

8X8 INC /DE/
Form 10-Q
January 26, 2015

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

FORM 10-Q

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

For the quarterly period ended December 31, 2014

OR

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

For the transition period from _____ to _____

Commission file number 000-21783

[8X8, INC.](#)

(Exact name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

77-0142404

(I.R.S. Employer Identification Number)

2125 O'Nel Drive
San Jose, CA 95131

(Address of Principal Executive Offices)

(408) 727-1885

(Registrant's Telephone Number, including Area Code)

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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 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 Web site, 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>	Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
	<input checked="" type="checkbox"/>			(Do not check if a smaller reporting company)			

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES NO

The number of shares of the Registrant's Common Stock outstanding as of January 21, 2015 was 89,867,601.

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Part I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

8X8, Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, unaudited)

	December 31, 2014	March 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 52,598	\$ 59,159
Short-term investments	135,291	47,181
Accounts receivable, net	7,233	5,503
Inventory	532	811
Deferred cost of goods sold	411	263
Deferred tax asset	1,731	2,065
Other current assets	2,521	1,951
Total current assets	200,317	116,933
Long-term investments	-	72,021
Property and equipment, net	10,179	7,711
Intangible assets, net	13,032	15,095
Goodwill	37,497	38,461
Non-current deferred tax asset	45,686	47,797
Other assets	1,307	1,185
Total assets	\$ 308,018	\$ 299,203
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 7,272	\$ 6,789
Accrued compensation	6,612	4,583
Accrued warranty	423	660
Accrued taxes	2,879	2,323
Deferred revenue	1,491	1,857
Other accrued liabilities	1,375	1,909
Total current liabilities	20,052	18,121
Non-current liabilities	1,425	1,619
Non-current deferred revenue	760	1,285
Total liabilities	22,237	21,025
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock	90	88
Additional paid-in capital	391,766	384,325
Accumulated other comprehensive gain (loss)	(1,153)	430
Accumulated deficit	(104,922)	(106,665)
Total stockholders' equity	285,781	278,178
Total liabilities and stockholders' equity	\$ 308,018	\$ 299,203

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

8X8, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts; unaudited)

	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2014	2013	2014	2013
Service revenue	\$ 37,802	\$ 29,737	\$ 108,199	\$ 84,062
Product revenue	3,570	3,008	10,684	8,749
Total revenue	41,372	32,745	118,883	92,811
Operating expenses:				
Cost of service revenue	7,544	5,584	22,046	15,579
Cost of product revenue	3,959	4,041	11,690	11,171
Research and development	3,868	3,325	10,770	8,301
Sales and marketing	20,559	16,051	59,159	42,868
General and administrative	4,617	5,547	12,388	11,444
Gain on patent sale	-	-	(1,000)	-
Total operating expenses	40,547	34,548	115,053	89,363
Income (loss) from operations	825	(1,803)	3,830	3,448
Other income, net	246	586	623	602
Income (loss) from continuing operations before provision (benefit) for income taxes	1,071	(1,217)	4,453	4,050
Provision (benefit) for income taxes	627	(1,306)	2,710	481
Income from continuing operations	444	89	1,743	3,569
Income from discontinued operations, net of income tax provision	-	-	-	301
Gain on disposal of discontinued operations, net of income tax provision of \$463	-	-	-	589
Net income	\$ 444	\$ 89	\$ 1,743	\$ 4,459
Income per share - continuing operations:				
Basic	\$ 0.01	\$ 0.00	\$ 0.02	\$ 0.05
Diluted	\$ 0.01	\$ 0.00	\$ 0.02	\$ 0.05
Income per share - discontinued operations:				
Basic	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.01
Diluted	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.01
Net income per share:				
Basic	\$ 0.01	\$ 0.00	\$ 0.02	\$ 0.06
Diluted	\$ 0.01	\$ 0.00	\$ 0.02	\$ 0.06
Weighted average number of shares:				
Basic	89,594	79,742	89,107	75,071
Diluted	91,974	83,182	91,752	78,389

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

8X8, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands, unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2014	2013	2014	2013
Net income	\$ 444	\$ 89	\$ 1,743	\$ 4,459
Other comprehensive income (loss), net of tax				
Unrealized gain (loss) on investments	(122)	(8)	(87)	(63)
Foreign currency translation adjustment	(1,005)	326	(1,496)	326
Comprehensive income (loss)	\$ (683)	\$ 407	\$ 160	\$ 4,722

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

8X8, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands, unaudited)

	Nine Months Ended December 31,	
	2014	2013
Cash flows from operating activities:		
Net income	\$ 1,743	\$ 4,459
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,513	1,888
Amortization of intangible assets	1,687	1,074
Amortization of capitalized software	255	92
Net accretion of discount and amortization of premium on marketable securities	659	-
Gain on disposal of discontinued operations	-	(589)
Gain on escrow settlement	-	(565)
Stock-based compensation	6,489	5,245
Deferred income tax provision	2,444	87
Other	268	490
Changes in assets and liabilities:		
Accounts receivable, net	(2,062)	(1,104)
Inventory	235	(245)
Other current and noncurrent assets	(505)	(570)
Deferred cost of goods sold	(179)	211
Accounts payable	(736)	(1,290)
Accrued compensation	2,044	1,217
Accrued warranty	(237)	182
Accrued taxes and fees	561	62
Deferred revenue	(840)	757
Other current and non-current liabilities	(564)	172
Net cash provided by operating activities	13,775	11,573
Cash flows from investing activities:		
Purchases of property and equipment	(4,523)	(2,081)
Cost of capitalized software	(456)	(590)
Acquisition of business, net of cash acquired	-	(18,474)
Proceeds from disposition of discontinued operations, net of transaction costs	-	3,000
Proceeds from maturity of investments	31,400	-
Sales of investments - available for sale	29,580	-
Purchases of investments - available for sale	(77,821)	-
Net cash used in investing activities	(21,820)	(18,145)
Cash flows from financing activities:		
Capital lease payments	(115)	(26)
Repurchase of common stock	(1,723)	(320)
Proceeds from issuance of common stock, net of issuance costs	-	125,758
Proceeds from issuance of common stock under employee stock plans	2,666	2,959
Net cash provided by financing activities	828	128,371
Effect of exchange rate changes on cash	656	10
Net (decrease) increase in cash and cash equivalents	(6,561)	121,809
Cash and cash equivalents at the beginning of the period	59,159	50,305
Cash and cash equivalents at the end of the period	\$ 52,598	\$ 172,114
<u>Supplemental cash flow information</u>		
Income taxes paid	\$ 181	\$ 479
Interest paid	25	4

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

8X8, Inc.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED
FINANCIAL STATEMENTS

1. DESCRIPTION OF THE BUSINESS

THE COMPANY

8x8, Inc. ("8x8" or the "Company") develops and markets a comprehensive portfolio of cloud-based communications and collaboration solutions that include hosted cloud telephony, unified communications, contact center, video conferencing and virtual desktop software and services. These unified communications and collaboration services are offered from the Internet cloud via a software-as-a-service subscription. The Company also provides cloud-based computing services. As of December 31, 2014, the Company had approximately 41,100 business customers.

The Company was incorporated in California in February 1987 and was reincorporated in Delaware in December 1996. The Company's fiscal year ends on March 31 of each calendar year. Each reference to a fiscal year in these notes to the condensed consolidated financial statements refers to the fiscal year ending March 31 of the calendar year indicated (for example, fiscal 2015 refers to the fiscal year ending March 31, 2015).

2. BASIS OF PRESENTATION

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared on substantially the same basis as our annual consolidated financial statements for the fiscal year ended March 31, 2014. In the opinion of the Company's management, these interim condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of our financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from these estimates.

The March 31, 2014 year-end condensed consolidated balance sheet data in this document was derived from audited consolidated financial statements and does not include all of the disclosures required by U.S. generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements as of and for the fiscal year ended March 31, 2014 and notes thereto included in the Company's fiscal 2014 Annual Report on Form 10-K.

The results of operations and cash flows for the interim periods included in these condensed consolidated financial statements are not necessarily indicative of the results to be expected for any future period or the entire fiscal year.

Service and Product Revenue

The Company recognizes service revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, price is fixed or determinable and collectability is reasonably assured. The Company defers recognition of service revenues in instances when cash receipts are received before services are delivered and recognizes deferred revenues ratably as services are provided.

The Company recognizes revenue from product sales for which there are no related services to be rendered upon shipment to customers provided that persuasive evidence of an arrangement exists, the price is fixed, title has transferred, collection of resulting receivables is reasonably assured, there are no customer acceptance requirements, and there are no remaining significant obligations. Gross outbound shipping and handling charges are recorded as

revenue, and the related costs are included in cost of goods sold. Reserves for returns and allowances for customer sales are recorded at the time of shipment. In accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 985-605, *Software - Revenue Recognition*, the Company records shipments to distributors, retailers, and resellers, where the right of return exists, as deferred

revenue. The Company defers recognition of revenue on sales to distributors, retailers, and resellers until products are resold to the customer.

The Company records revenue net of any sales-related taxes that are billed to its customers. The Company believes this approach results in consolidated financial statements that are more easily understood by users.

Under the terms of the Company's typical subscription agreement, new customers can terminate their service within 30 days of order placement and receive a full refund of fees previously paid. The Company has determined that it has sufficient history of subscriber conduct to make a reasonable estimate of cancellations within the 30-day trial period. Therefore, the Company recognizes new subscriber revenue in the month in which the new order was shipped, net of an allowance for expected cancellations.

Multiple Element Arrangements

ASC 605-25, *Multiple Element Arrangements - Revenue Recognition*, requires that revenue arrangements with multiple deliverables be divided into separate units of accounting if the deliverables in the arrangement meet specific criteria. The provisioning of the 8x8 cloud service with the accompanying 8x8 IP telephone constitutes a revenue arrangement with multiple deliverables. For arrangements with multiple deliverables, the Company allocates the arrangement consideration to all units of accounting based on their relative selling prices. In such circumstances, the accounting principles establish a hierarchy to determine the relative selling price to be used for allocating arrangement consideration to units of accounting as follows: (i) vendor-specific objective evidence of fair value ("VSOE"), (ii) third-party evidence of selling price ("TPE"), and (iii) best estimate of the selling price ("BESP").

VSOE generally exists only when the Company sells the deliverable separately, on more than a limited basis, at prices within a relatively narrow range. When VSOE cannot be established, the Company attempts to establish the selling price of deliverables based on relevant TPE. TPE is determined based on manufacturers' prices for similar deliverables when sold separately, when possible. When the Company is unable to establish selling price using VSOE or TPE, it uses a BESP for the allocation of arrangement consideration. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service was sold on a stand-alone basis. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings. The Company determines BESP for a product or service by considering multiple factors including, but not limited to:

- the price list established by its management which is typically based on general pricing practices and targeted gross margin of products and services sold; and
- analysis of pricing history of new arrangements, including multiple element and stand-alone transactions.

In accordance with the guidance of ASC 605-25, when the Company enters into revenue arrangements with multiple deliverables the Company allocates arrangement consideration, including activation fees, among the 8x8 IP telephones and subscriber services based on their relative selling prices. Arrangement consideration allocated to the IP telephones that is fixed or determinable and that is not contingent on future performance or deliverables is recognized as product revenues during the period of the sale less the allowance for estimated returns during the 30-day trial period. Arrangement consideration allocated to subscriber services telephones that is fixed or determinable and that is not contingent on future performance or deliverables is recognized ratably as service revenues as the related services are provided, which is generally over the initial contract term.

Deferred Cost of Goods Sold

Deferred cost of goods sold represents the cost of products sold for which the end customer or distributor has a right of return. The cost of the products sold is recognized contemporaneously with the recognition of revenue, when the subscriber has accepted the service.

Cash, Cash Equivalents and Investments

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Management determines the appropriate categorization of its investments at the time of purchase and reevaluates the classification at each reporting date. The cost of the Company's investments is determined based upon specific identification.

The Company's investments are comprised of mutual funds, commercial paper, corporate debt, municipal securities, asset backed securities, mortgage backed securities, international government securities, certificates of deposit and money market funds. At December 31, 2014 and March 31, 2014, all investments were classified as available-for-sale and reported at fair value, based either upon quoted prices in active markets, quoted prices in less active markets, or quoted market prices for similar investments, with unrealized gains and losses, net of related tax, if any, included in other comprehensive loss and disclosed as a separate component of consolidated stockholders' equity. Realized gains and losses on sales of all such investments are reported within the caption of "other income, net" in the consolidated statements of income and are computed using the specific identification method. The Company classifies its investments as current based on the nature of the investments and their availability for use in current operations. The Company's investments in marketable securities are monitored on a periodic basis for impairment. In the event that the carrying value of an investment exceeds its fair value and the decline in value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis for the investment is established. These available-for-sale investments are primarily held in the custody of a major financial institution.

Available-for-sale investments were (in thousands):

As of December 31, 2014	Amortized Costs	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
Money market funds	\$ 16,821	\$ -	\$ -	\$ 16,821
Fixed income				
Mutual funds	2,000	-	(129)	1,871
Commercial paper	22,948	4	-	22,952
Corporate debt	71,890	47	(22)	71,915
Municipal securities	5,435	3	(7)	5,431
Asset backed securities	23,598	2	(6)	23,594
Mortgage backed securities	6,583	-	(56)	6,527
International government securities	800	2	-	802
Certificates of deposit	2,200	-	(1)	2,199
Total available-for-sale investments	\$ 152,275	\$ 58	\$ (221)	\$ 152,112
Reported as (in thousands):				
Cash and cash equivalents				\$ 16,821
Short-term investments				135,291
Total				\$ 152,112

Contractual maturities of mutual funds, commercial paper, corporate debt, municipal securities, asset backed securities, mortgage backed securities, international government securities, certificates of deposit and money market funds as of December 31, 2014 are set forth below (in thousands):

Due within one year	\$	120,291
Due after one year		31,821
Total	\$	152,112

As of March 31, 2014	Amortized Costs	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
Money market funds	\$ 32,611	\$ -	\$ -	\$ 32,611
Fixed income				
Mutual funds	1,964	-	(55)	1,909
Commercial paper	30,374	5	-	30,379
Corporate debt	63,621	35	(39)	63,617
Municipal securities	5,435	5	(1)	5,439
Asset backed securities	17,049	6	(1)	17,054
International government securities	800	4	-	804
Total available-for-sale investments	\$ 151,854	\$ 55	\$ (96)	\$ 151,813

Reported as (in thousands):

Cash and cash equivalents	\$	32,611
Short-term investments		47,181
Long-term investments		72,021
Total	\$	151,813

Contractual maturities of mutual funds, commercial paper, corporate debt, municipal securities, asset backed securities, international government securities and money market funds as of March 31, 2014 are set forth below (in thousands):

Due within one year	\$	79,792
Due after one year		72,021
Total	\$	151,813

Intangible Assets

Amortization expense for the customer relationship intangible asset is included in sales and marketing expenses. Amortization expense for technology is included in cost of service revenue. The carrying values of intangible assets were as follows (in thousands):

	December 31, 2014			March 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Technology	\$ 8,242	\$ (2,699)	\$ 5,543	\$ 8,242	\$ (2,080)	\$ 6,162
Customer relationships	9,686	(3,154)	6,532	9,686	(1,710)	7,976
Trade names/domains	957	-	957	957	-	957
Total acquired identifiable intangible assets	\$ 18,885	\$ (5,853)	\$ 13,032	\$ 18,885	\$ (3,790)	\$ 15,095

At December 31, 2014, annual amortization of intangible assets, based upon our existing intangible assets and current useful lives, is estimated to be the following (in thousands):

	Amount
Remaining 2015	\$ 550
2016	2,198
2017	2,191
2018	1,943
2019	1,697
Thereafter	3,496
Total	\$ 12,075

Research, Development and Software Costs

The Company accounts for software to be sold or otherwise marketed in accordance with ASC 985-20 - *Costs of Software to be Sold, Leased or Marketed*, which requires capitalization of certain software development costs subsequent to the establishment of technological feasibility. The Company defines establishment of technological feasibility as the completion of a working model. Software development costs for software to be sold or otherwise marketed incurred prior to the establishment of technological feasibility are included in research and development and are expensed as incurred. Software development costs incurred subsequent to the establishment of technological feasibility through the period of general market availability of the product are capitalized, if material.

In the first nine months of fiscal 2015, the Company expensed all research and development costs in accordance with ASC 985-20. At December 31, 2014 and March 31, 2014, total capitalized software development costs included in other long-term assets was approximately \$1.5 million and \$1.0 million, respectively, and accumulated amortization costs related to capitalized software was approximately \$0.4 million and \$0.1 million, respectively.

In the first nine months of fiscal 2014, the Company capitalized \$0.6 million in accordance with ASC 985-20.

The Company accounts for computer software developed or obtained for internal use in accordance with ASC 350-40 - *Internal Use Software*, which requires capitalization of certain software development costs incurred during the application development stage. In the first nine months of fiscal 2015, the Company capitalized \$1.1 million in accordance with ASC 350-40, of which \$0.6 million is classified as property and equipment and \$0.5 million is classified as long-term assets. No such costs were capitalized in the first nine months of fiscal 2014.

Foreign Currency Translation

The Company has determined that the functional currency of its UK foreign subsidiary is the subsidiary's local currency, the British Pound Sterling ("GBP"), which the Company believes most appropriately reflects the current economic facts and circumstances of the UK subsidiary's operations. The assets and liabilities of the subsidiary are translated at the applicable exchange rate as of the end of the balance sheet period and revenue and expenses are translated at an average rate over the period presented. Resulting currency translation adjustments are recorded as a component of accumulated other comprehensive income or loss within the stockholders' equity in the consolidated balance sheets.

Stock Purchase Right/Restricted Stock Unit and Option Activity

Stock purchase right activity for the nine months ended December 31, 2014 is summarized as follows:

	Number of Shares	Weighted Average Grant-Date Fair Market Value	Weighted Average Remaining Contractual Term (in Years)
Balance at March 31, 2014	489,627	\$ 4.83	1.93
Granted	31,432	7.88	
Vested	(202,575)	3.96	
Forfeited	(69,864)	5.36	
Balance at December 31, 2014	248,620	\$ 5.77	1.68

Restricted stock unit and performance stock unit activity for the nine months ended December 31, 2014 is summarized as follows:

	Number of Shares	Weighted Average Purchase Price	Weighted Average Remaining Contractual Term (in Years)
Balance at March 31, 2014	1,134,856	\$ -	2.00
Granted	1,849,300		
Vested	(166,758)		
Forfeited	(141,600)		
Balance at December 31, 2014	2,675,798	\$ -	2.06

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Stock option activity and shares available for grant for all equity incentive plans for the nine months ended December 31, 2014 is summarized as follows:

	Shares Available for Grant	Shares Subject to Options Outstanding	Weighted Average Exercise Price Per Share
Balance at March 31, 2014	1,613,943	6,002,382	\$ 4.14
Additional shares authorized for grant	8,000,000		
Granted - options (1)	(1,295,906)	992,764	7.09
Stock purchase rights/restricted stock unit (2)	(1,880,732)	-	-
Exercised	-	(1,041,982)	1.60
Canceled/forfeited - options	392,076	(392,076)	5.74
Canceled/forfeited - restricted stock unit	142,910	-	
Balance at December 31, 2014	6,972,291	5,561,088	\$ 5.03

- (1) As reflected in the preceding table, for each share awarded as a stock option under the 2012 Amended and Restated Equity Incentive Plan, an equivalent of 1.5 shares were deducted from the shares available for grant balance.
(2) The reduction to shares available for grant includes awards granted of 1,880,732 shares.

The following table summarizes stock options outstanding and exercisable at December 31, 2014:

Range of Exercise Price	Shares	Options Outstanding		Aggregate Intrinsic	Options Exercisable	
		Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)		Weighted Average Exercise Price	Aggregate Intrinsic