matter(s) does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

***Revenue Recognition — Refer to Note 2 to the Consolidated Financial Statements***

*Critical Audit Matter Description*
The Company recognizes revenue upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company offers customers the ability to acquire multiple licenses of products and services.

Significant judgment is exercised by the Company in determining revenue recognition for these customer agreements, and includes the following:

- Determination of whether products and services are considered distinct performance obligations that should be accounted for separately versus together, such as hard goods and related services that are sold with telephony contracts.
- Determination of stand-alone selling prices for each distinct performance obligation and for products and services that are not sold separately.
- The pattern of delivery (i.e., timing of when revenue is recognized) for each distinct performance obligation.

Given these factors, the related audit effort in evaluating management's judgments in determining revenue recognition for these customer agreements required a high degree of auditor judgment.

*How the Critical Audit Matter Was Addressed in the Audit*
Our principal audit procedures related to the Company's revenue recognition for these customer agreements included the following:

- We gained an understanding of internal controls related to the identification of distinct performance obligations, the determination of the timing of revenue recognition, and the relative selling value.
- We evaluated management's significant accounting policies related to these customer agreements for reasonableness.
- We selected a sample of customer agreements and performed the following procedures:
  - Obtained and read contract source documents for each selection and other documents that were part of the agreement, if applicable.
  - Tested management's identification of significant terms for completeness, including the identification of distinct performance obligations and relative selling price.
  - Assessed the terms in the customer agreement and evaluated the appropriateness of management's application of their accounting policies, along with their use of estimates, in the determination of revenue recognition conclusions.
  - We evaluated the reasonableness of management's estimate of stand-alone selling prices for products and services that are not sold separately.
  - We tested the mathematical accuracy of management's calculations of revenue and the associated timing of revenue recognized in the financial statements.

***Income Taxes — Valuation Allowance on Deferred Tax Assets — Refer to Note 15 to the Consolidated Financial Statements***

*Critical Audit Matter Description*
The Company's consolidated net deferred tax assets primarily consisted of U.S. net operating loss carryforwards. Management records valuation allowances to reduce the carrying value of deferred tax assets to amounts that are more likely than not to be realized. Management assesses existing deferred tax assets by jurisdiction and expectations of the Company's ability to utilize these tax attributes through a review of past, current and estimated future taxable income, reversals of temporary differences and establishment of tax planning strategies. Management evaluated projections of future pretax income and the duration of statutory carry-forward periods to determine if the carryforwards could be utilized in whole or in part. As of December 31, 2022 the Company has a cumulative pretax loss for the three year lookback, which is considered significant objectively verifiable negative evidence. As a result, the Company recorded a full valuation allowance of $3,179,000 against its gross deferred tax asset balance as of December 31, 2022.

The principal considerations for our determination that performing procedures relating to the income tax valuation allowance on deferred tax assets is a critical audit matter as there was significant judgment by management when estimating future income. This in turn led to a high degree of auditor judgment, subjectivity and effort in performing procedures and in evaluating audit evidence relating to future income. In addition, the audit effort involved the use of professionals with specialized skill and knowledge to assist in performing these procedures and evaluating the audit evidence obtained.

*How the Critical Audit Matter Was Addressed in the Audit*
Our principal audit procedures to evaluate the valuation allowances on deferred tax assets, among others, included the following:

- We gained an understanding of internal controls related to the valuation allowances on deferred tax assets, including controls over the review of management's analysis by jurisdiction of cumulative income (loss).
- We considered the underlying historical data used in calculating the cumulative income (loss).
- We assessed effects of other events, including past Company transactions.
- We considered management's estimate of future taxable income, which included evaluating the reasonableness of significant assumptions and appropriateness of available tax planning strategies.
- Utilized professionals with specialized skill and knowledge to assist in evaluating management's analysis, including cumulative income (loss) as well as the reasonableness of the estimates.

***Business Combinations – Valuation of Intangible Assets — Refer to Note 4 to the Consolidated Financial Statements***

*Critical Audit Matter Description*
The Company completed the acquisition of Allegiant Networks, LLC for $9,400,000 (referred to as the "Acquisition") and accounted for as business combination. The methods used to estimate the fair value of acquired intangible assets involve assumptions. The assumptions applied by management in estimating the fair value of acquired intangible assets included income projections and discount rates.

The principal considerations for our determination that performing procedures relating to the valuation of intangible assets in the Acquisitions is a critical audit matter are (1) there was a degree in significant auditor judgement and subjectivity in applying procedures to the fair value of the intangible assets acquired due to the judgment by management when developing estimates and (2) audit effort was required relating to the estimates, projections, discount rates, and weighted average cost of capital utilized by the Company. In addition, the audit effort involved the use of professionals with specialized skill and knowledge to assist in performing these procedures and evaluating the conclusions.

*How the Critical Audit Matter Was Addressed in the Audit*
Our principal audit procedures to evaluate the valuation of intangible assets included the following:

- We read the purchase agreements used in the underlying acquisitions and utilized by the Company to allocate the purchase price.
- We obtained the valuation reports prepared by management's third-party expert.
- Utilized professionals with specialized skill and knowledge to evaluate the reasonableness of the methodology, assumptions, including the discount rate and weighted average cost of capital, as compared to their experience and publically available market data.
- Considered the reasonableness of the overall allocation of the total purchase price.

***Goodwill Impairment Assessment - Refer to Notes 1 and 8 to the Consolidated Financial Statements***

*Critical Audit Matter Description*
As described further in Notes 1 and 8 of the consolidated financial statements, the Company performed a goodwill impairment assessment as of December 31, 2022, the date of its annual impairment test, on its reporting units, Cloud Telecommunications and Software Solutions. The Company determined there was a triggering event, primarily caused by a sustained decrease in the Company's stock price.

The principal considerations for our determination that goodwill impairment assessment is a critical audit matter are the significant management estimates and judgements related to forecasts of expected future cash flows required to estimate the reporting units' fair value. Management's significant estimates and judgements include the determination of the discount rate, revenue growth rates, operating margins, and long-term growth rate. Auditing these estimates requires a high degree of auditor judgement, including the use of professionals with specialized skills and knowledge.

*How the Critical Audit Matter Was Addressed in the Audit*
Our principal audit procedures to evaluate the impairment of goodwill included the following:

- We assessed the design and implementation of management controls around the determination of inputs used in the quantitative impairment test.
- We assessed management's ability to forecast by comparing historical projections to actual results and comparing current forecasted projections to historical trends, industry data, and underlying business strategies.
- We evaluated managements revenue growth rates, operating margins, and cash flows for consistency with relevant historical data, recent changes in the business, and external industry data and forecasts.
- With the assistance of our valuation professionals with specialized skills and knowledge, we evaluated the valuation methodologies, inputs, and assumptions utilized by management, including the long-term growth rate and discount rate.
- We reconciled the value of the reported goodwill to the market capitalization

/s/ Urish Popeck & Co., LLC

We have served as the Company's auditor since 2016.

Pittsburgh, Pennsylvania

March 14, 2023

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

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 5,475 | $ 7,468 |
| Trade receivables, net of allowance for doubtful accounts of $131 as of December 31, 2022 and $72 as of December 31, 2021 | 3,297 | 2,177 |
| Contract assets | 318 | 261 |
| Inventories | 679 | 231 |
| Equipment financing receivables | 635 | 332 |
| Contract costs | 841 | 648 |
| Prepaid expenses | 431 | 358 |
| Income tax receivable | - | 11 |
| Other current assets | 674 | 74 |
| Total current assets | 12,350 | 11,560 |
| Long-term equipment financing receivables, net | 1,255 | 942 |
| Property and equipment, net | 3,315 | 2,989 |
| Deferred income tax assets, net | - | 986 |
| Operating lease right-of-use assets | 1,081 | 532 |
| Intangible assets, net | 26,725 | 22,161 |
| Goodwill | 9,454 | 36,972 |
| Contract costs, net of current portion | 1,304 | 697 |
| Other long-term assets | 150 | 313 |
| Total Assets | $ 55,634 | $ 77,152 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 1,206 | $ 476 |
| Accrued expenses | 4,890 | 4,904 |
| Finance leases | 95 | 110 |
| Notes payable | 420 | 1,873 |
| Operating lease liabilities | 363 | 447 |
| Income tax payable | 79 | 24 |
| Contract liabilities | 3,338 | 2,738 |
| Total current liabilities | 10,391 | 10,572 |
| Contract liabilities, net of current portion | 247 | 290 |
| Finance leases, net of current portion | 98 | 193 |
| Notes payable, net of current portion | 2,605 | - |
| Line of credit | 82 | - |
| Operating lease liabilities, net of current portion | 752 | 164 |
| Total liabilities | 14,175 | 11,219 |
| Commitments and contingencies (Note 17) | | |
| Stockholders' equity: | | |
| Preferred stock, par value $0.001 per share - authorized 5,000,000 shares; none issued | — | — |
| Common stock, par value $0.001 per share - authorized 50,000,000 shares, 25,670,773 shares issued and outstanding as of December 31, 2022 and 22,054,239 shares issued and outstanding as of December 31, 2021 | 26 | 22 |
| Additional paid-in capital | 129,192 | 118,432 |
| Accumulated deficit | (87,946) | (52,533) |
| Accumulated other comprehensive income | 187 | 12 |
| Total stockholders' equity | 41,459 | 65,933 |
| Total Liabilities and Stockholders' Equity | $ 55,634 | $ 77,152 |

*The accompanying notes are an integral part of the consolidated financial statements.*

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

| | Year Ended December 31, | |
|---|---|---|
| | **2022** | **2021** |
| Service revenue | $ 19,515 | $ 17,102 |
| Software solutions | 15,148 | $ 8,666 |
| Product revenue | 2,891 | $ 2,324 |
| Total revenue | 37,554 | 28,092 |
| Operating expenses: | | |
| Cost of service revenue | 6,711 | 5,104 |
| Cost of software solutions | 5,336 | 4,031 |
| Cost of product revenue | 1,637 | 1,525 |
| Selling and marketing | 11,725 | 8,260 |
| General and administrative | 12,904 | 10,586 |
| Research and development | 3,955 | 1,396 |
| Goodwill and long-lived asset impairment | 32,678 | - |
| Total operating expenses | 74,946 | 30,902 |
| Loss from operations | (37,392) | (2,810) |
| Other income/(expense): | | |
| Interest income | - | 1 |
| Interest expense | (78) | (84) |
| Other income/(expense), net | 1,295 | (17) |
| Total other income/(expense), net | 1,217 | (100) |
| Loss before income tax | (36,175) | (2,910) |
| Income tax benefit | 762 | 465 |
| Net loss | $ (35,413) | $ (2,445) |
| Earnings per common share: | | |
| Basic | $ (1.54) | $ (0.12) |
| Diluted | $ (1.54) | $ (0.12) |
| Weighted-average common shares outstanding: | | |
| Basic | 22,939,514 | 20,275,691 |
| Diluted | 22,939,514 | 20,275,691 |

*The accompanying notes are an integral part of the consolidated financial statements.*

**CREXENDO, INC. AND SUBSIDIARIES**
**Consolidated Statements of Comprehensive Income**
(In thousands)

| | Year Ended December 31, | |
|---|---|---|
| | **2022** | **2021** |
| Net loss | $ (35,413) | $ (2,445) |
| Other comprehensive income/(loss), net of tax | | |
| Foreign currency translation gain | 175 | 12 |
| Total other comprehensive income | 175 | 12 |
| Comprehensive loss | $ (35,238) | $ (2,433) |

*The accompanying notes are an integral part of the consolidated financial statements.*

**CREXENDO, INC. AND SUBSIDIARIES**
**Consolidated Statements of Stockholders' Equity**
(In thousands, except share data)

| | Common Stock | | Additional Paid-in | Accumulated Other Comprehensive | Accumulated | Total Stockholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Income | Deficit | Equity |
| **Balance, January 1, 2021** | 17,983,177 | $ 18 | $ 75,834 | - | $ (50,088) | 25,764 |
| Share-based compensation | - | - | 1,628 | - | - | 1,628 |
| Vesting of restricted stock units | 54,510 | - | - | - | - | - |
| Foreign currency translation adjustment, net of tax | - | - | - | 12 | - | 12 |
| Issuance of common stock for exercise of stock options | 872,581 | 1 | 1,728 | - | - | 1,729 |
| Taxes paid on the net settlement of stock options | - | - | (163) | - | - | (163) |
| Issuance of common stock in connection with business acquisitions | 3,143,971 | 3 | 39,405 | - | - | 39,408 |
| Net loss | - | - | - | | (2,445) | (2,445) |
| **Balance, December 31, 2021** | **22,054,239** | **22** | **118,432** | **12** | **(52,533)** | **65,933** |
| Share-based compensation | - | - | 4,374 | - | - | 4,374 |
| Vesting of restricted stock units | 361,889 | - | - | - | - | - |
| Foreign currency translation adjustment, net of tax | - | - | - | 175 | - | 175 |
| Issuance of common stock for exercise of stock options | 793,107 | 2 | 814 | - | - | 816 |
| Taxes paid on the net settlement of stock options | - | - | (290) | - | - | (290) |
| Issuance of common stock in connection with business acquisition | 2,461,538 | 2 | 6,324 | - | - | 6,326 |
| Dividends declared | - | - | (462) | - | - | (462) |
| Net loss | - | - | - | - | (35,413) | (35,413) |
| **Balance, December 31, 2022** | **25,670,773** | **$ 26** | **$ 129,192** | **$ 187** | **$ (87,946)** | **$ 41,459** |

*The accompanying notes are an integral part of the consolidated financial statements.*

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

| | Year Ended December 31, 2022 | Year Ended December 31, 2021 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | $ (35,413) | $ (2,445) |
| Adjustments to reconcile net loss to net cash used for operating activities: | | |
| Depreciation and amortization | 2,747 | 1,626 |
| Deferred tax asset | (936) | (499) |
| Share-based compensation | 4,374 | 1,628 |
| Goodwill and long-lived asset impairment | 32,678 | - |
| Non-cash release of sales tax accrual | (1,435) | - |
| Non-cash operating lease amortization | (23) | - |
| Changes in assets and liabilities: | | |
| Trade receivables | (361) | (501) |
| Contract assets | (57) | (102) |
| Equipment financing receivables | (616) | (82) |
| Inventories | 36 | 285 |
| Contract costs | (788) | (270) |
| Prepaid expenses | (25) | (92) |
| Income tax receivable | 11 | (7) |
| Other assets | (544) | 245 |
| Accounts payable and accrued expenses | 246 | (245) |
| Income tax payable | 55 | 24 |
| Contract liabilities | (360) | (571) |
| Net cash used for operating activities | (411) | (1,006) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of property and equipment | (289) | (101) |
| Acquisition of a business, net of cash acquired | (1,414) | (9,766) |
| Net cash used for investing activities | (1,703) | (9,867) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Borrowing on line of credit, net | 82 | - |
| Payment of contingent consideration | - | (746) |
| Repayments made on finance leases | (110) | (99) |
| Repayments made on notes payable | (90) | (71) |
| Proceeds from exercise of options | 816 | 1,729 |
| Dividend payments | (462) | - |
| Taxes paid on the net settlement of stock options and RSUs | (290) | (163) |
| Net cash provided by/(used for) financing activities | (54) | 650 |
| Effect of exchange rate changes on cash | 175 | 12 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,993) | (10,211) |
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR | 7,468 | 17,679 |
| CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR | $ 5,475 | $ 7,468 |
| Supplemental disclosure of cash flow information: | | |
| Cash used during the year for: | | |
| Income taxes, net | $ (118) | $ (15) |
| Interest expense | $ (78) | $ (84) |
| Supplemental disclosure of non-cash investing and financing information: | | |
| Stock issued for acquisitions | $ 6,326 | $ 17,288 |
| Stock options issued in connection with the merger with Net Sapiens | $ - | $ 22,120 |
| Property and equipment financed through finance leases | $ - | $ 273 |
| Prepaid assets financed through finance leases | $ - | $ 14 |

*The accompanying notes are an integral part of the consolidated financial statements.*

## 1. Description of Business and Significant Accounting Policies

**Description of Business –** Crexendo, Inc. is incorporated in the state of Nevada. As used hereafter in the notes to consolidated financial statements, we refer to Crexendo, Inc. and its wholly owned subsidiaries, as "we," "us," or "our Company." Crexendo, Inc. is an award-winning premier provider of cloud communication platform and services, video collaboration and managed IT services designed to provide enterprise-class cloud solutions to any size business. Our solutions currently support over three million end users globally. The Company has two operating segments, which consist of Cloud Telecommunications and Software Solutions.

**Basis of Presentation –** The consolidated financial statements include the accounts and operations of Crexendo, Inc. and its wholly owned subsidiaries, which include Allegiant Networks, LLC, Crexendo Business Solutions, Inc., NetSapiens, LLC, Crexendo Business Solutions of Virginia, Inc., NSHC, Inc., NetSapiens Canada, Inc., NetSapiens International Limited and Crexendo International, Inc. All intercompany account balances and transactions have been eliminated in consolidation. The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("US GAAP") and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These consolidated financial statements reflect the results of operations, financial position, changes in stockholders' equity, and cash flows of our Company.

Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations.

**Foreign Currency Translation -** The functional currency of our international subsidiaries is the local currency. We translate assets and liabilities of foreign subsidiaries, whose functional currency is their local currency, at exchange rates in effect at the balance sheet date. We translate revenue and expenses at the monthly average exchange rates. We include accumulated net translation adjustments in stockholders' equity as a component of accumulated other comprehensive income (loss).

Due to changes in exchange rates between reporting periods and changes in certain account balances, the foreign currency translation adjustment will change from period to period. During the year ended December 31, 2022 and 2021, we recorded foreign currency translation gains/(losses) of $175,000, and $12,000, respectively, in our statements of comprehensive income (loss).

**Cash and Cash Equivalents –** We consider all highly liquid, short-term investments with maturities of three months or less at the time of purchase to be cash equivalents. As of December 31, 2022 and 2021, we had cash and cash equivalents in financial institutions in excess of federally insured limits in the amount of $4,750,000 and $6,573,000, respectively.

**Trade Receivables –** Trade receivables from our cloud telecommunications services and software solutions segments are recorded at invoiced amounts.

**Allowance for Doubtful Accounts –** The allowance represents estimated losses resulting from customers' failure to make required payments. The allowance estimate is based on historical collection experience, specific identification of probable bad debts based on collection efforts, aging of trade receivables, customer payment history, and other known factors, including current economic conditions. We believe that the allowance for doubtful accounts is adequate based on our assessment to date, however, actual collection results may differ materially from our expectations.

**Contract Assets –** Contract assets primarily relate to the Company's rights to consideration for work completed but not billed as of the reporting date. The contract assets are transferred to receivables when the rights become unconditional.

**Contract Costs –** Contract costs primarily relate to incremental commission costs paid to sales representatives and sales leadership as a result of obtaining telecommunications contracts which are recoverable. The Company capitalized contract costs in the amount of $2,145,000 and $1,345,000 at December 31, 2022 and 2021, respectively. Capitalized commission costs are amortized based on the transfer of goods or services to which the assets relate which typically range from thirty-six to sixty months and are included in selling and marketing expenses. During the years ended December 31, 2022 and 2021, the Company amortized $1,249,000 and $869,000, respectively, and there was no impairment loss in relation to the costs capitalized.

**Inventory –** Finished goods telecommunications equipment inventory is stated at the lower of cost or net realizable value (first-in, first-out method). In accordance with applicable accounting guidance, we regularly evaluate whether inventory is stated at the lower of cost or net realizable value. If net realizable value is less than cost, the write-down is recognized as a loss in earnings in the period in which the excess occurs.

**Property and Equipment –** Depreciation and amortization expense is computed using the straight-line method in amounts sufficient to allocate the cost of depreciable assets over their estimated useful lives ranging from two to thirty-nine years. The cost of leasehold improvements is amortized using the straight-line method over the shorter of the estimated useful life of the asset or the term of the related lease. Land is not depreciable. Depreciable lives by asset group are as follows:

| | |
|---|---|
| Building | 39 years |
| Land | Not depreciated |
| Computer and office equipment | 2 to 5 years |
| Computer software | 3 years |
| Internal-use software | 3 years |
| Furniture and fixtures | 4 years |
| Leasehold improvements | 2 to 5 years |
| Vehicles | 5 years |

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

**Asset Acquisitions –** Periodically we acquire customer relationships that we account for as an asset acquisition and record a corresponding intangible asset that is amortized over its estimated useful life. Any excess of the fair value of the purchase price over the fair value of the identifiable assets and liabilities is allocated on a relative fair value basis. No goodwill is recorded in an asset acquisition. If the fair value of the assets acquired exceeds the initial consideration paid as of the date of acquisition but includes a contingent consideration arrangement and ASC 450 and ASC 815 do not apply to contingent consideration, we analogize to the guidance in ASC 323 on recognizing contingent consideration in the acquisition of an equity method investment. The Company recognizes a liability equal to the lesser of, the maximum amount of contingent consideration or the excess of the fair value of the net assets acquired over the initial cost measurement. In accordance with the requirements of ASC 323 for equity method investments, the Company recognizes any excess of the contingent consideration issued or issuable, over the amount that was initially recognized as a liability, as an additional cost of the asset acquisition. If the amount initially recognized as a liability exceeds the contingent consideration issued or issuable, the entity recognizes that amount as a reduction of the cost of the asset acquisition.

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

**Goodwill –** We have recorded goodwill related to various business acquisitions. Goodwill is recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net identified tangible and intangible assets acquired. In each of our acquisitions, the objective of the acquisition was to expand our product offerings and customer base and to achieve synergies related to cross selling opportunities, all of which contributed to the recognition of goodwill. We test goodwill for impairment on an annual basis or more frequently if events or changes in circumstances indicate that goodwill might be impaired. The estimated fair value of the reporting unit is determined using our market capitalization as of our annual impairment assessment date or more frequently if circumstances indicate the goodwill might be impaired. Items that could reasonably be expected to negatively affect key assumptions used in estimating fair value include but are not limited to: sustained decline in our stock price due to a decline in our financial performance due to the loss of key customers, loss of key personnel, emergence of new technologies or new competitors; and decline in overall market or economic conditions leading to a decline in our stock price.

The process of estimating the fair value of goodwill is subjective and required the Company to make estimates that may significantly impact the outcome of the analysis. A qualitative assessment considers events and circumstances such as macroeconomic conditions, industry and market conditions, cost factors and overall financial performance, as well as company specifications. If after performing this assessment, the Company concluded it is more likely than not that the fair value of the reporting unit is less than its carrying amount, then the Company performed the quantitative test.

Under the quantitative test, a goodwill impairment is identified by comparing the fair value of the reporting unit to the carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds the fair value of the reporting unit, goodwill is considered impaired and an impairment charge is recognized in an amount equal to the excess, not to exceed the carrying amount of goodwill.

The Company estimated the fair value of the reporting unit with an income approach using the discounted cash flow ("DCF") analysis and the Company also considered a market-based valuation methodology using comparable public company trading values and the Company's market capitalization. Determining fair value requires the exercise of significant judgments, including the amount and timing of expected future cash flows, long-term growth rates, the discount rate and relevant comparable public company earnings multiples. The cash flows employed in the DCF analysis are based on the Company's best estimate of future sales, earnings and cash flows after considering factors such as general market conditions and recent operating performance. The discount rate utilized in the DCF analysis is based on the reporting unit's weighted-average cost of capital, which takes into account the relative weights of each component of capital structure (equity and debt) and represents the expected cost of new capital, adjusted as appropriate to consider the risk inherent in future cash flows of the Company's reporting unit.

Impairment assessment inherently involves management judgments regarding a number of assumptions described above. The reporting unit fair value also depends on the future strength of the U.S. economy. New and developing competition as well as technological change could also adversely affect future fair value estimates. Due to the many variables inherent in the estimation of a reporting unit's fair value and the relative size of the Company's recorded goodwill, differences in assumptions could have a material effect on the estimated fair values. For further information, see Note 8 (Intangible Assets and Goodwill).

**Intangible Assets –** Our intangible assets consist of customer relationships, developed technologies, trademarks and trade name. The intangible assets are amortized following the patterns in which the economic benefits are consumed or straight-line over the estimated useful life. We periodically review the estimated useful lives of our intangible assets and review these assets for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The determination of impairment is based on estimates of future undiscounted cash flows. If an intangible asset is considered to be impaired, the amount of the impairment will be equal to the excess of the carrying value over the fair value of the asset. There was no impairment of intangible assets identified for the years ended December 31, 2022 and 2021.

**Contract Liabilities –** Our contract liabilities consist primarily of advance consideration received from customers for telecommunications contracts. The product and monthly service revenue is recognized on completion of the implementation and the remaining activation fees are reclassified as deferred revenue.

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

**Contingencies –** The Company accrues for claims and contingencies when losses become probable and reasonably estimable. As of the end of each applicable reporting period, the Company reviews each of its matters and, where it is probable that a liability has been or will be incurred, it accrues for all probable and reasonably estimable losses. Where the Company can reasonably estimate a range of losses it may incur regarding such a matter, it records an accrual for the amount within the range that constitutes its best estimate. If the Company can reasonably estimate a range but no amount within the range appears to be a better estimate than any other, it uses the amount that is the low end of such range.

**Service, Software Solutions and Product Revenue Recognition –** Revenue is recognized upon transfer of control of promised services, software solutions or products to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services and excludes any amounts collected on behalf of third parties. We enter into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. We recognize revenue for delivered elements only when we determine there are no uncertainties regarding customer acceptance. Changes in the allocation of the sales price between delivered and undelivered elements can impact the timing of revenue recognized but does not change the total revenue recognized on any agreement. Revenue is recognized net of any taxes collected from customers, which are subsequently remitted to governmental authorities. For more detailed information about revenue, see Note 2.

**Cost of Service Revenue –** Cost of service revenue includes cloud telecommunications services. Cloud telecommunications cost of service revenue primarily consists of fees we pay to third-party telecommunications and broadband Internet providers, costs of other third-party services we resell, personnel and travel expenses related to system implementation, and customer service.

**Cost of Software Solutions Revenue –** Cost of software solutions revenue consists primarily of royalties and other fees paid to third parties whose technology or products are sold as part of the Company's products, direct costs to manufacture and distribute products, direct costs to provide product support and professional support services, direct costs associated with delivery of the Company's software offerings, and amortization expense related to developed technology intangible assets.

**Cost of Product Revenue –** Cost of product revenue primarily consists of the costs associated with the purchase of desktop devices and other third-party equipment we purchase for resale.

**Product Warranty –** We provide for the estimated cost of product warranties at the time we recognize revenue. We evaluate our warranty obligations on a product group basis. Our standard product warranty terms generally include post-sales support and repairs or replacement of a product at no additional charge for a specified period of time. We base our estimated warranty obligation upon warranty terms, ongoing product failure rates, and current period product shipments. If actual product failure rates, repair rates or any other post-sales support costs were to differ from our estimates, we would be required to make revisions to the estimated warranty liability. Warranty terms generally last for the duration that the customer has service. For the years ended December 31, 2022 and 2021, actual warranty costs were approximately 1.3% and 1.9% of prior year net product revenue, respectively. The annual warranty provision for the year ended December 31, 2022 and 2021 was approximately 2.3% and 2.6% of current year net product revenue, respectively.

**Contingent Consideration –** Contingent consideration represents deferred business acquisition and asset acquisition consideration to be paid out at some point in the future, typically over a one-year period or less from the acquisition date. Contingent consideration is recorded at the asset acquisition date fair value. Contingent consideration recorded in connection with a business acquisition is reported at fair value each reporting period until the contingency is resolved. Any changes in fair value are recognized in earnings. Contingent consideration recorded in connection with an asset acquisition is not derecognized until the related contingency is resolved and the consideration is paid or becomes payable. If the amount initially recorded as contingent consideration exceeds the amount paid or payable, the Company recognizes that excess amount as a reduction in the cost of the related intangible assets.

**Research and Development –** Research and development expenses consist primarily of personnel and related expenses for the Company's research and development staff, including salaries, benefits, bonuses and stock-based compensation and the cost of certain third-party contractors. Research and development costs are expensed as incurred. Costs related to internally developed software are expensed as research and development expense until technological feasibility has been achieved, after which the costs are capitalized.

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

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

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

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

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

**Lease Obligations –** We determine if an agreement is a lease at inception. We evaluate the lease terms to determine whether the lease will be accounted for as an operating or finance lease. Operating leases are included in operating lease right-of-use ("ROU") assets, operating lease liabilities, current portion, and operating lease liabilities, net of current portion in our consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. We use the implicit rate when readily determinable. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

A lease that transfers substantially all of the benefits and risks incidental to ownership of property are accounted for as finance leases. At the inception of a finance lease, an asset and finance lease obligation is recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair market value. Finance lease obligations are classified as either current or long-term based on the due dates of future minimum lease payments, net of interest.

**Notes Payable –** We record notes payable net of any discounts or premiums. Discounts and premiums are amortized as interest expense or income over the life of the note in such a way as to result in a constant rate of interest when applied to the amount outstanding at the beginning of any given period.

**Income Taxes –** We recognize a liability or asset for the deferred tax consequences of all temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements that will result in taxable or deductible amounts in future years when the reported amounts of the assets and liabilities are recovered or settled. Accruals for uncertain tax positions are provided for in accordance with accounting guidance. Accordingly, we may recognize the tax benefits from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Accounting guidance is also provided on de-recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, and income tax disclosures. Judgment is required in assessing the future tax consequences of events that have been recognized in the financial statements or tax returns. Variations in the actual outcome of these future tax consequences could materially impact our financial position, results of operations, and cash flows. In assessing the need for a valuation allowance, we evaluate all significant available positive and negative evidence, including historical operating results, estimates of future taxable income and the existence of prudent and feasible tax planning strategies. At December 31, 2022, we determined that it is more likely-than-not that we will not be able to realize our deferred income tax assets in the future. A valuation allowance of $3,179,000 and $1,498,000 was recorded against our gross deferred tax asset balance as of December 31, 2022 and 2021, respectively.

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

**Stock-Based Compensation –** For equity-classified awards, compensation expense is recognized over the requisite service period based on the computed fair value on the grant date of the award. Equity classified awards include the issuance of stock options and restricted stock units ("RSUs").

**Operating Segments –** Accounting guidance establishes standards for the way public business enterprises are to report information about operating segments in annual financial statements and requires enterprises to report selected information about operating segments in financial reports issued to stockholders. The Company has reorganized into two operating segments, which consist of cloud telecommunications services and software solutions. The software solutions segment includes the results of operation of NetSapiens, LLC, NSHC, Inc., NetSapiens Canada, Inc., and NetSapiens International Limited. The cloud telecommunications segment includes the results of operations of Allegiant Networks, LLC, Crexendo Business Solutions, Inc., Crexendo International, Inc., and Crexendo Business Solutions of Virginia, Inc. We generate over 99% of our total revenue from customers within North America (United States and Canada) and less than 1% of our total revenues from customers in other parts of the world.

**Significant Customers –** No customer accounted for 10% or more of our total revenue for the years ended December 31, 2022 and 2022. No customer accounted for 10% or more of our total trade receivables as of December 31, 2022 and 2021.

**Recently Adopted Accounting Pronouncements –** In October 2021, the Financial Accounting Standards Board ("FASB") issued ASU 2021-08, Business Combinations (Topic 805)–Accounting for Contract Assets and Contract Liabilities from Contracts with Customers ("ASU 2021-08"). The amendments in this update require contract assets and contract liabilities acquired in a business combination to be recognized and measured by the acquirer on the acquisition date in accordance with Topic 606, Revenue from Contracts with Customers, as if it had originated the contracts. Under the current business combinations guidance, such assets and liabilities are recognized by the acquirer at fair value on the acquisition date. The amendments in ASU 2021-08 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2022, with early adoption permitted. We adopted this guidance in October 2021 an applied the amendment to all business combinations that occurred during the year ended December 31, 2021.

In December 2019, the FASB issued Accounting Standards Update ("ASU") 2019-12 to simplify the accounting in ASC 740, *Income Taxes*. This guidance removes certain exceptions related to the approach for intra-period tax allocation, the methodology for calculating income taxes in an interim period, and the recognition of deferred tax liabilities for outside basis differences. This guidance also clarifies and simplifies other areas of ASC 740. Certain amendments in this update must be applied on a prospective basis, certain amendments must be applied on a retrospective basis, and certain amendments must be applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings/(deficit) in the period of adoption. The Company adopted ASU 2019-12 effective January 1, 2021. The adoption of this guidance did not have a material impact on our consolidated financial statements and related disclosures.

In August 2020, the FASB issued ASU 2020-06, which simplifies the accounting for convertible instruments. ASU 2020-06 eliminates certain models that require separate accounting for embedded conversion features, in certain cases. Additionally, among other changes, the guidance eliminates certain of the conditions for equity classification for contracts in an entity's own equity. ASU 2020-06 also requires entities to use the if-converted method for all convertible instruments in the diluted earnings per share calculation and include the effect of share settlement for instruments that may be settled in cash or shares, except for certain liability-classified share-based payment awards. ASU 2020-06 is effective for our fiscal year beginning after December 15, 2021, including interim periods within this fiscal year. This guidance can be applied using either a modified or full retrospective approach. The Company adopted ASU 2020-06 effective January 1, 2022. The adoption of this guidance did not have a material impact on our consolidated financial statements and related disclosures.

**Recently Issued Accounting Pronouncements –** In September 2016, the FASB issued ASU 2016-13, which requires measurement and recognition of expected credit losses for financial assets held. Following the effective date philosophy for all other entities in ASU 2019-10, which includes smaller reporting companies (SRCs), this guidance is effective for fiscal years beginning after December 15, 2022 including interim periods within those fiscal years. The standard is to be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. We do not plan to early adopt this ASU. We are in the process of evaluating the potential impact of adopting this new accounting standard on our consolidated financial statements and related disclosures.

## 2. Revenue

Revenue is measured based on consideration specified in a contract with a customer, and excludes any sales incentives and amounts collected on behalf of third parties. The Company recognizes revenue when it satisfies a performance obligation by transferring control over a product, service, or software solution to a customer. Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by the Company from a customer, are excluded from revenue. The following is a description of principal activities – separated by reportable segments – from which the Company generates its revenue. For more detailed information about reportable segments, see Note 19.

***Cloud Telecommunications Services Segment***

Products and services may be sold separately or in bundled packages. The typical length of a contract for service is thirty-six to sixty months. Customers are billed for these services on a monthly basis. For bundled packages, the Company accounts for individual products and services separately if they are distinct – i.e. if a product or service is separately identifiable from other items in the bundled package and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The consideration (including any discounts) is allocated between separate products and services in a bundle based on their relative stand-alone selling prices. The stand-alone selling prices are determined based on the prices at which the Company separately sells the desktop devices and telecommunication services. For items that are not sold separately (e.g. additional features) the Company estimates stand-alone selling prices using the adjusted market assessment approach. When we provide a free trial period, we do not begin to recognize recurring revenue until the trial period has ended and the customer has been billed for the services.

*Desktop Devices* **–** Revenue generated from the sale of telecommunications equipment (desktop devices) is recognized when the customer takes possession of the devices and the cloud telecommunications services begin. The Company typically bills and collects the fees for the equipment upon entering into a contract with a customer. Cash receipts are recorded as a contract liability until implementation is complete and the services begin.

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

*Cloud Telecommunications Services* **–** Cloud telecommunication services include voice, data, collaboration software, broadband Internet access, managed IT services, cloud server rental and support, managed security, cabling, software license sales, interest generated from equipment financing revenue, and support for premise based PBX phone systems. The Company recognizes revenue as services are provided in service revenue. Fees generated from reselling broadband Internet access are recognized as revenue net of the costs charged by the third-party service providers. Cloud telecommunications services are billed and paid on a monthly basis. Our telecommunications services contracts typically have a term of thirty-six to sixty months.

*Fees, Commissions, and Other, Recognized over Time* **–** Includes contracted and non-contracted items such as:

- Contracted activation and flash fees – The Company generally allocates a portion of the activation fees to the desktop devices, which is recognized at the time of the installation or customer acceptance, and a portion to the service, which is recognized over the contract term using the straight-line method.
- Non-contracted carrier cost recovery fee – This fee recovers the various costs and expenses that the Company incurs in connection with complying with legal, regulatory, and other requirements, including without limitation federal, state, and local reporting and filing requirements. This fee is assessed as a set percentage of our monthly billing and is recognized monthly.
- Non-contracted administrative fees – Administrative fees are recognized as revenue on a monthly basis.

*One-Time Fees, Commissions, and Other* **–** Includes contracted and non-contracted items such as:

- Contracted professional service revenue – Professional service revenue includes professional installation services, custom integration, and other professional services. The Company typically bills and collects professional service revenue upon entering into a contract with a customer. Professional service revenue is recognized as revenue when the performance obligations are completed.
- Non-contracted cancellation fees – These cancellation fees relate to remaining contractual term buyout payments in connection with early cancellation and are billed and recognized as revenue upon receipt.
- Other non-contracted fees – These fees include disconnect fees, shipping fees, restocking fees, and porting fees. Other non-contracted fees are recognized as revenue upon receipt of payment.

***Software Solutions Segment***

The Software Solutions segment derives revenues from three primary sources: software licenses, software maintenance support and professional services. Software and services may be sold separately or in bundled packages. Generally, contracts with customers contain multiple performance obligations, consisting of software and services. For bundled packages, the Company accounts for individual products and services separately if they are distinct – i.e. if a product or service is separately identifiable from other items in the bundled package and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The consideration (including any discounts) is allocated between separate products and services in a bundle based on their relative stand-alone selling prices. The stand-alone selling prices are determined based on the prices at which the Company separately sells the software licenses and professional services. For items that are not sold separately (e.g. additional features) the Company estimates stand-alone selling prices using the adjusted market assessment approach. When we provide a free trial period, we do not begin to recognize recurring revenue until the trial period has ended and the customer has been billed for the services.

*Software Licenses* **-** The Company’s software licenses typically provide a perpetual right to use the Company’s software. The Company also sells term-based software licenses that expire and Software-as-a-Service (“SaaS”) based software which are referred to as subscription arrangements. The Company does not customize its software nor are installation services required, as the customer has a right to utilize internal resources or a third-party service company. The software is delivered before related services are provided and are functional without professional services or customer support. The Company has concluded that its software licenses are functional intellectual property that are distinct, as the user can benefit from the software on its own. The software license revenue could be recognized upon transfer of control or when the software is made available for download, as this is the point that the user of the software can direct the use of, and obtain substantially all of the remaining benefits from, the functional intellectual property. However, historical experience shows that customers regularly renegotiate the number of licenses during the installation process. Therefore, the Company recognizes revenue from software licenses when the setup is complete. The Company does not recognize software revenue related to the renewal of subscription software licenses earlier than the beginning of the subscription period.

- *SNAPsolution®* - a comprehensive, IP-based platform that provides a broad suite of UC services including hosted Private Branch Exchange (PBX), auto-attendant, call center, conferencing, and mobility. The platform includes a broad range of feature-sets, custom-built to provide unprecedented levels of flexibility, making the solution competitive with the market’s leading players. SNAPsolution includes a full suite of Voice over Internet Protocol (VoIP)/UC features with one low cost universal license, as opposed to pricing each feature individually. The Company licenses its platform based on concurrent sessions, not per seat/per feature. This allows service providers to oversubscribe their networks, driving down the cost per seat as volume increases. As the service provider increases their customer base, they only have to ensure they have sufficient concurrent call licenses to support users across the network. The Company recognizes one-time upfront software license revenue when the software setup is complete.
- *SNAPaccel – a* Software-as-a-Service (“SaaS”) based software license referred to as subscription arrangements. The Company recognizes revenue as subscriptions are provided in service revenue on a monthly basis.

*Subscription Maintenance and Support* - Subscription maintenance and support revenue includes revenue from maintenance service contracts, customer support, and other supportive services. The Company offers warranties on its products. The warranty period for the Company’s licensed software is generally 90 days. Certain of the Company’s warranties are considered to be assurance-type in nature and do not cover anything beyond ensuring that the product is functioning as intended. Based on the guidance in ASC 606, assurance-type warranties do not represent separate performance obligations. The Company also sells separately-priced maintenance service contracts, which qualify as service-type warranties and represent separate performance obligations. The Company does not typically allow and has no history of accepting material product returns. Customer support includes software updates on a when-and-if-available basis, telephone support, integrated web-based support and bug fixes or patches. Subscription and maintenance support revenue is recognized ratably over the term of the customer support agreement, which is typically one year.

*Professional Services and Other* - The Company's professional services include consulting, technical support, resident engineer services, design services and installation services. Revenue from professional services and other is recognized when the performance obligation is complete and the customer has accepted the performance obligation.

***Disaggregation of Revenue***

In the following table, revenue is disaggregated by primary major product line, and timing of revenue recognition. The table also includes a reconciliation of the disaggregated revenue with the reportable segments.

| **Year Ended December 31, 2022**<br>(In thousands) | **Cloud Telecommunications Segment** | **Software Solutions Segment** | **Total Reportable Segments** |
|---|---|---|---|
| **Major products/services lines** | | | |
| Desktop devices | $ 2,891 | $ - | $ 2,891 |
| Equipment financing revenue | 335 | - | 335 |
| Telecommunications services | 16,560 | - | 16,560 |
| Fees, commissions, and other, recognized over time | 1,709 | - | 1,709 |
| One time fees, commissions and other | 911 | - | 911 |
| Software licenses | - | 3,214 | 3,214 |
| Subscription maintenance and support | - | 10,829 | 10,829 |
| Professional services and other | - | 1,105 | 1,105 |
| | $ 22,406 | $ 15,148 | $ 37,554 |
| **Timing of revenue recognition** | | | |
| Products, services, and fees recognized at a point in time | $ 3,802 | $ 4,319 | $ 8,121 |
| Products, services, and fees transferred over time | 18,604 | 10,829 | 29,433 |
| | $ 22,406 | $ 15,148 | $ 37,554 |

| **Year Ended December 31, 2021**<br>(In thousands) | **Cloud Telecommunications Segment** | **Software Solutions Segment** | **Total Reportable Segments** |
|---|---|---|---|
| **Major products/services lines** | | | |
| Desktop devices | $ 2,324 | $ - | $ 2,324 |
| Equipment financing revenue | 266 | - | 266 |
| Telecommunications services | 14,764 | - | 14,764 |
| Fees, commissions, and other, recognized over time | 1,661 | - | 1,661 |
| One time fees, commissions and other | 411 | - | 411 |
| Software licenses | - | 2,556 | 2,556 |
| Subscription maintenance and support | - | 5,875 | 5,875 |
| Professional services and other | - | 235 | 235 |
| | $ 19,426 | $ 8,666 | $ 28,092 |
| **Timing of revenue recognition** | | | |
| Products, services, and fees recognized at a point in time | $ 2,684 | $ 2,791 | $ 5,475 |
| Products, services, and fees transferred over time | 16,742 | 5,875 | 22,617 |
| | $ 19,426 | $ 8,666 | $ 28,092 |

***Contract balances***

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers.

| (In thousands) | **December 31, 2022** | **December 31, 2021** |
|---|---|---|
| Receivables, which are included in Trade receivables, net of allowance for doubtful accounts | $ 3,297 | $ 2,177 |
| Contract assets | 318 | 261 |
| Contract liabilities | 3,585 | 3,028 |

Significant changes in the contract assets and the contract liabilities balances during the period are as follows:

| (In thousands) | For the Year Ended December 31, 2022 | | For the Year Ended December 31, 2021 | |
|---|---|---|---|---|
| | Contract Assets | Contract Liabilities | Contract Assets | Contract Liabilities |
| Revenue recognized that was included in the contract liability balance at the beginning of the period | $ - | $ (3,046) | $ - | $ (1,137) |
| Increase due to cash received, excluding amounts recognized as revenue during the period | - | 3,603 | - | 2,937 |
| Transferred to receivables from contract assets recognized at the beginning of the period | (166) | - | (60) | - |
| Increase due to additional unamortized discounts | 223 | - | 162 | - |

***Transaction price allocated to the remaining performance obligations***

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) at the end of the reporting period (in thousands):

| | 2023 | 2024 | 2025 | 2026 | 2027 and thereafter | Total |
|---|---|---|---|---|---|---|
| Desktop devices | $ 103 | - | - | - | - | $ 103 |
| Telecommunications services | $ 14,161 | 8,462 | 5,425 | 2,980 | 885 | $ 31,913 |
| Software Solutions | $ 8,789 | 3,353 | 1,950 | 738 | - | $ 14,830 |
| All consideration from contracts with customers is included in the amounts presented above | | | | | | |

**3. Earnings Per Common Share**

Basic net income/(loss) per common share is computed by dividing the net income for the period by the weighted-average number of common shares outstanding during the period. Diluted net income per common share is computed giving effect to all dilutive common stock equivalents, consisting of common stock options. Diluted net loss per common share for the years ended December 31, 2022 and 2021 are the same as basic net loss per common share because the common share equivalents were anti-dilutive due to the net loss. The following table sets forth the computation of basic and diluted net income per common share:

| | Year Ended December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Net loss (in thousands) (A) | $ (35,413) | $ (2,445) |
| Weighted-average share reconciliation: | | |
| Weighted-average basic shares outstanding (B) | 22,939,514 | 20,275,691 |
| Dilutive effect of stock-based awards | - | - |
| Diluted weighted-average outstanding shares of common stock (C) | 22,939,514 | 20,275,691 |
| Earnings per common share: | | |
| Basic (A/B) | $ (1.54) | $ (0.12) |
| Diluted (A/C) | $ (1.54) | $ (0.12) |

For the years ended December 31, 2022 and 2021, respectively, the following potentially dilutive common stock, including awards granted under our equity incentive compensation plans, were excluded from the computation of diluted earnings per share because including them would be anti-dilutive.

| | Year Ended December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Stock options | 2,846,670 | 924,742 |

## 4. Acquisitions

***Allegiant Networks, LLC Business Acquisition***

On October 17, 2022, the Company entered into an Acquisition Agreement with Allegiant Networks, LLC, a Kansas limited liability company (the "Allegiant Networks") to acquire from Seller one hundred percent (100%) of the issued and outstanding shares of Allegiant Networks in exchange for (i) a cash payment at closing in the amount of $2.0 million, (ii) a three-year promissory note by the Company in favor of Seller in the amount of $1.1 million, and (iii) 2,461,538 shares of the Company's common stock, par value $0.001 per share. Shares issued in the transaction shall be fully restricted for a period of 6 months from the date of issuance and subject to lock-up thereafter. Pursuant to the lock-up agreement, after 6 months, 25% of the shares will be permitted to be sold, with an additional 25% permitted to be sold every 6-month period thereafter. On November 1, 2022, the Company closed the transaction, and the Company issued the seller cash consideration of $2.0 million, a three-year promissory note for $1.1 million, and 2,461,538 shares of the Company's common stock, par value $0.001 per share valued at $2.57 per share, for an aggregate purchase price of approximately $9.4 million.

| (in thousands) | December 31, 2022 |
|---|---|
| **Consideration:** | |
| Cash | $ 2,000 |
| Common stock | 6,326 |
| Note Payable | 1,100 |
| Total consideration | $ 9,426 |

The acquisition was accounted for under the acquisition method of accounting and the operating results of Allegiant Networks have been included in our consolidated financial statements as of the closing date of the acquisition. Under the acquisition method of accounting, the aggregate amount of consideration paid by us was allocated to Allegiant Networks' net tangible assets and intangible assets based on their estimated fair values as of the acquisition closing date. The excess of the purchase price over the value of the net tangible assets and intangible assets was recorded to goodwill. The factors contributing to the recognition of goodwill were based upon our conclusion that there are strategic and synergistic benefits that are expected to be realized from the acquisition. Goodwill, which is non-deductible for tax purposes, represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired and is primarily attributable to the customer relationships of the acquired business and expected synergies at the time of the acquisition.

We retained an independent third-party valuation firm to assist management in our valuation of the acquired assets and liabilities. The following table presents the final allocation of the purchase price for Allegiant Networks as of December 31, 2022 (in thousands):

| | Final Purchase Price Allocation |
|---|---|
| Total purchase price | $ 9,426 |
| Cash | 586 |
| Accounts receivables | 759 |
| Prepaid expenses | 48 |
| Inventory | 484 |
| Other assets | 12 |
| Property, plant & equipment | 319 |
| Right to use assets | 861 |
| Intangible assets acquired (FV) | 7,000 |
| Total identifiable assets | 10,069 |
| | |
| Accounts payable | 1,162 |
| Accrued expenses | 714 |
| Contract liability | 917 |
| Operating lease liability | 877 |
| Direct financing liability | 142 |
| Buyers note | 1,100 |
| Deferred tax liability | 1,922 |
| Total liabilities assumed | 6,834 |
| Total goodwill | $ 5,091 |

The fair values of the customer relationships was established based upon the income approach. The income approach relies on an estimation of the present value of the future monetary benefits expected to flow to the owner of an asset during its remaining economic life. This approach requires a projection of the cash flow that the asset is expected to generate in the future. The projected cash flow is discounted to its present value using a rate of return, or discount rate that accounts for the time value of money and the degree of risk inherent in the asset. The income approach may take the form of a "relief from royalty" methodology, a cost savings methodology, a "with and without" methodology, or excess earnings methodology, depending on the specific asset under consideration.

The customer relationships was valued using the multi-period excess earnings method. The Inherent in the multi-period excess earnings method is the recognition that, in most cases, all of the assets of the business, both tangible and intangible, contribute to the generation of the cash flow of the business and the net cash flows attributable to the subject asset must recognize the support of the other assets which contribute to the realization of the cash flows. This future cash flow was then discounted using an estimated required rate of return for the asset to determine the present value of the future cash flows attributable to the asset. The key assumptions used in valuing the customer relationships acquired are as follows: weighted average cost of capital of 16.0%, tax rate of 25.0%, and estimated economic life of 15 years.

The following unaudited pro forma information presents our consolidated results of operations as if Allegiant Networks had been included in our consolidated results since January 1, 2021:

| | For the Year Ended December 31, (Unaudited, in thousands) | |
|---|---|---|
| | 2022 | 2021 |
| Revenues | $ 46,764 | $ 38,134 |
| Net loss | (35,545) | (1,246) |
| Earnings per share | $ (1.42) | $ (0.05) |

The unaudited pro forma financial information is presented for informational purposes only and may not necessarily reflect the Company's future results of operations or what the results of operations would have been had the Company owned and operated Allegiant Networks as of January 1, 2021.

Acquisition related expenses incurred by us in connection with the Allegiant Networks acquisition of $18,000 for the year ended December 31, 2022, are recorded within general and administrative expenses in our consolidated statements of operations.

***NetSapiens, Inc. Merger Agreement***

On June 1, 2021, the Company acquired 100% of the issued and outstanding shares of NetSapiens, Inc. ("NetSapiens"), a provider of a comprehensive suite of unified communications (UC), video conferencing, collaboration & contact center solutions to service providers, servicing over two million users around the globe. The aggregate purchase price was approximately $49.1 million, consisting of $10 million in cash, and approximately $39 million in common stock and stock options. In connection with the closing of the Merger, the Company issued 3,097,309 shares of the Company's common stock valued at $5.47 per share for common stock consideration of approximately $16.9 million, and 4,482,328 options under the Crexendo, Inc. 2021 Equity Incentive Plan with an aggregate value of $22.1 million, net of the aggregate exercise price of $5.6 million.

| (in thousands) | Initial Valuation | Adjustments | December 31, 2021 |
|---|---|---|---|
| **Consideration:** | | | |
| Cash | $ 10,000 | | $ 10,000 |
| Common stock | 16,942 | | 16,942 |
| Stock options | 22,120 | | 22,120 |
| Total consideration | $ 49,062 | | $ 49,062 |

The acquisition was accounted for under the acquisition method of accounting and the operating results of NetSapiens have been included in our consolidated financial statements as of the closing date of the acquisition. Under the acquisition method of accounting, the aggregate amount of consideration paid by us was allocated to NetSapiens net tangible assets and intangible assets based on their estimated fair values as of the acquisition closing date. The excess of the purchase price over the value of the net tangible assets and intangible assets was recorded to goodwill. The factors contributing to the recognition of goodwill were based upon our conclusion that there are strategic and synergistic benefits that are expected to be realized from the acquisition. Goodwill, which is non-deductible for tax purposes, represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired and is primarily attributable to the customer relationships, developed technology, and trademark and trade name of the acquired business and expected synergies at the time of the acquisition.

We retained an independent third-party valuation firm to assist management in our valuation of the acquired assets and liabilities. The following table presents the final allocation of the purchase price for NetSapiens and adjustments made during the period ended December 31, 2021 (in thousands):

| | Initial Valuation | Adjustments | December 31, 2021 |
|---|---|---|---|
| Total purchase price | $ 49,062 | | $ 49,062 |
| Cash | 1,658 | 739(b) | 2,397 |
| Accounts receivables | 846 | 107(f) | 953 |
| Prepaid expenses | 57 | | 57 |
| Contract cost | - | 105(f) | 105 |
| Other assets | 319 | 4(c) | 323 |
| Property, plant & equipment | 62 | (2)(c) | 60 |
| Right to use assets | 551 | 4(d) | 555 |
| Deferred tax assets | 2,829 | (2,829)(g) | - |
| Intangible assets acquired (FV) | 21,520 | (420)(a) | 21,100 |
| Long-term trade receivables, net of current | - | 63(f) | 63 |
| Other long-term assets | 84 | 5(c) | 89 |
| Total identifiable assets | 27,926 | | 25,702 |
| Accounts payable | 438 | 69(c) | 507 |
| Accrued expenses | 2,412 | 817(b)(c) | 3,229 |
| Contract liability | 1,475 | 732(e)(f) | 2,207 |
| Operating lease liability | 379 | 17(d) | 396 |
| Direct financing liability | 17 | (17)(d) | - |
| Contract liability, net of current portion | 629 | (629)(e) | - |
| Direct financing liability, net of current portion | 29 | (29)(d) | - |
| Operating lease liability, net of current portion | 219 | 30(d) | 249 |
| Deferred tax liability | - | 5,033(g) | 5,033 |
| Total liabilities assumed | 5,598 | | 11,621 |
| Total goodwill | $ 26,734 | 8,247 | $ 34,981 |

(a) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to the refinement of inputs used to calculate the fair value of the customer relationships, developed technology, and Trademarks and trade name intangible assets, with the assistance of an independent third-party valuation firm based on facts and circumstances that existed as of the acquisition date. The adjustment to customer relationships, developed technology, and addition of trademarks and trade name intangible assets was a decrease in the fair value of the intangible asset of $420,000, and an increase to goodwill of $420,000. As a result of the adjustments to the provisional amounts and estimated useful lives of intangible assets, during the fourth quarter the Company recognized $59,000 less amortization expense in cost of software solutions, $98,000 additional amortization expense in sales and marketing, and $37,000 additional amortization expense in general and administrative in the current period related to the effects that would have been recognized in previous quarters if the measurement period adjustment was recognized as of the date of acquisition.

(b) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to the delayed settlement of pre-acquisition liabilities resulted in an increase in opening balance sheet cash and accrued liabilities of $739,000, with no impact on goodwill.

(c) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to revisions to our estimates for various assets acquired and liabilities assumed resulting in an increase of $9,000 to assets acquired and a increase in liabilities assumed of $147,000 and an increase to goodwill of $140,000.

(d) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to the adoption of ASC 842, resulting in the reclassification of direct financing lease liabilities as operating lease liabilities, and an increase of $4,000 to the right to use assets balance and an increase of $1,000 to the operating lease liability and a decrease to goodwill of $3,000.

(e) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to revisions to our preliminary estimate of contract liabilities, net of current portion, which were determined to be current liabilities and have been reclassified as current contract liabilities with no impact on goodwill.

(f) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to the retroactive adoption of ASC 606, resulting in the recording of contract cost of $105,000, an increase to current and long-term accounts receivables of $170,000, an increase in contract liabilities of $103,000 and a decrease to goodwill of $172,000.

(g) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to recording of a valuation allowance on the deferred tax assets of $2,829,000, and recording a deferred tax liability of $5,033,000 for the intangible assets acquired and a increase to goodwill of $7,862,000.

The fair values of the customer relationships, developed technology, and trademark and trade name were established based upon the income approach. The income approach relies on an estimation of the present value of the future monetary benefits expected to flow to the owner of an asset during its remaining economic life. This approach requires a projection of the cash flow that the asset is expected to generate in the future. The projected cash flow is discounted to its present value using a rate of return, or discount rate that accounts for the time value of money and the degree of risk inherent in the asset. The income approach may take the form of a “relief from royalty” methodology, a cost savings methodology, a “with and without” methodology, or excess earnings methodology, depending on the specific asset under consideration.

The customer relationships was valued using the multi-period excess earnings method. The Inherent in the multi-period excess earnings method is the recognition that, in most cases, all of the assets of the business, both tangible and intangible, contribute to the generation of the cash flow of the business and the net cash flows attributable to the subject asset must recognize the support of the other assets which contribute to the realization of the cash flows. This future cash flow was then discounted using an estimated required rate of return for the asset to determine the present value of the future cash flows attributable to the asset. The key assumptions used in valuing the customer relationships, developed technology, and trademarks and trade names acquired are as follows: weighted average cost of capital of 11.0%, tax rate of 25.0%, and estimated economic life of 16 years.

The developed technology and trademarks and trade name were valued using the relief from royalty methodology. The relief-from-royalty method was used to value the developed technology and trademarks and trade name acquired from NetSapiens. The relief-from-royalty method estimates the cost savings that accrue to the owner of an intangible asset that would otherwise be required to pay royalties or license fees on revenues earned through the use of the asset. The royalty rate used is based on an analysis of empirical, market-derived royalty rates for guideline intangible assets. Typically, revenue is projected over the expected remaining useful life of the completed technology. The market-derived royalty rate is then applied to estimate the royalty savings. The key assumptions used in valuing the developed technology are as follows: royalty rate of 7%, discount rate of 11.0%, tax rate of 25% and estimated average economic life of 6 years. The key assumptions used in valuing the existing trademarks are as follows: royalty rate of 1.0%, discount rate of 11.0%, tax rate of 25% and estimated average economic life of 4 years.

Acquisition related expenses incurred by us in connection with the NetSapiens acquisition of $37,000 and $970,000 for the years ended December 31, 2022 and 2021, respectively, are recorded within general and administrative expenses in our consolidated statements of operations.

***Centric Telecom, Inc. Business Acquisition***

On January 14, 2021, the Company acquired 100% of the issued and outstanding shares of Centric Telecom, Inc., a provider of telecommunications products, services, and solutions in Northern Virginia. The aggregate purchase price of $3,255,000 consisted of $2,163,000 of cash paid at closing, 46,662 shares of our common stock with an estimated fair value of $346,000 issued at closing, and $746,000 of estimated contingent consideration to be paid out based on annualized revenue recognized during the nine month earn-out period. The fair value of the common stock issued as consideration was determined based on the closing market price of the Company's common stock on the date of the acquisition of $7.42. The aggregate purchase price is subject to customary upward or downward adjustments for Centric Telecom's net working capital.

| (in thousands) | Initial Valuation | Adjustments | December 31, 2021 |
|---|---|---|---|
| **Consideration:** | | | |
| Cash | $ 2,163 | | $ 2,163 |
| Common stock | 346 | | 346 |
| Contingent consideration | 746 | | 746 |
| Total consideration | $ 3,255 | | $ 3,255 |

The acquisition was accounted for under the acquisition method of accounting and the operating results of Centric Telecom have been included in our consolidated financial statements as of the closing date of the acquisition. Under the acquisition method of accounting, the aggregate amount of consideration paid by us was allocated to Centric Telecom's net tangible assets and intangible assets based on their estimated fair values as of the acquisition closing date. The excess of the purchase price over the value of the net tangible assets and intangible assets was recorded to goodwill. The factors contributing to the recognition of goodwill were based upon our conclusion that there are strategic and synergistic benefits that are expected to be realized from the acquisition. Goodwill, which is non-deductible for tax purposes, represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired and is primarily attributable to the customer relationships of the acquired business and expected synergies at the time of the acquisition.

We retained an independent third-party valuation firm to assist management in our valuation of the acquired assets and liabilities. The following table presents the final allocation of the purchase price for Centric Telecom and adjustments made during the period ended December 31, 2021 (in thousands):

| | Initial Valuation | Adjustments | December 31, 2021 |
|---|---|---|---|
| Total purchase price | $ 3,255 | | $ 3,255 |
| Cash | 7 | | 7 |
| Accounts receivables | 122 | | 122 |
| Prepaid expenses | 4 | | 4 |
| Inventory | 12 | | 12 |
| Other assets | 12 | | 12 |
| Property, plant & equipment | 57 | | 57 |
| Right to use assets | 134 | | 134 |
| Intangible assets acquired (FV) | 2,238 | (38)(a) | 2,200 |
| Other long-term assets | 44 | | 44 |
| Total identifiable assets | 2,630 | | 2,592 |
| | | | |
| Accounts payable | 26 | | 26 |
| Accrued expenses | 187 | 8(b) | 195 |
| Contract liability | 147 | | 147 |
| Operating lease liability | 118 | 16(c) | 134 |
| Direct financing liability | 20 | | 20 |
| Deferred tax liability | - | 534(d) | 534 |
| Total liabilities assumed | 498 | | 1,056 |
| Total goodwill | $ 1,123 | 596 | $ 1,719 |

(a) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to the refinement of inputs used to calculate the fair value of the customer relationships intangible asset, with the assistance of an independent third-party valuation firm based on facts and circumstances that existed as of the acquisition date. The adjustment to customer relationships intangible asset was a decrease in the fair value of the intangible asset of $38,000, and an increase to goodwill of $38,000. As a result of the adjustments to the provisional amounts and estimated useful lives of intangible assets, during the fourth quarter the Company recognized $16,000 less amortization expense in sales and marketing in the current period related to the effects that would have been recognized in previous quarters if the measurement period adjustment was recognized as of the date of acquisition.

(b) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to recording of pre-acquisition liabilities and resulted in an increase to accrued liabilities of $8,000 and an increase to goodwill of $8,000.

(c) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due to the adoption of ASC 842, resulting in an increase of $16,000 to the operating lease liability and an increase to goodwill of $16,000.

(d) During the fourth quarter of 2021, we identified measurement period adjustments related to preliminary fair value estimates. The measurement period adjustments were due recording a deferred tax liability of $534,000 for the intangible assets acquired and an increase to goodwill of $534,000.

The fair values of the customer relationships was established based upon the income approach. The income approach relies on an estimation of the present value of the future monetary benefits expected to flow to the owner of an asset during its remaining economic life. This approach requires a projection of the cash flow that the asset is expected to generate in the future. The projected cash flow is discounted to its present value using a rate of return, or discount rate that accounts for the time value of money and the degree of risk inherent in the asset. The income approach may take the form of a "relief from royalty" methodology, a cost savings methodology, a "with and without" methodology, or excess earnings methodology, depending on the specific asset under consideration.

The customer relationships was valued using the multi-period excess earnings method. The Inherent in the multi-period excess earnings method is the recognition that, in most cases, all of the assets of the business, both tangible and intangible, contribute to the generation of the cash flow of the business and the net cash flows attributable to the subject asset must recognize the support of the other assets which contribute to the realization of the cash flows. This future cash flow was then discounted using an estimated required rate of return for the asset to determine the present value of the future cash flows attributable to the asset. The key assumptions used in valuing the customer relationships acquired are as follows: weighted average cost of capital of 14.0%, tax rate of 25.0%, and estimated economic life of 15 years.

Acquisition related expenses incurred by us in connection with the Centric Telecom acquisition of $0 and $67,000 for the years ended December 31, 2022 and 2021, respectively, are recorded within general and administrative expenses in our consolidated statements of operations.

**5. Trade Receivables, net**

Our trade receivables balance consists of traditional trade receivables. Below is an analysis of our trade receivables as shown on our balance sheet (in thousands):

| | December 31, | |
|---|---|---|
| | **2022** | **2021** |
| Gross trade receivables | $ 3,428 | $ 2,249 |
| Less: allowance for doubtful accounts | (131) | (72) |
| Trade receivables, net | $ 3,297 | $ 2,177 |
| | | |
| Current trade receivables, net | $ 3,297 | $ 2,177 |
| Long-term trade receivables, net | - | - |
| Trade receivables, net | $ 3,297 | $ 2,177 |

### 6. Prepaid Expenses

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Prepaid corporate insurance | $ 117 | $ 90 |
| Prepaid software services and support | 122 | 160 |
| Prepaid employee insurance premiums | 30 | 9 |
| Nasdaq Listing Fee | 15 | 15 |
| Other prepaid expenses | 147 | 84 |
| Total prepaid assets | $ 431 | $ 358 |

Prepaid expenses consisted of the following (in thousands):

### 7. Property and Equipment

Property and equipment consisted of the following (in thousands):

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Building | $ 2,000 | $ 2,000 |
| Land | 500 | 500 |
| Computer and office equipment | 2,726 | 1,854 |
| Computer software | 576 | 576 |
| Internal-use software | 14 | 14 |
| Furniture and fixtures | 75 | 75 |
| Vehicles | 130 | 74 |
| Leasehold improvements | 15 | 7 |
| Less: accumulated depreciation | (2,721) | (2,111) |
| Total property and equipment, net | $ 3,315 | $ 2,989 |

Depreciation expense is included in general and administrative expenses and totaled $311,000 and $235,000 for the years ended December 31, 2022 and 2021, respectively.

### 8. Intangible Assets and Goodwill

On December 31, 2022, the Company determined there was a triggering event, primarily caused by a sustained decrease in the Company's stock price and we retained an independent third-party valuation firm to assist management in performing the quantitative impairment tests. The results of the goodwill and intangible asset impairment tests indicated that the carrying value of goodwill exceeded the estimated fair value and no impairment was required for intangible assets. Thus, as of December 31, 2022, the Company recorded an impairment of $32.6 million related to its goodwill book value for the software solutions operating segment. For further information, see Note 2 (Significant Accounting Polices).

On November 1, 2022, the Company acquired $7,000,000 in intangible assets in connection with the Allegiant Networks business acquisition. On June 1, 2021, the Company acquired $21,100,000 in intangible assets in connection with the NetSapiens business acquisition. On January 14, 2021, the Company acquired $2,200,000 in intangible assets in connection with the Centric Telecom business acquisition.

Acquired intangible assets subject to amortization consist of the following (in thousands):

| | December 31, 2022 | | | December 31, 2021 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Customer relationships | $ 26,073 | $ (3,052) | $ 23,021 | $ 19,073 | $ (1,619) | $ 17,454 |
| Developed technologies | 4,900 | (1,410) | 3,490 | 4,900 | (528) | 4,372 |
| Trademark and trade names | 400 | (186) | 214 | 400 | (65) | 335 |
| Total acquired intangible assets | $ 31,373 | $ (4,648) | $ 26,725 | $ 24,373 | $ (2,212) | $ 22,161 |

As of December 31, 2022, the weighted average remaining useful life for customer relationships was 14.4 years, developed technologies was 4.7 years, and trademarks and trade names was 2.7 years.

Amortization expense for customer relationships intangible assets is included in sales and marketing expenses and totaled $1,433,000 and $723,000 for the years ended December 31, 2022 and 2021, respectively. Amortization expense for developed technologies intangible assets is included in cost of software solutions revenue and totaled $882,000 and $528,000 for the years ended December 31, 2022 and 2021, respectively. Amortization expense for trademark and trade name intangible assets is included in general and administrative expenses and totaled $121,000 and $140,000 for the years ended December 31, 2022 and 2021, respectively.

As of December 31, 2022, annual amortization of definite lived intangible assets, based on existing intangible assets and current useful lives, is estimated to be the following (in thousands):

| **Year ending December 31,** | |
|---|---|
| 2023 | $ 3,170 |
| 2024 | 3,028 |
| 2025 | 2,770 |
| 2026 | 2,457 |
| 2027 and thereafter | 15,300 |
| Total | $ 26,725 |

The following table provides a summary of changes in the carrying amounts of goodwill (in thousands):

| | **Goodwill** |
|---|---|
| Balance at January 1, 2021 | $ 272 |
| Centric Telecom business acquisition | 1,719 |
| NetSapiens business acquisition | 34,981 |
| Balance at December 31, 2021 | 36,972 |
| Allegiant Networks business acquisition | 5,091 |
| Impairment | (32,609) |
| Balance at December 31, 2022 | $ 9,454 |

**9. Accrued Expenses**

Accrued expenses consisted of the following (in thousands):

| | **December 31,** | |
|---|---|---|
| | **2022** | **2021** |
| Accrued wages and benefits | $ 2,427 | $ 1,188 |
| Accrued accounts payable | 987 | 609 |
| Accrued sales and telecommunications taxes | 846 | 2,487 |
| Product warranty liability | 55 | 50 |
| Income tax payable | - | 10 |
| Other | 575 | 560 |
| Total accrued expenses | $ 4,890 | $ 4,904 |

The changes in aggregate product warranty liabilities for the years ended December 31, 2022 and 2021 were as follows (in thousands):

| | **Warranty Liabilities** |
|---|---|
| Balance at January 1, 2021 | $ 33 |
| Accrual for warranties | 50 |
| Adjustments related to pre-existing warranties | 1 |
| Warranty settlements | (34) |
| Balance at December 31, 2021 | 50 |
| Accrual for warranties | 55 |
| Adjustments related to pre-existing warranties | (26) |
| Warranty settlements | (24) |
| Balance at December 31, 2022 | $ 55 |

Product warranty expense is included in cost of product revenue and totaled $29,000 and $51,000 for the years ended December 31, 2022 and 2021, respectively.

**10. Notes Payable**

Notes payable consists of a short and long-term financing arrangements:

| | December 31, | |
|---|---|---|
| | **2022** | **2021** |
| Notes payable | $ 3,025 | $ 1,873 |
| Less: current notes payable | (420) | (1,873) |
| Notes payable, net of current portion | $ 2,605 | $ - |

On November 1, 2022, as part of the acquisition of Allegiant Networks, we entered into a promissory note with the seller in the amount of $1.1 million. The loan agreement has a term of three (3) years with quarterly payments of Ninety-Eight Thousand Three Hundred Eighty and 54/100 Dollars ($9,838,054), including interest at 4.00%, beginning on April 1, 2023.

As part of the November 1, 2022 acquisition of Allegiant Networks, we assumed two promissory notes with CrossFirst Bank. One loan agreement for $125,000 has a term of three (3) years with monthly payments of Three Thousand Seven Hundred Seven and 62/100 Dollars ($370,762), including interest of 4.25%, beginning on October 30, 2020. The second loan agreement for $150,000 has a term of three (3) years with monthly payments of Four Thousand Four Hundred Sixty-Six and 08/100 Dollars ($446,608), including interest of 4.50%, beginning on September 1, 2021.

On January 27, 2020, we entered into a Fixed Rate Term Loan Agreement with Bank of America, N.A. to finance Two Million Dollars ($2,000,000) to purchase our corporate office building. The Loan Agreement has a term of seven (7) years with monthly payments of Eleven Thousand Eight Hundred Forty-One and 15/100 Dollars ($1,184,115), including interest at 3.67%, beginning on March 1, 2020, secured by the office building. At December 31, 2021, we were in default of our basic fixed charge coverage ratio and classified the note payable as current on our consolidated balance sheet. During the year ended December 31, 2022, Bank of America, N.A. waived all financial covenants and the Company reclassified the long-term portion of the note payable as long-term.

As of December 31, 2022, future principal payments are scheduled as follows (in thousands):

| **Year ending December 31,** | |
|---|---|
| 2023 | $ 421 |
| 2024 | 484 |
| 2025 | 462 |
| 2026 | 183 |
| 2027 | 1,475 |
| Total | $ 3,025 |

**11. Line of Credit**

The Company maintains a line of credit with a maximum principal amount of $700,000, payable upon demand. The line of credit expires on April 15, 2023. The line of credit bears interest at 0.50% over the Wall Street Journal Prime Rate. As of December 31, 2022, there was an outstanding balance of $82,000 and $618,000 remained available for borrowing. The line of credit is collateralized by all company assets and is personally guaranteed by a member of senior management. Additionally, the line of credit is subject to certain financial covenants. On February 27, 2023, the Company renewed the line of credit through February 27, 2024. In the renewal, the personal guarantee was removed, but all other terms remained the same.

## 12. Fair Value Measurements

We have financial instruments as of December 31, 2022 and 2021 for which the fair value is summarized below (in thousands):

| | December 31, 2022 | | December 31, 2021 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Assets: | | | | |
| Trade receivables, net | $ 3,297 | $ 3,297 | $ 2,177 | $ 2,177 |
| Equipment financing receivables | 1,890 | 1,890 | 1,274 | 1,274 |
| Liabilities: | | | | |
| Finance leases | $ 193 | $ 193 | $ 303 | $ 303 |
| Notes payable | 3,025 | 2,724 | 1,873 | 1,873 |

We have no liabilities for which fair value is recognized in the balance sheet on a recurring basis as of December 31, 2022 and 2021.

In January 2021, the Company recorded $746,000 of contingent consideration in connection with the Centric Telecom business acquisition, to be paid based on the completion of the earn-out period. Upon completion of the earn-out period in October 2021, the Company paid out $746,000 of contingent consideration and additional consideration of $126,000 based on revenue target achievements, which was recorded as general and administrative expenses for the year ended December 31, 2021. The progression of the Company's Level 3 instruments fair valued on a recurring basis for the year ended December 31, 2022 and 2021 are shown in the table below (in thousands):

| | Asset and Business Acquisition Contingent Consideration |
|---|---|
| Balance at January 1, 2020 | $ - |
| Additions | $ 746 |
| Cash payments | (746) |
| Balance at December 31, 2021 | $ - |
| Additions | - |
| Cash payments | - |
| Balance at December 31, 2022 | $ - |

## 13. Equity

*Common Stock*

Shares of common stock reserved for future issuance as of December 31, 2022 were as follows:

| | |
|---|---|
| Stock-based compensation plans: | |
| Outstanding option awards | 7,886,942 |
| Available for future grants | 3,609,654 |
| | 11,496,596 |

## 14. Stock-Based Compensation

We have various incentive stock-based compensation plans that provide for the grant of stock options, restricted stock units (RSUs), and other share-based awards of up to 11,496,596 shares to eligible employees, consultants, and directors. As of December 31, 2022, we had 3,609,654 shares remaining in the plans available to grant.

*Stock Options*

The weighted-average fair value of stock options on the date of grant and the assumptions used to estimate the fair value of stock options granted during the years ended December 31, 2022 and 2021 using the Black-Scholes option-pricing model were as follows:

| | Year Ended December 31, | |
|---|---|---|
| | **2022** | **2021** |
| Weighted-average fair value of options granted | $ 2.31 | $ 0.65 |
| Expected volatility | 82% | 13% |
| Expected life (in years) | 5.72 | 0.81 |
| Risk-free interest rate | 2.99% | 0.14% |
| Expected dividend yield | 0.00% | 0.00% |

The expected volatility of the options is determined using historical volatilities based on historical stock prices. The expected life of the options granted is based on our historical share option exercise experience. The risk-free interest rate is determined using the yield available for zero-coupon U.S. government issues with a remaining term equal to the expected life of the option. During 2022, the Company has declared a quarterly dividend of $0.005, however, the expected annual dividend yield was less than half of one percent during 2022.

The following table summarizes the stock option activity under the plans for the years ended December 31, 2022 and 2021:

| | **Number of Shares** | **Weighted-Average Exercise Price** | **Weighted-Average Remaining Contract Life** | **Aggregate Intrinsic Value (in thousands)** |
|---|---|---|---|---|
| Outstanding at January 1, 2021 | 2,885,461 | 3.36 | 3.0 years | 10,310 |
| Granted | 5,349,828 | 2.06 | | |
| Exercised | (1,142,330) | 2.89 | | |
| Cancelled/forfeited | (104,116) | 5.70 | | |
| Outstanding at December 31, 2021 | 6,988,843 | 2.40 | 4.5 years | 19,829 |
| Granted | 1,926,000 | 3.34 | | |
| Exercised | (960,865) | 1.33 | | |
| Cancelled/forfeited | (301,014) | 3.59 | | |
| Outstanding at December 31, 2022 | 7,652,964 | 2.73 | 5.3 years | 3,362 |
| Shares vested and expected to vest | 7,533,780 | 2.73 | 5.3 years | 3,362 |
| Exercisable as of December 31, 2022 | 5,655,810 | 2.25 | 4.1 years | 3,362 |
| Exercisable as of December 31, 2021 | 5,917,757 | 1.74 | 4.0 years | 19,763 |

The total intrinsic value of options exercised during the years ended December 31, 2022 and 2021, was $1,576,000 and $2,894,000, respectively.

As of December 31, 2022, the total future compensation expense related to non-vested options not yet recognized in the consolidated statements of operations was approximately $5,232,000 and the weighted-average period over which these awards are expected to be recognized is approximately 2.0 years.

*Restricted Stock Units:*

The following table summarizes the RSUs outstanding:

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2023** | **2024** | **2025** |
| RSUs with service-based vesting conditions | 142,651 | 13,334 | - |

The following table summarizes the RSUs activity under the plans for the years ended December 31, 2022 and 2021:

| | Number of Units | Weighted-Average Fair Value |
|---|---|---|
| Outstanding at January 1, 2021 | 100,511 | $ 3.63 |
| Granted | - | - |
| Vested/released | (56,480) | 3.33 |
| Cancelled/forfeited | (4,893) | 3.79 |
| Outstanding at December 31, 2021 | 39,138 | 4.05 |
| Granted | 592,500 | 2.70 |
| Vested/released | (475,653) | 2.50 |
| Cancelled/forfeited | - | - |
| Outstanding at December 31, 2022 | 155,985 | 3.62 |

The weighted-average grant-date fair value of RSUs granted year ended December 31, 2022 was $2.70. There were no RSUs granted during the year ended December 31, 2021.

The total intrinsic value of RSUs that vested and were released during the years ended December 31, 2022 and 2021 was $1,167,000 and $341,000 respectively.

As of December 31, 2022, the total future compensation expense related to non-vested RSUs not yet recognized in the consolidated statements of operations was approximately $171,000 and the weighted-average period over which these awards are expected to be recognized is approximately 0.7 years.

The following table summarizes the statement of operations effect of stock-based compensation for the years ended December 31, 2022 and 2021 (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Share-based compensation expense by type: | | |
| Stock options | $ 2,798 | $ 1,441 |
| Restricted stock units | 1,576 | 187 |
| Total cost related to share-based compensation expense | $ 4,374 | $ 1,628 |
| Share-based compensation expense by financial statement line item: | | |
| Cost of revenue | $ 425 | $ 154 |
| Research and development | 542 | 125 |
| Selling and marketing | 681 | 271 |
| General and administrative | 2,726 | 1,078 |
| Total cost related to share-based compensation expense | $ 4,374 | $ 1,628 |

The tax benefit related to stock compensation expense on net deferred tax assets at December 31, 2022 and 2021 was $510,000 and $178,000, respectively.

**15. Income Taxes**

The income tax benefit/(expense) consisted of the following for the years ended December 31, 2022 and 2021 (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Current income tax expense: | | |
| Federal | $ - | $ - |
| State and local | (173) | (35) |
| Current income tax expense | (173) | (35) |
| Deferred income tax benefit: | | |
| Federal | 874 | 114 |
| State and local | 61 | 386 |
| Deferred income tax benefit | 935 | 500 |
| Total income tax benefit/(provision) | $ 762 | $ 465 |

The income tax provision attributable to income before income tax benefit for the years ended December 31, 2022 and 2021 differed from the amounts computed by applying the U.S. federal statutory tax rate of 21% and 21%, respectively, as a result of the following (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2022 | 2021 |
| U.S. federal statutory income tax benefit/(expense) | $ 7,596 | $ 611 |
| Increase in income tax benefit resulting from: | | |
| State and local income tax benefit/(expense), net of federal effect | 697 | 227 |
| Write-off goodwill | (6,848) | |
| Change in the valuation allowance for net deferred income tax assets | (785) | (231) |
| Stock-based compensation | 105 | 71 |
| Other, net | (3) | (213) |
| Income tax benefit | $ 762 | $ 465 |

As of December 31, 2022 and 2021, significant components of net deferred income tax assets and liabilities were as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Deferred income tax assets: | | |
| Accrued expenses | $ 490 | $ 242 |
| Deferred revenue | 698 | 722 |
| Net operating loss carry-forwards | 7,783 | 7,230 |
| Stock-based compensation | 510 | 178 |
| Other | 127 | 127 |
| Subtotal | 9,608 | 8,499 |
| Valuation allowance | (3,179) | (1,498) |
| Total deferred income tax assets | 6,429 | 7,001 |
| Deferred income tax liabilities: | | |
| Property and equipment | (134) | (31) |
| Prepaid expenses and other | (455) | (445) |
| Intangible assets | (5,840) | (5,539) |
| Total deferred income tax liabilities | (6,429) | (6,015) |
| Net deferred income tax assets (liabilities) | $ - | $ 986 |

As of December 31, 2022, we had NOL and research credit carry-forwards for U.S. federal income tax reporting purposes of approximately $26,892,000 and $66,000, respectively. $16,136,000 of the NOLs will begin to expire in 2032 through 2037, and the remaining $10,756,000 of the NOLs will not expire. The research tax credit will begin to expire in 2039 through 2040. Approximately $5,292,000 of the NOL carryforwards and $66,000 of the research credit carryforwards relate to the NetSapiens and Centric acquisitions. A valuation allowance of $3,179,000 and $1,498,000 was recorded against our gross deferred tax asset balance as of December 31, 2022 and 2021, respectively.

As of each reporting date, management considers new evidence, both positive and negative, that could affect its view of the future realization of deferred tax assets. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income in the periods in which those temporary differences become deductible. We reduce the carrying amounts of deferred tax assets by a valuation allowance if, based on the evidence available, it is more-likely-than-not that such assets will not be realized. In making the assessment under the more-likely-than-not standard, appropriate consideration must be given to all positive and negative evidence related to the realization of the deferred tax assets. This assessment considers, among other matters, the nature, frequency and severity of current and cumulative losses, forecasts of future profitability, the duration of statutory carry-forward periods by jurisdiction, unitary versus stand-alone state tax filings, our experience with loss carryforwards expiring unutilized, and all tax planning alternatives that may be available. As of December 31, 2022, management reviewed the weight of all the positive and negative evidence available. Management reviewed negative evidence such as three years of cumulative pretax loss in the U.S. federal tax jurisdiction, and positive evidence such as projections of future pretax income and the duration of statutory carry-forward periods. As of December 31, 2022 the Company has a cumulative pretax loss for the three year lookback, which is considered significant objectively verifiable negative evidence. Management also evaluated projections of future pretax income and the duration of statutory carry-forward periods to determine if the NOL carryforwards could be utilized in whole or in part before they expire unutilized. Forecasts and projections of future income are inherently subjective and therefore generally are given less weight, based on the extent to which the assumptions can be objectively verified based on historical experience. Although historical trends utilized in our projections are objectively verifiable we assigned less weight to this positive evidence given the subjective nature of assumptions in projections. Management reviewed negative evidence related to experience of credits and loss carryforwards expiring unutilized, and determined that although negative evidence exists, it was not significant evidence, as the current loss carryforwards do not begin to expire until 2032 and therefore risk is minimal. After reviewing the weight of the positive and negative evidence, management determined that the positive evidence was not sufficient enough to overcome the negative evidence of cumulative pretax losses for the three year lookback to conclude that it is more likely than not that deferred tax assets of $3,179,000 are realizable. Therefore, a valuation allowance of $3,179,000 was recorded against our gross deferred tax asset balance as of December 31, 2022.

We also have state NOL and research and development credit carry-forwards of approximately $29,034,000 and $61,000, which expire on specified dates as set forth in the rules of the various states to which the carry-forwards relate. The company has recorded a valuation allowance of $61,000 against the research and development credit carryforward.

We also have foreign NOL carryforwards of approximately $1,541,000 which will expire on various dates as set forth in the rules of the various countries to which the carryforwards relate. Due to the uncertainty on the Company's ability to utilize these NOL carryforwards the company has recorded a valuation allowance against these NOL carryovers of $354,000.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 ("Tax Act") was signed into law. The new law includes, among other items, a permanent reduction to the U.S. corporate income tax rate from 34% to 21% effective January 1, 2018. As a result of the reduction of the corporate income tax rate to 21%, U.S. GAAP requires companies to remeasure their deferred tax assets and liabilities as of the date of enactment, with resulting tax effects accounted for in the reporting period of enactment. The Company remeasured deferred tax assets and liabilities based on the rates at which they are expected to be utilized in the future. There was no charge to our income tax expense as a result of the reduction in corporate income tax rate.

Accounting guidance clarifies the accounting for uncertain tax positions and requires companies to recognize the impact of a tax position in their financial statements, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. Although we believe our estimates are reasonable, there can be no assurance that the final tax outcome of these matters will not be different from that which we have reflected in our historical income tax provisions and accruals. Such difference could have a material impact on our income tax provision and operating results in the period in which it makes such determination.

The aggregate changes in the balance of unrecognized tax benefits during the years ended December 31, 2022 and 2021 were as follows (in thousands):

| | |
|---|---|
| Balance as of January 1, 2021 | $ - |
| Reductions due to lapsed statute of limitations | - |
| Balance as of December 31, 2021 | - |
| Reductions due to lapsed statute of limitations | - |
| Balance as of December 31, 2022 | $ - |

Estimated interest and penalties related to the underpayment or late payment of income taxes are classified as a component of income tax provision in the consolidated statements of operations. There were no accrued interest and penalties as of December 31, 2022 and 2021, respectively.

Our U.S. federal income tax returns for fiscal 2019 through 2022 are open tax years. We also file in various states, with few exceptions, we are no longer subject to state income tax examinations by tax authorities for years prior to fiscal 2017.

## 16. Leases

*Lessee Accounting*

We determine if an agreement is a lease at inception. We lease office space, data center colocation space, other assets, and office equipment under operating leases. We lease data center equipment, including maintenance contracts and vehicles under finance leases.

Operating leases are recorded as right-of-use ("ROU") assets and lease liabilities on the balance sheet, excluding leases that are less than 12 months. ROU assets represent our right to use the leased asset for the lease term and lease liabilities represent our obligation to make lease payments. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of our leases do not provide an implicit rate, we use our estimated incremental borrowing rate at the commencement date to determine the present value of lease payments. The operating lease ROU assets also include any lease payments made and exclude lease incentives. The Company's lease agreements do not contain any variable lease payments, material residual value guarantees or any restrictive covenants. Our lease terms may include options, at our sole discretion, to extend or terminate the lease. At the adoption date of ASC Topic 842, the Company was reasonably certain that we would exercise our option to renew our corporate office building operating lease. Lease expense is recognized on a straight-line basis over the lease term.

We leased office space in McLean, Virginia under a non-cancelable operating lease agreement that expired on July 31, 2021. The operating lease contained customary escalation clauses. Rental expense for the years ended December 31, 2022 and 2021 was approximately $0 and $56,000, respectively.

We currently lease office space in Reston, Virginia under a non-cancelable operating lease agreement that expires in 2025. The operating lease contains customary escalation clauses. Rental expense for the years ended December 31, 2022 and 2021 was approximately $49,000 and $22,000, respectively.

We leased office space in La Jolla, California under a non-cancelable operating lease agreement that expired in 2022. The operating lease contains customary escalation clauses. Rental expense for the years ended December 31, 2022 and 2021 was approximately $373,000 and $210,000, respectively.

We currently lease office space in San Diego, California under a non-cancelable operating lease agreement that expires in 2023. Rental expense for the years ended December 31, 2022 and 2021 was approximately $8,000 and $0, respectively.

We currently lease office space in Overland Park, Kansas under a non-cancelable operating lease agreement that expires in 2027. The operating lease contains customary escalation clauses. Rental expense for the years ended December 31, 2022 and 2021 was approximately $30,000 and $0, respectively.

We currently lease other assets under multiple operating leases. The leases expire on various dates through 2027 and the interest rates range from 2.81% to 15.74%. The expense is included in cost of product expenses and totaled approximately $79,000 and $63,000 for the years ended December 31, 2022 and 2021, respectively.

We currently lease data center colocation space in Grand Rapids, Michigan, Las Vegas, Nevada, Dallas, Texas and Lenexa, Kansas, under non-cancelable operating lease agreements that expire in 2024. Rental expense for the years ended December 31, 2022 and 2021 was approximately $213,000 and $83,000, respectively.

We have lease agreements with lease and non-lease components, and we account for the lease and non-lease components as a single lease component. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants. The Company leases equipment and support under finance lease agreements which extends through 2026. The Company also leases three vehicles under financing agreements. One vehicle lease ended in 2021 and two vehicle leases ended in 2022. The outstanding balance for finance leases was $199,000 and $311,000 as of December 31, 2022 and 2021, respectively. The Company recorded assets classified as property and equipment under finance lease obligations of $486,000 and $486,000 as of December 31, 2022 and 2021, respectively. Related accumulated depreciation totaled $259,000 and $167,000 as of December 31, 2022 and 2021, respectively. The $40,000 in support contracts were classified as a prepaid expense and are being amortized over the service period of three years. One support contract expired in January 2021 and the other expires in June 2024. Amortization expense is included in general and administrative expenses and totaled $5,000 and $3,000 for the years ended December 31, 2022 and 2021, respectively. The interest rates on the finance lease obligations range from 1.37% and 15.74% and interest expense was $7,000 and $8,000 for the years ended December 31, 2022 and 2021, respectively.

The maturity of operating leases and finance lease liabilities as of December 31, 2022 are as follows:

| Year ending December 31, | Operating Leases | Finance Leases |
|---|---|---|
| 2023 | $ 454 | $ 98 |
| 2024 | 316 | 77 |
| 2025 | 178 | 21 |
| 2026 | 176 | 3 |
| 2027 | 132 | - |
| Total minimum lease payments | 1,256 | 199 |
| Less: amount representing interest | (90) | (6) |
| Present value of minimum lease payments | $ 1,166 | $ 193 |

| Lease term and discount rate | December 31, 2022 |
|---|---|
| **Weighted-average remaining lease term (years)** | |
| Operating leases | 3.8 |
| Finance leases | 2.1 |
| **Weighted-average discount rate** | |
| Operating leases | 4.1% |
| Finance leases | 2.6% |

| | Year Ended December 31, 2022 |
|---|---|
| **Cash paid for amounts included in the measurement of lease liabilities:** | |
| Operating cash flows from operating leases | $ 744 |
| Operating cash flows from finance leases | 10 |
| Financing cash flows from finance leases | (110) |

*Lessor Accounting*

Lessor accounting remained substantially unchanged with the adoption of ASC Topic 842. Crexendo offers its customers lease financing for the lease of our cloud telecommunication equipment (IP or cloud telephone desktop devices). We account for these transactions as sales-type leases. The vast majority of our leases that qualify as sales-type leases are non-cancelable and include cancellation penalties approximately equal to the full value of the lease receivables. Leases that do not meet the criteria for sales-type lease accounting are accounted for as operating leases. Operating lease revenue is classified as product revenue and totaled $268,000 and $204,000 for the years ended December 31, 2022 and 2021, respectively. Revenue from sales-type leases is recognized upon installation and the interest portion is deferred and recognized as earned. Revenue from operating leases is recognized ratably over the applicable service period.

Equipment finance receivables arising from the rental of our cloud telecommunications equipment through sales-type leases, were as follows (in thousands):

| | December 31, 2022 | December 31, 2021 |
|---|---|---|
| Gross financing receivables | $ 2,666 | $ 1,822 |
| Less: unearned income | (776) | (548) |
| Financing receivables, net | 1,890 | 1,274 |
| Less: current portion of finance receivables, net | (635) | (332) |
| Finance receivables due after one year | $ 1,255 | $ 942 |

Future minimum lease payments as of December 31, 2022, consisted of the following:

| Year ending December 31, | Lease Receivables |
|---|---|
| 2023 | $ 926 |
| 2024 | 824 |
| 2025 | 504 |
| 2026 | 281 |
| 2027 and thereafter | 131 |
| Gross equipment financing receivables | 2,666 |
| Less: unearned income | (776) |
| Equipment financing receivables, net | $ 1,890 |

### 17. Commitments and Contingencies

*Annual Incentive Bonuses Accrual*

We utilize incentive bonuses to reward performance achievements which provides for potential annual cash bonus awards to Company executives, non-executive management, and employees. Under the Bonus Plan, the Compensation Committee of the Board of Directors of the Company (the "Board") has established bonus pools for fiscal 2022 of $390,000 for the Company executives, and $350,000 for non-executive management and employees. The Company executives and non-executive management will be eligible to receive bonus awards for fiscal 2022 based upon annual performance targets established by the Compensation Committee relating to one or more of the following: annual revenue, Adjusted EBITDA, cash balance, and the Company's stock price measured at the end of the Company's fiscal year. Awards will be paid on a tiered scale based upon actual performance as a percentage of the performance targets with a floor and cap. Payments for performance targets met or exceeded are payable, whether or not all performance targets are met, consistent with the weighted amounts for each performance target within the bonus pools. Bonus awards for executives and non-executive management will be weighted 30% on annual revenue, 30% on Adjusted EBITDA, 20% on cash balance, and 20% on the Company's stock price. No bonus will be awarded for any performance target for which actual performance is less than 90% of target. At 90% or greater actual performance relative to the target, 50% of the weighted bonus amount apportioned for that target is payable. From 90% to 100% actual performance relative to the target, the remaining 50% of the weighted bonus amount is awarded pro rata with the percentage of actual performance exceeding 90% of target (i.e., each 1% excess over 90% of target equals 5% of the weighted bonus amount payable). For individuals included in this plan, if actual performance reaches 110% of target or greater for any performance target, then an additional 10% of the amount allocated to that performance target will be payable as an additional bonus. Employees will be eligible to receive bonus awards for fiscal 2022 based upon an Adjusted EBITDA performance target with a floor and cap. For the year ended December 31, 2022, the Company achieved three of the four performance targets, including Adjusted EBITDA, and $621,000 of the annual incentive bonuses was included in accrued expenses in the accompanying consolidated balance sheet as of December 31, 2022.

### 18. Employee Benefit Plan

We have established a retirement savings plan for eligible employees. The plan allows employees to contribute a portion of their pre-tax compensation in accordance with specified guidelines. For the years ended December 31, 2022 and 2021, we contributed approximately $365,000 and $178,000 to the retirement savings plan, respectively.

### 19. Segments

Our chief operating decision maker (who is our Chief Executive Officer) reviews our financial information presented on an operating segment basis for purposes of allocating resources and evaluating our financial performance. Following the merger with NetSapiens, Inc., the Company reorganized into two operating segments, a software solutions operating segment and a cloud telecommunications services operating segment. The cloud telecommunications services segment generates revenue from selling cloud telecommunication services, products, and other internet services. The software solutions segment generates revenue from selling perpetual software licenses and software subscriptions, subscription maintenance and support, and professional services. The Company has two reportable operating segments, which consist of cloud telecommunications services and software solutions. Segment revenue, income/(loss) from operations, other income/(expense) and income/(loss) before income tax provision are as follows (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2022 | 2021 |
| Revenue: | | |
| Cloud telecommunications service | $ 22,406 | $ 19,426 |
| Software solutions | 15,148 | 8,666 |
| Consolidated revenue | 37,554 | 28,092 |
| | | |
| Loss from operations: | | |
| Cloud telecommunications services | (3,877) | (2,643) |
| Software solutions | (33,515) | (167) |
| Total operating loss | (37,392) | (2,810) |
| Other income/(expense), net: | | |
| Cloud telecommunications services | (71) | (70) |
| Software solutions | 1,288 | (30) |
| Total other income/(expense), net | 1,217 | (100) |
| Loss before income tax benefit: | | |
| Cloud telecommunications services | (3,948) | (2,713) |
| Software solutions | (32,227) | (197) |
| Loss before income tax benefit | $ (36,175) | $ (2,910) |

Depreciation and amortization was $712,000 and $438,000 for the Cloud telecommunications services segment for the years ended December 31, 2022 and 2021, respectively. Depreciation and amortization was $2,035,000 and $1,189,000 for the Software solutions segment for the years ended December 31, 2022 and 2021, respectively.

Interest income was $0 and $1,000 for the cloud telecommunications services segment for the years ended December 31, 2022 and 2021, respectively. Interest income was $0 and $0 for the software solutions segment for the years ended December 31, 2022 and 2021, respectively.

Interest expense was $77,000 and $84,000 for the cloud telecommunications services segment for the years ended December 31, 2022 and 2021, respectively. Interest expense was $1,000 and $0 for the software solutions segment for the years ended December 31, 2022 and 2021, respectively.

**20. Quarterly Financial Information (in thousands, unaudited)**

| | For the three months ended | | | |
|---|---|---|---|---|
| **Consolidated** | **March 31, 2022** | **June 30, 2022** | **September 30, 2022** | **December 31, 2022** |
| Service revenue | $ 4,398 | $ 4,556 | $ 4,473 | $ 6,088 |
| Software Solutions | 3,268 | 3,598 | 3,875 | 4,407 |
| Product revenue | 492 | 692 | 760 | 947 |
| Total revenue | 8,158 | 8,846 | 9,108 | 11,442 |
| Operating expenses: | | | | |
| Cost of service revenue | 1,436 | 1,438 | 1,375 | 2,462 |
| Cost of software solutions | 1,661 | 1,131 | 1,141 | 1,403 |
| Cost of product revenue | 317 | 372 | 453 | 495 |
| Selling and marketing | 2,584 | 2,771 | 2,732 | 3,638 |
| General and administrative | 3,249 | 2,757 | 2,800 | 4,098 |
| Research and development | 304 | 1,229 | 1,151 | 1,271 |
| Goodwill and long-lived asset impairment | - | - | - | 32,678 |
| Total operating expenses | 9,551 | 9,698 | 9,652 | 46,045 |
| Loss from operations | (1,393) | (852) | (544) | (34,603) |
| Total other income/(expense), net | (28) | (126) | (184) | 1,555 |
| Loss before income taxes | (1,421) | (978) | (728) | (33,048) |
| Income tax benefit | 201 | 82 | 32 | 447 |
| Net loss | $ (1,220) | $ (896) | $ (696) | $ (32,601) |
| | | | | |
| Basic earnings per common share (1) | $ (0.05) | $ (0.04) | $ (0.03) | $ (1.33) |
| Diluted earnings per common share (1) | $ (0.05) | $ (0.04) | $ (0.03) | $ (1.33) |

| Consolidated | For the three months ended March 31, 2021 | June 30, 2021 | September 30, 2021 | December 31, 2021 |
|---|---|---|---|---|
| Service revenue | $ 4,139 | $ 4,327 | $ 4,325 | $ 4,311 |
| Software solutions revenue | - | 1,012 | 3,784 | 3,870 |
| Product revenue | 368 | 440 | 701 | 815 |
| Total revenue | 4,507 | 5,779 | 8,810 | 8,996 |
| Operating expenses: | | | | |
| Cost of service revenue | 1,259 | 1,347 | 1,210 | 1,288 |
| Cost of software solutions revenue | - | 526 | 1,675 | 1,830 |
| Cost of product revenue | 225 | 286 | 461 | 553 |
| Selling and marketing | 1,279 | 1,897 | 2,285 | 2,799 |
| General and administrative | 2,216 | 2,579 | 2,768 | 3,023 |
| Research and development | 350 | 388 | 358 | 300 |
| Total operating expenses | 5,329 | 7,023 | 8,757 | 9,793 |
| Income/(loss) from operations | (822) | (1,244) | 53 | (797) |
| Total other income/(expense), net | (17) | (19) | (41) | (23) |
| Income/(loss) before income taxes | (839) | (1,263) | 12 | (820) |
| Income tax benefit/(provision) | 124 | 260 | (137) | 218 |
| Net loss | $ (715) | $ (1,003) | $ (125) | $ (602) |
| Basic earnings per common share (1) | $ (0.04) | $ (0.05) | $ (0.01) | $ (0.03) |
| Diluted earnings per common share (1) | $ (0.04) | $ (0.05) | $ (0.01) | $ (0.03) |

(1) Earnings per common share is computed independently for each of the quarters presented. Therefore, the sums of quarterly earnings per common share amounts do not necessarily equal the total for the twelve month periods presented.

**21. Subsequent Events**

None

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

None

## ITEM 9A. CONTROLS AND PROCEDURES

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13(a)-15(b) under the Exchange Act, as the end of the period covered by this annual report on Form 10-K.

Based on this evaluation, our chief executive officer and chief financial officer concluded that, as of December 31, 2022 our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provided reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time period specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2022 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) of the Exchange Act. Our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework). Based on this assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2022.

**Limitations of Effectiveness of Control and Procedures**

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

## ITEM 9B. OTHER INFORMATION

None

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information with respect to this item will be set forth in the definitive proxy statement to be delivered to stockholders in connection with the 2023 Annual Meeting of Stockholders (the “Proxy Statement”). Such information is incorporated herein by reference.

We have adopted a code of ethics that applies to all employees, including employees of our subsidiaries, as well as each member of our Board of Directors. The code of ethics is available at our website at www.crexendo.com.

### ITEM 11. EXECUTIVE COMPENSATION

Information with respect to this item will be set forth in the Proxy Statement under the heading “Executive Compensation and Other Matters,” and is incorporated herein by reference.

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

Information with respect to this item will be set forth in the Proxy Statement under the heading “Beneficial Ownership of Shares,” and is incorporated herein by reference.

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

Information with respect to this item will be set forth in the Proxy Statement under the heading “Corporate Governance” and is incorporated herein by reference.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information with respect to this item will be set forth in the Proxy Statement under the headings “Fees of Independent Registered Public Accounting Firm” and “Pre-Approval Policies and Procedures,” and is incorporated herein by reference.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Documents filed as part of this Report:

1. Financial Statements – consolidated financial statements of Crexendo, Inc. and subsidiaries as set forth under Item 8 of this Report.
2. The Financial Statement Schedule on page 92 of this Annual Report.
3. Exhibit Index as seen below.

## EXHIBIT INDEX

| Exhibit No. | Exhibit Description | Incorporated By Reference | | | Filed Herewith |
|---|---|---|---|---|---|
| | | Form | Date | Number | |
| 2.1 | Agreement and Plan of Merger and Reorganization, dated March 5, 2021, by and among Crexendo, Inc., Crexendo Merger Sub, Inc., Crexendo Merger Sub, LLC, NetSapiens, Inc. and David Wang as stockholder representative. | 8-K | 3/8/2021 | 2.1 | |
| 2.2 | Acquisition Agreement, dated October 17, 2022, by and among Crexendo, Inc., Bryan J. Dancer and Allegiant Networks, LLC | 8-K/A | 10/21/2022 | 10.1 | |
| 3.1 | Articles of Incorporation | 8-K | 12/14/2016 | 3.1 | |
| 3.2 | Bylaws | 8-K | 12/14/2016 | 3.2 | |
| 4.1 | Description of Capital Stock | | | | X |
| 10.1* | 2021 Equity Incentive Plan | S-8 | 5/24/2021 | | |
| 10.2 | Reincorporation in state of Nevada for Crexendo, Inc. (Nevada) Articles of Incorporation | 8-K | 12/14/2016 | 3.1 | |
| 10.3 | Reincorporation in state of Nevada for Crexendo, Inc. (Nevada) bylaws | 8-K | 12/14/2016 | 3.2 | |
| 10.4 | Loan Agreement between Bank of America, N.A. and Crexendo Business Solutions, Inc. dated January 22 2020, entered into on January 27, 2020. | 8-K | 1/29/2020 | 10.2 | |
| 10.5 | Voting and Support Agreement, dated March 5, 2021, by and among Crexendo, Inc., Anand Buch, David T.K. Wang and James Murphy. | 8-K | 3/8/2021 | 10.1 | |
| 10.6 | Voting and Support Agreement, dated March 5, 2021, by and between NetSapiens, Inc. and Steven G. Mihaylo. | 8-K | 3/8/2021 | 10.2 | |
| 21.1 | Subsidiaries of Crexendo, Inc. | | | | X |
| 23.1 | Consent of Independent Registered Public Accounting Firm (Urish Popeck & Co., LLC) | | | | X |
| 31.1 | Certification Pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934 as amended | | | | X |
| 31.2 | Certification Pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934 as amended | | | | X |
| 32.1 | Certification Pursuant to 18 U.S.C. Section 1350 | | | | X |
| 32.2 | Certification Pursuant to 18 U.S.C. Section 1350 | | | | X |
| 101.INS | XBRL INSTANCE DOCUMENT | | | | |
| 101.SCH | XBRL TAXONOMY EXTENSION SCHEMA DOCUMENT | | | | |
| 101.CAL | XBRL TAXONOMY EXTENSION CALCULATION LINKBASE DOCUMENT | | | | |
| 101.DEF | XBRL TAXONOMY EXTENSION DEFINITION LINKBASE DOCUMENT | | | | |
| 101.LAB | XBRL TAXONOMY EXTENSION LABEL LINKBASE DOCUMENT | | | | |
| 101.PRE | XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE DOCUMENT | | | | |

* Indicates a 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, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**Crexendo, Inc.**

Date: March 14, 2023

By: /s/ STEVEN G. MIHAYLO
Steven G. Mihaylo
Chief Executive Officer

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

Date: March 14, 2023

By: /s/ STEVEN G. MIHAYLO
Steven G. Mihaylo
Chief Executive Officer,
Chairman of the Board of Directors

Date: March 14, 2023

By: /s/ RONALD VINCENT
Ronald Vincent
Chief Financial Officer

Date: March 14, 2023

By: /s/ TODD GOERGEN
Todd Goergen
Director

Date: March 14, 2023

By: /s/ JEFFREY P. BASH
Jeffrey P. Bash
Director

Date: March 14, 2023

By: /s/ DAVID WILLIAMS
David Williams
Director

Date: March 14, 2023

By: /s/ ANIL PURI
Anil Puri
Director

**CREXENDO, INC. AND SUBSIDIARIES**
**Schedule II- Valuation and Qualifying Accounts**

| | Balance at Beginning of Year | Additions | Deductions | Balance at End of Year |
|---|---|---|---|---|
| | | (in thousands) | | |
| Year ended December 31, 2022 | | | | |
| Allowance for doubtful accounts receivable | $ 72 | 59 | - | $ 131 |
| Deferred income tax asset valuation allowance | $ 1,498 | 1,681 | - | $ 3,179 |
| Year ended December 31, 2021 | | | | |
| Allowance for doubtful accounts receivable | $ 21 | 51 | - | $ 72 |
| Deferred income tax asset valuation allowance | $ 61 | 1,437 | - | $ 1,498 |