

Crexendo, Inc.  
Form 10-K  
March 07, 2017

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, 2016:

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 (Commission (I.R.S. Employer  
of Incorporation or Organization) File Number) 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 | OTCQX Marketplace                         |

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

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information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer    Accelerated filer    Non-accelerated filer    Smaller reporting company

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, 2016 was approximately \$5,541,000.

The number of shares of the registrant's common stock outstanding as of February 16, 2017 was 13,653,556.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Registrant's 2017 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, “StoresOnline™” and “Ride The Cloud™” are registered trademarks 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,” “PREPARE,” “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 is a CLEC cloud services company that provides award winning cloud telecommunications services, broadband Internet services and other cloud business services. Our solutions are designed to provide enterprise-class cloud services to any size businesses at affordable monthly rates.

Cloud Telecommunications Services segment - 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 a mobile device.

We generate recurring revenue from our cloud telecommunications and broadband Internet services. Our cloud telecommunications contracts typically have a thirty-six to sixty month term. We generate product revenue and equipment financing 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.

Web Services segment - We generate recurring revenue from website hosting and other professional services.

#### OUR SERVICES AND PRODUCTS

Our goal is to provide a broad range of Cloud-based products and services that nearly eliminate the cost of a businesses’ technology infrastructure and enable businesses of any size to more efficiently run their business. By providing a variety of comprehensive and scalable solutions, we are able to provide these solutions on a monthly basis to businesses of all sizes 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 and software and unified communication solutions for businesses using IP or cloud technology over any high-speed Internet connection. These services are rendered through a variety of devices and user interfaces such as a Crexendo branded desktop phones, 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 standard Internet, Web and IP or cloud technologies. Our services also use our complex infrastructure that we build and manage based on industry standard best practices to achieve greater efficiencies and customer satisfaction. Our infrastructure comprises of computing, 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;

Call Center Features such as Automated Call Distribution (ACD), Call Monitor, Whisper and Barge, Automatic Call Recording;

Advanced Unified Communication Features such as Find-Me-Follow-Me, Sequential Ring and Simultaneous Ring;

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; and

Web based online portal to administer, manage and provision the system.

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 SaaS offerings to make them more competitive and profitable.

Website Services - Our website services segment allows businesses to host their websites in our data center for a recurring monthly fee. For additional fees, we also provide professional web management services.

#### SEGMENT INFORMATION

The Company has two operating segments, which consist of Cloud Telecommunications Services and Web Services. Segment revenue and income (loss) before income tax provision was as follows (in thousands):

Year Ended  
December 31,

2016    2015

Revenue:

|                                   |         |         |
|-----------------------------------|---------|---------|
| Cloud Telecommunications Services | \$7,757 | \$5,989 |
| Web Services                      | 1,362   | 1,834   |
| Consolidated revenue              | \$9,119 | \$7,823 |

Year Ended  
December 31,

2016      2015

Income/(loss) before income tax provision:

|                                   |           |           |
|-----------------------------------|-----------|-----------|
| Cloud Telecommunications Services | \$(3,210) | \$(4,833) |
| Web Services                      | 430       | 280       |
| Loss before income tax            | \$(2,780) | \$(4,553) |



## 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 computing, storage, data and platforms offers us greater efficiencies. 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 private branch exchange (“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 device as if they were in the office. It also provided users instant access to visual voicemail and call logs; and

End User Portal and Unified Messaging with Voicemail, Call Recording and eFax inbox.

Our website software platform is continuously being enhanced and is an innovative website-building environment. We continue to invest and develop on our web platform to make it more easy-to-use, enable larger mobile and 3rd party integration features thus enabling our web customers to drive more traffic to their web-sites.

## RESEARCH AND DEVELOPMENT

We invested \$826,000 and \$779,000 for the years ended December 31, 2016 and 2015, respectively, in the research and development of our technologies and data center. The majority of these expenditures were for enhancements to our cloud telecommunications products and services and website development software.

## COMPETITION

Our markets are increasingly competitive. Our competitors include, but are not limited to, cloud telecommunications providers and traditional telephone service providers, application service providers, software vendors, systems integrators, direct providers, and information technology consulting services providers, and cloud service providers. Most of these competitors, however, do not offer their own suite of cloud telecommunications services but rather sell third party solutions and offerings. Many of our current and potential competitors have longer operating histories, larger customer bases, and longer relationships with customers as well as significantly greater financial, technical,

marketing and public relations resources than we do.

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.

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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 e-commerce or Internet based enterprises and 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. 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, 2016, we had 53 employees; 50 full-time and 3 part-time, including 4 executives, 15 sales representatives and sales management, 10 engineer and IT support in the development of our cloud services solutions, 17 in operations and customer support, 7 in finance, legal and business development, marketing, and other general administration.

#### 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. We changed the name to better reflect the scope and direction of our business activities of assisting and providing web-based technology solutions to businesses of any size who are seeking to take advantage of the benefits of conducting business on the cloud. 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.

We are headquartered at 1615 South 52nd Street, Tempe, AZ, 85281, and our telephone number is (602) 714-8500. Our website is [www.crexendo.com](http://www.crexendo.com). Our website and the information contained therein or connected thereto shall not be deemed to be incorporated into this Annual Report.





We make available free of charge on or through our Internet website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities Exchange and Commission (“SEC”).

You may read and copy this Annual Report at the SEC’s public reference room at 450 Fifth Street, NW, Washington D.C. 20549. Information on the operation of the public reference room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding our filings at [www.sec.gov](http://www.sec.gov).

#### 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 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. In particular, one channel we use to initially contact our customers is e-mail. The use of e-mail for this purpose has become the subject of a number of recently adopted and proposed laws and regulations. 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.

In addition to factors discussed elsewhere in this Annual Report, the following are important risks which could adversely affect our future results. If any of the risks we describe below materialize, or if any unforeseen risk develops, our operating results may suffer, our financial condition may deteriorate, the trading price of our common stock may decline and our investors could lose all or part of their investment.

The Company is operating essentially as a start-up company with the inherent risks and uncertainties of funding operations until and if profitability is achieved. After considering the Company’s historical negative cash flow from operating activities as well as a range of internal forecast outcomes, our cash and cash equivalents of \$619,000 at December 31, 2016 does not appear adequate to meet our obligations as they become due within one year following the date the financial statements are issued. Management evaluated the significance of the potential negative cash flows and determined that borrowing availability under an existing Loan Agreement would be sufficient to alleviate concerns about the Company’s ability to continue as a going concern, the Company entered into an amendment to our Loan Agreement with Steven G. Mihaylo, extending the ability of the Board of Directors to request the remaining \$1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018. Based on such commitment, along with its cash resources and loan borrowing availability, the Company believes it will have sufficient funds to sustain its operations during the next twelve months as a result of the sources of funding detailed above.

Changes in our business model and product strategies may adversely impact revenue.

Revenues from the discontinued seminar sales model continue to decrease. Almost all Extended Payment Term Agreements (EPTA’s) have been completed. Hosting fees from websites have continued to decline since the cessation of direct seminar sales. The Company has not actively marketed its website development software and new hosting fees from websites have been minimal.

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. The ultimate resolution of these or other inquiries or investigations 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 face risks in our strategy of developing new desktop telephones ("desktop devices"). Our telephony products are not currently programmed or intended to work with other competitors' service.

We continue to primarily sell and provide service to Crexendo® branded end points. The Company also sells and provides service for other manufactured phones although at present that is not the focus of sales by the Company. The desktop devices are being manufactured by third party vendors. The end points include Crexendo design, firmware certain technology and processes. The technology is dependent upon successful completion of the process by the third-party vendor. If the phones are successfully manufactured there is no assurance of the acceptance of the end points. Successful roll out is not guaranteed and is contingent on factors including but not limited to our meeting certain industry standards, the availability of our vendors to meet agreed terms, supply from vendors being sufficient to meet demand, industry acceptance of the end points, end points meeting the needs of our customers, competitive pricing of the end points, feature set of the end points being up to competitive standards, regulatory approval as required of the end points and competitor claims relating to the end points. Our failure to be able to fully implement the sale of the Crexendo end points or the inability to have end points manufactured to meet our supply needs may cause us damage as well as require us to have to purchase end points from other suppliers at a higher price which could affect sales and margins. Our VoIP telephony products are not currently intended to work with other competitors' or vendors' equipment. Our inability to operate with competitor's equipment or services may impact our competitiveness and our ability to acquire 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 those may subject us to penalties and may also require us to modify existing products and/or service.

The acceptance of telephony services and network services are 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.



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.

There is considerable uncertainty with respect to the state of law governing data transfers between the European Union ("EU"), and other countries with similar data protection laws, and it remains unclear what the final resolution will be for cross-border data transfers of personal information. There may be risks associated with data transfer and customers who use International Locations.

States are adding regulation for VoIP carriers 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 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 end points 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 offerings 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.

Our ability to offer services outside the U.S. is subject to different regulations which may be unknown and uncertain. Regulatory treatment of VoIP telephony 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.

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 in quarterly or annual results, and may delay or prevent cash flow break even or profitability.

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. This may result in service issues or cancellation of the entire contract. Further with larger enterprise customer sales, the risk of customers transporting desktop devices internationally without our knowledge may increase.

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



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. Our upstream carriers, suppliers and vendors may increase their rates thus directly impacting our cost of sales, which would affect our margins. Competitor rate decreases could require us to lower our rates to remain competitive, which could substantially reduce our revenues and profitability. 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. 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



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 VoIP telecommunication product competes with other VoIP providers. In addition, we also compete with traditional telephone service providers which provide telephone service based on the public switched telephone network. 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. Our competitors' financial resources may allow them to offer services at prices below cost or even for free in order to maintain and gain market share or otherwise improve their competitive positions.

The 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 service competes against established well financed alternative voice communication providers, (such as 8x8 and Ring Central) who may provide comparable services at comparable 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.

The FCC net neutrality rules may be subject to change. We cannot predict the effect of this rulemaking or predict whether any new rules will impact our business.

We believe interference with access to our products and services is unlikely, broadband Internet access provider interference has occurred in limited circumstances in the United States and could result in a loss of existing users and increased costs, and could impair our ability to attract new users, thereby negatively impacting our revenue and growth. The FCC has implemented network neutrality rules in the past legal challenges and congressional action may change current rules which could result in, interference with our service or higher charges. If that occurs it could cause us to lose existing customers, impair our ability to attract new customers, and harm our revenue and growth. These problems could also arise in international markets. Most foreign countries have not adopted formal net neutrality rules like those adopted by the FCC.

We have incurred operating losses.

We sustained operating losses in the current and prior years. Our ability to obtain positive cash flows from operating activities will depend on many factors including, but not limited to, our ability to (i) reduce costs, (ii) improve sales and marketing efficiencies, (iii) reach more highly qualified prospects, and (iv) achieve operational improvements. We have incurred operating losses in each of the three prior years and may incur operating losses in the foreseeable future. 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, 2016, we had net operating loss ("NOL") carry-forwards of approximately \$24,325,000, of which \$5,761,000 is subject to Section 382 limitations. 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. Since our formation, we have issued a significant number of shares, and purchasers of those shares have sold some of them, resulting in two ownership changes, as defined by Code Section 382. As a result of the most recent ownership change, utilization of our NOL is subject to an annual limitation determined by multiplying the value of our stock at the time of the ownership change by the applicable federal long-term tax-exempt rate. The annual limitation is approximately \$461,000. 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.



Fluctuations in our operating results may affect our stock price and ability to raise capital.

Our operating results for any given quarter or fiscal year should not be relied upon as an indication of future performance. Quarter to quarter comparisons of our results of operations may not be meaningful as a result of (i) our limited operating history relating to Web Services and Cloud Telecommunications Services and (ii) the emerging nature of the markets in which we compete, and (iii) our lack of profitability. Our future results will fluctuate, and those results may fall below the expectations of investors and may cause the trading price of our common stock to fall. This may impair our ability to raise capital, should we seek to do so. Our quarterly results may fluctuate based on, including but not limited to our sales efforts and results, marketing, management, our ability to compete, pricing and other risk factors contained in this section.:

Our Chief Executive Officer 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 CEO.

Steven G Mihaylo, our Chief Executive Officer (“CEO”), owns 68% of the outstanding shares of our common stock based on the number of shares outstanding as of December 31, 2016. As a result, Mr. Mihaylo would have 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 an independent board. As a director and officer, 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 certificate 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.

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 common stock is traded exclusively in the over-the-counter 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 sales of a large number of shares of our common stock in the market or the perception that these sales could occur. These sales also might make it more difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate. As of February 16, 2017, we had outstanding 13,653,556 shares of common stock.

Additional dilution will result if outstanding options to acquire shares of our common stock are exercised. In addition, in the event future financings are required they could be convertible into or exchangeable for our equity securities, investors may experience additional dilution.

Lack of sufficient stockholder equity or continued losses from operations could subject us to fail to comply with the listing requirements of the OTC.QX, 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. We do not meet the minimum listing requirement for the NYSE or NASDAQ

Our common stock is currently listed on OTC.QX. We have had annual losses from continuing operations for the last five years with the possibility of continued losses. While at current such losses would not impact our listing with OTC.QX regulations may change from time to time and it is possible we may not remain in compliance with the minimum condition of OTC.QX continued listing standards. Delisting from the OTC.QX 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. At present we do not meet the minimum listing requirements for the New York Stock Exchange (NYSE) or the NASDAQ Stock Exchange (NASDAQ) which may make raising capital, issuing additional securities or using the securities of the Company to effect acquisitions or merger more difficult or expensive.





If we do not successfully expand our sales including our partner program, direct sales and sales channels, we may be unable to substantially increase our sales.

We sell our products primarily through direct sales, inside sales and our telecommunications partner program, 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 network and the sales per partner and hire and retain qualified sales personnel or if new sales personnel fail to develop the necessary skills to be productive, or if they reach productivity more slowly than anticipated, our ability to increase our organic revenue and grow our business could be compromised. Our sales personnel may require a long period of time to become productive. The time required in achieving efficiency, as well as the challenge of attracting, training, and retaining qualified candidates, may make it difficult to grow revenue.

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

We have sold and will continue to attempt to sell to certain customer segments which may have certain requirements for additional privacy or security. In addition sales may be made to customers that are subject to additional security requirements and or HIPPA 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. In addition, there are risks associated with third party system failure, or parties illegally hacking into the Company systems. 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.

If we do not successfully expand our infrastructure and build diverse geo redundant locations which require large investments, we may be unable to substantially increase our sales and retain customers

Our ability to provide telecommunications services are dependent upon on Data center, facilities and equipment in our single Data Center. While most of our equipment required for operating these services are redundant in nature and offer high availability, 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, which may impact our revenue, profitability and retaining of customer and acquiring new customers. Our ability to provide telecommunication services due to loss of physical facilities in our only data center from act of God or terrorism or vandalism or gross negligence of person(s) currently or formerly associated with the company may result in loss of revenue and future business.

Our ability to recover from disasters, if and when they occur is paramount to offer continued service to our existing customers. While we have adequate equipment and procedures to handle disaster recovery including but not limited to offsite data storage; recovery from such scenarios may cause excessive delays in restoration of service and may result in some data loss. This may severely impact our revenue and may lead to loss of customers.

Our ability to provide telecommunications services is dependent upon third-party facilities and equipment, the failure of which could cause delays or interruptions of our service and impact our revenue and profitability.

Our ability to provide quality and reliable telephony service is in part dependent upon the proper functioning of facilities and equipment owned and operated by third parties and is, therefore, beyond our control. Our VoIP service (and to a lesser extend 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. We outsource several of our network functions to third-party providers. If 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 of any of these third party service providers to properly maintain services may be subject to factors including but not limited to the following: (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.



We rely on third parties to provide a portion of our customer service responses, initiate local number portability for our customers, deliver calls to and from PSTN and other public telephone VoIP/Wireless service providers and provide aspects of our E-911 service.

We offer our telephony customers support 24 hours a day, seven days a week. We rely on third parties (sometimes outside of the U.S) to provide some services that 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 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.

We also have agreements with companies that initiate our local number portability, which allow new customers to retain their existing telephone numbers when subscribing to our services. We will need to work with these companies to properly port numbers. The failure to port numbers may subject us to loss of customers or regulatory review.

If any of these third parties do not provide reliable, high-quality service, our reputation and our business will be harmed. In addition, industry consolidation among providers of services to us may impact our ability to obtain these services or increase our expense for these services.

Our dependence on outside contractors and third-party agents for fulfillment of certain items and critical manufacturing services could result in product or delivery delays and/or damage our customer relations.

We outsource the manufacturing of certain products we sell and products we 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.

Our success depends in part upon the capacity, reliability, and performance of our network infrastructure, including the capacity provided by our Internet bandwidth suppliers.

We depend on these companies to provide uninterrupted and error-free service. Some of these providers are also our competitors. We do not have control over these 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 success depends in part upon the capacity, reliability, and performance of our telecom carriers, and their network infrastructure, including the capacity provided by our Tier 1 and non-Tier 1 Telecom suppliers for Telecom Origination and Termination Services

We depend on these companies to provide uninterrupted and error-free service telecom services, sourcing of DIDs, porting of numbers and delivering telephone calls from and to endpoints and devices on our network. Some of these providers are also our competitors. We do not have control over these providers. We may be subject to interruptions or delays in their service. 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.

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

Our services (including e-commerce and VoIP) may be disrupted by problems with our technology and systems such as malfunctions in our 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 interruptions in the past and may experience interruptions in the future as a result of these types of problems. Interruptions could 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. Our customers' ability to use our services is dependent on third-party Internet providers which may suffer service disruptions. If service interruptions adversely affect the perceived reliability of our service, we may have difficulty attracting and retaining customers and our growth may suffer.



Our operations could be hurt by a natural disaster, network security breach, or other catastrophic event. We maintain a fully redundant network infrastructure in our data center in Tempe, Arizona. Currently, we do not have multiple site capacity if any catastrophic event occurs, although we expect to attain multiple site redundancy sometime in the future. 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. While we do not believe that we have lost customers as a consequence, the harm to our reputation is difficult to assess. We have taken and continue to take steps to improve our infrastructure to prevent service interruptions.

Failure in our data center 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.

Internet security issues and growing Cyber threats pose risks to the development of e-commerce and our business. Security and privacy concerns may inhibit the growth of the Internet and other online services generally, especially as a means of conducting commercial transactions.

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 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.

We depend upon Industry standard protocols, best practices, solutions, third-party software, technology, 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.

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.







Our publicly filed SEC reports are reviewed by the SEC from time to time and any significant changes required as a result of any such review may result in material liability to us and have a material adverse impact on the trading price of our common stock.

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 net operating loss 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.

We may 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 may 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. 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.

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

## ITEM 2.

### PROPERTIES

Our corporate offices consist of approximately 22,000 square feet of office space in Tempe, Arizona owned by our CEO and approximately 1,300 square feet of office space in Reno, NV which is leased from an unaffiliated third party. Our corporate office is located at 1615 South 52nd Street, Tempe, Arizona 85281. We maintain property insurance on the corporate office building as required by the lease and tenant fire and casualty insurance on our assets located in these buildings 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". The following table sets forth the range of high and low sales prices as reported on the OTCQX Marketplace for the periods indicated.

High    Low

## Year Ended December 31, 2016

|                          |        |        |
|--------------------------|--------|--------|
| October to December 2016 | \$1.55 | \$1.36 |
| July to September 2016   | 1.50   | 1.30   |
| April to June 2016       | 1.55   | 1.21   |
| January to March 2016    | 1.41   | 0.61   |

## Year Ended December 31, 2015

|                          |        |        |
|--------------------------|--------|--------|
| October to December 2015 | \$2.30 | \$1.10 |
| July to September 2015   | 2.25   | 1.85   |
| April to June 2015       | 2.33   | 1.82   |
| January to March 2015    | 2.70   | 1.40   |

## SECURITY HOLDERS

There were 137 holders of record of our shares of common stock as of February 16, 2017. The number of holders does not include individual participants in security positions listings.

## DIVIDENDS

There were no dividends declared for the years ended December 31, 2016 and 2015.

## ISSUER PURCHASES OF EQUITY SECURITIES

None

## RECENT SALES OF UNREGISTERED SECURITIES

On December 30, 2015, Crexendo, Inc. (the "Company") entered into a Term Loan Agreement (the "Loan Agreement"), with Steven G. Mihaylo, as Trustee of The Steven G. Mihaylo Trust dated August 19, 1999 (the "Lender"). Mr. Mihaylo is the principal shareholder and Chief Executive Officer of the Company. Pursuant to the Loan Agreement, the Lender has agreed to make an unsecured loan to the Company in the initial principal amount of \$1,000,000 (the "Loan"). The Loan Agreement contains a provision which requires the Lender to increase the amount of the Loan by up to an additional \$1,000,000 on the same terms and conditions as the initial advance if the independent directors of the Company, in their reasonable discretion, determine such an increase is necessary for the funding needs of the Company and that the terms of the Loan are in the best interests of the Company and its stockholders. The term of the Loan is five years, with simple interest paid at 9% per annum until a balloon payment is due December 30, 2020. The Loan Agreement provides for interest to be paid in shares of common stock of the Company (the "Common Stock") at a stock price of \$1.20 (which is the average of the high and low adjust close price of the Common Stock of

the Company for each business day for the period starting December 23, 2015 and ending December 29, 2015). For the first two years of the Loan term, interest will be paid in advance at the beginning of each year; for the last three years of the Loan term, interest will be paid at the end of each year. After the second year of the Loan term, there is no pre-payment penalty for early repayment of the outstanding principal amount of the Loan. If the Loan is repaid within the first two years of the Loan term, the Company will forfeit prepaid interest as a pre-payment penalty.



Contemporaneously with the execution of the Loan Agreement, the Company granted to the Lender a warrant to purchase 250,000 shares of Common Stock (the “Warrant”). The Warrant has a five-year term from the date of the Loan Agreement. The Warrant is exercisable by the Lender, at any time, and from time to time, during its term at a price of \$1.20 per share of Common Stock. The initial 250,000 warrants were exercised during 2016 generating proceeds of \$300,000. In the event the principal amount of the Loan is increased by an additional \$1,000,000, as determined by the independent directors of the Company, the Company has agreed to issue to the Lender a warrant to purchase an additional 250,000 shares of Common Stock on the same terms and subject to the same conditions set forth in the Warrant. Subsequent to December 31, 2016, the Company entered into an amendment to our Loan Agreement with Steven G. Mihaylo. The amendment extends the ability of the Board of Directors to request the remaining \$1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018.

The securities were offered and sold to Steven G. Mihaylo an accredited investor without registration under the Securities Act or state securities laws, in reliance on the exemptions provided by Section 4(2) of the Securities Act and Regulation D promulgated thereunder and in reliance on similar exemptions under applicable state laws.

#### 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 is a CLEC cloud services company that provides award winning cloud telecommunications services, broadband Internet services and other cloud business services. Our solutions are designed to provide enterprise-class cloud services to any size businesses at affordable monthly rates.

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 and broadband Internet services. Our cloud telecommunications contracts typically have a thirty-six to sixty month term. We generate product revenue and equipment financing 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 Services revenue increased 30% or \$1,768,000 to \$7,757,000 for the year ended December 31, 2016 as compared to \$5,989,000 for the year ended December 31, 2015. As of December 31, 2016 and 2015, our backlog was \$15,921,000 and \$13,907,000, respectively.

Web Services – We generate recurring revenue from website hosting and other professional services.

Our Web Services revenue decreased 26% or \$472,000 to \$1,362,000 for the year ended December 31, 2016 as compared to \$1,834,000 for the year ended December 31, 2015.

#### Use of Non-GAAP Financial Measures

To evaluate our business, we consider and use non-generally accepted accounting principles (Non-GAAP) net income (loss) 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 (loss) to be an important indicator of overall business performance because it allows us to evaluate results without the effects of share-based compensation, rent expense paid with common stock, and amortization of intangibles. We define EBITDA as U.S. GAAP net income (loss) before interest income, interest expense, other income and expense, provision 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 share-based compensation, and rent expense paid with stock. 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 7, 2017 earnings press release, as furnished on Form 8-K, we included Non-GAAP net loss, EBITDA and Adjusted EBITDA. The terms Non-GAAP net loss, 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 loss, EBITDA, and Adjusted EBITDA should not be considered in isolation, or as a substitute for net 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 (loss), EBITDA, and Adjusted EBITDA only as supplemental support for management's analysis of business performance. Non-GAAP net income (loss), 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 Loss to Non-GAAP Net Loss

(Unaudited)

|  | Year Ended<br>December 31, |           |
|--|----------------------------|-----------|
|  | 2016                       | 2015      |
|  | (In thousands)             |           |
| U.S. GAAP net loss   | \$(2,792)                  | \$(4,541) |
| Share-based compensation   | 653                        | 1,306     |
| Amortization of rent expense paid in stock, net of deferred gain | 229                        | 228       |
| Amortization of intangible assets                                | 131                        | 210       |
| Amortization of interest expense paid in stock                   | 101                        | -         |
| Non-GAAP net loss  | \$(1,678)                  | \$(2,797) |

Reconciliation of U.S. GAAP Net Loss to EBITDA to Adjusted EBITDA

(Unaudited)

|  | Year Ended<br>December 31, |           |
|--|----------------------------|-----------|
|  | 2016                       | 2015      |
|  | (In thousands)             |           |
| U.S. GAAP net loss   | \$(2,792)                  | \$(4,541) |
| Depreciation and amortization                                    | 146                        | 270       |
| Interest expense   | 138                        | 28        |
| Interest and other (income)/expense                              | ( 121)                     | ( 314)    |
| Income tax provision/(benefit)                                   | 12                         | ( 12)     |
| EBITDA   | (2,617)                    | (4,569)   |
| Share-based compensation   | 653                        | 1,306     |
| Amortization of rent expense paid in stock, net of deferred gain | 229                        | 228       |
| Adjusted EBITDA  | \$(1,735)                  | \$(3,035) |

## 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.

**Goodwill** – Goodwill is tested for impairment using a fair-value-based approach on an annual basis (December 31) and between annual tests if indicators of potential impairment exist.

**Intangible Assets** - Our intangible assets consist primarily of customer relationships and developed technology. The intangible assets are amortized following the patterns in which the economic benefits are consumed. 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.

**Contingent Liabilities** - Contingent liabilities require significant judgment in estimating potential payouts. Contingent considerations arising from business combinations 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 reviewed each reporting period to establish the fair value of the contingent liability.

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



## RESULTS OF OPERATIONS

## 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<br>December 31, |          |
|----------------------------------|----------------------------|----------|
| Consolidated                     | 2016                       | 2015     |
| Revenue                          | \$9,119                    | \$7,823  |
| Loss before income taxes         | (2,780)                    | (4,553)  |
| Income tax (provision)/benefit   | ( 12)                      | 12       |
| Net loss                         | (2,792)                    | (4,541)  |
| Basic/diluted net loss per share | \$(0.21)                   | \$(0.35) |

Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

## Revenue

Total revenue increased 17% or \$1,296,000 to \$9,119,000 for the year ended December 31, 2016 as compared to \$7,823,000 for the year ended December 31, 2015. Cloud Telecommunications Services segment revenue increased 30% or \$1,768,000, to \$7,757,000 for the year ended December 31, 2016 as compared to \$5,989,000 for the year ended December 31, 2015. Web Services segment revenue decreased 26% or \$472,000, to \$1,362,000 for the year ended December 31, 2016 as compared to \$1,834,000 for the year ended December 31, 2015.

## Loss Before Income Taxes

Loss before income tax decreased 39% or \$1,773,000 to \$2,780,000 for the year ended December 31, 2016 as compared to \$4,553,000 for the year ended December 31, 2015 primarily due to an increase in revenue of \$1,296,000 to \$9,119,000 for the year ended December 31, 2016 compared to \$7,823,000 for the year ended December 31, 2015, coupled with a decrease in total operating expenses of \$780,000 to \$11,882,000 for the year ended December 31, 2016 as compared to \$12,662,000 for the year ended December 31, 2015, offset by a reduction of other income of \$303,000.

## Income Tax Provision

We had an income tax provision of \$12,000 for the year ended December 31, 2016 compared to an income tax benefit of \$12,000 for the year ended December 31, 2015. We had a pre-tax loss for the years ended December 31, 2016 and 2015 of \$2,780,000 and \$4,553,000, respectively, and a full valuation allowance on all of our deferred tax assets for the years ended December 31, 2016 and 2015.

## Segment Operating Results



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



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

Year Ended  
December 31,

| Cloud Telecommunications Services | 2016      | 2015      |
|-----------------------------------|-----------|-----------|
| Revenue                           | \$7,757   | \$5,989   |
| Operating expenses:               |           |           |
| Cost of revenue                   | 3,422     | 3,175     |
| Research and development          | 793       | 731       |
| Selling and marketing             | 2,531     | 2,429     |
| General and administrative        | 4,185     | 4,558     |
| Total operating expenses          | 10,931    | 10,893    |
| Operating loss                    | (3,174)   | (4,904)   |
| Other income/(loss)               | (36)      | 71        |
| Loss before tax provision         | \$(3,210) | \$(4,833) |

Quarterly Financial Information

Year ended December 31, 2016

For the three months ended

| Cloud Telecommunications Services | March 31, | June 30, | September 30, | December 31, |
|-----------------------------------|-----------|----------|---------------|--------------|
|                                   | 2016      | 2016     | 2016          | 2016         |
| Revenue                           | \$1,778   | \$1,920  | \$2,013       | \$2,046      |
| Operating expenses:               |           |          |               |              |
| Cost of revenue                   | 848       | 864      | 878           | 832          |
| Research and development          | 218       | 207      | 183           | 185          |
| Selling and marketing             | 610       | 636      | 681           | 604          |
| General and administrative        | 1,065     | 1,085    | 987           | 1,048        |
| Total operating expenses          | 2,741     | 2,792    | 2,729         | 2,669        |
| Operating loss                    | (963)     | (872)    | (716)         | (623)        |
| Other expense                     | (7)       | (3)      | (11)          | (15)         |
| Loss before tax provision         | \$(970)   | \$(875)  | \$(727)       | \$(638)      |

Year ended December 31, 2015

For the three months ended

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Cloud Telecommunications Services March 31, June 30, September 30, December 31,

|                            | 2016      | 2016      | 2016      | 2016      |
|----------------------------|-----------|-----------|-----------|-----------|
| Revenue                    | \$1,324   | \$1,421   | \$1,542   | \$1,702   |
| Operating expenses:        |           |           |           |           |
| Cost of revenue            | 744       | 745       | 799       | 887       |
| Research and development   | 186       | 155       | 197       | 193       |
| Selling and marketing      | 600       | 569       | 624       | 636       |
| General and administrative | 1,144     | 1,043     | 1,041     | 1,330     |
| Total operating expenses   | 2,674     | 2,512     | 2,661     | 3,046     |
| Operating loss             | (1,350)   | (1,091)   | (1,119)   | (1,344)   |
| Other income               | 21        | 18        | 19        | 13        |
| Loss before tax provision  | \$(1,329) | \$(1,073) | \$(1,100) | \$(1,331) |



## Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

## Revenue

Cloud Telecommunications Services segment revenue increased 30% or \$1,768,000, to \$7,757,000 for the year ended December 31, 2016 as compared to \$5,989,000 for the year ended December 31, 2015. A substantial portion of Cloud Telecommunications Services segment revenue is generated through 36 to 60 month service contracts. As such, we believe growth in Cloud Telecommunications Services segment will initially be seen through increases in our backlog. Backlog represents future revenue on contracts signed with no service or payment provided at December 31, 2016 and December 31, 2015.

|   |          |
|---|----------|
| Cloud Telecommunications Services backlog as of December 31, 2016 | \$15,921 |
| Cloud Telecommunications Services backlog as of December 31, 2015 | \$13,907 |

## Cost of Revenue

Cost of revenue consists primarily of fees we pay to third-party telecommunications and business Internet providers, costs related to installations, customer service, and the costs associated with the purchase of desktop devices and third party equipment. Cost of revenue increased 8% or \$247,000, to \$3,422,000 for the year ended December 31, 2016 as compared to \$3,175,000 for the year ended December 31, 2015. The cost of revenue increase is directly related to the increase in revenue.

## Research and Development

Research and development expenses primarily consist of salaries and benefits, and materials related to the development of new cloud telecommunications products. Research and development expenses increased 8% or \$62,000, to \$793,000 for the year ended December 31, 2016 as compared to \$731,000 for the year ended December 31, 2015 due to fluctuations in headcount.

## Selling and Marketing

Selling and marketing expenses consist primarily of direct sales representative salaries and benefits, partner channel commissions, and the production of marketing materials. Selling and marketing expenses increased 4% or \$102,000, to \$2,531,000 for the year ended December 31, 2016 as compared to \$2,429,000 for the year ended December 31, 2015. The increase was primarily attributable to an increase in commission expenses of \$235,000 directly related to increase in revenue, offset by a decrease in CRM software expense of \$15,000 and a decrease in salaries and benefits of \$118,000.

## General and Administrative

General and administrative expenses consist of salaries and benefits for executives, administrative personnel, legal, rent, accounting and other professional services, and other administrative corporate expenses. General and administrative expenses decreased 8% or \$373,000, to \$4,185,000 for the year ended December 31, 2016 as compared to \$4,558,000 for the year ended December 31, 2015. The decrease in general and administrative expenses is primarily due to a company-wide reduction in general and administrative expenses as we continue to cut unnecessary expenses. Consolidated general and administrative expenses decreased 16%, or \$961,000 to \$4,900,000 for the year ended December 31, 2016 compared to \$5,861,000 for the year ended December 31, 2015. As Cloud Telecommunications Service revenue continues to grow and Web Services revenue decreases, we allocated less of the general and

administrative expenses to the Web Services segment and more expenses to the Cloud Telecommunications Services segment.

Other Income/(Expense)

Other income/(expense) primarily relates to the allocated portions of interest expense and sublease rental income. Other income/(expense) decreased 151% or \$107,000 to \$(36,000) for the year ended December 31, 2016 as compared to \$71,000 for the year ended December 31, 2015. The decrease is due to an increase in interest expense on notes payable and sublease income ending November 2016 from the expiration of the lease.





## Operating Results of our Web Services Segment (in thousands)

|                             | Year Ended<br>December 31, |         |
|-----------------------------|----------------------------|---------|
| Web Services                | 2016                       | 2015    |
| Revenue                     | \$1,362                    | \$1,834 |
| Operating expenses:         |                            |         |
| Cost of revenue             | 203                        | 402     |
| Research and development    | 33                         | 48      |
| Selling and marketing       | -                          | 16      |
| General and administrative  | 715                        | 1,303   |
| Total operating expenses    | 951                        | 1,769   |
| Operating income            | 411                        | 65      |
| Other income                | 19                         | 215     |
| Income before tax provision | \$430                      | \$280   |

## Quarterly Financial Information

Year ended December 31, 2016

For the three months ended

March 31, June 30, September 30, December 31,

| Web Services                | 2016  | 2016  | 2016  | 2016  |
|-----------------------------|-------|-------|-------|-------|
| Revenue                     | \$396 | \$347 | \$320 | \$299 |
| Operating expenses:         |       |       |       |       |
| Cost of revenue             | 65    | 53    | 54    | 31    |
| Research and development    | 11    | 9     | 6     | 7     |
| General and administrative  | 226   | 189   | 153   | 147   |
| Total operating expenses    | 302   | 251   | 213   | 185   |
| Operating income            | 94    | 96    | 107   | 114   |
| Other income                | 11    | 5     | 3     | -     |
| Income before tax provision | \$105 | \$101 | \$110 | \$114 |

Year ended December 31, 2015

For the three months ended

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March 31, June 30, September 30, December 31,

| Web Services                | 2015  | 2015  | 2015  | 2015  |
|-----------------------------|-------|-------|-------|-------|
| Revenue                     | \$528 | \$469 | \$430 | \$407 |
| Operating expenses:         |       |       |       |       |
| Cost of revenue             | 117   | 110   | 83    | 92    |
| Research and development    | 17    | 10    | 12    | 9     |
| Selling and marketing       | 3     | 11    | -     | 2     |
| General and administrative  | 416   | 332   | 268   | 287   |
| Total operating expenses    | 553   | 463   | 363   | 390   |
| Operating income/(loss)     | (25)  | 6     | 67    | 17    |
| Other income                | 194   | 15    | -     | 6     |
| Income before tax provision | \$169 | \$21  | \$67  | \$23  |

Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

Revenue

Revenue from Web Services is generated primarily through website hosting, professional web management services, and EPTAs. Web Services segment revenue decreased 26% or \$472,000, to \$1,362,000 for the year ended December 31, 2016 as compared to \$1,834,000 for the year ended December 31, 2015. The decrease in revenue is related to \$91,000 decrease in web management professional services, a \$127,000 decrease in EPTA revenue due to decrease in outstanding receivables, and a \$254,000 decrease in hosting revenue.



### Cost of Revenue

Cost of revenue consists primarily of bandwidth, customer service costs, and outsourcing fees related to fulfillment of our professional web management services. Cost of revenue decreased 50% or \$199,000, to \$203,000 for the year ended December 31, 2016 as compared to \$402,000 for the year ended December 31, 2015. The cost of revenue decrease is directly related to the reduction in revenue.

### Research and Development

Research and development expenses primarily consist of salaries and benefits, and related expenses which are attributable to the development of our website development software products. Research and development expenses decreased 31% or \$15,000, to \$33,000 for the year ended December 31, 2016 as compared to \$48,000 for the year ended December 31, 2015. The decrease was related to a reduction of salaries and benefits expenses.

### Selling and Marketing

Selling and marketing expenses consist primarily of salaries and benefits, commissions as well as production of marketing materials. Selling and marketing expense decreased 100% or \$16,000, to \$0 for the year ended December 31, 2016 compared to \$16,000 for the year ended December 31, 2015. The decrease is attributed to our shift in focus to our cloud telecommunications services segment.

### General and Administrative

General and administrative expenses consist of salaries and benefits for executives, administrative personnel, legal, rent, accounting and other professional services, and other administrative corporate expenses. General and administrative expenses decreased 45% or \$588,000, to \$715,000 for the year ended December 31, 2016 as compared to \$1,303,000 for the year ended December 31, 2015. The decrease in general and administrative expenses is primarily due to less of an allocation of corporate general and administrative expenses resulting from the 26% decrease in revenue for the year ended December 31, 2016 compared to the year ended December 31, 2015, and a company-wide reduction in general and administrative expenses as we continue to cut unnecessary expenses. Consolidated general and administrative expenses decreased 16%, or \$961,000 to \$4,900,000 for the year ended December 31, 2016 compared to \$5,861,000 for the year ended December 31, 2015.

### Other Income

Other income decreased 91% or \$196,000, to \$19,000 for the year ended December 31, 2016 as compared to \$215,000 for the year ended December 31, 2015. This decrease is primarily related to the reversal of certain legal accruals totaling \$193,000 during the year ended December 31, 2015 that were determined to no longer have a reasonable possibility of being paid out.

### LIQUIDITY AND CAPITAL RESOURCES

The Company has transformed into a start-up company with the inherent risks and uncertainties of funding operations until profitability is achieved. After considering the Company's historical negative cash flow from operating activities as well as a range of internal forecast outcomes, our cash and cash equivalents of \$619,000 at December 31, 2016 does not appear adequate to meet our obligations as they become due within one year following the date the financial statements are issued. Management evaluated the significance of the potential negative cash flows and determined that borrowing availability under an existing Loan Agreement would be sufficient to alleviate concerns about the Company's ability to continue as a going concern, the Company entered into an amendment to our Loan Agreement

with Steven G. Mihaylo, extending the ability of the Board of Directors to request the remaining \$1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018.

Working Capital

Working capital decreased 94% or \$941,000 to \$57,000 as of December 31, 2016 as compared to \$998,000 as of December 31, 2015. The decrease in working capital is primarily due to a decrease in cash and restricted cash of \$890,000, a decrease in prepaid expenses of \$360,000, and an increase in accrued expenses of \$185,000. Additionally, during the year ended December 31, 2016, the Company adopted ASU 2015-17, Balance Sheet Classification of Deferred Taxes, which requires entities to present deferred tax assets and deferred tax liabilities as non-current. As a result, we reclassified current deferred income tax assets of \$423,000 to non-current during 2016.



#### Cash and Cash Equivalents

Cash and cash equivalents decreased 59% or \$878,000, to \$619,000 as of December 31, 2016 as compared to \$1,497,000 as of December 31, 2015. During the year ended December 31, 2016, we used cash flows for operating activities of \$1,126,000, offset by \$11,000 provided by investing activities and \$237,000 provided by financing activities.

#### Trade Receivables

Current and long-term trade receivables, net of allowance for doubtful accounts, decreased 13% or \$56,000, to \$389,000 as of December 31, 2016 as compared to \$445,000 as of December 31, 2015. Long-term trade receivables, net of allowance for doubtful accounts, decreased 47% or \$38,000, to \$43,000 as of December 31, 2016 as compared to \$81,000 as of December 31, 2015. In prior years, we offered our customers an installment contract with payment terms between 24 and 36 months, as one of several payment options. The payments that become due more than 12 months after the end of the reporting period are classified as long-term trade receivables. The decrease in our accounts receivable balance is primarily related to outstanding balances with our third-party leasing companies at the end of 2015, which have been collected.

#### Accounts Payable

Accounts payable increased 53% or \$40,000, to \$116,000 as of December 31, 2016 as compared to \$76,000 as of December 31, 2015. The aging of accounts payable as of December 31, 2016 and 2015 were generally within our vendors' terms of payment.

#### Notes Payable

Notes payables increased 1% or \$10,000, to \$1,032,000 as of December 31, 2016 as compared to \$1,022,000 at December 31, 2015. The increase is primarily due to accreting the related party notes payable balance up \$23,000 from the note payable discount, offset by payments on other notes payable balances (Note 10).

#### Capital

Total stockholders' equity decreased 77% or \$1,689,000, to \$515,000 as of December 31, 2016 as compared to \$2,204,000 as of December 31, 2015. The decrease in total stockholders' equity was attributable to net loss of \$2,792,000 offset by an increase in additional paid-in capital of \$653,000 for stock options issued to employees, \$300,000 for the exercise of warrants, \$9,000 for the exercise of employee stock options, \$101,000 in common stock issued for annual interest payment on note payable, and \$40,000 issued to settle contingent consideration obligations.

#### OFF BALANCE SHEET ARRANGEMENTS

As of December 31, 2016, 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

##### Note Payable

On December 30, 2015, Crexendo, Inc. (the "Company") entered into a Term Loan Agreement (the "Loan Agreement"), with Steven G. Mihaylo, as Trustee of The Steven G. Mihaylo Trust dated August 19, 1999 (the "Lender"). Mr. Mihaylo is the principal shareholder and Chief Executive Officer of the Company. Pursuant to the Loan Agreement, the Lender has agreed to make an unsecured loan to the Company in the initial principal amount of \$1,000,000 (the "Loan"). The Loan Agreement contains a provision which requires the Lender to increase the amount of the Loan by up to an additional \$1,000,000 on the same terms and conditions as the initial advance if the independent directors of the Company, in their reasonable discretion, determine such an increase is necessary for the funding needs of the Company and that the terms of the Loan are in the best interests of the Company and its stockholders. The term of the Loan is five years, with simple interest paid at 9% per annum until a balloon payment is due December 30, 2020. The Loan Agreement provides for interest to be paid in shares of common stock of the Company (the "Common Stock") at a stock price of \$1.20 (which is the average of the high and low adjust close price of the Common Stock of the Company for each business day for the period starting December 23, 2015 and ending December 29, 2015). For the first two years of the Loan term, interest will be paid in advance at the beginning of each year; for the last three years of the Loan term, interest will be paid at the end of each year. After the second year of the Loan term, there is no

pre-payment penalty for early repayment of the outstanding principal amount of the Loan. If the Loan is repaid within the first two years of the Loan term, the Company will forfeit prepaid interest as a pre-payment penalty.





Contemporaneously with the execution of the Loan Agreement, the Company granted to the Lender a warrant to purchase 250,000 shares of Common Stock (the "Warrant"). The Warrant has a five-year term from the date of the Loan Agreement. The Warrant is exercisable by the Lender, at any time, and from time to time, during its term at a price of \$1.20 per share of Common Stock. The initial 250,000 warrants were exercised during 2016 generating proceeds of \$300,000. In the event the principal amount of the Loan is increased by an additional \$1,000,000, as determined by the independent directors of the Company, the Company has agreed to issue to the Lender a warrant to purchase an additional 250,000 shares of Common Stock on the same terms and subject to the same conditions set forth in the Warrant.

On June 28, 2016, the Company entered into an Amendment to the Loan Agreement, extending the period which the Company can increase the loan up to an additional \$1,000,000 to May 30, 2017. All other terms remain the same as initial loan agreement. Subsequent to December 31, 2016, the Company entered into a second amendment to our Loan Agreement with Steven G. Mihaylo. The amendment extends the ability of the Board of Directors to request the remaining \$1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018. All other terms remain the same as initial Loan Agreement.

## RECENT ACCOUNTING PRONOUNCEMENTS

### Recently Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, Compensation - Stock Compensation (Topic 718), improvement to employee share-based payment accounting. The new standard contains several amendments that will simplify the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The changes in the new standard eliminate the accounting for excess tax benefits to be recognized in additional paid-in capital and tax deficiencies recognized either in the income tax provision or in additional paid-in capital. The Company elected early adoption of ASU 2016-09 in 2016. Due to the Company's valuation allowance on its deferred tax assets, no income tax benefit will be recognized in 2016 as a result of the adoption of ASU 2016-09. There will be no change to retained earnings with respect to excess tax benefits, as this is not applicable to the Company. The treatment of forfeitures has not changed as we are electing to continue our current process of estimating the number of forfeitures. As such, this has no cumulative effect on retained earnings. With the early adoption of 2016-09, we have elected to present the cash flow statement on a prospective transition method and no prior periods have been adjusted. In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, which will require entities to present deferred tax assets (DTAs) and deferred tax liabilities (DTLs) as noncurrent in a classified balance sheet. The ASU simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and noncurrent in a classified balance sheet. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016 (and interim periods within those annual periods) and early adoption is permitted. ASU 2015-17 may be either applied prospectively to all deferred tax assets and liabilities or retrospectively to all periods presented. We have elected to early adopt ASU 2015-17 prospectively in the fourth quarter of 2016. As a result, we have presented all deferred tax assets and liabilities as noncurrent on our consolidated balance sheet as of December 31, 2016, but have not reclassified current deferred tax assets and liabilities on our consolidated balance sheet as of December 31, 2015. There was no impact on our results of operations as a result of the adoption of ASU 2015-17.

In September 2015, the FASB issued ASU 2015-16, Business Combinations, which requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period for a business combination in the reporting period in which the adjustment amounts are determined. Prior to the issuance of the standard, entities were required to retrospectively apply adjustments made to provisional amounts recognized in a business combination. We adopted this guidance effective January 1, 2016. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles—Goodwill and Other—Internal-Use Software, which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change U.S. generally accepted accounting principles ("GAAP") for a customer's accounting for service contracts. We adopted this guidance effective January 1, 2016. The adoption of this guidance did not have a material impact on our consolidated financial statements.



In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements – Going Concern, which requires management to assess an entity’s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the ASU (1) provides a definition of the term substantial doubt, (2) requires an evaluation every reporting period including interim periods, (3) provides principles for considering the mitigating effect of management’s plans, (4) requires certain disclosures when substantial doubt is alleviated as a result of consideration of management’s plans, (5) requires an express statement and other disclosures when substantial doubt is not alleviated, and (6) requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). We adopted this guidance on December 31, 2016 and management assessed the entity’s ability to continue as a going concern. After considering the Company’s historical negative cash flow from operating activities as well as a range of internal forecast outcomes, our cash and cash equivalents of \$619,000 at December 31, 2016 does not appear adequate to meet our obligations as they become due within one year following the date the financial statements are issued. Management evaluated the significance of the potential negative cash flows and determined that borrowing availability under an existing Loan Agreement would be sufficient to alleviate concerns about the Company’s ability to continue as a going concern, the Company entered into an amendment to our Loan Agreement with Steven G. Mihaylo, extending the ability of the Board of Directors to request the remaining \$1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018. Substantial doubt was alleviated as a result of considerations of management’s plans. Certain disclosures were added to comply with the disclosure requirements of the ASU.

#### Recently Issued Accounting Pronouncements

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which amends ASC 230, to clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows. The FASB issued ASU 2016-15 with the intent of reducing diversity in practice with respect to eight types of cash flows. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. We are in the process of evaluating the adoption and potential impact of this new ASU on our consolidated financial statements.

In May 2016, the FASB issued ASU 2016-12, Narrow-Scope Improvements and Practical Expedients, makes certain targeted amendments to Topic 606, Revenue from Contracts with Customers:

**Assessing collectibility.** The amendments add a “substantially all” threshold to the collectibility criterion, and also clarify that the objective of the collectibility assessment is to determine whether the contract is valid and represents a substantive transaction based on whether a customer has the ability and intent to pay for the goods or services that will be transferred to the customer, as opposed to all of the goods or services promised in the contract. The ASU also clarifies how an entity may recognize as revenue consideration received in circumstances where a contract does not meet the criteria required at inception to apply the recognition guidance within the revenue standard.

**Presenting sales taxes and other similar taxes collected from customers.** The amendments provide an accounting policy election whereby an entity may exclude from the measurement of transaction price all taxes assessed by a taxing authority related to the specific transaction and that are collected from the customer. Such amounts would be presented “net” under this option.

**Noncash consideration.** The amendments clarify that the fair value of noncash consideration is measured at contract inception, and specify how to account for subsequent changes in the fair value of noncash consideration.

**Contract modifications at transition.** The amendments provide a new practical expedient whereby an entity electing either the full or modified retrospective method of transition is permitted to reflect the aggregate effect of all prior period modifications (using hindsight) when identifying satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price to satisfied and unsatisfied obligations.

Completed contracts at transition. The amendments include certain practical expedients in transition related to completed contracts. The amendments also clarify the definition of a completed contract.

Disclosing the accounting change in the period of adoption. ASU 2016-12 provides an exception to the requirement in Topic 250, Accounting Changes and Error Corrections, to disclose the effect on the current period of retrospectively adopting a new accounting standard. As such, the disclosure requirement does not apply to adoption of the new revenue standard with respect to the year of adoption.

The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements of ASU 2014-09 (Topic 606). The Company is currently in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10, Identifying Performance Obligations and Licensing, more clearly articulates the guidance for assessing whether promises are separately identifiable in the overall context of the contract, which is one of two criteria for determining whether promises are distinct. The ASU also clarifies the factors an entity should consider when assessing whether two or more promises are separately identifiable, and provides additional examples within the implementation guidance for assessing these factors. The ASU further clarifies that an entity is not required to identify promised goods or services that are immaterial in the context of the contract, although customer options to purchase additional goods or services that represent a material right should not be designated as immaterial in the context of the contract. The ASU also provides an accounting policy election whereby an entity may account for shipping and handling activities as a fulfillment activity rather than as an additional promised service in certain circumstances.



The ASU also clarifies whether a license of intellectual property (IP) represents a right to use the IP (which is satisfied at a point in time) or a right to access the IP (which is satisfied over time) by categorizing the underlying IP as either functional or symbolic. A promise to grant a license that is not a separate performance obligation must be considered in the context above (i.e., functional or symbolic), in order to determine whether the combined performance obligation is satisfied at a point in time or over time, and how to best measure progress toward completion if recognized over time. Regardless of a license's nature (i.e., functional or symbolic), an entity may not recognize revenue from a license of IP before 1) it provides or otherwise makes available a copy of the IP to the customer, and 2) the period during which the customer is able to use and benefit from the license has begun (i.e., the beginning of the license period). Additionally, the ASU clarifies that 1) an entity should not split a sales-based or usage-based royalty into a portion subject to the guidance on sales-based and usage-based royalties and a portion that is not subject to that guidance; and 2) the guidance on sales-based and usage-based royalties applies whenever the predominant item to which the royalty relates is a license of IP. Lastly, the amendments distinguish contractual provisions requiring the transfer of additional rights to use or access IP that the customer does not already control from provisions that are attributes of a license (e.g., restrictions of time, geography, or use). License attributes define the scope of the rights conveyed to the customer; they do not determine when the entity satisfies a performance obligation. The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements of ASU 2014-09 (Topic 606). The Company is currently in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases, in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. The ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. The Company is currently in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation, which requires that a performance target that affects vesting and could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, Compensation-Stock Compensation, as it relates to such awards. ASU 2014-12 is effective for us in our first quarter of fiscal 2017 with early adoption permitted using either of two methods: (i) prospective to all awards granted or modified after the effective date; or (ii) retrospective to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter, with the cumulative effect of applying ASU 2014-12 as an adjustment to the opening retained earnings balance as of the beginning of the earliest annual period presented in the financial statements. The Company will adopt the ASU effective January 1, 2017. Adoption of this ASU will not impact our consolidated financial statements as no outstanding awards contain performance targets.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract.

In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 for all entities by one year. Accordingly, public business entities should apply the guidance in ASU 2014-09 to annual reporting periods (including interim periods within those periods) beginning after December 15, 2017. Early adoption is permitted but not before annual periods beginning after December 15, 2016. The standard permits the use of the retrospective or the modified approach method. We have not yet selected a transition method, and are currently in the process of



evaluating the impact of adoption of this ASU on our consolidated financial statements and disclosures.

ITEM 7A.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

Not required

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ITEM 8.

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CREXENDO, INC. AND SUBSIDIARIES

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Crexendo, Inc.  
Tempe, AZ

We have audited the accompanying consolidated balance sheet of Crexendo, Inc. and subsidiaries (the "Company") as of December 31, 2016, and the related consolidated statement of operations, stockholders' equity, and cash flows for the year then ended. Our audit also included the financial statement schedule listed in the Index at Item 15. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements and financial statement schedule of Crexendo, Inc. and subsidiaries as of December 31, 2015, and for the year then ended were audited by other auditors whose report dated March 1, 2016, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, 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. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2016 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Crexendo, Inc. and subsidiaries as of December 31, 2016, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the 2016 financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Urish Popeck & Co., LLC

Pittsburgh, PA  
March 7, 2017



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Crexendo, Inc.

We have audited the accompanying consolidated balance sheet of Crexendo, Inc. and subsidiaries (the "Company") as of December 31, 2015, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year ended December 31, 2015. Our audit also included the financial statement schedule listed in the Index at Item 15 for the year ended December 31, 2015. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, 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. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Crexendo, Inc. and subsidiaries at December 31, 2015, and the results of their operations and their cash flows for the year ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule for the year ended December 31, 2015, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/DELOITTE & TOUCHE LLP

Salt Lake City, Utah  
March 1, 2016





## CREXENDO, INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

(In thousands, except par value and share data)

|   | December 31, |         |
|---|--------------|---------|
|   | 2016         | 2015    |
| Assets  |              |         |
| Current assets:   |              |         |
| Cash and cash equivalents   | \$619        | \$1,497 |
| Restricted cash   | 100          | 112     |
| Trade receivables, net of allowance for doubtful accounts of \$34 as of December 31, 2016 and \$35 as of December 31, 2015        | 346          | 364     |
| Inventories   | 170          | 134     |
| Equipment financing receivables   | 121          | 131     |
| Prepaid expenses  | 686          | 1,046   |
| Other current assets  | 8            | 15      |
| Total current assets  | 2,050        | 3,299   |
| Certificate of deposit  | 252          | 251     |
| Long-term trade receivables, net of allowance for doubtful accounts of \$13 as December 31, 2016 and \$24 as of December 31, 2015 | 43           | 81      |
| Long-term equipment financing receivables   | 176          | 319     |
| Property and equipment, net   | 18           | 33      |
| Deferred income tax assets, net   | -            | 482     |
| Intangible assets, net  | 335          | 466     |
| Goodwill  | 272          | 272     |
| Long-term prepaid expenses  | 251          | 288     |
| Other long-term assets  | 136          | 169     |
| Total Assets  | \$3,533      | \$5,660 |
| Liabilities and Stockholders' Equity  |              |         |
| Current liabilities:  |              |         |
| Accounts payable  | \$116        | \$76    |
| Accrued expenses  | 997          | 812     |
| Notes payable, current portion  | 66           | 57      |
| Income taxes payable  | 5            | -       |
| Contingent consideration  | -            | 99      |
| Deferred income tax liability   | -            | 482     |
| Deferred revenue, current portion   | 809          | 775     |
| Total current liabilities   | 1,993        | 2,301   |
| Deferred revenue, net of current portion  | 43           | 81      |
| Notes payable, net of current portion   | 966          | 965     |

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|   |           |           |
|---|-----------|-----------|
| Other long-term liabilities   | 16        | 109       |
| Total liabilities   | 3,018     | 3,456     |
| Commitments and contingencies   |           |           |
| 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 25,000,000 shares, 13,578,556 shares issued and outstanding as of December 31, 2016 and 13,227,489 shares issued and outstanding as of December 31, 2015 | 14        | 13        |
| Additional paid-in capital  | 58,716    | 57,614    |
| Accumulated deficit   | ( 58,215) | ( 55,423) |
| Total stockholders' equity  | 515       | 2,204     |
| Total Liabilities and Stockholders' Equity  | \$3,533   | \$5,660   |

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, |            |
|---|-------------------------|------------|
|   | 2016                    | 2015       |
| Revenue                                     | \$9,119                 | \$7,823    |
| Operating expenses:                         |                         |            |
| Cost of revenue                             | 3,625                   | 3,577      |
| Selling and marketing                       | 2,531                   | 2,444      |
| General and administrative                  | 4,900                   | 5,862      |
| Research and development                    | 826                     | 779        |
| Total operating expenses                    | 11,882                  | 12,662     |
| Loss from operations                        | ( 2,763)                | ( 4,839)   |
| Other income/(expense):                     |                         |            |
| Interest income                             | 15                      | 24         |
| Interest expense                            | ( 138)                  | ( 28)      |
| Other income, net                           | 106                     | 290        |
| Total other income/(expense), net           | ( 17)                   | 286        |
| Loss before income tax                      | ( 2,780)                | ( 4,553)   |
| Income tax (provision)/benefit              | ( 12)                   | 12         |
| Net loss                                    | \$(2,792)               | \$(4,541)  |
| Net loss per common share:                  |                         |            |
| Basic                                       | \$(0.21)                | \$(0.35)   |
| Diluted                                     | \$(0.21)                | \$(0.35)   |
| Weighted-average common shares outstanding: |                         |            |
| Basic                                       | 13,358,311              | 12,960,625 |
| Diluted                                     | 13,358,311              | 12,960,625 |

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



## CREXENDO, INC. AND SUBSIDIARIES

## Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2016 and December 31, 2015

(In thousands, except share data)

|   | Common Stock |        | Additional |             | Total         |
|---|--------------|--------|------------|-------------|---------------|
|   |              |        | Paid-in    | Accumulated | Stockholders' |
|   | Shares       | Amount | Capital    | Deficit     | Equity        |
| Balance, January 1, 2015  | 12,681,617   | \$13   | \$55,413   | \$(50,882)  | \$4,544       |
| Expense for stock options granted to employees                      | -            | -      | 1,306      | -           | 1,306         |
| Stock issued under stock award plans                                | 26,865       | -      | 50         | -           | 50            |
| Issuance of common stock in a business acquisition                  | 19,007       | -      | 40         | -           | 40            |
| Issuance of common stock warrants in connection with note payable   | -            | -      | 115        | -           | 115           |
| Issuance of common stock for exercise of common stock warrants      | 500,000      | -      | 690        | -           | 690           |
| Net loss  | -            | -      | -          | (4,541)     | (4,541)       |
| Balance, December 31, 2015  | 13,227,489   | 13     | 57,614     | (55,423)    | 2,204         |
| Expense for stock options granted to employees                      | -            | -      | 653        | -           | 653           |
| Stock issued under stock award plans                                | 8,310        | -      | 9          | -           | 9             |
| Issuance of common stock in a business acquisition                  | 17,757       | -      | 40         | -           | 40            |
| Issuance of common stock for interest on related party note payable | 75,000       | -      | 101        | -           | 101           |
| Issuance of common stock for exercise of common stock warrants      | 250,000      | 1      | 299        | -           | 300           |
| Net loss  | -            | -      | -          | (2,792)     | (2,792)       |
| Balance, December 31, 2016  | 13,578,556   | \$14   | \$58,716   | \$(58,215)  | \$515         |

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<br>December 31, |                 |
|--|----------------------------|-----------------|
|  | 2016                       | 2015            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                  |                            |                 |
| Net loss   | \$(2,792)                  | \$(4,541)       |
| Adjustments to reconcile net loss to net cash used for operating activities: |                            |                 |
| Amortization of prepaid rent   | 322                        | 322             |
| Depreciation and amortization  | 146                        | 270             |
| Expense for stock options issued to employees                                | 653                        | 1,306           |
| Non-cash interest expense  | 124                        | -               |
| Amortization of deferred gain  | (93)                       | (94)            |
| Change in fair value of contingent consideration                             | -                          | (11)            |
| Changes in assets and liabilities, net of effects of acquisitions:           |                            |                 |
| Trade receivables  | 56                         | 162             |
| Equipment financing receivables  | 153                        | 176             |
| Inventories  | (36)                       | (62)            |
| Prepaid expenses   | 75                         | (112)           |
| Other assets   | 40                         | (69)            |
| Accounts payable and accrued expenses  | 225                        | (380)           |
| Income tax payable   | 5                          | (7)             |
| Deferred revenue   | (4)                        | 66              |
| Net cash used for operating activities                                       | (1,126)                    | (2,974)         |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                  |                            |                 |
| Purchase of property and equipment   | -                          | ( 25)           |
| Release of restricted cash   | 12                         | 21              |
| Purchase of long-term investment   | (1)                        | -               |
| Net cash provided by/(used for) investing activities                         | 11                         | ( 4)            |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                  |                            |                 |
| Proceeds from notes payable  | 150                        | 1,000           |
| Repayments made on notes payable   | (163)                      | (110)           |
| Proceeds from exercise of options  | 9                          | 50              |
| Payment of contingent consideration  | (59)                       | (61)            |
| Proceeds from exercise of warrants   | 300                        | 690             |
| Net cash provided by financing activities                                    | 237                        | 1,569           |
| <b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>                             | <b>( 878)</b>              | <b>( 1,409)</b> |



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|   |       |         |
|---|-------|---------|
| CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR                                | 1,497 | 2,906   |
| CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR                                      | \$619 | \$1,497 |
| Supplemental disclosure of cash flow information:                                     |       |         |
| Cash used during the year for:  |       |         |
| Income taxes, net   | \$(2) | \$(1)   |
| Supplemental disclosure of non-cash investing and financing information:              |       |         |
| Issuance of common stock for payment of interest on related-party note payable        | \$101 | \$-     |
| Issuance of common stock for contingent consideration related to business acquisition | \$40  | \$40    |
| Prepaid assets financed through notes payable   | \$124 | \$137   |
| Note payable discount   | \$-   | \$115   |

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



## CREXENDO, INC. AND SUBSIDIARIES

### Notes to 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 is a CLEC cloud services company that provides award winning cloud telecommunications services, broadband Internet services and other cloud business services. Our solutions are designed to provide enterprise-class cloud services available to any size businesses at affordable monthly rates. The Company has two operating segments, which consist of Cloud Telecommunications Services and Web Services.

The Company has transformed into a start-up company with the inherent risks and uncertainties of funding operations until profitability is achieved. After considering the Company’s historical negative cash flow from operating activities as well as a range of internal forecast outcomes, our cash and cash equivalents of \$619,000 at December 31, 2016 does not appear adequate to meet our obligations as they become due within one year following the date the financial statements are issued. Management evaluated the significance of the potential negative cash flows and determined that borrowing availability under an existing Loan Agreement would be sufficient to alleviate concerns about the Company’s ability to continue as a going concern, the Company entered into an amendment to our Loan Agreement with Steven G. Mihaylo, extending the ability of the Board of Directors to request the remaining \$1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018.

Basis of Presentation – The consolidated financial statements include the accounts and operations of Crexendo, Inc. and its wholly owned subsidiaries, which include Crexendo Business Solutions, Inc., StoresOnline Inc., StoresOnline International Canada ULC, Avail 24/7 Inc., 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. 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.

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, 2016 and 2015, we had cash and cash equivalents in financial institutions in excess of federally insured limits in the amount of \$413,000 and \$1,384,000, respectively.

Restricted Cash – We classified \$100,000 and \$112,000 as restricted cash as of December 31, 2016 and 2015, respectively. Cash is restricted for compensating balance requirements on purchasing card agreements. As of December 31, 2016 and 2015, we had restricted cash in financial institutions in excess of federally insured limits in the amount of \$100,000 and \$112,000, respectively.

Trade Receivables – Trade receivables from our cloud telecommunications and web services segments are recorded at invoiced amounts. We have historically offered to our web site development software customers the option to finance, typically through 24 and 36-month extended payment term agreements (“EPTAs”). EPTAs are reflected as short-term and long-term trade receivables, as applicable, as we have the intent and ability to hold the receivables for the foreseeable future, until maturity or payoff. EPTAs are recorded on a nonaccrual cash basis beginning on the contract date.

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.

Inventory – Finished goods telecommunications equipment inventory is stated at the lower of cost or market (first-in, first-out method). In accordance with applicable accounting guidance, we regularly evaluate whether inventory is stated at the lower of cost or market.

Certificate of Deposit - We hold a \$252,000 certificate of deposit as collateral for merchant accounts, which automatically renews every 12 months. The certificate of deposit is classified as long-term in the consolidated balance sheets.



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 five 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. Depreciation expense is included in general and administrative expenses and totaled \$15,000 and \$60,000 for the years ended December 31, 2016 and 2015, respectively. Depreciable lives by asset group are as follows:

|                               |              |
|-------------------------------|--------------|
| Computer and office equipment | 2 to 5 years |
| Computer software             | 3 years      |
| Furniture and fixtures        | 4 years      |
| Leasehold improvements        | 2 to 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 net income or loss for the year.

Goodwill – Goodwill is tested for impairment using a fair-value-based approach on an annual basis (December 31) and between annual tests if indicators of potential impairment exist.

Intangible Assets - Our intangible assets consist primarily of customer relationships and developed technology. The intangible assets are amortized following the patterns in which the economic benefits are consumed. 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.

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, allowances for doubtful accounts, uncertainties related to certain income tax benefits, valuation of deferred income tax assets, valuations of share-based payments and recoverability of long-lived assets. 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.

Revenue Recognition - In general, we recognize revenue when all of the following conditions are satisfied: (1) there is persuasive evidence of an arrangement; (2) the product or service has been provided to the customer; (3) the amount of fees to be paid by the customer is fixed or determinable; and (4) the collection of our fees is probable. We recognize revenue from our Cloud Telecommunications Services and Web Services segments on an accrual basis, with the exception of our extended payment term agreement cash receipts which are recognized on a cash basis. Specifics to revenue category are as follows:

We enter into agreements where revenue is derived from multiple deliverables including any mix of products and/or services. For these arrangements, we determine whether the delivered item(s) has value to the customer on a stand-alone basis, and in the event the arrangement includes a general right of return relative to the delivered item(s), whether the delivery or performance of the undelivered item(s) is considered probable and substantially in our control. If these criteria are met, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative selling price. If these criteria are not met, the arrangement is accounted for as a single unit of accounting which would result in revenue being recognized ratably over the contract term or deferred until the earlier of when such criteria are met or when the last undelivered element is delivered. The amount of product and services revenue recognized for arrangements with multiple deliverables is impacted by the allocation of arrangement consideration to

the deliverables in the arrangement based on the relative selling prices. In determining our selling prices, we apply the selling price hierarchy using vendor specific objective evidence (“VSOE”) when available, third-party evidence of selling price (“TPE”) if VSOE does not exist, and best estimated selling price (“BESP”) if neither VSOE nor TPE is available.

VSOE of fair value for elements of an arrangement is based upon the normal pricing and discounting practices for a deliverable when sold separately. In determining VSOE, we require that a substantial majority of the selling prices fall within a reasonably narrow pricing range, generally evidenced by a substantial majority of such historical stand-alone transactions falling within a reasonably narrow range of the median rate. In addition, we consider major service groups, geographies, customer classifications, and other variables in determining VSOE.

We are typically not able to determine TPE for our products or services. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our offerings contain a significant level of differentiation such that the comparable pricing of products with similar functionality is difficult to obtain. Furthermore, we are unable to reliably determine what similar competitor products’ selling prices are on a stand-alone basis.





When we are unable to establish the selling price using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. We determine BESP for a product or service by considering multiple factors including, but not limited to, cost of products, gross margin objectives, pricing practices, geographies, customer classes and distribution channels.

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.

**Professional Services Revenue** - Fees collected for professional services, including website design and development, search engine optimization services, link-building, paid search management services, and telecom installation services are recognized as revenue, net of expected customer refunds, over the period during which the services are performed, based upon the value for such services.

**Cloud Services Hosting and Web Hosting Revenue** - Fees collected for hosting revenue are recognized ratably as services are provided. Customers are billed for these services on a monthly or annual basis at the customer's option. We recognize revenue ratably over the applicable service period. 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.

**Equipment Sales and Financing Revenue** - Revenue generated from the sale of telecommunications equipment is recognized when the devices are installed and cloud telecommunications services begin.

Fees generated from renting our cloud telecommunication equipment (IP or cloud telephone 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 is recognized ratably over the applicable service period.

**Commission Revenue** - We have affiliate agreements with third-party entities that are resellers of satellite television services and Internet service providers. We receive commissions when the services are bundled with our offerings and we recognize commission revenue when received.

**Cost of Revenue** – Cost of Cloud Telecommunications Service revenue primarily consists of fees we pay to third-party telecommunications and business Internet providers, personnel and travel expenses related to system implementation, customer service, and the costs associated with the purchase of desktop devices and other third party equipment. Cost of Web Services revenue consists primarily of customer service costs and outsourcing fees related to fulfillment of our professional web management services.

**Prepaid Sales Commissions** - For arrangements where we recognize revenue over the relevant contract period, we defer related commission payments to our direct sales force and amortize these amounts over the same period that the related revenues are recognized. This is done to match commissions with the related revenues. Commission payments

are nonrefundable unless amounts due from a customer are determined to be uncollectible or if the customer subsequently changes or terminates the level of service, in which case commissions which were paid are recoverable by us.

**Research and Development** - 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.

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. We have placed a full valuation allowance on net deferred tax assets.

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

We do not intend to indefinitely reinvest the undistributed earnings of our United Kingdom subsidiary, therefore, we have provided for U.S. deferred income taxes on such undistributed foreign earnings. All other foreign subsidiaries are considered disregarded foreign entities for US tax purposes.

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.

Comprehensive Loss – There were no other components of comprehensive loss other than net loss for the years ended December 31, 2016 and 2015.

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 two operating segments, which consist of Cloud Telecommunications Services and Web Services. Research and development expenses are allocated to Cloud Telecommunications Services and Web Services segments based on the level of effort, measured primarily by wages and benefits attributed to our engineering department. Indirect sales and marketing expenses are allocated to the Cloud Telecommunications Services and Web Services segments based on level of effort, measured by month-to-date contract bookings. General and administrative expenses are allocated to both segments based on revenue recognized for each segment. Accounting guidance also establishes standards for related disclosure about products and services, geographic areas and major customers. We generate over 90% of our total revenue from customers within North America (United States and Canada) and less than 10% 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, 2016 and 2015. One Telecommunications Services customer accounted for 11% of total trade accounts receivable as of December 31, 2016, and no customer accounted for 10% or more of our total trade accounts receivable as of December 31, 2015.

Recently Adopted Accounting Pronouncements - In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718), improvement to employee share-based payment accounting. The new standard contains several amendments that will simplify the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The changes in the new standard eliminate the accounting for excess tax benefits to be recognized in additional paid-in capital and tax deficiencies recognized either in the income tax provision or in additional paid-in capital. The Company elected early adoption of ASU 2016-09 in 2016. Due to the Company's valuation allowance on its deferred tax assets, no income tax benefit will be recognized in 2016 as a result of the adoption of ASU 2016-09. There will be no change to retained earnings with respect to excess tax benefits, as this is not applicable to the Company. The treatment of forfeitures has not changed as we are electing to continue our current process of estimating the number of forfeitures. As such, this has no cumulative effect on retained earnings. With the early adoption of 2016-09, we have elected to present the cash flow statement on a prospective transition method and no prior periods have been adjusted.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, which will require entities to present deferred tax assets (DTAs) and deferred tax liabilities (DTLs) as noncurrent in a classified balance sheet. The ASU simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and noncurrent in a classified balance sheet. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016 (and interim periods within those annual periods) and early adoption is permitted. ASU 2015-17 may be either applied prospectively to all deferred tax assets and liabilities or retrospectively to all periods presented. We have elected to early adopt ASU 2015-17 prospectively in the fourth quarter of 2016. As a result, we have presented all deferred tax assets and liabilities as noncurrent on our consolidated balance sheet as of December 31, 2016, but have not reclassified current deferred tax assets and liabilities on our consolidated balance sheet as of December 31, 2015. There was no impact on our results of operations as a result of the adoption of ASU 2015-17.

In September 2015, the FASB issued ASU 2015-16, Business Combinations, which requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period for a business combination in the reporting period in which the adjustment amounts are determined. Prior to the issuance of the standard, entities were required to retrospectively apply adjustments made to provisional amounts recognized in a business combination. We adopted this guidance effective January 1, 2016. The adoption of this guidance did not have an impact on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, Intangibles—Goodwill and Other—Internal-Use Software, which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change U.S. GAAP for a customer's accounting for service contracts. We adopted this guidance effective January 1, 2016. The adoption of this guidance did not have an impact on our consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements – Going Concern, which requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the ASU (1) provides a definition of the term substantial doubt, (2) requires an evaluation every reporting period including interim periods, (3) provides principles for considering the mitigating effect of management's plans, (4) requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (5) requires an express statement and other disclosures when substantial doubt is not alleviated, and (6) requires an assessment for a period of one year after the date that the

financial statements are issued (or available to be issued). We adopted this guidance on December 31, 2016 and management assessed the entity's ability to continue as a going concern. After considering the Company's historical negative cash flow from operating activities as well as a range of internal forecast outcomes, our cash and cash equivalents of \$619,000 at December 31, 2016 does not appear adequate to meet our obligations as they become due within one year following the date the financial statements are issued. Management evaluated the significance of the potential negative cash flows and determined that borrowing availability under an existing Loan Agreement would be sufficient to alleviate concerns about the Company's ability to continue as a going concern, the Company entered into an amendment to our Loan Agreement with Steven G. Mihaylo, extending the ability of the Board of Directors to request the remaining \$1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018. Substantial doubt was alleviated as a result of considerations of management's plans. Certain disclosures were added to comply with the disclosure requirements of the ASU.





Recently Issued Accounting Pronouncements - In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which amends ASC 230, to clarify guidance on the classification of certain cash receipts and payments in the statement of cash flows. The FASB issued ASU 2016-15 with the intent of reducing diversity in practice with respect to eight types of cash flows. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. We are in the process of evaluating the adoption and potential impact of this new ASU on our consolidated financial statements.

In May 2016, the FASB issued ASU 2016-12, Narrow-Scope Improvements and Practical Expedients, makes certain targeted amendments to Topic 606, Revenue from Contracts with Customers:

Assessing collectibility. The amendments add a “substantially all” threshold to the collectibility criterion, and also clarify that the objective of the collectibility assessment is to determine whether the contract is valid and represents a substantive transaction based on whether a customer has the ability and intent to pay for the goods or services that will be transferred to the customer, as opposed to all of the goods or services promised in the contract. The ASU also clarifies how an entity may recognize as revenue consideration received in circumstances where a contract does not meet the criteria required at inception to apply the recognition guidance within the revenue standard.

Presenting sales taxes and other similar taxes collected from customers. The amendments provide an accounting policy election whereby an entity may exclude from the measurement of transaction price all taxes assessed by a taxing authority related to the specific transaction and that are collected from the customer. Such amounts would be presented “net” under this option.

Noncash consideration. The amendments clarify that the fair value of noncash consideration is measured at contract inception, and specify how to account for subsequent changes in the fair value of noncash consideration.

Contract modifications at transition. The amendments provide a new practical expedient whereby an entity electing either the full or modified retrospective method of transition is permitted to reflect the aggregate effect of all prior period modifications (using hindsight) when identifying satisfied and unsatisfied performance obligations, determining the transaction price, and allocating the transaction price to satisfied and unsatisfied obligations.

Completed contracts at transition. The amendments include certain practical expedients in transition related to completed contracts. The amendments also clarify the definition of a completed contract.

Disclosing the accounting change in the period of adoption. ASU 2016-12 provides an exception to the requirement in Topic 250, Accounting Changes and Error Corrections, to disclose the effect on the current period of retrospectively adopting a new accounting standard. As such, the disclosure requirement does not apply to adoption of the new revenue standard with respect to the year of adoption.

The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements of ASU 2014-09 (Topic 606). The Company is currently in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements.

In April 2016, the FASB issued ASU 2016-10, Identifying Performance Obligations and Licensing, more clearly articulates the guidance for assessing whether promises are separately identifiable in the overall context of the contract, which is one of two criteria for determining whether promises are distinct. The ASU also clarifies the factors an entity should consider when assessing whether two or more promises are separately identifiable, and provides additional examples within the implementation guidance for assessing these factors. The ASU further clarifies that an entity is not required to identify promised goods or services that are immaterial in the context of the contract, although customer options to purchase additional goods or services that represent a material right should not be designated as immaterial in the context of the contract. The ASU also provides an accounting policy election whereby an entity may

account for shipping and handling activities as a fulfillment activity rather than as an additional promised service in certain circumstances.

The ASU also clarifies whether a license of intellectual property (IP) represents a right to use the IP (which is satisfied at a point in time) or a right to access the IP (which is satisfied over time) by categorizing the underlying IP as either functional or symbolic. A promise to grant a license that is not a separate performance obligation must be considered in the context above (i.e., functional or symbolic), in order to determine whether the combined performance obligation is satisfied at a point in time or over time, and how to best measure progress toward completion if recognized over time. Regardless of a license's nature (i.e., functional or symbolic), an entity may not recognize revenue from a license of IP before 1) it provides or otherwise makes available a copy of the IP to the customer, and 2) the period during which the customer is able to use and benefit from the license has begun (i.e., the beginning of the license period). Additionally, the ASU clarifies that 1) an entity should not split a sales-based or usage-based royalty into a portion subject to the guidance on sales-based and usage-based royalties and a portion that is not subject to that guidance; and 2) the guidance on sales-based and usage-based royalties applies whenever the predominant item to which the royalty relates is a license of IP. Lastly, the amendments distinguish contractual provisions requiring the transfer of additional rights to use or access IP that the customer does not already control from provisions that are attributes of a license (e.g., restrictions of time, geography, or use). License attributes define the scope of the rights conveyed to the customer; they do not determine when the entity satisfies a performance obligation. The effective date and transition requirements for ASU 2016-10 are the same as the effective date and transition requirements of ASU 2014-09 (Topic 606). The Company is currently in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements.



In February 2016, the FASB issued ASU 2016-02, Leases, in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. The ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. The Company is currently in the process of evaluating the impact of adoption of the ASU on its consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation, which requires that a performance target that affects vesting and could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in ASC 718, Compensation-Stock Compensation, as it relates to such awards. ASU 2014-12 is effective for us in our first quarter of fiscal 2017 with early adoption permitted using either of two methods: (i) prospective to all awards granted or modified after the effective date; or (ii) retrospective to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter, with the cumulative effect of applying ASU 2014-12 as an adjustment to the opening retained earnings balance as of the beginning of the earliest annual period presented in the financial statements. The Company will adopt the ASU effective January 1, 2017. Adoption of this ASU will not impact our consolidated financial statements as there are no performance targets associated with outstanding awards.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract.

In August 2015, the FASB issued ASU 2015-14, which defers the effective date of ASU 2014-09 for all entities by one year. Accordingly, public business entities should apply the guidance in ASU 2014-09 to annual reporting periods (including interim periods within those periods) beginning after December 15, 2017. Early adoption is permitted but not before annual periods beginning after December 15, 2016. The standard permits the use of the retrospective or the modified approach method. We have not yet selected a transition method, and are currently in the process of evaluating the impact of adoption of this ASU on our consolidated financial statements and disclosures.

2.

#### Net Loss Per Common Share

Basic net loss per common share is computed by dividing the net loss for the period by the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is computed giving effect to all dilutive common stock equivalents, consisting of common stock options and warrants. Diluted net loss per common share for the year ended December 31, 2016 and 2015 is the same as basic net loss per common share as the common share equivalents were anti-dilutive due to the net loss. The following table sets forth the computation of basic and diluted net loss per common share:

|                         | Year Ended December 31, |           |
|-------------------------|-------------------------|-----------|
|                         | 2016                    | 2015      |
| Net loss (in thousands) | \$(2,792)               | \$(4,541) |

Weighted-average share reconciliation:

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|   |            |            |
|---|------------|------------|
| Weighted-average shares outstanding       | 13,358,311 | 12,960,625 |
| Weighted-average basic shares outstanding | 13,358,311 | 12,960,625 |
| Diluted shares outstanding                | 13,358,311 | 12,960,625 |
| Net loss per common share:                |            |            |
| Basic                                     | \$(0.21)   | \$(0.35)   |
| Diluted                                   | \$(0.21)   | \$(0.35)   |



Common stock equivalent shares are not included in the computation of diluted loss per share, as the Company has a net loss and the inclusion of such shares would be anti-dilutive due to the net loss. At December 31, 2016 and 2015, the common stock equivalent shares were, as follows:

|  | Year Ended December<br>31, |           |
|--|----------------------------|-----------|
|  | 2016                       | 2015      |
| Shares of common stock issuable under equity incentive plans outstanding | 3,932,114                  | 4,380,698 |
| Shares of common stock issuable upon conversion of warrants              | -                          | 250,000   |
| Common stock equivalent shares excluded from diluted net loss per share  | 3,932,114                  | 4,630,698 |

3.

#### Trade Receivables, net

Our trade receivables balance consists of traditional trade receivables and residual Extended Payment Term Agreements (EPTAs) sold prior to July 2011. Below is an analysis of the days outstanding of our trade receivables as shown on our balance sheet (in thousands):

|                                       | December 31, |       |
|---------------------------------------|--------------|-------|
|                                       | 2016         | 2015  |
| Trade receivables                     | \$366        | \$378 |
| Conforming EPTAs                      | 66           | 94    |
| Non-Conforming EPTAs:                 |              |       |
| 1 - 30 days                           | 4            | 11    |
| 31 - 60 days                          | -            | 4     |
| 61 - 90 days                          | -            | 17    |
| Gross trade receivables               | 436          | 504   |
| Less: allowance for doubtful accounts | (47)         | (59)  |
| Trade receivables, net                | \$389        | \$445 |
| Current trade receivables, net        | \$346        | \$364 |
| Long-term trade receivables, net      | 43           | 81    |
| Trade receivables, net                | \$389        | \$445 |

All current and long-term EPTAs in the table above had original contract terms of greater than one year. The Company wrote off \$37,000 and \$66,000 of EPTAs during the years ended December 31, 2016 and 2015, respectively, of which, all had original contract terms of greater than one year.

4.

#### Equipment Financing Receivables

We rent certain cloud telecommunication equipment (IP desktop devices) through leasing contracts that we classify as either operating leases or sale-type leases. Equipment finance receivables are expected to be collected over the next



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

|   | December 31, |         |
|---|--------------|---------|
|   | 2016         | 2015    |
| Gross financing receivables                       | \$573        | \$1,030 |
| Less unearned income                              | (276)        | (580)   |
| Financing receivables, net                        | 297          | 450     |
| Less: Current portion of finance receivables, net | (121)        | (131)   |
| Finance receivables due after one year            | \$176        | \$319   |

5.

Prepaid Expenses

Prepaid expenses consisted of the following (in thousands):

41



December 31,

|                               | 2016  | 2015    |
|-------------------------------|-------|---------|
| Prepaid rent                  | \$54  | \$376   |
| Prepaid commissions           | 503   | 456     |
| Prepaid software support      | 42    | 181     |
| Prepaid software subscription | 16    | 103     |
| Prepaid inventory deposits    | 156   | -       |
| Other prepaid expenses        | 166   | 218     |
| Total prepaid assets          | \$937 | \$1,334 |

Included in the totals above is \$251,000 of long-term prepaid commissions as of December 31, 2016 and \$234,000 of long-term prepaid commissions and \$54,000 of long-term prepaid rent as of December 31, 2015.

6.

## Property and Equipment

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

December 31,

|  | 2016    | 2015    |
|--|---------|---------|
| Software                                       | \$681   | \$681   |
| Computers and office equipment                 | 1,685   | 1,685   |
| Leasehold improvements                         | 27      | 27      |
| Less accumulated depreciation and amortization | (2,375) | (2,360) |
| Total property and equipment, net              | \$18    | \$33    |

Depreciation and amortization expense is included in general and administrative expenses and totaled \$15,000 and \$60,000 for the years ended December 31, 2016 and 2015, respectively.

7.

## Intangible Assets

The net carrying amount of intangible assets is as follows (in thousands):

December 31,

|                               | 2016   | 2015   |
|-------------------------------|--------|--------|
| Customer relationships        | \$941  | \$941  |
| Technical know-how            | 60     | 60     |
| Non-compete                   | 60     | 60     |
| Developed technology          | 198    | 198    |
| Less accumulated amortization |        |        |
| Customer relationships        | ( 607) | ( 482) |
| Technical know-how            | ( 60)  | ( 60)  |

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|                      |        |        |
|----------------------|--------|--------|
| Non-compete          | ( 60)  | ( 60)  |
| Developed technology | ( 197) | ( 191) |
| Total                | \$335  | \$466  |

Amortization expense is included in general and administrative expenses and totaled \$131,000 and \$210,000 for the years ended December 31, 2016 and 2015, respectively.

The following table outlines the estimated future amortization expense related to intangible assets held at December 31, 2016 (in thousands):



Year ending December 31,

|            |       |
|------------|-------|
| 2017       | \$97  |
| 2018       | 72    |
| 2019       | 53    |
| 2020       | 39    |
| 2021       | 29    |
| Thereafter | 45    |
| Total      | \$335 |

8.

#### Goodwill

The Company has recorded goodwill as a result of its 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 the Company's acquisitions, the objective of the acquisition was to expand the Company's product offerings and customer base and to achieve synergies related to cross selling opportunities, all of which contributed to the recognition of goodwill

The Company tests goodwill for impairment on an annual basis or more frequently if events or changes in circumstances indicate that goodwill might be impaired. The changes in the carrying amount of goodwill for the years ended December 31, 2016 and 2015 were as follows:

#### Acquisition Related Goodwill

|                              |       |
|------------------------------|-------|
| Balance at January 1, 2015   | \$272 |
| Increase (decrease)          | -     |
| Balance at December 31, 2015 | 272   |
| Increase (decrease)          | -     |
| Balance at December 31, 2016 | \$272 |

9.

#### Accrued Expenses

Accrued expenses consisted of the following (in thousands):

|  | December 31, |       |
|--|--------------|-------|
|  | 2016         | 2015  |
| Accrued salaries and benefits              | \$369        | \$298 |
| Accrued accounts payable                   | 230          | 153   |
| Accrued sales and telecommunications taxes | 310          | 223   |
| Other                                      | 88           | 138   |
| Total accrued expenses                     | \$997        | \$812 |

10.

#### Notes Payable

#### Related Party Note Payable

On December 30, 2015, Crexendo, Inc. (the "Company") entered into a Term Loan Agreement (the "Loan Agreement"), with Steven G. Mihaylo, as Trustee of The Steven G. Mihaylo Trust dated August 19, 1999 (the "Lender"). Mr. Mihaylo is the principal shareholder and Chief Executive Officer of the Company. Pursuant to the Loan Agreement, the Lender has agreed to make an unsecured loan to the Company in the initial principal amount of \$1,000,000 (the "Loan"). The Loan Agreement contains a provision which requires the Lender to increase the amount of the Loan by up to an additional \$1,000,000 on the same terms and conditions as the initial advance if the independent directors of the Company, in their reasonable discretion, determine such an increase is necessary for the funding needs of the Company and that the terms of the Loan are in the best interests of the Company and its stockholders. The term of the Loan is five years, with simple interest paid at 9% per annum until a balloon payment is due December 30, 2020. The Loan Agreement provides for interest to be paid in shares of common stock of the Company (the "Common Stock") at a stock price of \$1.20 (which is the average of the high and low adjust close price of the Common Stock of the Company for each business day for the period starting December 23, 2015 and ending December 29, 2015.). For the first two years of the Loan term, interest will be paid in advance at the beginning of each year; for the last three years of the Loan term, interest will be paid at the end of each year. After the second year of the Loan term, there is no pre-payment penalty for early repayment of the outstanding principal amount of the Loan. If the Loan is repaid within the first two years of the Loan term, the Company will forfeit prepaid interest as a pre-payment penalty.





Contemporaneously with the execution of the Loan Agreement, the Company granted to the Lender a warrant to purchase 250,000 shares of Common Stock (the "Warrant"). The Warrant has a five-year term from the date of the Loan Agreement. The Warrant is exercisable by the Lender, at any time, and from time to time, during its term at a price of \$1.20 per share of Common Stock. The initial 250,000 warrants were exercised during 2016 generating proceeds of \$300,000. In the event the principal amount of the Loan is increased by an additional \$1,000,000, as determined by the independent directors of the Company, the Company has agreed to issue to the Lender a warrant to purchase an additional 250,000 shares of Common Stock on the same terms and subject to the same conditions set forth in the Warrant.

On June 28, 2016, the Company entered into an Amendment to the Loan Agreement, extending the period which the Company can increase the loan up to an additional \$1,000,000 to May 30, 2017. All other terms remain the same as initial loan agreement. Subsequent to December 31, 2016, the Company entered into a second amendment to our Loan Agreement with Steven G. Mihaylo. The amendment extends the ability of the Board of Directors to request the remaining \$1.0 million available under the Loan Agreement if necessary to fund operations through May 30, 2018. All other terms remain the same as initial Loan Agreement.

#### Other notes payable

Other notes payable consists of short and long-term financing arrangements for software licenses, subscriptions, support and corporate insurance.

The Company's outstanding balances under its note payable agreements as of December 31, 2016 and 2015 were as follows (in thousands):

|  | Year Ended<br>December 31, |         |
|--|----------------------------|---------|
|  | 2016                       | 2015    |
| Related party note payable                       | \$1,000                    | \$1,000 |
| Other notes payable                              | 124                        | 137     |
|  | 1,124                      | 1,137   |
| Less: notes payable discount                     | (92)                       | (115)   |
| Net carrying value of notes payable              | 1,032                      | 1,022   |
| Less: current portion of long-term notes payable | (66)                       | (57)    |
| Long-term notes payable                          | \$966                      | \$965   |

As of December 31, 2016, future principal payments are scheduled as follows (in thousands):

#### Year ending December 31,

|      |       |
|------|-------|
| 2017 | \$66  |
| 2018 | 52    |
| 2019 | 6     |
| 2020 | 1,000 |

Total \$1,124

11.

Fair Value Measurements

We have financial instruments as of December 31, 2016 and 2015 for which the fair value is summarized below (in thousands):

44



|   | December 31, 2016 |                      | December 31, 2015 |                      |
|---|-------------------|----------------------|-------------------|----------------------|
|   | Carrying Value    | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| Assets:   |                   |                      |                   |                      |
| Trade receivables, net                              | \$389             | \$389                | \$445             | \$445                |
| Equipment financing receivables                     | 297               | 297                  | 450               | 450                  |
| Certificate of deposit                              | 252               | 252                  | 251               | 251                  |
| Liabilities:  |                   |                      |                   |                      |
| Acquisition related contingent consideration        | -                 | -                    | 99                | 99                   |
| Notes payable including discount from warrant grant | 1,032             | 1,133                | 1,022             | 1,146                |

Assets and liabilities for which fair value is recognized in the balance sheet on a recurring basis are summarized below as of December 31, 2016 and 2015 (in thousands):

Fair value measurement at reporting date

| Description | As of December 31, 2016 | Level 1 | Level 2 | Level 3 |
|-------------|-------------------------|---------|---------|---------|
|-------------|-------------------------|---------|---------|---------|

Assets:

|                        |       |     |       |     |
|------------------------|-------|-----|-------|-----|
| Certificate of deposit | \$252 | \$- | \$252 | \$- |
|------------------------|-------|-----|-------|-----|

| Description | As of December 31, 2015 | Level 1 | Level 2 | Level 3 |
|-------------|-------------------------|---------|---------|---------|
|-------------|-------------------------|---------|---------|---------|

Assets:

|                        |       |     |       |     |
|------------------------|-------|-----|-------|-----|
| Certificate of deposit | \$251 | \$- | \$251 | \$- |
|------------------------|-------|-----|-------|-----|

Liabilities:

|  |    |   |   |    |
|--|----|---|---|----|
| Acquisition related contingent consideration | 99 | - | - | 99 |
|--|----|---|---|----|

The carrying amount of certificates of deposit approximates fair value, as determined by certificates of deposit with similar terms and conditions.

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The recurring Level 3 measurement of our contingent consideration liability includes the following significant unobservable inputs at December 31, 2015 (in thousands):

| Contingent consideration liability | Fair Value at December 31, 2015 | Valuation technique  | Unobservable inputs              | Range |
|------------------------------------|---------------------------------|----------------------|----------------------------------|-------|
| Revenue - based payments           | \$99                            | Discounted cash flow | Discount Rate                    | 12.5% |
|                                    |                                 |                      | Probability of milestone payment | 100%  |
|                                    |                                 |                      | Projected year of payments       | 2016  |

Level 3 instruments are valued based on unobservable inputs that are supported by little or no market activity and reflect the Company's own assumptions in measuring fair value. Future changes in fair value of the contingent financial milestone consideration, as a result of changes in significant inputs such as the discount rate and estimated probabilities of financial milestone achievements, could have a material effect on the statement of operations and balance sheet in the period of the change.

The progression of the Company's Level 3 instruments fair valued on a recurring basis for the year ended December 31, 2016 and 2015 are shown in the table below (in thousands):



## Acquisition Related Contingent Consideration

|  |       |
|--|-------|
| Balance at January 1, 2015                             | \$211 |
| Change in fair value                                   | (11)  |
| Cash payments  | (61)  |
| Issuance of common stock from contingent consideration | (40)  |
| Balance at December 31, 2015                           | 99    |
| Cash payments  | (59)  |
| Issuance of common stock from contingent consideration | (40)  |
| Balance at December 31, 2016                           | \$-   |

12.

## Equity

## Common Stock

Shares of common stock reserved for future issuance as of December 31, 2016 were as follows:

## Stock-based compensation plans:

|                             |           |
|-----------------------------|-----------|
| Outstanding option awards   | 3,932,114 |
| Available for future grants | 2,326,295 |
|                             | 6,258,409 |

## Warrants

On December 30, 2015, the Company entered into a term loan agreement with a major shareholder and CEO of the Company, whereby the lender has agreed to make an unsecured loan to the Company in the initial principal amount of \$1,000,000. The Loan Agreement contains a provision which requires the lender to increase the amount of the loan by up to an additional \$1,000,000 on the same terms and conditions as the initial advance if the independent directors of the Company, in their reasonable discretion, determine such an increase is necessary for the funding needs of the Company and that the terms of the loan are in the best interests of the Company and its stockholders. In connection with the term loan agreement, the Company granted to the lender a warrant to purchase 250,000 shares of Common Stock. The warrant has a five-year term from the date of the loan agreement. The warrant is exercisable by the lender, at any time, and from time to time, during its term at a price of \$1.20 per share of Common Stock. In the event the principal amount of the loan is increased by an additional \$1,000,000, as determined by the independent directors of the Company, the Company has agreed to issue to the lender a warrant to purchase an additional 250,000 shares of Common Stock on the same terms and subject to the same conditions set forth in the warrant. The warrants are legally detachable and separately exercisable. The proceeds from the term loan agreement were allocated to note payable and the warrants based on the relative fair value of the instruments. Fair value of the warrants was calculated using the Black-Scholes option-pricing model with the following assumptions:

|                          |       |
|--------------------------|-------|
| Expected volatility      | 62%   |
| Expected life (in years) | 4.27  |
| Risk-free interest rate  | 1.80% |
| Expected dividend yield  | 0.00% |

During the years ended December 31, 2016 and 2015, the Company exercised its right to require the purchaser to exercise 250,000 and 500,000 warrants, respectively. The exercise generated an additional \$300,000 and \$690,000 in cash provided by financing activities, respectively.







13.

## Stock-Based Compensation

We have various incentive stock-based compensation plans that provide for the grant of stock options, restricted stock, and other share-based awards of up to 6,258,409 shares to eligible employees, consultants, and directors. As of December 31, 2016, we had 2,326,295 shares remaining in the plans available to grant.

The following table summarizes the statement of operations effect of stock-based compensation for the years ended December 31, 2016 and 2015 (in thousands):

|  | Year Ended<br>December 31, |         |
|--|----------------------------|---------|
|  | 2016                       | 2015    |
| Share based compensation expense by financial statement line item: |                            |         |
| Cost of revenue  | \$102                      | \$80    |
| Research and development   | 119                        | 166     |
| Selling and marketing  | 90                         | 115     |
| General and administrative   | 342                        | 945     |
| Total cost related to share-based compensation expense             | \$653                      | \$1,306 |

There was no cost allocated to share-based compensation expense related to warrants issued during the year ended December 31, 2016 and 2015, respectively (Note 12).

There is no tax benefit related to stock compensation expense due to a full valuation allowance on net deferred tax assets at December 31, 2016 and 2015, respectively.

## 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, 2016 and 2015 using the Black-Scholes option-pricing model were as follows:

|   | Year Ended<br>December 31, |        |
|---|----------------------------|--------|
|   | 2016                       | 2015   |
| Weighted-average fair value of options and warrants granted | \$0.61                     | \$0.69 |
| Expected volatility   | 63%                        | 58%    |
| Expected life (in years)                                    | 4.30                       | 4.30   |
| Risk-free interest rate                                     | 1.52%                      | 1.68%  |
| 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. The Company has not declared any dividends, therefore, it is assumed to be zero.





The following table summarizes the stock option activity for all plans for the years ended December 31, 2016 and 2015:

|                                     | Number of | Weighted-Average | Weighted-Average | Aggregate       |
|-------------------------------------|-----------|------------------|------------------|-----------------|
|                                     | Shares    | Exercise Price   | Remaining        | Intrinsic Value |
|                                     |           |                  | Contract Life    | (in thousands)  |
| Outstanding at January 1, 2015      | 2,147,561 | \$3.78           | 6.9 years        | \$-             |
| Granted                             | 2,578,000 | 1.50             |                  |                 |
| Exercised                           | (26,865)  | 1.85             |                  |                 |
| Cancelled/forfeited                 | (317,998) | 2.16             |                  |                 |
| Outstanding at December 31, 2015    | 4,380,698 | 2.56             | 6.2 years        | -               |
| Granted                             | 78,500    | 1.21             |                  |                 |
| Exercised                           | (8,310)   | 1.11             |                  |                 |
| Cancelled/forfeited                 | (518,774) | 2.20             |                  |                 |
| Outstanding at December 31, 2016    | 3,932,114 | 2.59             | 5.2 years        | 400             |
| Shares vested and expected to vest  | 3,759,703 | 2.59             | 5.2 years        | 369             |
| Exercisable as of December 31, 2016 | 3,181,892 | 2.84             | 5.1 years        | 268             |
| Exercisable as of December 31, 2015 | 2,716,262 | 3.04             | 6.1 years        | -               |

The total intrinsic value of options exercised during the years ended December 31, 2016 and 2015, was \$2,000 and \$8,000 respectively.

As of December 31, 2016, the total future compensation expense related to non-vested options not yet recognized in the consolidated statements of operations was approximately \$511,000 and the weighted-average period over which these awards are expected to be recognized is approximately 1.5 years.

14.

#### Income Taxes

The income tax expense/(benefit) consisted of the following for the years ended December 31, 2016 and 2015 (in thousands):

|  | Year Ended<br>December 31, |      |
|--|----------------------------|------|
|  | 2016                       | 2015 |

Current income tax expense/(benefit):

|                                      |      |        |
|--------------------------------------|------|--------|
| Federal                              | \$-  | \$-    |
| State and local                      | 12   | (12)   |
| Foreign                              | -    | -      |
| Current income tax expense/(benefit) | \$12 | \$(12) |

There was no deferred income tax expense (benefit) for the years ended December 31, 2016 and 2015.

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The income tax provision attributable to loss before income tax benefit for the years ended December 31, 2016 and 2015 differed from the amounts computed by applying the U.S. federal statutory tax rate of 34.0% as a result of the following (in thousands):

|  | Year Ended<br>December 31, |           |
|--|----------------------------|-----------|
|  | 2016                       | 2015      |
| U.S. federal statutory income tax benefit                            | \$(945)                    | \$(1,548) |
| Increase in income tax benefit resulting from:                       |                            |           |
| State and local income tax expense/(benefit), net of federal effect  | ( 879)                     | 213       |
| Change in the valuation allowance for net deferred income tax assets | 1,723                      | 1,212     |
| Other, net   | 113                        | 111       |
| Income tax expense/(benefit)   | \$12                       | \$(12)    |



As of December 31, 2016 and 2015, significant components of net deferred income tax assets and liabilities were as follows (in thousands):

|  | As of December 31,<br>2016 |             | As of December 31,<br>2015 |             |
|--|----------------------------|-------------|----------------------------|-------------|
|  | Current                    | Non-current | Current                    | Non-current |
| Deferred income tax assets:                  |                            |             |                            |             |
| Accrued expenses                             | \$-                        | \$99        | \$168                      | \$-         |
| Deferred revenue                             | -                          | 324         | 326                        | -           |
| Net operating loss carry-forwards            | -                          | 9,643       | -                          | 8,024       |
| Foreign tax credits                          | -                          | 892         | -                          | 892         |
| Stock-based compensation                     | -                          | 3,402       | -                          | 3,277       |
| Property and equipment                       | -                          | 13          | -                          | 58          |
| Other  | -                          | 788         | -                          | 833         |
| Subtotal                                     | -                          | 15,161      | 494                        | 13,084      |
| Valuation allowance                          | -                          | (14,810)    | (485)                      | (12,602)    |
| Total deferred income tax assets             | -                          | 351         | 9                          | 482         |
| Deferred income tax liabilities:             |                            |             |                            |             |
| Property and equipment                       | -                          | -           | -                          | -           |
| Prepaid expenses and other                   | -                          | (351)       | (491)                      | -           |
| Total deferred income tax liabilities        | -                          | (351)       | (491)                      | -           |
| Net deferred income tax assets (liabilities) | \$-                        | \$-         | \$(482)                    | \$482       |

During the fiscal year ended June 30, 2002 (our fiscal year was subsequently changed to December 31), we experienced a change in ownership, as defined by the Internal Revenue Code, as amended (the "Code") under Section 382. A change of ownership occurs when ownership of a company increases by more than 50 percentage points over a three-year testing period of certain stockholders. As a result of this ownership change we determined that our annual limitation on the utilization of our federal net operating loss ("NOL") carry-forwards is approximately \$461,000 per year. We will only be able to utilize \$5,761,000 of our pre-ownership change NOL carry-forwards and will forgo utilizing \$14,871,000 of our pre-ownership change NOL carry-forwards as a result of this ownership change. We do not account for forgone NOL carryovers in our deferred tax assets and only account for the NOL carry-forwards that will not expire unutilized as a result of the restrictions of Code Section 382.

As of December 31, 2016, we had NOL, research and development, and foreign tax credit carry-forwards for U.S. federal income tax reporting purposes of approximately \$24,325,000, \$129,000 and \$892,000 respectively. The NOLs will begin to expire in 2020 through 2036, the research and development credits will begin to expire in 2019 through 2020, and the foreign tax credits will expire in 2017, if not utilized.

We also have state NOL and research and development credit carry-forwards of approximately \$18,991,000 and \$61,000 which expire on specified dates as set forth in the rules of the various states to which the carry-forwards relate.



We also have foreign NOL carry-forwards of approximately \$710,000 which expire on specified dates as set forth in the rules of the various countries in which the carry-forwards relate.

In assessing the recovery of the deferred tax assets, we considered whether it is more likely than not that some portion or all of our deferred tax assets will not be realized. 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 considered the scheduled reversals of future deferred tax liabilities, projected future taxable income, the suspension of the sale of product and services through the direct mail seminar sales channel for our Web Services segment, from telecommunications services segment, and tax planning strategies in making this assessment. As a result, we determined it was more likely than not that the deferred tax assets would not be realized as of December 31, 2016 and 2015; accordingly, we recorded a full valuation allowance. The valuation allowance for deferred tax assets as of December 31, 2016 and 2015 was \$14,810,000 and \$13,087,000 respectively.



The net change in our valuation allowance was an increase of \$1,723,000 for the year ended December 31, 2016 and an increase of \$1,212,000 for the year ended December 31, 2015.

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, 2016 and 2015 were as follows (in thousands):

|   |       |
|---|-------|
| Balance as of January 1, 2015                   | \$891 |
| Reductions due to lapsed statute of limitations | -     |
| Balance as of December 31, 2015                 | 891   |
| Reductions due to lapsed statute of limitations | -     |
| Balance as of December 31, 2016                 | \$891 |

As of December 31, 2016, we had unrecognized tax benefits of \$891,000, which if recognized, none would reduce our effective tax rate.

Estimated interest and penalties related to the underpayment or late payment of income taxes are classified as a component of income tax provision (benefit) in the consolidated statements of operations. There were no accrued interest and penalties as of December 31, 2016 and 2015, respectively.

Our U.S. federal income tax returns for fiscal 2013 through 2016 are open tax years. The IRS recently completed an audit of fiscal years 2005 through 2007. We also file in various state and foreign jurisdictions. With few exceptions, we are no longer subject to state and non-U.S. income tax examinations by tax authorities for years prior to fiscal 2012.

## 15. Commitments and Contingencies

### Operating Leases

We lease certain of our corporate offices under a non-cancelable operating lease agreement expiring in 2018. The operating lease for our Reno, NV office contains customary escalation clauses. Future aggregate minimum lease obligations under the operating lease as of December 31, 2016, exclusive of taxes and insurance, are as follows (in thousands):

Years ending December 31,

|       |      |
|-------|------|
| 2017  | 20   |
| 2018  | 15   |
| Total | \$35 |

Rental expense for the year ended December 31, 2016 and 2015 was approximately \$103,000 and \$120,000, respectively.

### Sale-Leaseback

On February 28, 2014, the Company sold and leased back the land, building and furniture associated with the corporate headquarters in Tempe, Arizona to a Company that is owned by the major shareholder and CEO of the Company for \$2.0 million in cash. The Company recognized a deferred gain of \$281,000 on sale-leaseback, which

will be amortized over the initial lease term of 36 months to offset rent expense. The net deferred gain is included in other long-term liabilities in the consolidated balance sheets as of December 31, 2016 and 2015.

The lease agreement called for rent payments for the initial three year term to be made in advance in the form of 300,000 shares of common stock of Crexendo, Inc. The fair value price per share at the time of the lease was \$3.22 per share, resulting in rent expense of \$322,000 per year for three years. At December 31, 2016 and 2015, prepaids included prepaid rent of \$54,000 and \$376,000, respectively. Rent expense incurred on the sale-leaseback, net of \$265,000 deferred gain amortization, during the years ended December 31, 2016 and 2015 was \$322,000 and \$322,000, respectively.



#### 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.

We are also subject to various claims and legal proceedings covering matters that arise in the ordinary course of business. We believe that the resolution of these other cases will not have a material adverse effect on our business, financial position, or results of operations.

We have recorded liabilities of approximately \$0 and \$0 as of December 31, 2016 and 2015, respectively, for estimated losses resulting from various legal proceedings in which we are engaged. Attorney's fees associated with the various legal proceedings are expensed as incurred. We are also subject to various claims and legal proceedings covering matters that arise in the ordinary course of business. We believe that the resolution of these other cases will not have a material adverse effect on our business, financial position, or results of operations.

16.

#### 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 year ended December 31, 2016 and 2015, we contributed approximately \$119,000 and \$133,000 to the retirement savings plan, respectively.

17.

#### Segments

Management has chosen to organize the Company around differences based on its products and services. Cloud Telecommunications Services segment generates revenue from selling cloud telecommunication services and broadband Internet services. Web Services segment generates revenue from website hosting and search engine optimization/management. The Company has two operating segments, which consist of Cloud Telecommunications Services and Web Services. Segment revenue and income (loss) before income tax provision was as follows (in thousands):



December 31,

2016      2015

## Revenue:

|                                   |         |         |
|-----------------------------------|---------|---------|
| Cloud telecommunications services | \$7,757 | \$5,989 |
| Web services                      | 1,362   | 1,834   |
| Consolidated revenue              | 9,119   | 7,823   |

## Income/(loss) from operations:

|                                   |         |         |
|-----------------------------------|---------|---------|
| Cloud telecommunications services | (3,174) | (4,904) |
| Web services                      | 411     | 65      |
| Total operating loss              | (2,763) | (4,839) |

## Other income/(expense), net:

|                                   |      |     |
|-----------------------------------|------|-----|
| Cloud telecommunications services | (36) | 71  |
| Web services                      | 19   | 215 |
| Total other income/(expense), net | (17) | 286 |

## Income/(loss) before income tax provision

|                                   |           |           |
|-----------------------------------|-----------|-----------|
| Cloud telecommunications services | (3,210)   | (4,833)   |
| Web services                      | 430       | 280       |
| Loss before income tax provision  | \$(2,780) | \$(4,553) |

Depreciation and amortization was \$126,000 and \$210,000 for the Cloud Telecommunications Services segment for the years ended December 31, 2016 and 2015, respectively. Depreciation and amortization was \$20,000 and \$60,000 for the Web Services segment for the years ended December 31, 2016 and 2015, respectively.

Interest income was \$15,000 and \$24,000 for the Web Services segment for the years ended December 31, 2016 and 2015, respectively.

Interest expense was \$120,000 and \$16,000 for the Cloud Telecommunications Services segment for the years ended December 31, 2016 and 2015, respectively. Interest expense was \$18,000 and \$12,000 for the Web Services segment for the years ended December 31, 2016 and 2015, respectively.





18.

## Quarterly Financial Information (in thousands, unaudited)

## Year ended December 31, 2016

## For the three months ended

| Consolidated                          | March 31, | June 30, | September 30, | December 31, |
|---------------------------------------|-----------|----------|---------------|--------------|
|                                       | 2016      | 2016     | 2016          | 2016         |
| Revenue                               | \$2,174   | \$2,267  | \$2,333       | \$2,345      |
| Operating expenses:                   |           |          |               |              |
| Cost of revenue                       | 913       | 917      | 932           | 863          |
| Selling and marketing                 | 610       | 636      | 681           | 604          |
| General and administrative            | 1,291     | 1,274    | 1,140         | 1,195        |
| Research and development              | 229       | 216      | 189           | 192          |
| Total operating expenses              | 3,043     | 3,043    | 2,942         | 2,854        |
| Loss from operations                  | (869)     | (776)    | (609)         | (509)        |
| Total other income/(expense), net     | 4         | 2        | (8)           | (15)         |
| Loss before income taxes              | (865)     | (774)    | (617)         | (524)        |
| Income tax provision                  | (3)       | (4)      | (4)           | (1)          |
| Net loss                              | \$(868)   | \$(778)  | \$(621)       | \$(525)      |
| Basic net loss per common share (1)   | \$(0.07)  | \$(0.06) | \$(0.05)      | \$(0.04)     |
| Diluted net loss per common share (1) | \$(0.07)  | \$(0.06) | \$(0.05)      | \$(0.04)     |

## Year ended December 31, 2015

## For the three months ended

| Consolidated               | March 31, | June 30, | September 30, | December 31, |
|----------------------------|-----------|----------|---------------|--------------|
|                            | 2015      | 2015     | 2015          | 2015         |
| Revenue                    | \$1,852   | \$1,890  | \$1,972       | \$2,109      |
| Operating expenses:        |           |          |               |              |
| Cost of revenue            | 861       | 855      | 882           | 979          |
| Selling and marketing      | 603       | 580      | 624           | 637          |
| General and administrative | 1,560     | 1,375    | 1,309         | 1,618        |
| Research and development   | 203       | 165      | 209           | 202          |
| Total operating expenses   | 3,227     | 2,975    | 3,024         | 3,436        |

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|                                       |           |           |           |           |
|---------------------------------------|-----------|-----------|-----------|-----------|
| Loss from operations                  | (1,375)   | (1,085)   | (1,052)   | (1,327)   |
| Total other income, net               | 215       | 33        | 19        | 19        |
| Loss before income taxes              | (1,160)   | (1,052)   | (1,033)   | (1,308)   |
| Income tax benefit/(provision)        | (10)      | (8)       | (10)      | 40        |
| Net loss                              | \$(1,170) | \$(1,060) | \$(1,043) | \$(1,268) |
| Basic net loss per common share (1)   | \$(0.09)  | \$(0.08)  | \$(0.08)  | \$(0.10)  |
| Diluted net loss per common share (1) | \$(0.09)  | \$(0.08)  | \$(0.08)  | \$(0.10)  |

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



CREXENDO, INC. AND SUBSIDIARIES  
 Schedule II- Valuation and Qualifying Accounts  
 Year Ended December 31, 2016 and 2015

|   | Balance at     |           | Balance at |        |
|---|----------------|-----------|------------|--------|
|   | Beginning      |           | End of     |        |
|   | of Year        | Additions | Deductions | Year   |
|   | (in thousands) |           |            |        |
| Year ended December 31, 2016                  |                |           |            |        |
| Allowance for doubtful accounts receivable    | \$59           | \$-       | \$(12)     | \$47   |
| Deferred income tax asset valuation allowance | 13,087         | 1,723     | -          | 14,810 |
| Year ended December 31, 2015                  |                |           |            |        |
| Allowance for doubtful accounts receivable    | \$68           | \$-       | \$(9)      | \$59   |
| Deferred income tax asset valuation allowance | 11,875         | 1,212     | -          | 13,087 |



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, 2016 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, 2016 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, 2016.

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

DIRECTORS

Set forth in the table below are the names, ages and positions of each person on our Board:







| Name              | Age | Position                                       |
|-------------------|-----|--|
| Steven G. Mihaylo | 73  | Chairman of the Board, Chief Executive Officer |
| Jeffrey P. Bash   | 75  | Director                                       |
| Anil Puri         | 68  | Director                                       |
| David Williams    | 62  | Director                                       |
| Todd Goergen      | 44  | Director                                       |

#### Steven G. Mihaylo

Mr. Mihaylo was appointed our Chief Executive Officer in 2008 and Chairman of the Board in November 2010. Mr. Mihaylo is the former Chairman and Chief Executive Officer of Inter-Tel, Incorporated (“Inter-Tel”), which he founded in 1969 and where he continued to serve until 2007. Mr. Mihaylo led the development of Inter-Tel from providing business telephone systems to offering complete managed services and software that help businesses facilitate communication and increase customer service and productivity. Before selling Inter-Tel to Francisco Partners, a private equity firm, for approximately \$720 million in 2007, Mr. Mihaylo grew the business to nearly \$500 million in annual sales. The Board nominated Mr. Mihaylo to the Board in part because he is the Chief Executive Officer of the Company and has more than 40 years of experience in the industry in which the Company competes. Mr. Mihaylo is the only officer of the Company nominated to serve as a director, and he plays a critical role in communicating the Board’s expectations, concerns, and encouragement to the Company’s employees. Mr. Mihaylo performs an extremely valuable role as the Chairman of the Board and is a tremendous asset to the Company.

Mr. Mihaylo was awarded an honorary PhD from California State University - Fullerton and received a bachelor of arts in business administration in accounting & finance from California State University, Fullerton in 1969. The College of Business and Economics at California State University, Fullerton was renamed the Steven G. Mihaylo College of Business and Economics in 2008. Mr. Mihaylo has served on boards of numerous community organizations including the Arizona Heart Foundation, Junior Achievement of Arizona, Arizona Museum of Science and Technology and the Arizona State University College of Business Dean’s Council of 100. Committed to education, Mr. Mihaylo is involved with the Karl Eller College of Management at the University of Arizona and has served on the advisory board of Junior Achievement of Central Arizona for over 25 years, as a member of the board of directors of the Big Bear High School Education Foundation and on the Dean’s Advisory Board of California State University, Fullerton.

#### David Williams

Mr. Williams has been a director of the company since May 2008. Since 2008, Mr. Williams has served as the Chairman and Chief Executive Officer at Equity Capital Management Corp, which provides asset management, tax consulting and financing for real estate investors. From 1996 to 2008, Mr. Williams acted as an independent consultant in taxation, real estate transactions and venture capital. Mr. Williams served as Chief Financial Officer and tax counsel at Wilshire Equities Corp., from 1987 to 1990 and as President from 1990 to 1996. From 1980 to 1987, Mr. Williams rose from a junior staff member to director position at Arthur Young & Co., a public accounting firm. The Board recognizes Mr. Williams' business, finance and tax experience and values his contributions to Board discussions and to the Company. Mr. Williams is a certified public accountant in California, Nevada and Washington, and holds a juris doctorate degree in law and taxation from the McGeorge Law School at University of the Pacific. Mr. Williams graduated from Stanford University with a Masters of Science degree in engineering finance and a Bachelor of science degree in biological science with honors.

#### Todd Goergen

Mr. Goergen has been a director of the company since November 2006 and served as Chairman of the Board from August 2007 to November 2010. Mr. Goergen has served as Managing Member of Ropart Asset Management, LLC (“RAM”) since 2001. RAM makes direct investments in small to mid-size companies. In addition, Mr. Goergen is a Managing Member of Ropart Investments, LLC, a private investment partnership. Between 1999 and 2000, Mr.

Goergen was the Director of Acquisitions and Corporate Development at Blyth, Inc., a designer and direct marketer of home decorative and fragrance products. From 1994 to 1999, Mr. Goergen was an Associate/Analyst in the Mergers and Acquisitions Group of Donaldson, Lufkin & Jenrette, an investment banking firm. The Board recognizes the breadth and depth of Mr. Goergen's considerable business and investment experience. The Board values Mr. Goergen's prior contributions as Chairman of the Board and the insights and skills he brings to Board discussions. Mr. Goergen received his degree in economics and political science in 1994 from Wake Forest University. Mr. Goergen is the Chairman of Digital Traffic Systems, Inc., a business consulting firm, and Chairman of the Board of Visalus Holdings, LLC, a producer and marketer of weight management and nutritional supplements.



Jeffrey P. Bash

Mr. Bash has been a long-time investor in Crexendo and has extensive investing and corporate finance experience. Bash is a Vice President of private, family-owned Richmond Corporation of Dallas, TX, providing corporate finance services. From 2008 to the present Bash has also worked as a consultant to the private equity firm, General Pacific Partners LLC of Newport Beach, CA, providing strategic planning, corporate finance, structure, analysis, research and report writing services. Since 2006 Bash has been a private investor and advocate for stockholder interests with both managements and Boards. Prior to 2006, Bash was a Corporate Vice President & Actuary for New York Life Insurance Company, becoming a Fellow of the Society of Actuaries (FSA) from 1970 until his retirement in 1995. Mr. Bash received his Bachelor of Arts degree in mathematics from Oberlin College.

Anil Puri

Dr. Puri is the Dean of the College of Business and Economics at California State University, Fullerton and director of the Woods Center for Economic Analysis and Forecasting. Prior to becoming Dean in 1998, Dr. Puri was department chair and professor of economics at California State University, Fullerton. Dr. Puri is a noted economist and scholar who has served as the Executive Vice President of the Western Economic Association International, the second largest professional association of economists in the United States and is a member of the American Economic Association, and the National Association of Business Economists. Dr. Puri brings to the Board extensive business and financial experience. Dr. Puri has previously served and counseled public boards and he is a panel member of the National Association of Business Economists' Survey of Economic Conditions.

#### EXECUTIVE OFFICERS

The name, age, position and a brief account of the business experience of each of our executive officers as of December 31, 2016 are set forth below:

| Name              | Age | Position  |
|-------------------|-----|---|
| Steven G. Mihaylo | 73  | Chief Executive Officer and Chairman of the Board |
| Jeff Korn         | 59  | Chief Legal Officer                               |
| Doug Gaylor       | 51  | Chief Operating Officer and President             |
| Ron Vincent       | 41  | Chief Financial Officer                           |

Steven G. Mihaylo – Biographical information for Mr. Mihaylo is set forth above under “Directors”

Jeffrey G. Korn – Mr. Korn has served as our Chief Legal Officer since February 2009. From 2002 until his appointment as Chief Legal Officer, Mr. Korn served as our General Counsel. Prior to joining the company, Mr. Korn had a private consulting practice from 2001 until 2002 and before that, he served as General Counsel of ProsoftTraining, an Internet training education and certification company which was previously listed on NASDAQ, from 1999 until 2001. From 1983 until 1999, Mr. Korn was a partner in a Jacksonville, Florida, law firm, specializing in corporate matters and litigation. Mr. Korn has been an advisor to private venture firms, as well as a lecturer and a college instructor. Mr. Korn currently serves on several private, not-for-profit, charitable and educational boards. Mr. Korn has a Bachelor degree from the State University of New York at New Paltz and a juris doctorate degree from Stetson University College.

Doug Gaylor – Mr. Gaylor has served as our President and Chief Operating Officer (COO) since May 2012. From 2009 until his appointment as President and Chief Operating Officer (COO), Mr. Gaylor served as our VP of sales. Prior to joining the Company, Mr. Gaylor held positions of increasing responsibility, culminating with the position of Sr. Vice President at Inter-Tel/Mitel, where he was originally hired in 1987. Mr. Gaylor was responsible for overseeing the sales efforts in the Western United States where he was ultimately responsible for the activities of approximately 200 representatives. Under his leadership, yearly sales for his region reached over \$175,000,000 annually. Mr. Gaylor holds a Bachelor degree in Communications from the University of Houston.

Ron Vincent – Mr. Vincent has served as our Chief Financial Officer since May 2012 after joining the Company in April 2012 as Vice President of Finance. Prior to joining the Company, Mr. Vincent was an audit senior manager for Ernst & Young, LLP in Phoenix since 2005. Mr. Vincent managed client relationships for clients of all sizes; his

experience included auditing cloud telecommunication companies, content delivery network providers, Internet marketing service providers, manufacturing and healthcare networks. Prior to his employment with Ernst & Young, Mr. Vincent was an auditor with Mukai, Greenlee & Company and John C. Todd II, P.C. for a total of 13 years of experience as an auditor. Mr. Vincent is a licensed Certified Public Accountant in the state of Arizona. Mr. Vincent holds a Bachelor degree in accounting and finance from Indiana University Bloomington.



## CORPORATE GOVERNANCE

### Board Meetings

During the years ended December 31, 2016 and 2015, our Board met seven times. Each director attended at least 75% of the aggregate of the total number of meetings of our Board and the total number of all meetings held by committees on which he served during the years ended December 31, 2016 and 2015. All of our directors are invited, but not required, to attend the annual meeting.

### Information about Committees of our Board of Directors

Our Board of Directors has established three committees, the Audit Committee, comprised of Messrs. Williams (chairman), Goergen and Dr. Puri, the Compensation Committee comprised of Messrs. Goergen (chairman) and Bash, and the Nominating Committee, comprised of Messrs. Bash (chairman), Goergen, and Williams. Our Board of Directors has determined that each of these persons is “independent” under the rules of the OTCQX Marketplace and applicable regulatory requirements.

### Audit Committee

Mr. Williams serves as Chairman of our Audit Committee. Our Audit Committee held four meetings during the years ended December 31, 2016 and 2015, and operates under a charter adopted by our Board on March 23, 2004 and amended and restated on August 9, 2006. The charter is available on our website at [www.crexendo.com](http://www.crexendo.com). Our Audit Committee is responsible for reviewing and discussing our audited financial statements with management, discussing information with our auditors relating to the auditors' judgments about the quality of our accounting policies and procedures, recommending to our Board that the audited financials be included in our Annual Report on Form 10-K and overseeing compliance with the Securities and Exchange Commission requirements for disclosure of auditors' services and activities.

Our Board of Directors has determined that David Williams, Chairman of our Audit Committee, is an audit committee financial expert as defined in Item 407(d) of Regulation S-K under the Securities Exchange Act of 1934, as amended. No Audit Committee member serves on more than three publicly-traded companies.

### Compensation Committee

Mr. Goergen serves as Chairman of our Compensation Committee. The Compensation Committee held two meetings during the years ended December 31, 2016 and 2015, and evaluates the performance of executives, pursuant to the Compensation Committee Charter, a copy of which is posted on our website at [www.crexendo.com](http://www.crexendo.com). The Compensation Committee recommends to our Board policies for executive compensation and approves the remuneration of all our officers, including our Chief Executive Officer. It also administers our stock option and incentive compensation plans and recommends the establishment of and monitors the compensation and incentive program for all our executives.

The Compensation Committee did not retain a compensation consultant during the years ended December 31, 2016 and 2015.

Our senior management works closely with the Compensation Committee to evaluate and recommend compensation for our other officers and employees. In addition, the CEO makes recommendations to the Compensation Committee regarding compensation for other executives.



## Nominating Committee

Mr. Bash serves as the Chairman of our Nominating Committee. Our Nominating Committee, which held one meeting since our last annual meeting, reviews and suggests candidates for election or appointment to our Board, and operates pursuant to our Nominating Committee Charter, a current copy of which is posted on our website at [www.crexendo.com](http://www.crexendo.com). Our Nominating Committee may attempt to recruit persons who possess the appropriate skills and characteristics required of members of our Board. Our Nominating Committee may use any reasonable means for recruitment of potential members including their own expertise or the use of one or more third-party search firms to assist with this purpose.

In the course of reviewing potential director candidates, the Nominating Committee considers nominees recommended by our shareholders. When considering a potential candidate for service as a director, the Nominating Committee may consider, in addition to the minimum qualifications and other criteria approved by our Board, all facts and circumstances that the Nominating Committee deems appropriate or advisable, including, among other things, the skills of the proposed director candidate, his or her availability, depth and breadth of business experience or other background characteristics, his or her independence and the needs of our Board. At a minimum, each nominee, whether proposed by a stockholder or any other party, is expected to have the highest personal and professional integrity, demonstrate sound judgment and possesses the ability to effectively interact with other members of our Board to serve the long-term interests of our company and shareholders. In addition, the Nominating Committee may consider whether the nominee has direct experience in our industry or in the markets in which we operate and whether the nominee, if elected, assists in achieving a mix of Board members that represent a diversity of background and experience. The procedures to be followed by shareholders in submitting such recommendations are described below in the section entitled “Submission of Securities Holder Recommendations for Director Candidates.”



### Independence of our Board of Directors

Under the OTCQX Marketplace listing standards, a majority of the members of a listed company's board of directors must qualify as "independent," as affirmatively determined by its board of directors. Our Board consults with our legal counsel to ensure that our Board's determinations are consistent with relevant securities and other laws and regulations regarding the definition of "independent," including those set forth in pertinent listing standards of the OTCQX Marketplace, as in effect from time to time.

Consistent with these considerations, after review of all relevant transactions or relationships between each director, or any of his or her family members, and our company, our senior management and our independent auditors, our Board has affirmatively determined that the following four directors are independent directors within the meaning of the applicable rules of the OTCQX Marketplace: Mr. Goergen, Mr. Williams, Mr. Bash and Dr. Puri. In making this determination, our Board found that none of these directors or nominees for director had a material or other disqualifying relationship with the Company.

### Leadership Structure

Our Chief Executive Officer serves as the Chairman of the Board. We believe that this leadership structure is appropriate due to the nature of our business. Mr. Mihaylo's experience in leadership positions throughout our company during his tenure, as well as his role in developing and executing the strategic plan, is critical to our future results. Mr. Mihaylo was able to utilize his in-depth knowledge and perspective gained in running our company to effectively and efficiently guide the full Board by recommending Board and committee meeting agendas, leading Board discussions on critical issues and creating a vital link among the Board, management and shareholders. Our Board believes this structure serves our shareholders by ensuring the development and implementation of our company's strategies.

### Risk Oversight

Our primary risk consists of managing our operations within the current environment of being a start-up cloud telecom service provider. Our Telecommunication Services segment products and services are sold nationwide and our success is dependent on that being managed effectively. In general, our Board, as a whole and also at the committee level, oversees our risk management activities. Our Board annually reviews management's long-term strategic plan and the annual budget that results from that strategic planning process. Using that information, our Compensation Committee establishes both the short-term and long-term compensation programs that include all our executives (including the named executive officers identified in the Summary Compensation Table on page 19 (the "NEOs")). These compensation programs are ratified by our Board, as a whole. The compensation programs are designed to focus management on the performance metrics underlying the operations of the Company, while limiting risk exposure to our company. Our Board receives periodic updates from management on the status of our operations and performance (including updates outside of the normal Board meetings). Finally, as noted below, our Board is assisted by our Audit Committee in fulfilling its responsibility for oversight of the quality and integrity of our accounting, auditing and financial reporting practices. Thus, in performing its risk oversight our Board establishes the performance metrics, monitors on a timely basis the achievement of those performance metrics, and oversees the mechanisms that report those performance metrics.

### Code of Business Conduct

We have adopted a Code of Business Conduct and Ethics applicable to our directors, officers and employees. A copy of this code is posted on our website at [www.crexendo.com](http://www.crexendo.com). In the event that we amend or waive any of the provisions of the Code of Business Conduct and Ethics applicable to our Chief Executive Officer and Chief Financial

Officer, we intend to satisfy our disclosure obligations under Item 5.05 of Form 8-K by posting such information on our website.

#### Certain Relationships and Related Transactions

Our Audit Committee is responsible for review and, as it determines appropriate, approval or ratification of “related-party transactions” between our company and related persons or entities, other than executive compensation decisions which are addressed by our Compensation Committee. We have adopted policies and procedures that apply to any transaction or series of transactions in which our company or a subsidiary is a participant, the amount involved exceeds \$10,000, and a related person or entity has a direct or indirect material interest. Our Audit Committee has determined that, barring additional facts or circumstances, a related person or entity does not have a direct or indirect material interest in any of the following categories of transactions:



any transaction with another company for which a related person's only relationship is as an employee (other than an executive officer), director, or beneficial owner of less than 10% of that company's shares, if the amount involved does not exceed \$10,000;

any charitable contribution, grant, or endowment by the company to a charitable organization, foundation, or university for which a related person's only relationship is as an employee (other than an executive officer) or a director, if the amount involved does not exceed \$10,000;

compensation to directors, for service as directors, determined by our Board;

transactions in which all securities holders receive proportional benefits; or

banking-related services involving a bank depository of funds, transfer agent, registrar, trustee under a trust indenture, or similar service.

Transactions involving related persons or entities that are not included in one of the above categories are reviewed by our Audit Committee. Our Audit Committee determines whether the related person or entity has a material interest in a transaction and may approve, not approve or take other action with respect to the transaction in its discretion.

#### Director Compensation

The annual pay package for non-employee directors is designed to attract and retain highly qualified professionals to represent our shareholders. We also reimburse our directors for travel, lodging and related expenses they incur on company-related business, including Board and committee meetings. In setting director compensation, we consider the amount of time that directors spend in fulfilling their duties to the Company as well as the skill level required by our directors. Directors who are also employees receive no additional compensation for serving on our Board. For the years ended December 31, 2016 and 2015, non-employee director compensation consisted of the following.

**Cash Compensation.** For the years ended December 31, 2016 and 2015, our non-employee directors did not receive any cash compensation.

**Stock Options and Restricted Shares.** On January 5, 2015, we granted to each non-employee director an option to purchase 20,000 shares of common stock at an exercise price of \$1.85, which price was not less than 100% of the fair market value of an underlying share of common stock on the date of grant. Each such option was fully vested and exercisable on the date of grant. In conformity with accounting guidance, the option awards to our non-employee directors were valued using the Black-Scholes option-pricing model on the date of grant, which were valued at \$0.83 per share.

On December 31, 2015, we granted to each non-employee director an option to purchase 25,000 shares of common stock at an exercise price of \$1.11, which price was not less than 100% of the fair market value of an underlying share of common stock on the date of grant. Each such option was fully vested and exercisable on the date of grant. In conformity with accounting guidance, the option awards to our non-employee directors were valued using the Black-Scholes option-pricing model on the date of grant, which were valued at \$0.55 per share.

The following table summarizes the compensation earned by and paid to our non-employee directors for the year ended December 31, 2016:

Director

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|                 | Fees Earned or<br>Paid in Cash | Option Awards | All Other<br>Compensation | Total |
|-----------------|--------------------------------|---------------|---------------------------|-------|
| Todd Goergen    | \$-                            | \$-           | \$-                       | \$-   |
| Jeffrey P. Bash | -                              | -             | -                         | -     |
| David Williams  | -                              | -             | -                         | -     |
| Anil Puri       | -                              | -             | -                         | -     |

The following table summarizes the compensation earned by and paid to our non-employee directors for the year ended December 31, 2015:





| Director        | Fees Earned or Paid in Cash | Option Awards (1) | All Other Compensation | Total    |
|-----------------|-----------------------------|-------------------|------------------------|----------|
| Todd Goergen    | \$-                         | \$30,432          | (2) -                  | \$30,432 |
| Jeffrey P. Bash | -                           | 30,432            | (4) -                  | 30,432   |
| David Williams  | -                           | 30,432            | (2) -                  | 30,432   |
| Anil Puri       | -                           | 30,432            | (3) -                  | 30,432   |

(1)

Represents the dollar amount of all option awards recognized for financial statement reporting purposes for the year in accordance with accounting guidance. Estimates of forfeitures related to service-based vesting conditions have been disregarded. The assumptions used in the calculation of these amounts are included in the notes to our consolidated financial statements for the years ended December 31, 2016 and 2015, included herein.

(2)

As of December 31, 2016, each of Messrs. Goergen and Williams held unexercised options to purchase an aggregate of 105,000 shares of our common stock.

(3)

As of December 31, 2016, Messr. Dr. Puri held unexercised options to purchase an aggregate of 125,000 shares of our common stock.

(4)

As of December 31, 2016, Messr. Bash held unexercised options to purchase an aggregate of 65,000 shares of our common stock.

## ITEM 11.

### EXECUTIVE COMPENSATION

#### Compensation Discussion and Analysis

The overall objective of our executive compensation program is to help create long-term value for our shareholders by attracting and retaining talented executives, rewarding superior operating and financial performance, and aligning the long-term interests of our executives with those of our shareholders. Accordingly, our executive compensation program incorporates the following principles:

We believe that retaining experienced, competent, goal-oriented executives and minimizing executive turnover is in our shareholders' best interests;

We believe that a portion of our executives' compensation should be tied to measures of performance of our business as a whole and that such measures of performance should be non-discretionary;

We believe that a portion of our executives' compensation should be tied to measures of performance within each executive's specific job responsibilities and that those measures should be as non-discretionary as possible;

We believe that the interests of our executives should be linked with those of our shareholders through the risks and rewards of owning our common stock;

We believe that a meaningful portion of each executive's long-term incentives, and merit increases will vary based upon individual performance;

We believe that each executive's performance against corporate and individual objectives for the previous year should be periodically reviewed, and that the difficulty of achieving desired results in any particular year must be considered; and

We believe that we should consider the ability of each executive to support our long-term performance goals; as well as each executive's ability to fulfill his or her management responsibilities and his or her ability to work with and contribute to our executive management team.

#### Executive Compensation Procedures

In conjunction with our efforts to achieve the executive compensation objectives and implement the underlying compensation principles described above, we follow the procedures described below:

#### Role of the Compensation Committee

The Compensation Committee periodically requests and receives survey data from our human resource department on the compensation levels and practices of companies that need executive officers with skills and experience similar to what we require, companies that are in the same or similar industries as us, and companies with market capitalizations and revenues similar to us. The Compensation Committee uses this broad based survey information as a check on whether our compensation packages are consistent with current industry practices and are at a level that will enable us to attract and retain capable executive officers. We did not retain the services of a compensation consulting firm during the years ended December 31, 2016 and 2015.



With respect to executives other than the Chief Executive Officer, the Compensation Committee seeks and receives recommendations from the Chief Executive Officer with respect to performance and appropriate levels of compensation. The Committee does not request or accept recommendations from the Chief Executive Officer concerning his own compensation.

The Compensation Committee's conclusions and recommendations on the compensation packages for our executive officers are based on the total mix of information from the sources described above, as well as the Committee Members' general knowledge of executive compensation practices and their personal evaluations of the likely effects of compensation levels and structure on the attainment of our business and financial objectives.

Each year, our senior management prepares a business plan and establishes goals for our company. The Compensation Committee reviews, modifies (if necessary), occasionally sets, and ultimately approves these goals, which are then incorporated into the company's business plan. Periodically throughout the year, the Compensation Committee compares Company goals against actual circumstances and accomplishments. The Compensation Committee may revise the Company's goals and business plan if they determine that circumstances warrant.

The Compensation Committee relies on its judgment in making compensation recommendations and decisions after reviewing our company's overall performance and evaluating each executive's performance against established goals, leadership ability, responsibilities within the company, and current compensation arrangements. The compensation program for NEOs and the Compensation Committee assessment process are designed to be flexible so as to better respond to the evolving business environment and individual circumstances.

The Compensation Committee may, in its discretion, delegate all or a portion of its duties and responsibilities to a subcommittee of the Compensation Committee consisting of one or more members of the committee. In particular, the Compensation Committee may delegate the approval of certain transactions to a subcommittee consisting solely of members of the committee who are (a) "Non-Employee Directors" for the purpose of Rule 16b-3 under the Securities Exchange Act of 1934, as in effect from time to time, and (b) "outside directors" for the purposes of Section 162(m) of the Internal Revenue Code, as in effect from time to time.

Elements of our Compensation Programs: What our Compensation Programs are Designed to Award and Why We Choose Each Element

Elements of Compensation. We implement the executive compensation objectives and principles described above through the use of the following elements of compensation, each of which is described in greater detail below:

Base Salary

Stock Option Awards

Retirement Benefits

Other Personal Benefits

The Compensation Committee evaluates overall compensation levels for each NEO in relation to other executives within our company and in relation to the NEO's prior year compensation. The Compensation Committee also considers competing offers made to NEOs, if any. The Compensation Committee considers each element of compensation collectively with the other elements when establishing the various forms and levels of compensation for each NEO. The Compensation Committee approves compensation programs which it believes are competitive with our peers, such that the combination of base pay and performance-based bonuses results in an aggregate rate of cash salary, bonus compensation, equity awards and other benefits for our NEOs within competitive market standards.

In determining long-term equity awards to executives, the Compensation Committee considers total equity awards available under the Plan, the number of equity awards to be granted to each executive in relation to other executives, the overall compensation objective for each executive, and the number and type of awards to executives in prior years.

**Base Pay.** Base salaries of the NEOs are set at levels that the Compensation Committee believes are generally competitive with our market peers so as to attract, reward, and retain executive talent. The Compensation Committee may opt to pay higher or lower amounts depending on individual circumstances. The Compensation Committee sets the base pay of the Chief Executive Officer and the other NEOs after reviewing recommendations from our Chief Executive Officer. Annual adjustments are influenced by growth of our operations, revenues and profitability, individual performance, changes in responsibility, and other factors. The table below summarizes base pay for our NEOs as of December 31, 2016 and 2015:



| Name               | Base Pay  | Position  |
|--------------------|-----------|---|
| Steven G. Mihaylo  | \$-       | Chief Executive Officer and Chairman of the Board |
| Doug Gaylor        | \$200,000 | Chief Operating Officer and President             |
| Satish Bhagavatula | \$180,000 | Former Chief Technology Officer                   |
| Jeff Korn          | \$150,000 | Chief Legal Officer                               |
| Ron Vincent        | \$150,000 | Chief Financial Officer                           |

Stock Option Awards. The Compensation Committee grants discretionary, long-term equity awards to our NEOs under the Plan. These awards have historically been in the form of stock options. The Compensation Committee believes that stock option awards align the interests of NEOs with the interests of our shareholders and will incentivize the NEOs to provide stockholder value. The Compensation Committee believes that such grants provide long-term performance-based compensation, help retain executives through the vesting periods, and serve to align management and stockholder interests. In making awards under the Plan, the Compensation Committee considers grant size. Options vest only to the extent that the NEO remains a company employee through the applicable vesting dates, typically monthly over three - four years. We believe the three - four year vesting schedule assists in retaining executives and encourages the NEOs to focus on long-term performance.

We have granted stock options to our NEOs with an exercise price equal to the closing price per share on the date of the grant. We do not grant options with an exercise price below 100% of the trading price of the underlying shares of our common stock on the date of grant. Stock options only have a value to the extent the value of the underlying shares on the exercise date exceeds the exercise price. Accordingly, stock options provide compensation only if the underlying share price increases over the option term and the NEO's employment continues with us until the vesting date.

In granting stock options to the NEOs, we also consider the impact of the grant on our financial performance, as determined in accordance with accounting guidance. For share-based equity awards, we record expense in accordance with accounting guidance. The amount of expense we record pursuant to accounting guidance may vary from the corresponding compensation value we use in determining the amount of the awards.

Retirement and Other Personal Benefits. All of our NEOs receive similar retirement and other personal benefits. We sponsor the Crexendo, Inc. Retirement Savings Plan (the "401(k) Plan") for eligible employees. Our NEOs participate in the 401(k) Plan. The 401(k) Plan is a broad-based, tax-qualified retirement plan under which eligible employees, including the NEOs, may make annual pre-tax salary reduction contributions, subject to the various limits imposed under the Internal Revenue Code of 1986, as amended (the "Code"). We make matching contributions under the 401(k) Plan on behalf of eligible participants, including the NEOs, at the rate of 100% of the first one percent and 50% of each additional percentage of each participating NEO's salary up to a six percent deferral, with a two-year vesting schedule for the matched portion. Matching contributions are not subject to non-discrimination requirements imposed by the Code. The 401(k) Plan is intended to help us attract and retain qualified executives through the offering of competitive employee benefits. We do not maintain any other pension or retirement plans for the NEOs.

We provide other traditional benefits and limited perquisites to our NEOs in order to achieve a competitive pay package as detailed in the Summary Compensation Table. The Compensation Committee believes that these benefits, which are detailed in the Summary Compensation Table under the heading "All Other Compensation", are reasonable, competitive, appropriate, and consistent with our overall executive compensation program. Other than our company's contributions to the 401(k) Plan, these benefits consist principally of employer-paid premiums on health insurance, personal automobile reimbursements, and mobile phone communications charges.

Compensation of Steven G. Mihaylo, Chief Executive Officer. Mr. Mihaylo is primarily responsible for investor relations activities and the general management of our NEOs. Mr. Mihaylo receives a small base salary to cover personal insurance premiums. Mr. Mihaylo does not participate in any non-equity incentive plans, but is eligible to receive stock option awards or other equity compensation. The Compensation Committee believes Mr. Mihaylo's interests are directly aligned with the interests of our shareholders because of Mr. Mihaylo's significant equity holdings in our company and his eligibility to participate in stock option awards or other equity compensation.

Compensation of Ronald Vincent, Chief Financial Officer. Mr. Vincent has general responsibility for our accounting, finance, and human resource functions. Mr. Vincent receives a base salary similar to the other NEOs. Mr. Vincent also receives retirement and other personal benefits similar to the other NEOs. Mr. Vincent receives stock options or other equity compensation similar to Messrs. Gaylor and Korn.

Compensation of Doug Gaylor, President and Chief Operating Officer. Mr. Gaylor has general responsibility for our operations. Mr. Gaylor receives a base salary similar to the other NEOs. Mr. Gaylor also receives retirement and other personal benefits similar to the other NEOs. Mr. Gaylor receives stock options or other equity compensation similar to Messrs. Korn and Vincent.





Compensation of Jeffrey G. Korn, Chief Legal Officer. Mr. Korn has general responsibility for our regulatory and legal compliance. Mr. Korn receives a base salary similar to the other NEOs. Mr. Korn also receives retirement and other personal benefits similar to the other NEOs. Mr. Korn receives stock options or other equity compensation similar to Messrs. Gaylor and Vincent.

Deductibility of Executive Compensation. Section 162(m) of the Code imposes a \$1 million annual limit on the amount that a public company may deduct for compensation paid to its chief executive officer during a tax year or to any of its three other most highly compensated executive officers who are still employed at the end of the tax year. The limit does not apply to compensation that meets the requirements of Code Section 162(m) for “qualified performance-based” compensation (i.e., compensation paid only if the executive meets pre-established, objective goals based upon performance criteria approved by the shareholders).

The Compensation Committee reviews and considers the deductibility of executive compensation under Section 162(m) of the Internal Revenue Code. In certain situations, the Compensation Committee may approve compensation that will not meet the requirements of Code Section 162(m) in order to ensure competitive levels of total compensation for our executive officers. We do not have a stockholder approved non-equity incentive compensation plan. As a result, all bonus amounts paid to the NEOs do not constitute qualified performance-based compensation for purposes of Code Section 162(m). For the years ended December 31, 2016 and 2015, the compensation paid to the NEOs did not exceed the limitations imposed by Code Section 162(m).

#### Summary Compensation Table

The table below summarizes the total compensation paid or earned by each of our NEOs for the year ended December 31, 2016 (marked as “2016” in the year column), and for the year ended December 31, 2015 (marked as “2015” in the year column).

| Name and Principal Position                               | Year | Salary    | Bonus | Option Awards (1) | Non-Equity Incentive Plan | All Other Compensation | Total Compensation |
|---|------|-----------|-------|-------------------|---------------------------|------------------------|--------------------|
| Steven G. Mihaylo<br>Chief Executive Officer              | 2016 | \$3,616   | \$-   | \$-               | \$-                       | \$-                    | \$3,616            |
|   | 2015 | \$3,542   | \$-   | \$326,904         | \$-                       | \$-                    | \$330,446          |
| Ronald Vincent (2)<br>Chief Financial Officer             | 2016 | \$150,000 | \$-   | \$-               | \$-                       | \$12,702               | \$162,702          |
|   | 2015 | \$155,769 | \$-   | \$117,558         | \$-                       | \$13,191               | \$286,518          |
| Doug Gaylor (2)<br>Chief Operating Officer & President    | 2016 | \$200,000 | \$-   | \$-               | \$-                       | \$14,016               | \$214,016          |
|   | 2015 | \$207,692 | \$-   | \$145,058         | \$-                       | \$15,014               | \$367,764          |
| Satish Bhagavatula (3)<br>Former Chief Technology Officer | 2016 | \$31,253  | \$-   | \$-               | \$-                       | \$1,671                | \$-                |
|   | 2015 | \$186,923 | \$-   | \$62,558          | \$-                       | \$16,236               | \$265,717          |
| Jeffrey Korn (2)<br>Chief Legal Officer                   | 2016 | \$150,000 | \$-   | \$-               | \$-                       | \$12,439               | \$162,439          |
|   | 2015 | \$155,769 | \$-   | \$117,558         | \$-                       | \$12,132               | \$285,459          |

(1)

The amounts shown in the “Stock Awards” and “Option Awards” column represent the aggregate grant date fair value of the options and restricted stock units granted to the NEOs, computed in accordance with accounting guidance. Estimates of forfeitures related to service-based vesting conditions have been disregarded. The assumptions used in the calculation of these amounts are included in notes to our consolidated financial statements for the year ended December 31, 2016.

(2)

All other compensation for Messrs. Vincent, Gaylor, and Korn consists primarily of matching contributions to the 401(k) Plan, automobile allowance, and other miscellaneous benefits, none of which exceeded \$10,000.

(3)

All other compensation for Messr. Bhagavatula consists primarily of matching contributions to the 401(k) Plan, matching contributions to the HSA account, automobile allowance, and other miscellaneous benefits, none of which exceeded \$10,000.



## Outstanding Equity Awards as of December 31, 2016

The table below provides information on the holdings of stock options by the NEOs as of December 31, 2016.

| Name           | Option Awards  |   | Stock Awards          |                        |   |   |
|----------------|--|---|-----------------------|------------------------|---|---|
|                | Number of Securities of Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Option Exercise Price | Option Expiration Date | Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested | Equity Incentive Plan Awards: Market of Payout Value of Unearned Shares, Unites or Other Rights That Have Not Vested (\$) |
| Steven Mihaylo | 100,000  | -   | \$7.69                | 2019-9-8               |   |   |
|                | 70,322   | -   | \$3.30                | 2020-7-16              |   |   |
|                | 170,000  | -   | \$5.90                | 2021-5-17              |   |   |
|                | 191,678  | -   | \$4.08                | 2022-3-1               |   |   |
|                | 257,771  | 17,229  | (1) \$2.45            | 2023-3-18              |   |   |
|                | 127,974  | 12,026  | (2) \$3.19            | 2021-3-4               |   |   |
|                | 95,999   | 39,001  | (3) \$1.85            | 2022-1-5               |   |   |
|                | 150,000  | -   | \$1.11                | 2022-12-31             |   |   |
| Ronald Vincent | 22,392   | -   | \$3.55                | 2022-5-15              |   |   |
|                | 46,867   | 3,133   | (1) \$2.45            | 2023-3-18              |   |   |
|                | 22,852   | 2,148   | (2) \$3.19            | 2021-3-4               |   |   |
|                | 53,337   | 21,663  | (3) \$1.85            | 2022-1-5               |   |   |
|                | 100,000  | -   | \$1.11                | 2022-12-31             |   |   |
| Doug Gaylor    | 10,000   | -   | \$7.12                | 2019-10-26             |   |   |
|                | 10,000   | -   | \$3.30                | 2020-7-16              |   |   |
|                | 25,000   | -   | \$5.90                | 2021-5-17              |   |   |
|                | 25,000   | -   | \$4.08                | 2022-3-1               |   |   |
|                | 50,000   | -   | \$3.55                | 2022-5-15              |   |   |

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|              |         |        |            |            |
|--------------|---------|--------|------------|------------|
|              | 46,867  | 3,133  | (1) \$2.45 | 2023-3-18  |
|              | 36,564  | 3,436  | (2) \$3.19 | 2021-3-4   |
|              | 53,337  | 21,663 | (3) \$1.85 | 2022-1-5   |
|              | 150,000 | -      | \$1.11     | 2022-12-31 |
| Jeffrey Korn | 20,000  | -      | \$3.49     | 2019-2-10  |
|              | 25,000  | -      | \$3.30     | 2020-7-16  |
|              | 25,000  | -      | \$5.90     | 2021-5-17  |
|              | 20,000  | -      | \$4.08     | 2022-3-1   |
|              | 23,433  | 1,567  | (1) \$2.45 | 2023-3-18  |
|              | 22,852  | 2,148  | (2) \$3.19 | 2021-3-4   |
|              | 53,337  | 21,663 | (3) \$1.85 | 2022-1-5   |
|              | 100,000 | -      | \$1.11     | 2022-12-31 |

(1)

Remaining unexercisable options vest ratably on a monthly basis through March 18, 2017.

(2)

Remaining unexercisable options vest ratably on a monthly basis through March 4, 2017.

(3)

Remaining unexercisable options vest ratably on a monthly basis through January 5, 2018.



## Option Exercises and Stock Vested

The following table presents information about the exercise of Stock Options by NEOs during the years ended December 31, 2016 and 2015.

| Name               | Option Awards                             |                                 | Stock Awards                              |                                 |
|--------------------|---|---------------------------------|---|---------------------------------|
|                    | Number of shares acquired on exercise (#) | Value realized on exercise (\$) | Number of shares acquired on exercise (#) | Value realized on exercise (\$) |
| Satish Bhagavatula | 26,665                                    | \$8,540                         | -   | \$-                             |

## Equity Compensation Plan Information

The following table presents information about our common stock that was issuable upon the exercise of options, warrants and rights under existing equity compensation plans as of December 31, 2016.

| Plan Category  | Number of Securities To Be Issued Upon Exercise Of Outstanding Options | Weighted-average Exercise Price Of Outstanding Options | Number Of Securities Remaining Available For Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected In Column (a)) |
|--|--|--|---|
|  | (a)  | (b)  | (c)   |
| Equity Compensation Plans Approved By Securities Holders     | 3,932,114  | \$2.59   | 2,326,295   |
| Equity Compensation Plans Not Approved By Securities Holders | -  | -  | -   |
| Total  | 3,932,114  | \$2.59   | 2,326,295   |

## Potential Payments upon Termination or Change-in-Control

Acceleration of Vesting of Options and Other Stock Awards upon Change in Control. All outstanding stock options awarded to the NEOs become fully vested upon a “change in control,” without regard to whether the NEO terminates employment in connection with or following the change in control.

If a change in control results in acceleration of vesting of an NEO’s otherwise unvested stock options and other stock awards, and if the value of such acceleration exceeds 2.99 times the NEO’s average W-2 compensation from employment with the company for the five taxable years preceding the year of the change in control (the “Base Period Amount”), the acceleration would result in an excess parachute payment under Code Section 280G equal to the value of such acceleration which is in excess of the NEO’s average W-2 compensation from employment with the company for the five taxable years preceding the year of the change in control. An NEO would be subject to a 20% excise tax under Code Section 4999 on any such excess parachute payment and we would be unable to deduct the excess parachute payment.

ITEM 12.



**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS MATTERS**

The following table sets forth, as of December 31, 2016, the number of shares of our common stock beneficially owned by each of the following persons and groups and the percentage of the outstanding shares owned by each person and group including: (i) each person who is known by us to be the owner of record or beneficial owner of more than 5% of the outstanding shares of our common stock; (ii) each director and nominee; (iii) each of our NEO's; and (iv) all of our current directors and executive officers as a group.

With respect to certain of the individuals listed below, we have relied upon information set forth in statements filed with the Securities and Exchange Commission pursuant to Section 13(d) or 13(g) of the Securities Exchange Act of 1934. Except as otherwise noted below, the address of each person identified in the following table is c/o Crexendo, Inc., 1615 South 52nd Street, Tempe, Arizona, 85281.



| Name of Beneficial Owner  | Shares Owned | Number of Outstanding Warrants and Options | Total Beneficial Ownership (1) | Percent of Class Beneficially Owned |
|---|--------------|--|--------------------------------|-------------------------------------|
| Steven G. Mihaylo   | 9,227,016    | 1,163,744                                  | 10,390,760                     | 70.5%                               |
| Todd Goergen  | 355,000      | 105,000                                    | 460,000                        | 3.4%                                |
| Jeffrey Bash  | 135,000      | 65,000                                     | 200,000                        | 1.5%                                |
| David Williams  | 10,000       | 105,000                                    | 115,000                        | *                                   |
| Anil Puri   | 3,501        | 125,000                                    | 128,501                        | *                                   |
| Doug Gaylor   | -            | 406,768                                    | 406,768                        | 2.9%                                |
| Jeffrey Korn  | 26,500       | 289,622                                    | 316,122                        | 2.3%                                |
| Ron Vincent   | -            | 248,056                                    | 248,056                        | 1.8%                                |
| All current directors and executive officers as a group (8 persons) | 9,757,017    | 2,508,190                                  | 12,265,207                     | 76.2%                               |

\*

Less than one percent.

(1)

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission, based upon 13,578,556 shares of common stock outstanding on December 31, 2016.

#### Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our directors and executive officers, and persons who own more than ten percent of a registered class of our equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock and other equity securities. Officers, directors and greater than ten percent shareholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file. Based on a review of reports and representations submitted to us, all reports regarding beneficial ownership of our securities required to be filed under Section 16(a) for the years ended December 31, 2016 and 2015 were timely filed.

#### 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

##### Fees of Independent Registered Public Accounting Firm

We have set forth below the aggregate fees billed for professional services rendered to us by Urish Popeck and Deloitte for the year ended December 31, 2016 and Deloitte for the year ended December 31, 2015. All of the services described in the following fee table were approved in conformity with the Audit Committee's pre-approval process.

| Year Ended | Year Ended |
|------------|------------|
| December   | December   |
| 31,        | 31,        |
| 2016       | 2015       |

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|  |           |           |
|--|-----------|-----------|
| Audit Fees (1) (audit of our annual financial statements, review of our quarterly financial statements, review of our SEC filings and correspondence with the SEC) | \$164,187 | \$199,859 |
| Tax Fees   | 38,700    | -         |

(1)

Audit Fees: Fees billed by Urish Popeck and Deloitte for professional services rendered for the audit and reviews of our financial statements filed with the SEC on Forms 10-K, 10-KT and 10-Q and reviews of our correspondence with the Securities and Exchange Commission.

Pre-Approval Policies and Procedures

The Audit Committee has adopted a policy and procedures for the pre-approval of audit and non-audit services rendered by our independent registered public accounting firm. The policy generally provides for the pre-approval of the scope of and fees for services in the defined categories of audit services, audit-related services, and tax services. Pre-approval is usually provided by the Audit Committee on a project-by-project basis before the independent registered public accounting firm is engaged to provide that service, and for de minimus projects only, pre-approval is provided with a not-to-exceed fee level determined for a group of such de minimus projects. The pre-approval of services may be delegated to the Chairman of the Audit Committee, but the decision must be reported to and ratified by the full Audit Committee at its next meeting.

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## 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 56 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 dated February 28, 2000 by and among Netgateway, Inc., Galaxy Acquisition Corp. and Galaxy Enterprises, Inc.                              | 8-K                       | 3/21/00  | 10.1   |                |
| 3.1         | Certificate of Incorporation   | S-1                       | 6/1/99   | 3.1    |                |
| 3.2         | Certificate of Amendment to Certificate of Incorporation   | S-1                       | 9/7/00   | 3.1    |                |
| 3.3         | Certificate of Amendment to Certificate of Incorporation   | 10-K                      | 10/15/02 | 3.3    |                |
| 3.4         | Amended and Restated Bylaws  | 10-Q                      | 11/20/01 | 3.2    |                |
| 3.5         | Certificate of Ownership and Merger (4)  | S-1/A                     | 11/12/99 | 3.3    |                |
| 3.6         | Articles of Merger   | S-1/A                     | 11/12/99 | 3.4    |                |
| 4.1         | Form of Common Stock Certificate   | 10-K                      | 10/15/02 | 4.1    |                |
| 4.2*        | Form of Representatives' Warrant   | S-1                       | 6/1/99   | 4.1    |                |
| 10.1*       | 1998 Stock Compensation Program  | S-1                       | 6/1/99   | 10.6   |                |
| 10.2*       | Amended and Restated 1998 Stock Option Plan for Senior Executives  | 10-K                      | 9/29/03  | 10.2   |                |
| 10.3*       | Amended and Restated 1999 Stock Option Plan for Non-Executives   | 10-K                      | 9/29/03  | 10.3   |                |
| 10.5*       | 2003 Equity Incentive Plan   | 10-K                      | 9/10/04  | 10.11  |                |
| 10.6*       | 2013 Long-Term Incentive Plan  | 10-Q                      | 5/6/08   | 10.1   |                |
| 10.7        | Deed of Sale, dated February 28, 2014, from Crexendo, Inc. to SGM EXE, LLC.  | 8-K                       | 3/4/14   | 10.1   |                |
| 10.8        | Lease Agreement dated as of March 1, 2014 between Crexendo, Inc. and SGM EXE, LLC.   | 8-K                       | 3/4/14   | 10.2   |                |
| 10.9        | Stock Purchase Agreement, dated December 24, 2014 between Crexendo, Inc. and CEO Steven G. Mihaylo   | 8-K                       | 12/24/14 | 10.1   |                |
| 10.10       | Term Loan Agreement, dated December 31, 2015 between Crexendo, Inc. and CEO Steven G. Mihaylo  | 8-K                       | 12/31/15 | 10.1   |                |
| 10.11       | Amendment to a term Loan Agreement, dated June 28, 2016, between Crexendo, Inc. and Steven G. Mihaylo, as Trustee of the Steven G. Mihaylo Trust dated August 19, 1999 | 8-K                       | 6/30/16  | 10.1   |                |
| 10.12       | Reincorporation in state of Nevada for Crexendo, Inc. (Nevada) Articles of Incorporation   | 8-K                       | 12/14/16 | 3.1    |                |
| 10.13       |  | 8-K                       | 12/14/16 | 3.2    |                |

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|             |  |     |         |      |
|-------------|--|-----|---------|------|
|             | Reincorporation in state of Nevada for Crexendo, Inc. (Nevada) bylaws  |     |         |      |
| 10.14       | Amendment to a term Loan Agreement, dated February 27, 2017, between Crexendo, Inc. and Steven G. Mihaylo, as Trustee of the Steven G. Mihaylo Trust dated August 19, 1999 | 8-K | 2/28/17 | 10.1 |
| <u>21.1</u> | Subsidiaries of Crexendo, Inc.   |     |         | X    |
| <u>23.1</u> | Consent of Independent Registered Public Accounting Firm (Deloitte & Touche LLP)   |     |         | X    |
| <u>31.1</u> | Certification Pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934 as amended   |     |         | X    |
| <u>31.2</u> | Certification Pursuant to Rules 13a-14(a) under the Securities Exchange Act of 1934 as amended   |     |         | X    |
| <u>32.1</u> | Certification Pursuant to 18 U.S.C. Section 1350   |     |         | X    |
| <u>32.2</u> | 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 7, 2017 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 7, 2017 By: /s/ Steven G. Mihaylo  
Steven G. Mihaylo  
Chief Executive Officer, Chairman of the Board of Directors

Date: March 7, 2017 By: /s/ Ronald Vincent  
Ronald Vincent  
Chief Financial Officer

Date: March 7, 2017 By: /s/ Todd Goergen  
Todd Goergen  
Director

Date: March 7, 2017 By: /s/ Jeff Bash  
Jeff Bash  
Director

Date: March 7, 2017 By: /s/ David Williams  
David Williams  
Director

Date: March 7, 2017 By: /s/ Anil Puri  
Anil Puri  
Director