

J2 GLOBAL COMMUNICATIONS INC  
Form 10-Q  
November 08, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011

OR

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

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

Commission File Number: 0-25965

j2 GLOBAL COMMUNICATIONS, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)

51-0371142  
(I.R.S. Employer  
Identification No.)

6922 Hollywood Boulevard, Suite 500  
Los Angeles, California 90028  
(Address of principal executive offices)

(323) 860-9200  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required 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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).



j2 GLOBAL COMMUNICATIONS, INC.

FOR THE QUARTER ENDED SEPTEMBER 30, 2011

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

j2 Global Communications, Inc.  
Condensed Consolidated Balance Sheets  
(Unaudited, in thousands)

|  | September 30,<br>2011 | December 31,<br>2010 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Cash and cash equivalents  | \$ 134,190            | \$ 64,752            |
| Short-term investments   | 29,005                | 14,035               |
| Accounts receivable, net of allowances of \$3,527 and \$2,588, respectively  | 17,723                | 17,423               |
| Prepaid expenses and other current assets  | 16,145                | 15,196               |
| Deferred income taxes  | 3,160                 | 4,096                |
| Total current assets   | 200,223               | 115,502              |
| Long-term investments  | 30,635                | 8,175                |
| Property and equipment, net  | 14,335                | 13,567               |
| Tradenames, net  | 34,940                | 33,396               |
| Patent and patent licenses, net  | 17,608                | 18,102               |
| Customer relationships, net  | 37,538                | 36,674               |
| Goodwill   | 279,007               | 281,848              |
| Other purchased intangibles, net   | 10,283                | 11,782               |
| Deferred income taxes  | 11,677                | 12,967               |
| Other assets   | 659                   | 610                  |
| Total assets   | \$ 636,905            | \$ 532,623           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                       |                      |
| Accounts payable and accrued expenses  | \$ 22,903             | \$ 25,112            |
| Income taxes payable   | 2,343                 | 1,798                |
| Deferred revenue   | 27,275                | 16,938               |
| Liability for uncertain tax positions  | 297                   | 13,471               |
| Deferred income taxes  | 680                   | 573                  |
| Total current liabilities  | 53,498                | 57,892               |
| Liability for uncertain tax positions  | 27,897                | 24,391               |
| Deferred income taxes  | 20,042                | 15,293               |
| Other long-term liabilities  | 3,072                 | 3,302                |
| Total liabilities  | 104,509               | 100,878              |
| Commitments and contingencies  | —                     | —                    |
| Preferred stock, \$0.01 par value. Authorized 1,000,000 and none issued  | —                     | —                    |
| Common stock, \$0.01 par value. Authorized 95,000,000 at September 30, 2011 and December 31, 2010; total issued 55,348,571 and 53,700,629 shares at September 30, 2011 and December 31, 2010, respectively; and total outstanding 46,668,003 and 45,020,061 shares | 553                   | 537                  |

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at September 30, 2011 and December 31, 2010, respectively

|  |            |            |
|--|------------|------------|
| Additional paid-in capital   | 194,649    | 164,769    |
| Treasury stock, at cost (8,680,568 shares at September 30, 2011 and December 31, 2010) | (112,671)  | (112,671)  |
| Retained earnings  | 452,489    | 381,145    |
| Accumulated other comprehensive loss   | (2,624)    | (2,035)    |
| Total stockholders' equity   | 532,396    | 431,745    |
| Total liabilities and stockholders' equity   | \$ 636,905 | \$ 532,623 |

See Notes to Condensed Consolidated Financial Statements

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j2 Global Communications, Inc.  
Condensed Consolidated Statements of Operations  
(Unaudited, in thousands except share and per share data)

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|-----------|------------------------------------|------------|
|  | 2011                                | 2010      | 2011                               | 2010       |
| Revenues:  |                                     |           |                                    |            |
| Subscriber   | \$ 85,622                           | \$ 62,066 | \$ 243,788                         | \$ 182,173 |
| Other  | 405                                 | 712       | 1,299                              | 2,196      |
|  | 86,027                              | 62,778    | 245,087                            | 184,369    |
| Cost of revenues (including share-based compensation of \$246 and \$736 for the three and nine months of 2011, respectively, and \$304 and \$963 for the three and nine months of 2010, respectively)                      | 15,002                              | 10,732    | 45,952                             | 31,378     |
| Gross profit   | 71,025                              | 52,046    | 199,135                            | 152,991    |
| Operating expenses:  |                                     |           |                                    |            |
| Sales and marketing (including share-based compensation of \$350 and \$1,049 for the three and nine months of 2011, respectively, and \$464 and \$1,460 for the three and nine months of 2010, respectively)               | 15,073                              | 10,878    | 44,929                             | 32,327     |
| Research, development and engineering (including share-based compensation of \$110 and \$367 for the three and nine months of 2011, respectively, and \$204 and \$645 for the three and nine months of 2010, respectively) | 4,105                               | 3,008     | 12,714                             | 8,810      |
| General and administrative (including share-based compensation of \$1,542 and \$4,532 for the three and nine months of 2011, respectively, and \$1,805 and \$5,699 for the three and nine months of 2010, respectively)    | 15,403                              | 10,921    | 44,037                             | 34,263     |
| Total operating expenses   | 34,581                              | 24,807    | 101,680                            | 75,400     |
| Operating earnings   | 36,444                              | 27,239    | 97,455                             | 77,591     |

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|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Interest and other income<br>(expense), net | 290        | 491        | 262        | 1,750      |
| Earnings before income taxes                | 36,734     | 27,730     | 97,717     | 79,341     |
| Income tax expense                          | 11,236     | 7,896      | 12,770     | 23,161     |
| Net earnings                                | \$ 25,498  | \$ 19,834  | \$ 84,947  | \$ 56,180  |
| Net earnings per common share:              |            |            |            |            |
| Basic                                       | \$ 0.55    | \$ 0.44    | \$ 1.84    | \$ 1.26    |
| Diluted                                     | \$ 0.54    | \$ 0.43    | \$ 1.81    | \$ 1.23    |
| Weighted average shares<br>outstanding:     |            |            |            |            |
| Basic                                       | 45,993,328 | 44,716,366 | 45,498,763 | 44,488,561 |
| Diluted                                     | 46,455,584 | 45,939,172 | 46,108,890 | 45,738,389 |
| Cash dividends paid per common<br>share     |            |            |            |            |
|   | \$ 0.20    |            | \$ 0.20    |            |

See Notes to Condensed Consolidated Financial Statements



j2 Global Communications, Inc.  
Condensed Consolidated Statement of Cash Flows  
(Unaudited, in thousands)

|   | Nine Months Ended<br>September 30,<br>2011 | 2010      |
|---|--|-----------|
| Cash flows from operating activities:   |  |           |
| Net earnings  | \$ 84,947                                  | \$ 56,180 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |  |           |
| Depreciation and amortization   | 14,892                                     | 10,973    |
| Amortization of discount or premium of investments                                  | 600  | 670       |
| Share-based compensation  | 6,672                                      | 8,767     |
| Excess tax benefits from share-based compensation                                   | (13,246)                                   | (164)     |
| Provision for doubtful accounts   | 4,963                                      | 1,542     |
| Deferred income taxes   | 5,394                                      | (815)     |
| Decrease (increase) in:   |  |           |
| Accounts receivable   | (7,074)                                    | (1,354)   |
| Prepaid expenses and other current assets   | 3,811                                      | 1,097     |
| Other assets  | 153  | (262)     |
| (Decrease) increase in:   |  |           |
| Accounts payable and accrued expenses   | (1,112)                                    | 2,350     |
| Income taxes payable  | 8,885                                      | (11,426)  |
| Deferred revenue  | 9,723                                      | (422)     |
| Liability for uncertain tax positions   | (9,668)                                    | 6,339     |
| Other   | 293  | 677       |
| Net cash provided by operating activities   | 109,233                                    | 74,152    |
| Cash flows from investing activities:   |  |           |
| Maturity of certificates of deposits  | —  | 31,653    |
| Purchase of certificate of deposit  | (8,000)                                    | —         |
| Redemptions/sales of available-for-sale investments                                 | 20,127                                     | 9,019     |
| Purchase of available-for-sale investments  | (50,192)                                   | (52,921)  |
| Purchases of property and equipment   | (5,075)                                    | (1,273)   |
| Proceeds from sale of assets  | 4  | —         |
| Acquisition of businesses, net of cash received                                     | (3,244)                                    | (36,546)  |
| Purchases of intangible assets  | (2,616)                                    | (6,953)   |
| Net cash (used in) investing activities   | (48,996)                                   | (57,021)  |
| Cash flows from financing activities:   |  |           |
| Repurchases of common stock and restricted stock                                    | (1,273)                                    | (4,175)   |
| Issuance of common stock under employee stock purchase plan                         | 110  | 85        |
| Exercise of stock options   | 7,001                                      | 2,349     |
| Dividends paid  | (9,463)                                    | —         |
| Excess tax benefits from share-based compensation                                   | 13,246                                     | 164       |
| Net cash provided by (used in) financing activities                                 | 9,621                                      | (1,577)   |
| Effect of exchange rate changes on cash and cash equivalents                        | (420)                                      | (265)     |

|  |            |            |
|--|------------|------------|
| Net increase in cash and cash equivalents        | 69,438     | 15,289     |
| Cash and cash equivalents at beginning of period | 64,752     | 197,411    |
| Cash and cash equivalents at end of period       | \$ 134,190 | \$ 212,700 |

See Notes to Condensed Consolidated Financial Statements

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2011

(UNAUDITED)

1. Basis of Presentation

j2 Global Communications, Inc. (“j2 Global” or the “Company”) is a Delaware corporation founded in 1995. j2 Global provides cloud-based, value-added communication, messaging and data backup services to businesses of all sizes, from individuals to enterprises. The Company’s hosted solutions deliver its customers greater efficiency, flexibility, mobility, business continuity and security. j2 Global offers online fax, virtual phone systems, hosted email, email marketing, online backup and bundled suites of these services. The Company markets its services principally under the brand names eFax®, eVoice®, FuseMail®, Campaigner®, KeepItSafe® and Onebox®.

The accompanying interim condensed consolidated financial statements include the accounts of j2 Global and its direct and indirect wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

The accompanying interim condensed consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”), including those for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X issued by the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and note disclosures required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been reflected in these interim financial statements. These financial statements should be read in conjunction with the audited financial statements and related notes for the year ended December 31, 2010 included in our Annual Report on Form 10-K filed with the SEC on February 28, 2011. Accordingly, significant accounting policies and other disclosures normally provided have been omitted since such items are disclosed therein.

The results of operations for this interim period are not necessarily indicative of the operating results for the full year or for any future period.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, including judgments about investment classifications, and the reported amounts of net revenue and expenses during the reporting period. On an ongoing basis, management evaluates its estimates based on historical experience and on various other factors that the Company believes to be reasonable under the circumstances. Actual results could differ from those estimates.

In the first quarter of 2011, the Company made a change in estimate regarding the remaining service obligations to its annual eFax® subscribers. As a result of system upgrades, the Company is now basing the estimate on the actual remaining service obligations to these customers. Due to this change, the Company recorded a one-time, non-cash increase to deferred revenues of \$10.3 million with an equal offset to revenues. This change in estimate reduced net income by approximately \$7.6 million, net of tax, and reduced basic and diluted earnings per share for the nine months ended September 30, 2011 by \$0.17 and \$0.16, respectively.

Allowances for Doubtful Accounts

j2 Global reserves for receivables it may not be able to collect. These reserves are typically driven by the volume of credit card declines and past due invoices and are based on historical experience as well as an evaluation of current market conditions. On an ongoing basis, management evaluates the adequacy of these reserves.

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## Revenue Recognition

The Company's subscriber revenues substantially consist of monthly recurring subscription and usage-based fees, which are primarily paid in advance by credit card. In accordance with GAAP, the Company defers the portions of monthly, quarterly, semi-annually and annually recurring subscription and usage-based fees collected in advance and recognizes them in the period earned. Additionally, the Company defers and recognizes subscriber activation fees and related direct incremental costs over a subscriber's estimated useful life.

The Company's advertising revenues (included in "other revenues") primarily consist of revenues derived by delivering email messages to its customers on behalf of advertisers. Revenues are recognized in the period in which the advertising services are performed, provided that no significant j2 Global obligations remain and the collection of the resulting receivable is reasonably assured.

The Company's patent revenues (included in "other revenues") consist of patent license revenues generated under license agreements that provide for the payment of contractually determined fully paid-up or royalty-bearing license fees to j2 Global in exchange for the grant of non-exclusive, retroactive and future licenses to the Company's patented technology. Patent revenues also consist of revenues generated from the sale of patents. Patent license revenues are recognized when earned over the term of the license agreements. With regard to fully paid-up license arrangements, the Company generally recognizes as revenue in the period the agreement is executed the portion of the payment attributable to past use of the patented technology and amortizes the remaining portion of such payments on a straight line basis over the life of the licensed patent(s). With regard to royalty-bearing license arrangements, j2 Global recognizes revenues of license fees earned during the applicable period. With regard to patent sales, the Company recognizes as revenue in the period of the sale the portion of the purchase price over the carrying value of the patent(s) sold.

## Fair Value Measurements

j2 Global complies with the provisions of Financial Accounting Standards Board ("FASB") ASC Topic No. 820, Fair Value Measurements and Disclosures ("ASC 820"), in measuring fair value and in disclosing fair value measurements. ASC 820 provides a framework for measuring fair value and expands the disclosures required for fair value measurements of financial and non-financial assets and liabilities.

As of September 30, 2011 and December 31, 2010, the carrying value of cash and cash equivalents, short-term investments, accounts receivable, interest receivable, accounts payable, accrued expenses, interest payable and customer deposits approximated fair value due to the short-term nature of such instruments. As of the same dates, the carrying value of other long-term liabilities approximated fair value as the related interest rates approximate rates currently available to j2 Global.

## Concentration of Credit Risk

All of the Company's cash, cash equivalents and marketable securities are invested at major financial institutions primarily within the United States, United Kingdom and Ireland. These institutions are required to invest the Company's cash in accordance with the Company's investment policy with the principal objectives being preservation of capital, fulfillment of liquidity needs and above market returns commensurate with preservation of capital. The Company's investment policy also requires that investments in marketable securities be in only highly rated instruments, with limitations on investing in securities of any single issuer. However, these investments are not insured against the possibility of a total or near complete loss of earnings or principal and are inherently subject to the credit risk related to the continued credit worthiness of the underlying issuer and general credit market risks. At September 30, 2011 and December 31, 2010, the Company's cash and cash equivalents were maintained in accounts that are insured up to the limit determined by the applicable governmental agency. The amount held by Irish banks are

fully insured through December 31, 2011; however, the insured amount held in other institutions is immaterial in comparison to the total amount of the Company's cash and cash equivalents held by these institutions which is not insured. These institutions are primarily in the United States, however, the Company does have accounts within several other countries including Australia, Austria, China, France, Germany, Italy, Japan, Malaysia, the Netherlands, Poland and the United Kingdom.

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## Income Taxes

The Company must make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the following areas, among others: (i) calculation of tax credits, benefits and deductions; (ii) calculation of tax assets and liabilities arising from differences in the timing of recognition of revenue and expense for tax and financial statement purposes; and (iii) interest and penalties related to uncertain tax positions. Significant changes to these estimates may result in an increase or decrease to the Company's tax provision in the current or a subsequent period.

The Company must assess the likelihood that it will be able to recover its deferred tax assets. If recovery is not likely, the Company must increase its provision for taxes by recording a valuation allowance against the deferred tax assets that the Company estimates will not ultimately be recoverable. The Company believes that it will ultimately recover a substantial majority of the deferred tax assets recorded on its consolidated condensed balance sheets. However, should there be a change in the Company's ability to recover its deferred tax assets, the Company's tax provision would increase in the period in which j2 Global determined that the recovery was not likely.

The calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax laws. j2 Global recognizes liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. If the Company determines that a tax position will more likely than not be sustained on audit, then the second step requires j2 Global to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as j2 Global has to determine the probability of various possible outcomes. j2 Global reevaluates these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision.

## 2. Recent Accounting Pronouncements

In January 2010, the FASB issued Accounting Standards Update (“ASU”) No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. This guidance amends the disclosure requirements related to recurring and nonrecurring fair value measurements and requires new disclosures on the transfer of assets and liabilities between Level 1 (quoted prices in active markets for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons for and the timing of the transfer. Additionally, the guidance requires a roll forward of activities on purchase, sale, issuance and settlement of Level 3 assets and liabilities (significant unobservable inputs). The guidance became effective for the reporting period beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which became effective for the reporting period beginning January 1, 2011. Other than requiring additional disclosures, adoption of this new guidance has not had a significant impact on the Company’s consolidated financial statements.

In February 2010, the FASB issued updated guidance related to subsequent events. As a result of this updated guidance, while public filers must still evaluate subsequent events through the issuance date of their financial statements, they are not required to disclose in their financial statements the date on which subsequent events were evaluated. This amended guidance became effective upon its issuance on February 24, 2010, at which time the Company adopted this updated guidance.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This guidance was issued to achieve common fair value measurement and disclosure requirements between GAAP and International Financial Reporting Standards. This new guidance amends current fair value measurement and disclosure guidance to include increased transparency around valuation inputs and investment categorization. This ASU is effective for interim and annual periods beginning after December 15, 2011. The adoption of this new guidance is not expected to have a significant impact on the Company’s fair value measurements, financial condition, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This guidance is effective for interim and annual periods beginning December 15, 2011 and will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The standard does not change the items which must be reported in other comprehensive income, how such items are measured or when they must be reclassified to net income. Because this guidance impacts presentation only, it will have no effect on the Company's consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles – Goodwill and Other (Topic 350), which simplifies how entities test goodwill for impairment and permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This ASU is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 (early adoption is permitted). The adoption of this guidance did not have a significant impact on the Company's consolidated financial position or results of operations.

## 3. Business Acquisition

In July 2011, we purchased for cash Data Haven Limited, an Ireland-based provider of online data backup services for businesses, and certain assets of the virtual PBX business of Buzz Networks Limited, a UK-based provider of voice



services.

These acquisitions are designed to be accretive and to provide the Company additional online data backup and voice customers. The financial impact to j2 Global for these transactions is immaterial as of the date of the acquisition. The condensed consolidated statement of operations and balance sheet as of September 30, 2011 reflect the results of operations of these acquisitions. Total consideration for these transactions was \$3.4 million, net of cash acquired.

The initial accounting for the acquisition of Venali, Inc. was completed during the fourth quarter 2010; however, this accounting is subject to change during the measurement period. Based upon an income tax position taken by the seller during the third quarter 2011 for a tax deduction prior to the acquisition in connection with certain acquired liabilities, the Company recorded an adjustment to the purchase price allocation of Venali, Inc. for the finalization of certain tax benefits on these acquired liabilities that were greater than previously estimated. The Company has recorded an increase in deferred tax assets of approximately \$0.6 million with a corresponding decrease to goodwill.

During 2010, j2 Global acquired several businesses, including Protus IP Solutions, Inc. ("Protus"), a Canadian provider of Software-as-a-Service ("SaaS") communication services and solutions to the business market.

The initial accounting of Protus was completed during the first quarter 2011 but is subject to change during the measurement period. The Company completed the valuation of certain intangible assets, finalized the working capital and recorded adjustments to the initial purchase price allocation in the first quarter 2011. During the second quarter of 2011, the Company recorded an adjustment to the value of certain software due to insufficient licensing by the seller prior to acquisition. As a result, the Company has recorded an increase in goodwill to adjust the fair value of these assets to the correct amount. Management has determined that this adjustment is immaterial to the previously presented financial statements; accordingly, the adjustment is presented in the current period.

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The following table summarizes the allocation of the aggregate purchase price of Protus (in thousands):

| Asset                       | Valuation  |
|-----------------------------|------------|
| Accounts Receivable         | \$ 2,338   |
| Property and Equipment      | 3,137      |
| Technology                  | 2,600      |
| Other Assets                | 1,812      |
| Customer Relationship       | 29,640     |
| Trade Name                  | 26,982     |
| Non-Compete Agreements      | 1,576      |
| Goodwill                    | 164,498    |
| Deferred Revenue            | (4,928)    |
| Accounts Payable            | (1,219)    |
| Accrued Liabilities         | (5,295)    |
| Deferred Tax Liability, net | (13,796)   |
| Total                       | \$ 207,345 |

#### 4. Investments

Short-term investments consist generally of corporate debt securities which are stated at fair market value. Realized gains and losses of short- and long-term investments are recorded using the specific identification method.

The following table summarizes j2 Global's debt securities designated as available-for-sale, classified by the contractual maturity date of the security (in thousands):

|   | September 30,<br>2011 | December 31,<br>2010 |
|---|-----------------------|----------------------|
| Due within 1 year                                   | \$ 21,003             | \$ 14,029            |
| Due within more than 1 year but less than 5 years   | 27,834                | 7,383                |
| Due within more than 5 years but less than 10 years | 598                   | —                    |
| Due 10 years or after                               | 2,203                 | 792                  |
| Total   | \$ 51,638             | \$ 22,204            |

The following table summarizes the Company's investments designated as trading and available-for-sale (in thousands):

|                    | September 30,<br>2011 | December 31,<br>2010 |
|--------------------|-----------------------|----------------------|
| Trading            | \$ 2                  | \$ 6                 |
| Available-for-sale | 51,638                | 22,204               |
| Total              | \$ 51,640             | \$ 22,210            |

The following table summarizes the gross unrealized gains and losses and fair values for investments as of September 30, 2011 and December 31, 2010 aggregated by major security type (in thousands):

|                    | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--------------------|-------------------|------------------------------|-------------------------------|---------------|
| September 30, 2011 |                   |                              |                               |               |
| Debt Securities    | \$ 51,214         | \$ 424                       | \$ —                          | \$ 51,638     |
| December 31, 2010  |                   |                              |                               |               |
| Debt Securities    | \$ 21,882         | \$ 322                       | \$ —                          | \$ 22,204     |

At September 30, 2011, corporate and auction rate debt securities were recorded as available-for-sale. The corporate debt securities have a fixed interest rate. Certain of the auction rate debt securities are illiquid due to failed auctions or conversion following failed auctions into other illiquid instruments. There have been no significant changes in the maturity dates and average interest rates for the Company's investment portfolio and debt obligations subsequent to September 30, 2011. At September 30, 2011, the Company's long-term available-for-sale securities are carried at fair value, with the unrealized gains and losses reported as a component of stockholders' equity.

Investments that have been in an unrealized loss position as of September 30, 2011 and December 31, 2010 were not material to the financial statements.

## Recognition and Measurement of Other-Than-Temporary Impairment

j2 Global regularly reviews and evaluates each investment that has an unrealized loss. An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. Unrealized losses that are determined to be temporary in nature are recorded, net of tax, in accumulated other comprehensive income for available-for-sale securities, while such losses related to held-to-maturity securities are not recorded, as these investments are carried at their amortized cost.

Regardless of the classification of the securities as available-for-sale or held-to-maturity, the Company has assessed each position for impairment.

Factors considered in determining whether a loss is temporary include:

the length of time and the extent to which fair value has been below cost;

the severity of the impairment;

the cause of the impairment and the financial condition and near-term prospects of the issuer;

activity in the market of the issuer which may indicate adverse credit conditions; and

the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

j2 Global's review for impairment generally entails:

identification and evaluation of investments that have indications of possible impairment;

analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position and the expected recovery period;

discussion of evidential matter, including an evaluation of factors or triggers that could cause individual investments to qualify as having an other-than-temporary impairment and those that would not support an other-than-temporary impairment;

documentation of the results of these analyses, as required under business policies; and

information provided by third-party valuation experts.

For these securities, a critical component of the evaluation for other-than-temporary impairments is the identification of credit impairment, where management does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the security. Credit impairment is assessed using a combination of a discounted cash flow model that estimates the cash flows on the underlying securities and a market comparables method, where the security is valued based upon indications from the secondary market of what discounts buyers demand when purchasing similar securities. The cash flow model incorporates actual cash flows from the securities through the current period and then projects the remaining cash flows using relevant interest rate curves over the remaining term. These cash flows are discounted using a number of assumptions, some of which include prevailing implied credit risk premiums, incremental credit spreads and illiquidity risk premiums, among others.

Securities that have been identified as other-than-temporarily impaired are written down to their current fair value. For debt securities that are intended to be sold or that management believes it more-likely-than-not that will be required to sell prior to recovery, the full impairment is recognized immediately in earnings.

For available-for-sale and held-to-maturity securities that management has no intent to sell and believes that it more-likely-than-not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the rest of the fair value impairment is recognized in other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security.

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## 5. Fair Value Measurements

j2 Global complies with the provisions of ASC 820, which defines fair value, provides a framework for measuring fair value and expands the disclosures required for fair value measurements of financial and non-financial assets and liabilities. ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

- § Level 1 – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- § Level 2 – Include other inputs that are directly or indirectly observable in the marketplace.
- § Level 3 – Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company measures its cash equivalents and investments at fair value. j2 Global's cash equivalents, short-term investments and other debt securities are primarily classified within Level 1. Investments in auction rate securities are classified within Level 3. The valuation technique used under Level 3 consists of a discounted cash flow analysis which includes numerous assumptions, including prevailing implied credit risk premiums, incremental credit spreads and illiquidity risk premiums, among others, and a market comparables model where the security is valued based upon indicators from the secondary market of what discounts buyers demand when purchasing similar auction rate securities. There was no change in the technique during the period. Cash equivalents and marketable securities are valued primarily using quoted market prices utilizing market observable inputs. The Company's investments in auction rate securities are classified within Level 3 because there are no active markets for the auction rate securities and, therefore, the Company is unable to obtain independent valuations from market sources. Some of the inputs to the cash flow model are unobservable in the market.

The following tables present the fair values of the Company's financial instruments that are measured at fair value on a recurring basis (in thousands):

| September 30, 2011  | Level 1    | Level 2 | Level 3 | Fair Value |
|---|------------|---------|---------|------------|
| Cash  | \$ 134,190 | \$ —    | \$ —    | \$ 134,190 |
| Equity securities   | 2          | —       | —       | 2          |
| Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies | 5,563      | —       | —       | 5,563      |
| Debt securities issued by states of the United States and political subdivisions of the states  | 14,027     | —       | —       | 14,027     |
| Debt securities issued by foreign governments   | 3,552      | —       | —       | 3,552      |
| Corporate debt securities   | 27,898     | —       | —       | 27,898     |

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|                         |    |         |    |   |     |     |            |
|-------------------------|----|---------|----|---|-----|-----|------------|
| Auction rate securities |    | —       |    | — | 598 |     | 598        |
| Total                   | \$ | 185,232 | \$ | — | \$  | 598 | \$ 185,830 |

| December 31, 2010   | Level 1   | Level 2 | Level 3 | Fair Value |
|---|-----------|---------|---------|------------|
| Cash  | \$ 64,752 | \$ —    | \$ —    | \$ 64,752  |
| Equity securities   | 6         | —       | —       | 6          |
| Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies | 6,603     | —       | —       | 6,603      |
| Debt securities issued by foreign governments   | 2,865     | —       | —       | 2,865      |
| Corporate debt securities   | 12,240    | —       | —       | 12,240     |
| Auction rate securities   | —         | —       | —       | 496        |
| Total   | \$ 86,466 | \$ —    | \$ —    | \$ 86,962  |

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The following table provides a summary of changes in fair value of the Company's Level 3 financial assets as of September 30, 2011 (in thousands):

|   | Level 3 Financial Assets                    |  |
|---|---|--|
|   | Three Months<br>Ended September<br>30, 2011 | Nine Months<br>Ended September<br>30, 2011 |
| Beginning Balance   | \$ 538                                      | \$ 496                                     |
| Total gains (losses) - realized/unrealized<br>Included in earnings                                      | —   | —  |
| Not included in earnings  | 60  | 102  |
| Purchases, issuances and settlements  | —   | —  |
| Transfers in and/or out of Level 3  | —   | —  |
| Balance, September 30, 2011   | \$ 598                                      | \$ 598                                     |
| Total losses for the period included in earnings relating to assets still<br>held at September 30, 2011 | \$ —  | \$ —                                       |

Losses associated with other-than-temporary impairments are recorded as a component of other income. Gains and losses not associated with other-than-temporary impairments are recorded as a component of other comprehensive income.

## 6. Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination. Intangible assets resulting from the acquisitions of entities accounted for using the purchase method of accounting are recorded at the estimated fair value of the assets acquired. Identifiable intangible assets are comprised of purchased customer relationships, trademarks and tradenames, developed technologies and other intangible assets. The fair values of these identified intangible assets are based upon expected future cash flows or income, which take into consideration certain assumptions such as customer turnover, tradenames and patent lives. These determinations are primarily based upon the Company's historical experience and expected benefit of each intangible asset. If it is determined that such assumptions are not accurate, then the resulting change will impact the fair value of the intangible asset. Identifiable intangible assets are amortized using the straight-line method over estimated useful lives ranging from one to 20 years.

The changes in carrying amounts of goodwill for the nine months ended September 30, 2011 are as follows (in thousands):

|                                  |            |
|----------------------------------|------------|
| Balance as of January 1, 2011    | \$ 281,848 |
| Goodwill acquired                | 2,311      |
| Purchase Accounting Adjustments  | (5,156)    |
| Foreign Exchange Translation     | 4          |
| Balance as of September 30, 2011 | \$ 279,007 |

Intangible assets are summarized as of September 30, 2011 as follows (in thousands):

Intangible assets with indefinite lives:



|           |    |        |
|-----------|----|--------|
| Tradename | \$ | 29,653 |
| Other     |    | 5,196  |
| Total     | \$ | 34,849 |

Intangible assets subject to amortization:

|                                | Weighted-Average<br>Amortization<br>Period | Historical<br>Cost | Accumulated<br>Amortization | Net       |
|--------------------------------|--|--------------------|-----------------------------|-----------|
| Tradenames                     | 13.7 years                                 | \$ 9,188           | \$ (3,901)                  | \$ 5,287  |
| Patent and patent licenses     | 8.4 years                                  | 37,451             | (19,843)                    | 17,608    |
| Customer relationships         | 6.7 years                                  | 49,317             | (11,780)                    | 37,537    |
| Other purchased<br>intangibles | 4.7 years                                  | 11,424             | (6,336)                     | 5,088     |
| Total                          |  | \$ 107,380         | \$ (41,860)                 | \$ 65,520 |

Amortization expense, included in general and administrative expense, approximated \$3.4 million and \$1.7 million for the three month period ended September 30, 2011 and 2010, respectively, and \$10.1 million and \$6.6 million for the nine month period ended September 30, 2011 and 2010, respectively. Amortization expense is estimated to approximate \$13.3 million, \$12.3 million, \$11.7 million, \$10.8 million and \$10.0 million for fiscal years 2011 through 2015, respectively, and \$17.4 million thereafter through the duration of the amortization period.

## 7. Commitments and Contingencies

### Litigation

From time-to-time, j2 Global is involved in litigation and other disputes or regulatory inquiries that arise in the ordinary course of its business. Many of these actions involve or are filed in response to patent actions filed by j2 Global against others. The number and significance of these disputes and inquiries has increased as our business has expanded and j2 Global has grown. Any claims or regulatory actions against j2 Global, whether meritorious or not, could be time-consuming, result in costly litigation, require significant management time and result in diversion of significant operational resources.

As part of the Company's continuing effort to prevent the unauthorized use of its intellectual property, j2 Global has initiated litigation against several companies for infringing its patents relating to Internet fax and other messaging technologies, including Open Text Corporation and its Captaris business ("Open Text"), EasyLink Services International Corporation ("EasyLink") and RingCentral, Inc. ("RingCentral"). Three of the patents at issue in some of these lawsuits have been reaffirmed through reexamination proceedings with the United States Patent and Trademark Office (the "USPTO").

Open Text and EasyLink have each filed counterclaims against the Company, including seeking declaratory judgments of non-infringement, invalidity and unenforceability of j2 Global's patents. Open Text also asserted counterclaims purporting to allege antitrust violations of Section 2 of the Sherman Act and California's Business and Professions Code §§ 16720 and 17200, but on September 14, 2011, Open Text dismissed its antitrust counterclaims. Open Text is seeking dismissal of j2 Global's patent infringement claims, damages, including treble and punitive damages, injunctions against further violations and attorneys' fees and costs. These cases are being litigated in the United States District Court for the Central District of California before the same judge, who has indicated that the cases will be handled in a coordinated fashion. Discovery in the cases is underway. The Court completed Part One of a Markman hearing in these cases on October 15, 2010, and issued a related Markman Order on March 4, 2011. Open Text filed a motion for reconsideration of certain portions of the Markman Order, which motion the Court denied in July 2011. The Court completed Part Two of the Markman Hearing on July 29, 2011 and issued a related Markman Order on October 20, 2011, in which the Court adopted j2 Global's proposed construction of every disputed claim term of U.S. Patent Nos. 6,597,688 and 7,020,132. Trial is currently scheduled to begin on May 1, 2012.

On June 1, 2011, j2 Global and one of its affiliates filed suit against RingCentral in the United States District Court for the Central District of California. The complaint alleges infringement of U.S. Patent Numbers 6,208,638, 6,350,066 and 7,020,132. j2 Global and its affiliate are seeking a permanent injunction against continued infringement, a finding of willfulness, compensatory and treble damages, attorneys' fees, interest and costs. On October 11, 2011, RingCentral filed an answer and counterclaims, alleging infringement of U.S. Patent Number 7,702,699 and unfair competition in violation of California's Business & Professions Code § 17200 et. seq.; and seeking declaratory judgment of non-infringement and invalidity and requesting damages, injunctive relief, interest and attorneys' fees and costs. .

On December 24, 2009, COA Network, Inc. ("COA") filed a complaint in the United States District Court for the District of New Jersey, seeking declaratory judgment of non-infringement, invalidity and unenforceability of several of j2 Global's patents. On March 3, 2010, the Company filed an answer to the complaint and counterclaims asserting

that COA infringes two of the Company's patents. Also on March 3, 2010, j2 Global moved to transfer the case to the United States District Court for the Central District of California, or in the alternative to stay the case. On June 17, 2010 the Court granted the Company's motion, transferring the case to the Central District of California. The case is currently in discovery.

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On September 15, 2006, one of the Company's affiliates filed a patent infringement suit against Integrated Global Concepts, Inc. ("IGC") in the United States District Court for the Northern District of Georgia. On May 13, 2008, IGC filed counterclaims alleging violations of Section 2 of the Sherman Act and breach of contract. IGC is seeking damages, including treble and punitive damages, an injunction against further violations, divestiture of certain assets, attorneys' fees and costs. On June 13, 2008, the Company moved to dismiss the amended counterclaims. On February 18, 2009, the Court granted j2 Global's motion to stay the case pending the conclusion of the Company's appeal of a summary judgment ruling of non-infringement in another case which involved the same patents and issues as this action. On January 22, 2010, the Federal Circuit affirmed the District Court's non-infringement ruling in the other case. On June 7, 2010 the Court lifted the stay. On July 16, 2010, the Company renewed its motion to dismiss IGC's amended counterclaims. The Company's motion was heard on February 15, 2011. Subsequently, the case was transferred to a new judge, who conducted a second hearing on the motion. The court ruled on the motion on September 2, dismissing IGC's breach of contract counterclaim and one portion of IGC's antitrust counterclaim.

On May 9, 2007, Bear Creek Technologies, Inc. ("Bear Creek") filed suit against j2 Global in the United States District Court for the Eastern District of Texas, alleging infringement of U.S. Patent Number 6,985,494 (the "'494 patent"). Bear Creek is seeking damages in at least the amount of a reasonable royalty, a permanent injunction against continued infringement, treble damages, attorneys' fees, interest and costs. On June 29, 2007, the Company filed an answer to the complaint denying liability, asserting affirmative defenses and asserting counterclaims of non-infringement and invalidity. On September 21, 2007, Bear Creek filed its reply to the Company's counterclaims, denying each one. On February 11, 2008, j2 Global filed a request for reexamination of the '494 patent with the USPTO. On February 28, 2008, the Court stayed the case during the pendency of the reexamination proceedings. On February 12, 2009, the USPTO finally rejected the reexamined claims and Bear Creek failed to file a response within the prescribed timeframe. On June 16, 2009, the USPTO issued a right to appeal the Examiner's rejection. Bear Creek filed its appeal on September 16, 2009. j2 Global filed its response to Bear Creek's appeal on October 14, 2009. The Examiner provided an answer on June 18, 2010, agreeing with the great majority of the Company's positions. Bear Creek's reply brief was filed July 19, 2010. The USPTO affirmed the Examiner's original rejection of the reexamined claims on September 29, 2011. On September 10, 2009, the Court "Administratively Closed" the case pending resolution of the reexamination proceeding.

In December 2008, AGV Sports Group, Inc. and other co-plaintiffs (collectively, "AGV") filed suit in the United States District Court for the District of Maryland against the Company's newly acquired subsidiary Protus IP Solutions, Inc. ("Protus"), three of Protus' employees and other co-defendants for allegedly sending at least 974 unsolicited fax advertisements to AGV in violation of the federal Telephone Consumer Protection Act of 1991 (the "TCPA") and the Maryland Telephone Consumer Protection Act ("MD-TCPA"). AGV seeks judgment against Protus and the individual defendants for \$500 for each alleged violation of the TCPA, trebled for willfulness pursuant to the TCPA and \$500 for each violation of the MD-TCPA. Protus filed a successful motion to dismiss for lack of personal jurisdiction on behalf of its three employees named as individual defendants. The case has been settled with two of the plaintiffs, representing approximately half of the faxes at issue in the case, and their claims have been dismissed with prejudice. Discovery in the case has closed, except with respect to certain information that was the subject of a motion to compel by Protus. Trial is currently scheduled for January 2012.

On February 17, 2011, Emmanuel Pantelakis ("Pantelakis") filed suit against Protus in the Ontario Supreme Court of Justice alleging that Protus breached a contract with Pantelakis in connection with Protus' e-mail marketing services. Pantelakis is seeking damages, attorneys' fees, interest and costs. Protus filed a responsive pleading on March 23, 2011. Discovery has not yet commenced.

On March 7, 2011, Xpedite Systems, LLC, a subsidiary of Easylink ("Xpedite"), filed suit against j2 Global in the United States District Court for the Northern District of Georgia, Atlanta Division. The complaint alleges infringement of U.S. Patent Numbers 5,872,640 (the "'640 patent") and 7,804,823 (the "'823 patent"). Xpedite is seeking a permanent injunction against continued infringement, damages, treble damages, an accounting of sales and profits,

and interest and costs. j2 Global filed a responsive pleading in this matter in May 2011. In early July 2011, j2 Global submitted requests to put both patents at issue into reexamination proceedings. On September 8, 2011, the Examiner granted j2 Global's reexamination request with respect to the '823 patent, then on September 9, closed the prosecution and affirmed all the claims in the patent. j2 Global intends to appeal this decision with the Board of Patent Appeals and Interferences. On October 1, 2011, the USPTO granted the reexamination request with respect to the '640 patent. On October 14, 2011, j2 Global filed a motion to stay the case in chief while the '640 reexamination proceeding is pending. Discovery has commenced and is ongoing.

On May 10, 2011, Klausner Technologies, Inc. ("Klausner") filed suit against 24 defendants, including j2 Global, in the United States District Court for the Eastern District of Texas, Tyler Division. The complaint alleges infringement of U.S. Patent Numbers 5,572,576 and 5,283,818. Klausner is seeking a permanent injunction against continued infringement, compensatory damages, attorneys' fees, interest and costs. j2 Global filed an answer to the complaint on September 2, 2011. Discovery has not yet commenced.

j2 Global does not believe, based on current knowledge, that any of the foregoing legal proceedings or claims, after giving effect to existing reserves, is likely to have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows. However, depending on the amount and the timing, an unfavorable resolution of some or all of these matters could materially affect j2 Global's consolidated financial position, results of operations or cash flows in a particular period. The Company has not accrued for a loss contingency relating to certain of these legal proceedings because unfavorable outcomes are not considered by management to be probable or reasonably estimable.

## 8. Income Taxes

The Company's tax provision for interim periods is determined using an estimate of the Company's annual effective tax rate. Each quarter the Company updates the estimate of the annual effective tax rate and, if the estimated tax rate changes, makes a cumulative adjustment. j2 Global's annual effective tax rate is normally lower than the 35% U.S. federal statutory rate and applicable apportioned state tax rates primarily due to anticipated earnings of the Company's subsidiaries outside of the U.S. in jurisdictions where the Company's effective tax rate is lower than in the U.S. For the quarter ended September 30, 2011, the effective tax rate was 30.6% which includes certain return to provision adjustments offset by a reversal of uncertain income tax positions as a result of expiring statutes of limitations. j2 Global does not provide for U.S. income taxes on the undistributed earnings of the Company's foreign operations because the Company intends to reinvest such earnings in foreign jurisdictions. Income before income taxes included income from domestic operations of \$47.2 million and \$82.5 million for the nine months ended September 30, 2011 and 2010, respectively, and income (loss) from foreign operations of \$50.5 million and (\$3.2) million for the nine months ended September 30, 2011 and 2010, respectively.

As of September 30, 2011 and December 31, 2010, the Company had \$28.2 million and \$37.9 million, respectively, in liabilities for uncertain income tax positions. The decrease in liabilities for uncertain income tax positions was primarily the result of expiration of statutes of limitations. Accrued interest and penalties related to unrecognized tax benefits are recognized in income tax expense on the Company's consolidated statement of operations.

Cash paid for income taxes was \$8.1 million for the nine months ended September 30, 2011.

Certain tax payments are prepaid during the year and included within prepaid expenses and other current assets on the consolidated balance sheet. The Company's prepaid tax payments were \$12.3 million and \$7.5 million at September 30, 2011 and December 31, 2010, respectively.

j2 Global is currently under audit by the California Franchise Tax Board ("FTB") for tax years 2005 through 2007. The FTB has also issued Information Document Requests regarding the 2008 tax year, although no formal notice of audit for 2008 has been provided. The Company is also under audit by the IRS for tax year 2009 and has received verbal notice from the Canada Revenue Agency ("CRA") regarding an audit of value added sales taxes for tax years 2009 through 2011. It is possible that these audits may conclude in the next 12 months and that the unrecognized tax benefits the Company has recorded in relation to these tax years may change compared to the liabilities recorded for these periods. However, it is not currently possible to estimate the amount, if any, of such change.

j2 Global is also under audit by various states for non-income related taxes.

## 9. Stockholders' Equity

### Common Stock Repurchase Program

In May 2010, j2 Global's Board of Directors approved a program authorizing the repurchase of up to ten million shares of the Company's common stock through the end of April 30, 2012. On May 4, 2010, the Company entered into a Rule 10b5-1 trading plan to facilitate the repurchase program. During the year ended December 31, 2010, 6,300 shares were repurchased at an aggregated cost of \$0.1 million (including an immaterial amount of commission fees). j2 Global has accounted for these repurchases using the cost method. No shares were repurchased by the Company under the repurchase program during the nine months ended September 30, 2011.

Periodically, participants in j2 Global's stock plans surrender to the Company shares of j2 Global stock to pay the exercise price or to satisfy tax withholding obligations arising upon the exercise of stock options or the vesting of

restricted stock. During the three month period ended September 30, 2011, the Company purchased 249,179 shares from plan participants for this purpose. See Item II, Part 2. Unregistered Sales of Equity Securities and Use of Proceeds.

#### Dividends

On August 1, 2011, the Company's Board of Directors approved the initiation of quarterly cash dividends to its stockholders. The first quarterly dividend of \$0.20 per share of common stock was paid on September 19, 2011 to all stockholders of record as of the close of business on September 2, 2011. On November 2, 2011, the Company announced that its Board of Directors had approved the declaration of a quarterly cash dividends to its stockholders of \$0.205 per share of common stock payable on November 28, 2011 to all stockholders of record as of the close of business on November 14, 2011. Future dividends will be subject to Board approval.

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## 10. Stock Options and Employee Stock Purchase Plan

j2 Global's share-based compensation plans include the Second Amended and Restated 1997 Stock Option Plan (the "1997 Plan"), 2007 Stock Plan (the "2007 Plan") and 2001 Employee Stock Purchase Plan (the "Purchase Plan"). Each plan is described below.

The 1997 Plan terminated in 2007. A total of 12,000,000 shares of common stock were authorized to be used for 1997 Plan purposes. An additional 840,000 shares were authorized for issuance upon exercise of options granted outside the 1997 Plan. As of September 30, 2011, 1,017,852 shares underlying options and 33,840 shares of restricted stock were outstanding under the 1997 Plan, all of which continue to be governed by the 1997 Plan.

The 2007 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, restricted stock units and other share-based awards. 4,500,000 shares of common stock are authorized to be used for 2007 Plan purposes. Options under the 2007 Plan may be granted at exercise prices determined by the Board of Directors, provided that the exercise prices shall not be less than the fair market value of j2 Global's common stock on the date of grant for incentive stock options and not less than 85% of the fair market value of j2 Global's common stock on the date of grant for non-statutory stock options. As of September 30, 2011, 1,084,271 shares underlying options and 715,843 shares of restricted stock were outstanding under the 2007 Plan.

All stock option grants are approved by "outside directors" within the meaning of Internal Revenue Code Section 162(m).

### Stock Options

The following table represents stock option activity for the nine months ended September 30, 2011:

|  | Number of<br>Shares | Weighted-<br>Average<br>Exercise<br>Price | Weighted-Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value |
|--|---------------------|---|---|---------------------------------|
| Outstanding at January 1, 2011                       | 3,794,394           | \$ 14.40                                  |   |                                 |
| Granted  | 130,819             | 29.01                                     |   |                                 |
| Exercised  | (1,781,950)         | 8.04                                      |   |                                 |
| Canceled   | (41,140)            | 24.69                                     |   |                                 |
| Outstanding at September 30, 2011                    | 2,102,123           | 20.50                                     | 5.8   | \$ 15,655,942                   |
| Exercisable at September 30, 2011                    | 1,179,263           | 19.23                                     | 4.3   | \$ 10,587,334                   |
| Vested and expected to vest at<br>September 30, 2011 | 1,959,636           | \$ 20.34                                  | 5.6   | \$ 14,970,305                   |

For the nine months ended September 30, 2011, j2 Global granted 130,819 options to purchase shares of common stock pursuant to the 2007 Plan. These stock options vest 20% per year and expire 10 years from the date of grant.

The per share weighted-average grant-date fair values of stock options granted during the nine months ended September 30, 2011 and 2010 were \$13.12 and \$10.94, respectively.

The aggregate intrinsic values of options exercised during the nine months ended September 30, 2011 and 2010 were \$38.9 million and \$10.0 million, respectively.



As of September 30, 2011 and December 31, 2010, unrecognized stock compensation related to non-vested stock options granted under the 1997 Plan and the 2007 Plan approximated \$10.2 million and \$12.9 million, respectively. Unrecognized stock compensation expense related to non-vested stock options granted under these plans is expected to be recognized ratably over a weighted-average period of 2.6 years (i.e., the remaining requisite service period).

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## Fair Value Disclosure

j2 Global uses the Black-Scholes option pricing model to calculate the fair value of each option grant. The expected volatility for the nine months ended September 30, 2011 is based on historical volatility of the Company's common stock. The Company elected to use the simplified method for estimating the expected term. Under the simplified method, the expected term is equal to the midpoint between the vesting period and the contractual term of the stock option. The risk-free interest rate is based on U.S. Treasury zero-coupon issues with a term equal to the expected term of the option assumed at the date of grant. Prior to the initial declaration of a cash dividend on August 1, 2011, the fair value of stock options, restricted stock and restricted stock units were measured based upon an expected dividend yield of 0% as the Company did not historically pay cash dividends on its common stock. For awards granted on or subsequent to August 1, 2011, the Company uses an annualized dividend yield based upon the per share dividends declared by its Board of Directors. No awards were granted subsequent to August 1, 2011; accordingly, the assumptions below in determining the fair values of stock options include a dividend yield of 0%. Estimated forfeiture rates were 14.82% and 14.19% as of September 30, 2011 and 2010, respectively.

The weighted-average fair values of stock options granted have been estimated utilizing the following assumptions:

|                             | Nine Months Ended     |       |
|-----------------------------|-----------------------|-------|
|                             | September 30,<br>2011 | 2010  |
| Risk-free interest rate     | 2.39%                 | 2.65% |
| Expected term (in years)    | 6.5                   | 6.5   |
| Dividend yield              | 0%                    | 0%    |
| Expected volatility         | 42%                   | 44%   |
| Weighted-average volatility | 42%                   | 45%   |

## Restricted Stock

j2 Global has awarded restricted stock and restricted stock units to its board of directors and senior staff pursuant to the 1997 Plan and the 2007 Plan. Compensation expense resulting from restricted stock and restricted unit grants is measured at fair value on the date of grant and is recognized as share-based compensation expense over a five-year vesting period. The Company recognized \$1.0 million and \$2.8 million of compensation expense in the three and nine months ended September 30, 2011, respectively, related to restricted stock and restricted stock units. As of September 30, 2011 and December 31, 2010, the Company had unrecognized share-based compensation cost of approximately \$11.5 million and \$12.0 million, respectively, associated with these shares and units. This cost is expected to be recognized over a weighted-average period of 2.7 years for awards and 3.8 years for units.

Restricted stock award activity for the nine months ended September 30, 2011 is set forth below:

|                                 | Shares    | Weighted-Average<br>Grant-Date<br>Fair Value |
|---------------------------------|-----------|--|
| Nonvested at January 1, 2011    | 816,670   | \$19.59                                      |
| Granted                         | 95,712    | 28.85  |
| Vested                          | (152,524) | 20.94  |
| Canceled                        | (28,675)  | 17.61  |
| Nonvested at September 30, 2011 | 731,183   | \$20.60                                      |

Restricted stock unit award activity for the nine months ended September 30, 2011 is set forth below:

|                                 | Shares  |    | Weighted-Average<br>Grant-Date<br>Fair Value |
|---------------------------------|---------|----|--|
| Nonvested at January 1, 2011    | 17,500  | \$ | 23.59  |
| Granted                         | 2,000   |    | 29.21  |
| Vested                          | (1,000) |    | 20.72  |
| Canceled                        | —       |    | —  |
| Nonvested at September 30, 2011 | 18,500  | \$ | 23.75  |

## Share-Based Compensation Expense

The following table represents share-based compensation expense included in cost of revenues and operating expenses in the accompanying condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010 (in thousands):

|                                       | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                       | 2011                                | 2010     | 2011                               | 2010     |
| Cost of revenues                      | \$ 246                              | \$ 304   | \$ 736                             | \$ 963   |
| Operating expenses:                   |                                     |          |                                    |          |
| Sales and marketing                   | 350                                 | 464      | 1,049                              | 1,460    |
| Research, development and engineering | 110                                 | 204      | 367                                | 645      |
| General and administrative            | 1,542                               | 1,805    | 4,532                              | 5,699    |
| Total                                 | \$ 2,248                            | \$ 2,777 | \$ 6,684                           | \$ 8,767 |

## Employee Stock Purchase Plan

The Purchase Plan provides for the issuance of a maximum of two million shares of common stock. Under the Purchase Plan, eligible employees can have up to 15% of their earnings withheld, up to certain maximums, to be used to purchase shares of j2 Global's common stock at certain plan-defined dates. The price of the common stock purchased under the Purchase Plan for the offering periods is equal to 95% of the fair market value of the common stock at the end of the offering period. For the nine months ended September 30, 2011 and 2010, 4,127 and 3,937 shares were purchased under the plan, respectively. Cash received upon the issuance of common stock under the Purchase Plan was \$110,000 and \$85,000 for the nine months ended September 30, 2011 and 2010, respectively. As of September 30, 2011, 1,652,506 shares were available under the Purchase Plan for future issuance.

## 11. Earnings Per Share

The components of basic and diluted earnings per share are as follows (in thousands, except share and per share data):

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2011                                | 2010       | 2011                               | 2010       |
| Numerator for basic and diluted net earnings per common share: |                                     |            |                                    |            |
| Net earnings   | \$ 25,498                           | \$ 19,834  | \$ 84,947                          | \$ 56,180  |
| Net earnings available to participating securities (a)         | (392 )                              | —          | (1,414 )                           | —          |
| Net earnings available to common shareholders                  | 25,106                              | 19,834     | 83,533                             | 56,180     |
| Denominator:   |                                     |            |                                    |            |
| Weighted-average outstanding shares of common stock            | 45,993,328                          | 44,716,366 | 45,498,763                         | 44,488,561 |

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Dilutive effect of:                       |            |            |            |            |
| Dilutive effect of equity incentive plans | 462,256    | 1,222,806  | 610,127    | 1,249,828  |
| Common stock and common stock equivalents | 46,455,584 | 45,939,172 | 46,108,890 | 45,738,389 |
| Net earnings per share:                   |            |            |            |            |
| Basic                                     | \$ 0.55    | \$ 0.44    | \$ 1.84    | \$ 1.26    |
| Diluted                                   | \$ 0.54    | \$ 0.43    | \$ 1.81    | \$ 1.23    |

- (a) Represents unvested share-based payment awards that contain certain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid).

For the three and nine months ended September 30, 2011 and 2010, there were 400,352 and 709,067 options outstanding, respectively, and 404,973 and 709,930 options outstanding, respectively, which were excluded from the computation of diluted earnings per share because the exercise prices were greater than the average market price of the common shares.

## 12. Comprehensive Income

The components of comprehensive income were net earnings and accumulated other comprehensive income. Comprehensive income for the three and nine months ended September 30, 2011 and 2010 is as follows (in thousands):

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2011                                | 2010      | 2011                               | 2010      |
| Net Earnings   | \$ 25,498                           | \$ 19,834 | \$ 84,947                          | \$ 56,180 |
| Other comprehensive income, net of tax:                              |                                     |           |                                    |           |
| Foreign currency translation adjustment, net of tax                  | (1,864)                             | 1,624     | (417)                              | (222)     |
| Unrealized (loss) gain on available-for-sale investments, net of tax | (73)                                | 629       | (23)                               | 1,043     |
| Other comprehensive (loss) income, net of tax                        | (1,936)                             | 2,253     | (440)                              | 821       |
| Comprehensive Income   | \$ 23,562                           | \$ 22,087 | \$ 84,507                          | \$ 57,001 |

## 13. Geographic Information

j2 Global maintains operations in the U.S., Canada, Ireland, Japan and other international territories. Geographic information about the U.S. and international territories for the reporting periods is presented below. Such information attributes revenues based on the tax jurisdiction applicable to the operation generating the revenue.

|                     | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|---------------------|-------------------------------------|-----------|------------------------------------|------------|
|                     | 2011                                | 2010      | 2011                               | 2010       |
| Revenues:           |                                     |           |                                    |            |
| United States       | \$ 52,891                           | \$ 52,241 | \$ 150,493                         | \$ 155,158 |
| All other countries | 33,136                              | 10,537    | 94,593                             | 29,211     |
|                     | \$ 86,027                           | \$ 62,778 | \$ 245,087                         | \$ 184,369 |

|                     | September 30,<br>2011 | December 31,<br>2010 |
|---------------------|-----------------------|----------------------|
| Long-lived assets:  |                       |                      |
| United States       | \$ 34,766             | \$ 36,033            |
| All other countries | 45,088                | 45,078               |
| Total               | \$ 79,854             | \$ 81,111            |

Revenues for the nine months ended September 30, 2011 reflect a change in estimate of the remaining service obligation to eFax® annual subscribers in the amount of \$10.3 million which reduced subscriber revenues

predominately in the United States (See Note 1 – Basis of Presentation) for further details.

14. Subsequent Events

In October 2011, we purchased for cash the online backup business of C Infinity, an Ireland-based provider of online data backup and hosting services for businesses. This acquisition is designed to be accretive and to provide us additional online data backup customers. The financial impact to j2 Global for this transactions is immaterial as of the date of the acquisition.

On November 2, 2011, the Company announced that its Board of Directors had approved the declaration of a quarterly cash dividend to its shareholders. The dividend of \$0.205 per common share will be paid on November 28, 2011 to all shareholders of record as of the close of business on November 14, 2011. Future dividends will be subject to Board approval.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Information

In addition to historical information, the foregoing Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. These forward-looking statements involve risks, uncertainties and assumptions. The actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those discussed below, the risk factors discussed in Part II, Item 1A - "Risk Factors" of this Quarterly Report on Form 10-Q (if any) and in Part I, Item 1A - "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010 (together, the "Risk Factors"), and the factors discussed in the section in this Quarterly Report on Form 10-Q entitled "Quantitative and Qualitative Disclosures About Market Risk." Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's opinions only as of the date hereof. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Readers should carefully review the Risk Factors and the risk factors set forth in other documents we file from time to time with the SEC.

Some factors that could cause actual results to differ materially from those anticipated in these forward-looking statements include, but are not limited to, our ability and intention to:

- O Sustain growth or profitability, particularly in light of an uncertain U.S. or worldwide economy and the related impact on customer acquisition and retention rates, customer usage levels and credit and debit card payment declines;
- O Maintain and expand our customer base and maintain or increase the average revenue per subscriber;
- O Continue to expand our business and operations internationally in the wake of numerous risks, including adverse currency fluctuations, difficulty in staffing and managing international operations, higher operating costs as a percentage of revenues or the implementation of adverse regulations;
- O Maintain our financial position, operating results and cash flows in the event that we incur new or unanticipated costs or income, sales or other tax liabilities;
- O Accurately estimate the assumptions underlying our effective worldwide tax rate;
- O Continue to pay a comparable cash dividend on a quarterly basis;
- O Maintain favorable relationships with critical third-party vendors whose financial condition will not negatively impact the services they provide;
- O Manage certain risks inherent to our business, such as costs associated with fraudulent activity, a system failure or security breach of our network, effectively maintaining and managing our billing systems, time and resources required to manage our legal proceedings or adhering to our internal controls and procedures;



- O Compete with other similar providers with regard to price, service and functionality;
- O Cost-effectively procure, retain and deploy large quantities of telephone numbers in desired locations in the United States and abroad;
- O Achieve business and financial objectives in light of burdensome domestic and international telecommunications, Internet or other regulations including data privacy, security and retention;
- O Successfully manage our growth, including but not limited to our operational and personnel-related resources, and integrate newly acquired businesses;
- O Successfully adapt to technological changes in the value added messaging and communications services industry;
- O Successfully develop and protect our intellectual property, both domestically and internationally, including our brands, patents, trademarks and domain names, and avoid infringing upon the proprietary rights of others;
- O Diversify our service offerings and derive more revenue from those services at acceptable levels of returns-on-investment; and
- O Recruit and retain key personnel.

In addition, our financial results could be materially impacted by risks associated with new accounting pronouncements.

## Overview

j2 Global Communications, Inc. (“j2 Global”, “our”, “us” or “we”) is a Delaware corporation founded in 1995. We provide cloud-based, value-added communication, messaging and data backup services to businesses of all sizes, from individuals to enterprises. Our hosted solutions deliver our customers greater efficiency, flexibility, mobility, business continuity and security. We offer online fax, virtual phone systems, hosted email, email marketing, online backup and bundled suites of these services. We market our services principally under the brand names eFax®, eVoice®, FuseMail®, Campaigner®, KeepItSafe® and Onebox®.

We deliver many of our services in more than 4,600 cities in 49 countries across six continents. We provide these services through equipment we co-locate at various locations worldwide, telephone numbers (referred to herein as Direct Inward-Dial numbers or “DIDs”) obtained from third-party telecommunications providers and Internet bandwidth typically obtained from third-party co-location providers. Most of the DIDs we obtain for our services are “local” (as opposed to toll-free), which enables us to provide our paying subscribers DIDs with a geographic identity.

Our services make our customers more efficient, more mobile, more cost-effective and more secure than traditional alternatives. We generate substantially all of our revenues from subscribers that pay subscription and usage fees. Subscription fees are referred to as “fixed” revenues, while usage fees are referred to as “variable” revenues. We also generate revenues from patent licensing and sales, advertising and revenue share from our customers’ use of premium rate DIDs. Of the 13.3 million DIDs deployed as of September 30, 2011, over 1.9 million were serving paying subscribers, with the balance deployed to free subscribers, including those with premium rate DIDs. We operate in one reportable segment: cloud-based, value-added communication, messaging and data backup services.

During the past three years, we have derived a substantial portion of our revenues from our DID-based services, including eFax, Onebox and eVoice . As a result, we believe that paying DIDs and the revenues associated therewith are an important metric for understanding our business. It has been and continues to be our objective to increase the number of paying DIDs through a variety of distribution channels and marketing arrangements and by enhancing our brand awareness. In addition, we seek to increase revenues through a combination of stimulating use by our customers of usage-based services and introducing new services.

We market our services to a broad spectrum of prospective business customers including individuals, small to medium-sized businesses and large enterprises and government organizations. Our marketing efforts include enhancing brand awareness; utilizing online advertising, search engines and affiliate programs; and selling through both a telesales and direct sales force. We continuously seek to extend the number of distribution channels through which we acquire paying customers and improve the cost and volume of customers obtained through our current channels.

In addition to growing our business organically, we have used acquisitions to grow our customer base, enhance our technology, expand our service offerings and acquire skilled personnel. Since fiscal year 2000, we have completed 34 acquisitions in the cloud-based, value-added communication, messaging and data backup services industry.

Through a combination of internal technology development and acquisitions, we have built a portfolio of numerous U.S. and foreign patents and multiple pending U.S. and foreign patent applications. We generate licensing revenues from some of these patents. We intend to continue to invest in patents, to aggressively protect our patent assets from unauthorized use and to continue to generate patent licensing revenues from authorized users.

The following table sets forth certain key operating metrics for the three and nine months ended September 30, 2011 and 2010 (in thousands, except for percentages):

|  | September 30,      |           |                   |            |
|--|--------------------|-----------|-------------------|------------|
|  | 2011               | 2010      |                   |            |
| Free service telephone numbers           | 11,327             |           | 11,078            |            |
| Paying telephone numbers                 | 1,994              |           | 1,411             |            |
| Total active telephone numbers           | 13,321             |           | 12,489            |            |
|  |                    |           |                   |            |
|  | Three Months Ended |           | Nine Months Ended |            |
|  | September 30,      | 2010      | September 30,     | 2010       |
|  | 2011               |           | 2011 (1)          |            |
| Subscriber revenues:                     |                    |           |                   |            |
| Fixed                                    | \$ 70,365          | \$ 50,270 | \$ 197,061        | \$ 148,606 |
| Variable                                 | 15,258             | 11,796    | 46,727            | 33,567     |
| Total subscriber revenues                | \$ 85,622          | \$ 62,066 | \$ 243,788        | \$ 182,173 |
| Percentage of total subscriber revenues: |                    |           |                   |            |
| Fixed                                    | 82.2%              | 81.0%     | 80.8%             | 81.6%      |
| Variable                                 | 17.8%              | 19.0%     | 19.2%             | 18.4%      |
| Revenues:                                |                    |           |                   |            |
| DID-based                                | \$ 79,856          | \$ 59,585 | \$ 226,506        | \$ 175,221 |
| Non-DID-based                            | 6,171              | 3,193     | 18,581            | 9,148      |
| Total revenues                           | \$ 86,027          | \$ 62,778 | \$ 245,087        | \$ 184,369 |

- (1) The amounts above reflect the change in estimate relating to the remaining service obligations to annual eFax® subscribers (See Note 1 – Basis of Presentation), which reduced subscriber revenues for the nine months ended September 30, 2011 by \$10.3 million.

#### Critical Accounting Policies and Estimates

In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements. Actual results could differ significantly from those estimates under different assumptions and conditions. Our critical accounting policies are described in our 2010 Annual Report on Form 10-K filed with the SEC on February 28, 2011. During the three months ended September 30, 2011, there were no significant changes in our critical accounting policies and estimates.

## Results of Operations for the Three and Nine Months Ended September 30, 2011

## Revenues

## Subscriber Revenues.

| (in thousands,<br>except percentages) | Three months ended<br>September 30, |          | Percentage<br>Change | Nine months ended<br>September 30, |           | Percentage<br>Change |
|---------------------------------------|-------------------------------------|----------|----------------------|------------------------------------|-----------|----------------------|
|                                       | 2011                                | 2010     |                      | 2011                               | 2010      |                      |
| Subscriber Revenues                   | \$85,622                            | \$62,066 | 38%                  | \$243,788                          | \$182,173 | 34%                  |

Subscriber revenues consist of both a fixed monthly or annual recurring subscription component and a variable component which is driven by the actual usage of our service offerings. Over the past three calendar years, the fixed portion of our subscriber revenues has generally contributed an increasing percentage to our total subscriber revenues. This increase in subscriber revenues was due to an increase in our subscriber base offset by the impact of our change in estimate relating to remaining service obligations to eFax® annual subscribers (See Note 1 – Basis of Presentation) which reduced subscriber revenues for the nine months ended September 30, 2011 by \$10.3 million. The increase in our subscriber base primarily resulted from new subscribers due to business acquisitions and subscribers coming directly to our websites, free-to-paid subscriber upgrades, small to mid-sized corporate and enterprise sales, direct large enterprise and government sales, direct marketing costs for acquisition of paying subscribers and international sales, in each case net of cancellations.

## Other Revenues.

| (in thousands,<br>except percentages) | Three months ended<br>September 30, |       | Percentage<br>Change | Nine months ended<br>September 30, |         | Percentage<br>Change |
|---------------------------------------|-------------------------------------|-------|----------------------|------------------------------------|---------|----------------------|
|                                       | 2011                                | 2010  |                      | 2011                               | 2010    |                      |
| Other Revenues                        | \$405                               | \$712 | (43)%                | \$1,299                            | \$2,196 | (41)%                |

Other revenues consist primarily of patent licensing revenues, patent sale-related revenues and advertising revenues generated by delivering email messages to our free customers on behalf of advertisers. The decrease in other revenues for the three and nine months ended September 30, 2011 resulted primarily from reduced advertising activities and a reduction in patent related revenues due to the expiration of certain patents under license.

## Cost of Revenues

| (in thousands,<br>except percentages) | Three months ended<br>September 30, |          | Percentage<br>Change | Nine months ended<br>September 30, |          | Percentage<br>Change |
|---------------------------------------|-------------------------------------|----------|----------------------|------------------------------------|----------|----------------------|
|                                       | 2011                                | 2010     |                      | 2011                               | 2010     |                      |
| Cost of revenue                       | \$15,002                            | \$10,732 | 41%                  | \$45,952                           | \$31,378 | 46%                  |
| As a percent of revenue               | 17%                                 | 17%      | -%                   | 19%                                | 17%      | 2%                   |

Cost of revenues is primarily comprised of costs associated with data and voice transmission, DIDs, network operations, customer service, online processing fees and equipment depreciation. The increase in cost of revenues for the three and nine months ended September 30, 2011 was primarily due to an increase in costs associated with businesses acquired in fiscal 2010 and 2011 that for at least some portion of the first nine months of fiscal 2011 were not yet fully integrated into j2 Global.

## Operating Expenses

## Sales and Marketing.

| (in thousands,<br>except percentages) | Three months ended<br>September 30, |          | Percentage<br>Change | Nine months ended<br>September 30, |          | Percentage<br>Change |
|---------------------------------------|-------------------------------------|----------|----------------------|------------------------------------|----------|----------------------|
|                                       | 2011                                | 2010     |                      | 2011                               | 2010     |                      |
| Sales and<br>Marketing                | \$15,073                            | \$10,878 | 39%                  | \$44,929                           | \$32,327 | 39%                  |
| As a percent of<br>revenue            | 18%                                 | 17%      | 1%                   | 18%                                | 18%      | -%                   |

Our sales and marketing costs consist primarily of Internet-based advertising, sales and marketing, personnel costs and other business development-related expenses. Our Internet-based advertising relationships consist primarily of fixed cost and performance-based (cost-per-impression, cost-per-click and cost-per-acquisition) advertising relationships with an array of online service providers. We have a disciplined return-on-investment approach to our Internet-based advertising and marketing spend, which causes sales and marketing costs as a percentage of total revenues to vary from period to period based upon available opportunities. Advertising cost for the three months ended September 30, 2011 and 2010 was \$11.8 million and \$8.7 million, respectively, and for the nine months ended September 30, 2011 and 2010 were \$34.2 million and \$25.9 million, respectively. The increase in sales and marketing expenses for the three months ended September 30, 2011 was primarily due to increased marketing worldwide for recently acquired brands and certain international locations and an increase in personnel associated with businesses acquired subsequent to the prior comparable quarter. The increase in sales and marketing expenses for the nine months ended September 30, 2011 was primarily due to increased marketing worldwide for recently acquired brands and certain international locations and an increase in personnel and severance costs associated with businesses acquired subsequent to the prior comparable period.

## Research, Development and Engineering.

| (in thousands,<br>except percentages)       | Three months ended<br>September 30, |         | Percentage<br>Change | Nine months ended<br>September 30, |         | Percentage<br>Change |
|---|-------------------------------------|---------|----------------------|------------------------------------|---------|----------------------|
|   | 2011                                | 2010    |                      | 2011                               | 2010    |                      |
| Research,<br>Development and<br>Engineering | \$4,105                             | \$3,008 | 36%                  | \$12,714                           | \$8,810 | 44%                  |
| As a percent of<br>revenue                  | 5%                                  | 5%      | -%                   | 5%                                 | 5%      | -%                   |

Our research, development and engineering costs consist primarily of personnel-related expenses. The increase in research, development and engineering costs for the three months ended September 30, 2011 was primarily due to an increase in personnel associated with businesses acquired subsequent to the prior comparable quarter. The increase in research, development and engineering costs for the nine months ended September 30, 2011 was primarily due to an increase in personnel and severance costs associated with businesses acquired subsequent to the prior comparable period.

## General and Administrative.

| (in thousands,<br>except percentages) | Three months ended<br>September 30, |          | Percentage<br>Change | Nine months ended<br>September 30, |          | Percentage<br>Change |
|---------------------------------------|-------------------------------------|----------|----------------------|------------------------------------|----------|----------------------|
|                                       | 2011                                | 2010     |                      | 2011                               | 2010     |                      |
| General and<br>Administrative         | \$15,403                            | \$10,921 | 41%                  | \$44,037                           | \$34,263 | 29%                  |
| As a percent of<br>revenue            | 18%                                 | 17%      | 1%                   | 18%                                | 19%      | (1)%                 |

Our general and administrative costs consist primarily of personnel-related expenses, depreciation and amortization, share-based compensation expense, bad debt expense, professional fees and insurance costs. The increase in general and administrative expense for the three months ended September 30, 2011 was primarily due to an increase in personnel associated with businesses acquired subsequent to the prior comparable quarter, increased bad debt, increased professional fees and amortization of intangible assets relating to acquisitions closed during 2010 and 2011. The increase in general and administrative expense for the nine months ended September 30, 2011 was primarily due to an increase in personnel and severance costs associated with businesses acquired subsequent to the prior comparable quarter, increased bad debt, increased professional fees and amortization of intangible assets relating to acquisitions closed during 2010 and 2011.

## Share-Based Compensation

The following table represents share-based compensation expense included in cost of revenues and operating expenses in the accompanying condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010 (in thousands):

|                     | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|---------------------|-------------------------------------|--------|------------------------------------|--------|
|                     | 2011                                | 2010   | 2011                               | 2010   |
| Cost of revenues    | \$ 246                              | \$ 304 | \$ 736                             | \$ 963 |
| Operating expenses: |                                     |        |                                    |        |
| Sales and marketing | 350                                 | 464    | 1,049                              | 1,460  |

|                                       |          |          |          |          |
|---------------------------------------|----------|----------|----------|----------|
| Research, development and engineering | 110      | 204      | 367      | 645      |
| General and administrative            | 1,542    | 1,805    | 4,532    | 5,699    |
| Total                                 | \$ 2,248 | \$ 2,777 | \$ 6,684 | \$ 8,767 |

#### Non-Operating Income and Expenses

Interest and Other Income (Expense), net . Our interest and other income (expense), net is generated primarily from interest earned on cash, cash equivalents and short-term and long-term investments and gain or losses on foreign exchange. Interest and other income (expense), net was \$0.3 million and \$0.5 million for the three months ended September 30, 2011 and 2010, respectively, and \$0.3 million and \$1.8 million for the nine months ended September 30, 2011 and 2010, respectively. The decrease in interest and other income (expense), net was primarily due to reduced interest income as a result of the sale of interest-bearing securities to fund acquisitions.

## Income Taxes

Our effective tax rate is based on pre-tax income, statutory tax rates, tax regulations (including those related to transfer pricing) and different tax rates in the various jurisdictions in which we operate. The tax bases of our assets and liabilities reflect our best estimate of the tax benefits and costs we expect to realize. When necessary, we establish valuation allowances to reduce our deferred tax assets to an amount that will more likely than not be realized.

Provision for income taxes amounted to \$11.2 million and \$7.9 million for the three months ended September 30, 2011 and 2010, respectively. Income tax expense for the nine months ended September 30, 2011 and 2010 was \$12.8 million and \$23.2 million, respectively. Our effective tax rate was 30.6% and 28.5% for the three months ended September 30, 2011 and 2010, respectively, and 13.1% and 29.2% for the nine months ended September 30, 2011 and 2010, respectively. The increase in our effective income tax rate for the three months ended September 30, 2011 was primarily attributable to return to provision adjustments offset by a reversal of uncertain income tax positions as a result of expiring statutes of limitations. The decrease in our effective income tax rate for the nine months ended September 30, 2011 was primarily attributable to the following:

1. a reversal during the first quarter 2011 of approximately \$14.1 million and the third quarter 2011 of approximately \$1.1 million of uncertain income tax positions as a result of expiring statutes of limitations, offset by return to provision adjustments in the third quarter of 2011;
2. an increase during 2011 in foreign tax credits and our ability to offset such credits against Subpart F income;
3. the use of the federal research and development tax credit in 2011, which was previously suspended as of June 30, 2010;
4. an increase during 2011 in the portion of our income being taxed in foreign jurisdictions and subject to lower tax rates than in the U.S., partially offset by:
5. a 2010 book but not tax gain on the sale of an impaired auction rate security, which sale resulted in a significant portion of the valuation allowance being reversed; and
6. a reversal in 2010 of certain income tax contingencies allowed to be recognized as a result of effectively settling the transfer pricing portion of the Internal Revenue Service's audit of our income tax returns for 2004 through 2008.

## Liquidity and Capital Resources

### Cash and Cash Equivalents and Investments

At September 30, 2011, we had cash and investments of \$193.8 million compared to cash and investments of \$87.0 million at December 31, 2010. The increase in cash and investments resulted primarily from cash provided by operations. At September 30, 2011, cash and investments consisted of cash and cash equivalents of \$134.2 million, short-term investments of \$29.0 million and long-term investments of \$30.6 million. Our investments are comprised primarily of readily marketable corporate debt securities, money-market accounts and time deposits. For financial statement presentation, we classify our investments primarily as available-for-sale; thus, they are reported as short- and long-term based upon their maturity dates. Short-term investments mature within one year of the date of the financial statements and long-term investments mature one year or more from the date of the financial statements. Our long-term investments consist primarily of corporate and government debt securities. There have been no significant changes in the maturity dates and average interest rates for our investment portfolio and debt



obligations subsequent to September 30, 2011. We retain a substantial portion of our cash and investments in foreign jurisdictions for future reinvestment. As of September 30, 2011, cash and investments held within foreign and domestic jurisdictions were \$73.4 million and \$120.4 million, respectively. If we were to repatriate funds held within foreign jurisdictions, we would incur U.S. income tax on the repatriated amount at an approximate blended federal and state rate of 40%, net of a credit for foreign taxes paid on such amounts.

On August 1, 2011, the Company's Board of Directors approved the initiation of quarterly cash dividends to its stockholders. The first quarterly dividend of \$0.20 per share of common stock was paid on September 19, 2011 to all stockholders of record as of the close of business on September 2, 2011. On November 2, 2011, the Company announced that its Board of Directors had approved the declaration of a quarterly cash dividend to its stockholders. The dividend of \$0.205 per share of common stock will be paid on November 28, 2011 to all stockholders of record as of the close of business on November 14, 2011. Future dividends are subject to Board approval and certain restrictions within the Credit Agreement (the "Credit Agreement") with Union Bank, N.A. ("Lender").

We currently anticipate that our existing cash and cash equivalents and short-term investment balances and cash generated from operations will be sufficient to meet our anticipated needs for working capital, capital expenditure, investment requirements, stock repurchases and cash dividends for at least the next 12 months.

## Cash Flows

Our primary sources of liquidity are cash flows generated from operations, together with cash and cash equivalents and short-term investments. Net cash provided by operating activities was \$109.2 million and \$74.2 million for the nine months ended September 30, 2011 and 2010, respectively. Our operating cash flows resulted primarily from cash received from our subscribers offset by excess tax benefit from share-based compensation, cash payments we made to third parties for their services, employee compensation and tax payments. Certain tax payments are prepaid during the year and included within prepaid expenses and other current assets on the consolidated balance sheet. Our prepaid tax payments were \$12.3 million and \$7.5 million at September 30, 2011 and December 31, 2010, respectively. A significant portion of our subscribers pay us via credit cards and therefore our receivables from subscribers generally settle quickly. Our cash and cash equivalents and short-term investments were \$163.2 million at September 30, 2011.

Net cash (used in) investing activities was approximately (\$49.0) million and (\$57.0) million for the nine months ended September 30, 2011 and 2010, respectively. For the nine months ended September 30, 2011, net cash used in investing activities was primarily attributable to the purchase of available-for-sale investments, purchase of certificates of deposit and property and equipment partially offset by the sale of available-for-sale investments. For the nine months ended September 30, 2010, net cash used in investing activities was primarily attributable to the purchase of available-for-sale investments and business acquisitions partially offset by the maturity of certificates of deposit and sale of available-for-sale investments.

Net cash provided by (used in) financing activities was approximately \$9.6 million and (\$1.6) million for the nine months ended September 30, 2011 and 2010, respectively. For the nine months ended September 30, 2011, net cash provided by financing activities was primarily attributable to excess tax benefit from share-based compensation and the exercise of options partially offset by dividends paid and repurchases of stock. For the nine months ended September 30, 2010, net cash used in financing activities was primarily attributable to the repurchases of stock partially offset by the exercise of stock options.

## Contractual Obligations and Commitments

The following table summarizes our contractual obligations and commitments as of September 30, 2011:

| Contractual Obligations                         | Payments Due in |          |          |          |          |            | Total     |
|---|-----------------|----------|----------|----------|----------|------------|-----------|
|   | 2011            | 2012     | 2013     | 2014     | 2015     | Thereafter |           |
| Operating leases (a)                            | \$ 668          | \$ 2,493 | \$ 2,153 | \$ 2,124 | \$ 1,735 | \$ 6,897   | \$ 16,070 |
| Telecom services and co-location facilities (b) | 3,101           | 5,443    | 2,719    | 216      | 16       | —          | 11,495    |
| Computer software and related services (c)      | 1,362           | 345      | 92       | —        | —        | —          | 1,799     |
| Holdback payment (d)                            | 365             | 705      | 216      | —        | —        | —          | 1,286     |
| Other (e)                                       | 321             | 567      | 107      | —        | —        | —          | 995       |
| Total   | \$ 5,817        | \$ 9,553 | \$ 5,287 | \$ 2,340 | \$ 1,751 | \$ 6,897   | \$ 31,645 |

- (a) These amounts represent undiscounted future minimum rental commitments under noncancellable leases.
- (b) These amounts represent service commitments to various telecommunication providers.
- (c) These amounts represent software license commitments.
- (d) These amounts represent the holdback amounts in connection with certain business acquisitions.
- (e) These amounts primarily represent certain marketing and consulting arrangements.

As of September 30, 2011, our liability for uncertain tax positions was \$28.2 million. The future payments related to uncertain tax positions have not been presented in the table above due to the uncertainty of the amounts and timing of cash settlement with the taxing authorities.

#### Credit Agreement

On January 5, 2009, we entered into a Credit Agreement with Union Bank, N.A. in order to further enhance our liquidity in the event of potential acquisitions or other corporate purposes. On August 16, 2010, we entered into an amended Credit Agreement with the Lender. We have not drawn down any amounts under the Credit Agreement. See Note 8 - Commitments and Contingencies within our Annual Report on Form 10-K for the year ended December 31, 2010 for further details regarding the Credit Agreement.

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### Item 3. Quantitative and Qualitative Disclosures About Market Risk

The following discussion of the market risks we face contains forward-looking statements. Forward-looking statements are subject to risks and uncertainties. Actual results could differ materially from those discussed in the forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's opinions only as of the date hereof. j2 Global undertakes no obligation to revise or publicly release the results of any revision to these forward-looking statements. Readers should carefully review the risk factors described in this document as well as in other documents we file from time to time with the SEC, including the Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K filed or to be filed by us in 2011.

#### Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We maintain an investment portfolio of various holdings, types and maturities. The primary objectives of our investment activities are to preserve our principal while at the same time maximizing yields without significantly increasing risk. To achieve these objectives, we maintain our portfolio of cash equivalents and investments in a mix of instruments that meet high credit quality standards, as specified in our investment policy. Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of September 30, 2011, the carrying value of our cash and cash equivalents approximated fair value. Our return on these investments is subject to interest rate fluctuations.

Our short- and long-term investments are comprised primarily of readily marketable corporate debt securities, auction rate securities and certificates of deposits. Investments in fixed rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. Our interest income is sensitive to changes in the general level of U.S. and foreign countries' interest rates. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates.

As of September 30, 2011, we had investments in debt securities with effective maturities greater than one year of approximately \$30.6 million. Such investments had a weighted average yield of approximately 1.0%. As of September 30, 2011 and December 31, 2010, we had cash and cash equivalent investments in time deposits and money market funds with maturities of 90 days or less of \$134.2 million and \$64.8 million, respectively. Based on our cash and cash equivalents and short- and long-term investment holdings as of September 30, 2011, an immediate 100 basis point decline in interest rates would decrease our annual interest income to approximately zero.

We are parties to the Credit Agreement with the Lender, as amended. If we were to borrow under the Credit Agreement we would be subject to the prevailing interest rates and could be exposed to interest rate fluctuations.

We cannot ensure that future interest rate movements will not have a material adverse effect on our future business, prospects, financial condition, operating results and cash flows. To date, we have not entered into interest rate hedging transactions to control or minimize certain of these risks.

#### Foreign Currency Risk

We conduct business in certain foreign markets, primarily in Canada and the European Union. Our primary exposure to foreign currency risk relates to investment in foreign subsidiaries that transact business in a functional currency other than the U.S. Dollar, primarily the Canadian Dollar, Euro and British Pound Sterling. However, the exposure is mitigated by our practice of generally reinvesting profits from international operations in order to grow that business.

As we increase our operations in international markets we become increasingly exposed to changes in currency exchange rates. The economic impact of currency exchange rate movements is often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, could cause us to adjust our financing and operating strategies.

As currency exchange rates change, translation of the income statements of the international businesses into U.S. Dollars affects year-over-year comparability of operating results. Historically, we have not hedged translation risks because cash flows from international operations were generally reinvested locally; however, we may do so in the future. Our objective in managing foreign exchange risk is to minimize the potential exposure to changes that exchange rates might have on earnings, cash flows and financial position.

Foreign exchange gains and losses were not material to our earnings for the three and nine months ended September 30, 2011, amounting to approximately \$0.1 million and (\$0.1) million, respectively. As of September 30, 2011, cumulative translation adjustments included in other comprehensive income amounted to approximately (\$0.6) million.

We currently do not have derivative financial instruments for hedging, speculative or trading purposes and therefore are not subject to such hedging risk. However, we may in the future engage in hedging transactions to manage our exposure to fluctuations in foreign currency exchange rates.

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Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

j2 Global's management, with the participation of our principal executive officer and principal financial officer, performed an evaluation of j2 Global's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 ("Exchange Act")) as of the end of the period covered by this report. Our principal executive officer and principal financial officer have concluded that j2 Global's disclosure controls and procedures were effective to ensure that information required to be disclosed in reports we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (2) accumulated and communicated to our management to allow their timely decisions regarding required disclosure.

(b) Changes in Internal Controls

There were no changes in our internal control over financial reporting that occurred during the third quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

See Note 7 – Commitments and Contingencies of the Notes to Financial Statements (Part I, Item 1) for information regarding certain legal proceedings in which we are involved.

## Item 1A. Risk Factors

In addition to the other information set forth in this report, before deciding to invest in j2 Global or to maintain or increase your investment, you should carefully consider the factors discussed in Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2010 (the “10-K Risk Factors”). If any of these risks occur, our business, prospects, financial condition, operating results and cash flows could be materially adversely affected. The 10-K Risk Factors are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. There have been no material changes from the 10-K Risk Factors, except as discussed below:

We may not continue to issue quarterly dividends or we could decrease the amount of any future dividends. On August 1, 2011, the Company’s Board of Directors approved the initiation of quarterly cash dividends to its stockholders. The first quarterly dividend of \$0.20 per share of common stock was paid on September 19, 2011 to all stockholders of record as of the close of business on September 2, 2011. Future dividends are subject to Board approval and certain restrictions within the Credit Agreement with Union Bank, N.A.. We cannot assure that the Company will continue to pay a dividend in the future or the amount of any future dividends.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

## (a) Unregistered Sales of Equity Securities

None.

## (b) Issuer Purchases of Equity Securities

In May 2010, our Board of Directors approved a program authorizing the repurchase of up to ten million shares of our common stock through the end of April 30, 2012. On May 4, 2010, we entered into a Rule 10b5-1 trading plan to facilitate the repurchase program. During the three months ended September 30, 2011, we did not repurchase any shares under the repurchase program.

The following table details the repurchases that were made under and outside the program during the three months ended September 30, 2011:

| Period | Total Number of Shares Purchased (1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of a Publicly Announced Program | Maximum Number of Shares That May Yet Be Purchased Under the Publicly Announced |
|--------|--------------------------------------|------------------------------|--|---|
|        |                                      |                              |  |   |

|  |         |    |       | Program |           |
|--|---------|----|-------|---------|-----------|
| July 1, 2011 - July 31, 2011           | —       | \$ | —     | —       | 9,993,700 |
| August 1, 2011 - August 31, 2011       | 249,179 | \$ | 29.55 | —       | 9,993,700 |
| September 1, 2011 - September 30, 2011 | —       | \$ | —     | —       | 9,993,700 |
| Total                                  | 249,179 |    |       | —       | 9,993,700 |

(1) Includes shares surrendered to the Company to pay the exercise price and/or to satisfy tax withholding obligations in connection with employee stock options and/or the vesting of restricted stock issued to employees.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Reserved

Item 5. Other Information

None.

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Item 6. Exhibits

- 31.1 Rule 13a-14(a) Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Rule 13a-14(a) Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Section 1350 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Section 1350 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 The following financial information from j2 Global Communications, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2010, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2010, and (iv) the Notes to Condensed Consolidated Financial Statements.

SIGNATURE

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

j2 Global Communications, Inc.

Date: November 8, 2011

By: /s/ NEHEMIA ZUCKER  
Nehemia Zucker  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 8, 2011

By: /s/ KATHLEEN M. GRIGGS  
Kathleen M. Griggs  
Chief Financial Officer  
(Principal Financial Officer)

INDEX TO EXHIBITS

| Exhibit Number | Description   |
|----------------|---|
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