OOMA INC
Form 10-Q
December 10, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 31, 2015

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: 001-37493

Ooma, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	06-1713274
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1880 Embarcadero Road, Palo Alto, California 94303

(Address of principal executive offices)

(650) 566-6600

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x (do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of December 7, 2015, there were 16,843,618 shares of the registrant's common stock outstanding.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

OOMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

(Unaudited)

	October 31, 2015	January 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$57,285	$9,133
Accounts receivable, net	6,247	4,394
Inventories	5,789	8,081
Deferred inventory costs	2,674	2,248
Prepaid expenses and other current assets	1,440	945
Total current assets	73,435	24,801
Property and equipment, net	3,543	2,893
Intangible assets, net	983	1,278
Goodwill	1,117	1,117
Other assets	730	1,188
Total assets	$79,808	$31,277
Liabilities, convertible preferred stock, and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	$6,361	$3,967
Accrued expenses	12,793	10,313
Short-term debt	679	1,562
Convertible preferred stock warrant liability	—	474
Deferred revenue	15,549	14,348
Total current liabilities	35,382	30,664
Long-term debt	118	10,398
Convertible preferred stock warrant liability - noncurrent	—	743
Other long-term liabilities	224	980
Total liabilities	35,724	42,785
Commitments and contingencies (Note 7)		
Convertible preferred stock $0.0001 par value: no shares authorized, issued or outstanding on October 31, 2015 and 8,708,333 shares authorized and 8,353,748 shares issued and outstanding on January 31, 2015	—	33,637

Stockholders' equity (deficit):		
Preferred stock $0.0001 par value: 10,000,000 shares authorized; no shares issued and outstanding on October 31, 2015; and no shares authorized, issued and outstanding on January 31, 2015	—	—
Common stock $0.0001 par value: 100,000,000 shares authorized; 16,791,033 shares issued and outstanding on October 31, 2015; and 13,000,000 shares authorized; 2,515,065 share issued and outstanding on January 31, 2015	2	—
Additional paid-in capital	105,707	5,611
Accumulated deficit	(61,625)	(50,756)
Total stockholders' equity (deficit)	44,084	(45,145)
Total liabilities, convertible preferred stock, and stockholders' equity (deficit)	$79,808	$31,277

See notes to condensed consolidated financial statements

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OOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	October 31, 2015	October 31, 2014	October 31, 2015	October 31, 2014
Revenue:				
Subscription and services	$19,470	$14,316	$52,495	$37,904
Product and other	4,006	3,971	11,969	13,383
Total revenue	23,476	18,287	64,464	51,287
Cost of revenue:				
Subscription and services	6,715	4,830	18,649	13,052
Product and other	4,277	4,065	12,067	12,610
Total cost of revenue	10,992	8,895	30,716	25,662
Gross profit	12,484	9,392	33,748	25,625
Operating expenses:				
Sales and marketing	7,539	5,958	20,247	15,518
Research and development	4,948	3,365	13,329	8,596
General and administrative	3,499	1,565	9,666	3,783
Total operating expenses	15,986	10,888	43,242	27,897
Loss from operations	(3,502)	(1,496)	(9,494)	(2,272)
Other (expense) income:				
Interest expense, net	(10)	(61)	(902)	(165)
Change in fair value of warrants	—	(151)	(442)	(366)
Other (expense) income, net	(19)	(11)	(31)	(20)
Loss before income taxes	(3,531)	(1,719)	(10,869)	(2,823)
Income tax benefit	—	—	—	502
Net loss	$(3,531)	$(1,719)	$(10,869)	$(2,321)
Net loss per share of common stock:				
Basic and diluted	$(0.21)	$(0.72)	$(1.38)	$(1.04)
Weighted-average number of shares used in per share amounts:				
Basic and diluted	16,703,852	2,379,125	7,875,761	2,221,414

See notes to condensed consolidated financial statements

OOMA, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	October 31, 2015	October 31, 2014
Cash flows from operating activities:		
Net loss	$(10,869)	$ (2,321)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	2,725	171
Depreciation and amortization	1,046	644
Amortization of intangible assets	295	207
Deferred income taxes	—	(502)
Non-cash interest expense	64	40
Write-off of non-cash deferred debt issuance costs	332	—
Change in fair value of acquisition related contingent consideration	167	334
Change in fair value of warrant liability	442	366
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,853)	(1,801)
Inventories	2,292	(6,038)
Deferred inventory costs	(426)	(1,080)
Prepaid expenses and other assets	(531)	(396)
Accounts payable and accrued expenses	4,509	2,932
Other long term liabilities	(88)	17
Deferred revenue	1,199	4,035
Net cash used in operating activities	(696)	(3,392)
Cash flows from investing activities:		
Purchases of property and equipment	(1,117)	(961)
Business acquisition, net of cash assumed	—	(672)
Net cash used in investing activities	(1,117)	(1,633)
Cash flows from financing activities:		
Proceeds from initial public offering, net	57,303	—
Proceeds from Series Beta preferred stock, net	5,000	—
Repayment of debt and capital leases	(11,457)	(1,081)
Proceeds from issuance of debt	—	4,984
Payment of acquisition related earn-out	(475)	—
Proceeds from issuance of common stock related to warrants and employee stock benefit plans	178	385
Payment of preferred warrant liability	(584)	—
Net cash provided by financing activities	49,965	4,288
Net increase (decrease) in cash and cash equivalents	48,152	(737)
Cash and cash equivalents at beginning of period	9,133	6,364
Cash and cash equivalents at end of period	$57,285	$ 5,627
Supplemental disclosure of cash flow information:		

Income taxes paid	$2	$ 1
Interest paid	$560	$ 111
Non-cash investing and financing activities:		
Conversion of preferred stock to common stock	$38,629	$ —
Unpaid offering costs	$241	$ —
De-recognition of warrant liability to additional paid-in capital	$1,075	$ —
Issuance of warrants in connection with long-term debt	$—	$ 61
Shares issued as consideration in business acquisition and related earnout	$451	$ 338
Unpaid portion of property and equipment purchases	$578	$ 22

See notes to condensed consolidated financial statements

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Ooma, Inc. (the “Company”) is a leading provider of innovative communications solutions and other connected services to small business, home, and mobile users. The Company’s unique hybrid Software-as-a-Service (“SaaS”) platform, consisting of its proprietary cloud, on-premises appliances, mobile applications, and end-point devices, provides the connectivity and functionality that enables solutions. The Company was incorporated in Delaware on November 19, 2003.

2. Summary of Significant Accounting Policies

Basis of Presentation

These unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (the “SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, the information included in this Quarterly Report on Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s prospectus filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933, as amended, on July 17, 2015 (the “Prospectus”). There have been no changes to the significant accounting policies described in the prospectus that have had a material impact on the condensed consolidated financial statements and related notes.

These financial statements have been prepared on the same basis as the Company’s annual financial statements and, in the opinion of management, reflect all normal recurring adjustments necessary to present fairly the Company’s financial position, its results of operations, and cash flows for the interim periods presented, but are not necessarily indicative of the results of operations to be anticipated for the full fiscal year ending January 31, 2016. The condensed consolidated balance sheet as of January 31, 2015 included herein was derived from the audited financial statements as of that date.

The condensed consolidated financial statements include accounts and the accounts of the Company’s wholly-owned subsidiary. All significant intercompany transactions and balances have been eliminated upon consolidation.

Reverse Stock Split

Effective July 6, 2015, the Company completed a one-for-two reverse stock split, as approved by its Board of Directors (the “Board”). All shares and warrants and per share and warrant amounts set forth herein give effect to this reverse stock split.

Initial Public Offering and Conversion of Preferred Stock

On July 22, 2015, the Company completed its initial public offering (the "IPO"). As a result, the following transactions were recorded in the Company's consolidated financial statements as of October 31, 2015:

- The Company issued 5,000,000 shares of its common stock at the initial public offering price of $13.00 per share. The net proceeds from the sale of the shares was $57.0 million after deducting the underwriters' discounts and commissions of $4.5 million and $3.5 million of offering expenses.
- 8,353,748 shares of Series Alpha convertible preferred stock and Series Alpha-1 convertible preferred stock were collectively converted into 8,353,748 shares of common stock on a 1:1 basis. The public offering price of $13.00 per share triggered an automatic conversion of 241,469 shares of Series Beta convertible preferred stock, which automatically converted to 525,109 shares of common stock based on an adjusted conversion price equal to 75% of the $13.00 public offering price, or $9.75, rather than the $21.2028 per share consideration paid, pursuant to the conversion price adjustment provision applicable to such shares in the Company's then-current amended and restated certificate of incorporation.
- The warrant issued in December 2010 to purchase 70,287 shares of Series Alpha convertible preferred stock was cash settled at the IPO price of $13.00 per share after deducting the exercise price of $4.70 per share. The Company paid $0.6 million to the warrant holder on settlement.
- Of the warrants to purchase 34,397 shares of Series Alpha convertible preferred stock issued in June 2009, warrants to purchase 2,769 shares of Series Alpha convertible preferred stock were cash exercised at an exercise price of $4.70 per share and resulted in 2,769 shares of common stock; warrants to purchase 21,529 shares of Series Alpha convertible preferred stock were net exercised using the IPO price of $13.00 per share net of the exercise price of $4.70 per share resulting in issuance of 13,752 shares of common stock; and warrants to purchase 10,099 shares of common stock were terminated due to failure to exercise on or before the IPO date per the terms of the warrant agreements.

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

- On the completion of the IPO, the warrants to purchase 21,299 shares of Series Alpha convertible preferred stock issued in May 2009 and warrants to purchase 66,026 shares of Series Alpha convertible preferred stock issued in conjunction with the Company's debt in April and December 2012 and October 2014 were converted on a 1:1 basis into warrants to purchase shares of common stock.
- Of the warrants to purchase 87,828 shares of common stock outstanding prior to the IPO, 6,542 common warrants were cash exercised and converted to 6,542 shares of common stock and 4,100 common warrants were exercised net of the respective exercise price per warrant to 2,612 shares of common stock and 556 common warrants were terminated due to non-exercise on IPO per the terms of the warrant agreement.

Use of Estimates

The preparation of the Company's condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of income and expenses during the reporting period. These estimates are based on information available as of the date of the condensed consolidated financial statements, and assumptions are inherently subjective in nature; therefore, actual results could differ from management's estimates.

Comprehensive Loss

The Company does not have any components of comprehensive income (loss), as such the net loss for all periods reported equals comprehensive loss.

Concentration of Risk— The concentration of accounts receivable, net of allowance of returns of $0 and $0.1 million as of October 31, 2015 and January 31, 2015, respectively are as follows:

	As of October 31, 2015	January 31, 2015
Customer A	11 %	*
Customer B	*	11 %
Customer C	*	23 %
Customer D	*	10 %

* represents less than 10% during the period

There were no customers that individually exceeded 10% of revenue during the three and nine months ended October 31, 2015 and 2014.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standard Update ("ASU") No. 2014-09 (ASC 606), Revenue from Contracts with Customers, which affects any entity that either enters into contracts with customers to transfer goods and services or enters into contracts for the transfer of nonfinancial assets. ASU 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under the currently effective guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In July 2015, the FASB approved a one-year deferral of the effective date of the standard with the issuance of by ASU 2015-14, Revenue from Contracts with Customers (ASC 606) Deferral of Effective Date. As a result, ASU 2014-09 will become effective for the Company in the first quarter of fiscal 2019 and can be adopted either retrospectively to each prior reporting period presented or as a cumulative effect adjustment as of the date of adoption. Early adoption is permitted but not before the original effective date of annual periods beginning after December 15, 2016. The Company is currently evaluating the impact of this guidance on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15 (ASC 205), Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern. The new standard provides guidance around management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

In July 2015, the FASB issued ASU No. 2015-11 (ASC 330), Simplifying the Measurement of Inventory related to measure inventory. Update No. 2015-11 requires companies to measure inventory using the lower of cost and net realizable value. It is effective for annual reporting periods beginning after December 15, 2016 and interim periods within those fiscal years. The Company is currently evaluating the impact, if any, of this guidance on the Company's consolidated financial statements.

3. Fair Value Measurement

The Company records its financial assets and liabilities at fair value. The inputs used in the valuation methodologies in measuring fair value are defined in the fair value hierarchy as follows:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities and which reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

The Company's financial instruments consist of Level 1 assets and Level 3 liabilities. Money market funds have been classified as Level 1 because these securities are valued based upon quoted prices in active markets. The money market funds are classified as cash equivalents.

As of January 31, 2015, the Level 3 liabilities consists of the Company's convertible preferred stock warrant liability and acquisition-related contingent consideration. As of October 31, 2015, the Level 3 liabilities consisted of acquisition-related contingent consideration.

There were no transfers into or out of the Level 3 category during the nine months ended October 31, 2015.

The Company's financial assets and liabilities that are measured at fair value on a recurring basis by level within the fair value hierarchy are as follows (in thousands):

	Balance as of October 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash	$254	$ —	$—	$254
Money market fund	57,031	—	—	57,031
Total cash and cash equivalents	$57,285	$ —	$—	$57,285

Liabilities:				
Acquisition-related contingent consideration	$—	$ —	$841	$841
Total liabilities	$—	$ —	$841	$841

	Balance as of January 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash	$115	$ —	$—	$115
Money market fund	9,018	—	—	9,018
Total cash and cash equivalents	$9,133	$ —	$—	$9,133
Liabilities:				
Acquisition-related contingent consideration	$—	$ —	$1,695	$1,695
Convertible preferred stock warrant liability	—	—	1,217	1,217
Total liabilities	$—	$ —	$2,912	$2,912

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Changes in the Level 3 fair value category for the periods presented are as follows (in thousands):

	Convertible Preferred Stock Warrant Liability	Acquisition-Related Contingent Consideration
Balance at January 31, 2015	$ 1,217	$ 1,695
Payout of consideration	—	(570)
Issuance of shares	—	(451)
Changes in fair value	442	167
Payment of preferred warrant liability upon IPO	(584)	—
De-recognition of preferred warrant liability to additional paid-in capital	(1,075)	—
Balance at October 31, 2015	$ —	$ 841

Level 3 instruments consisted of the Company's preferred stock warrant liability. Prior to the Company's IPO, outstanding warrants to purchase shares of the Company's convertible preferred stock were classified as other liabilities. At every reporting date the warrants were remeasured and the change in the fair value was recorded as a component of other (expense) income, in the condensed consolidated statement of operations and liabilities on the condensed consolidated balance sheet.

Upon the closing of the Company's IPO, a warrant to purchase 70,287 shares of Series Alpha convertible preferred stock was remeasured at the initial offering price of $13.00 per share less the exercise price of $4.70 per share. The total warrant liability of $0.6 million related to this warrant was cash settled. The aggregate fair value of the other warrants was de-recognized and reclassified from liabilities to additional paid-in capital, a component of stockholders' equity (deficit), and the Company ceased recording any further changes.

The carrying value of the Company's accounts receivable, inventory and other current assets and current liabilities approximates fair value due to short maturities.

4. Balance Sheet Components

Inventories

The following table shows the components of inventories (in thousands):

	October 31, 2015	January 31, 2015
Finished goods	$5,100	$5,719
Raw material	689	2,362
Total inventory	$5,789	$8,081

Deferred Revenue

The following table shows the components of deferred revenue (in thousands):

	October 31, 2015	January 31, 2015
Deferred revenue:		
Subscription and services	$11,601	$9,863
Product and other	3,982	4,523
Total deferred revenue	15,583	14,386
Less: current portion of deferred revenue	15,549	14,348
Deferred revenue, noncurrent portion included in other long-term liabilities	$34	$38

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Accrued Expenses

The following table shows the components of accrued expenses (in thousands):

	October 31, 2015	January 31, 2015
Accrued regulatory fees and taxes	$4,736	$4,762
Accrued payroll and related expenses	2,761	2,022
Acquisition-related contingent consideration-current portion	841	1,027
Other accrued expenses	4,455	2,502
Total accrued expenses	$12,793	$10,313

Included in other accrued expenses is $1.2 million and $0.1 million of advertising costs as of October 31, 2015 and January 31, 2015, respectively.

5. Debt

In April 2012, (amended in October 2012), the Company entered into a secured debt agreement ("Term Debt") in the amount of $4.0 million. The debt had a maturity date in September 2015 and a fixed interest rate of 5.75%. The Company made monthly interest-only payments through September 2012, and monthly payments of principal and interest thereafter. In July 2015, the Company paid off the remaining balance of $0.3 million using a portion of the IPO proceeds.

In December 2012, the Company entered into an amended secured debt agreement, adding a revolving line of credit in the amount of $6.0 million ("the Revolver"). The interest rate on the Revolver is 2.75% above the prime rate (6.0% at January 31, 2015). The Revolver includes a financial covenant that the Company is required to have a certain number of subscribers each quarter. The Revolver was originally due to mature in December 2014. In July 2014, the Company entered into an amended agreement to extend the maturity date until July 2016. In October 2014, the Company borrowed $5.0 million under the Revolver. The outstanding debt of $5.0 million was repaid in July 2015 using a portion of the IPO proceeds.

In January 2015, the Company entered into an amended line of credit under a loan and security agreement with its current lender which increased the amount available under the Revolver to $12.0 million and added a new line of credit of up to $10.0 million. The Company's credit agreements with its lender contain customary negative covenants that limit the ability to, among other things, incur additional indebtedness, grant liens, make investments, repurchase stock, pay dividends, transfer assets and merge or consolidate. In January 2015, the Company drew down $5.0 million of this new line of credit. The interest rate on advances under the line of credit is 11%, and interest is payable monthly. The original maturity date of the line of credit was January 2018. The Company repaid this outstanding debt of $5.0 million in July 2015 using a portion of the IPO proceeds. In connection with the agreement, the Company issued warrants to purchase 76,630 shares of the Company's common stock with an exercise price of $6.04 per share that are exercisable until January 2025. These warrants remained outstanding as of October 31, 2015.

The Company has certain non-financial covenants in connection with the borrowings. As of January 31, 2015 and October 31, 2015, the Company was in compliance with all the covenants under the Revolver agreement.

As of October 31, 2015, the amount available under the Revolver agreement was $12.0 million.

Total interest expense recognized was $10,000 and $0.1 million for the three months ended October 31, 2015 and 2014, respectively, and $0.9 million and $0.2 million for the nine months ended October 31, 2015 and 2014, respectively. Total amortization of debt issuance costs recognized was $0 and $12,000 for the three months ended October 31, 2015 and 2014, respectively and $0.1 million and $40,000 for the nine months ended October 31, 2015 and 2014, respectively.

Interest expense for the three and nine months ended October 31, 2015 also included $0 and $0.3 million write-off of non-cash deferred issuance costs due to the repayment by the Company of all of the outstanding debt in July 2015.

As of October 31, 2015, the debt on the consolidated balance sheet related to equipment acquired under capital lease.

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

6. Convertible Preferred Stock Warrant Liability

At each balance sheet date, the Company had the following warrants to purchase convertible preferred stock outstanding:

	Warrants outstanding as of January 31, 2015	Fair value of Warrants Liabilities as of January 31, 2015 (in thousands)	Warrants outstanding as of April 30, 2015	Fair value of Warrants Liabilities as of April 30, 2015 (in thousands)	Warrants outstanding as of July 31, and October 31, 2015	Fair value of Warrants Liabilities as of July 31, and October 31, 2015 (in thousands)
December 2010 warrant	70,287	$ 474	70,287	$ 726	—	$ —
April 2012, December 2012 and October 2014 warrants	66,026	374	66,026	611	—	—
May and June 2009 warrants	55,696	369	55,696	596	—	—
Total	192,009	$ 1,217	192,009	$ 1,933	—	$ —

In December 2010, the Company issued a warrant to purchase 70,287 shares of Series Alpha convertible preferred stock at an exercise price of $4.70 per share. On completion of the IPO, the Company remeasured the warrant at the IPO price of $13.00 per share, after deducting the exercise price the fair value of the warrant was determined to be $0.6 million. The warrant was cash settled and the Company paid $0.6 million to the warrant holder upon the IPO.

The warrant was initially measured at its fair value and recorded as a derivative liability. On each reporting date the change in fair value of the warrant was determined based on Monte-Carlo valuation model or IPO pricing on payout. The Company recorded a remeasurement gain (loss) of $0 million and $(0.1) million during the three months ended October 31, 2015 and 2014, respectively; and $(0.1) million and $(0.2) million during the nine months ended October 31, 2015 and 2014, respectively.

In April 2012, December 2012 and October 2014, the Company issued warrants to purchase an aggregate of 66,026 shares of Series Alpha convertible preferred stock with an exercise price of $4.70 per share in connection with a debt agreement with a lender. The warrants had expiration dates ranging from April 2022 to December 2022. The Company recorded the warrants as a derivative liability. The warrants were initially measured at fair value and remeasured at every reporting period date using Monte-Carlo valuation. The Company recorded a remeasurement gain (loss) of $0 million and $(13,000) for the three months ended October 31, 2015 and 2014 respectively, and $(0.3) million and $(0.1) million for the nine months ended October 31, 2015 and 2014, respectively. Upon completion of the IPO on July 22, 2015, the total aggregate liability of $0.7 million related to these warrants was derecognized and reclassified to additional paid in capital which then automatically converted into warrants to purchase shares of common stock on a 1:1 basis.

In June 2009, the Company issued warrants to purchase 34,397 shares of Series Alpha convertible preferred stock and in May 2009, the Company issued warrants to purchase 21,299 shares of convertible preferred stock. The Company recorded the warrants to purchase shares of convertible preferred stock as derivative liabilities. These warrants were initially measured at fair value and remeasured at every reporting period date using a Black Scholes valuation model and the change in the fair value was recorded in other (expense) income in the condensed consolidated statement of operations. The Company recorded a remeasurement gain (loss) of $0 million and $(0.1) million for the three months ended October 31, 2015 and 2014, respectively, and $(0.1) million and $(0.1) million for the nine months ended October 31, 2015 and 2014, respectively.

Upon completion of the IPO on July 22, 2015, of the warrants to purchase 34,397 shares of Series Alpha convertible preferred stock issued in June 2009, warrants to purchase 2,769 shares of Series Alpha convertible preferred were cash exercised at an exercise price of $4.70 per share to 2,769 shares of common stock; warrants to purchase 21,529 shares of Series Alpha convertible preferred stock were net exercised using the IPO price of $13.00 per share net of the exercise price of $4.70 per share to 13,752 shares of common stock; and warrants to purchase 10,099 shares were terminated due to failure to exercise on or before the IPO per the terms of the warrant agreement. The Company recognized a gain of $0.1 million on the termination of 10,099 warrants. The IPO also triggered the 21,299 warrants issued in May 2009, to convert to common warrants to purchase 21,299 shares of common stock. The total aggregate liability of $0.4 million related to these warrants was derecognized and reclassified to additional paid in capital.

The following assumptions were used to calculate the fair value of the warrants:

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2015	2014	2015	2014
Assumptions:				
Expected volatility	— %	70%	66%-70%	70%
Expected term (in years)	—	1.6	0-1.1	1.6-2.1
Risk-free interest rate	— %	0.3%-0.4%	0%-0.3%	0.3%-0.5%
Dividend yield	— %	— %	— %	— %

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

7. Commitments and Contingencies

The Company leases office space in Palo Alto and Newark, California under operating leases that are scheduled to expire through February 2018.

In January 2015, the Company entered into a capital lease for computer equipment that matures in December 2016 with the right to purchase the equipment at maturity for one dollar.

Minimum rental commitments under all non-cancelable leases with an initial term in excess of one year as of October 31, 2015, were as follows (in thousands):

Year Ending January 31,	Capital Leases	Operating Leases
2016 (remaining three months)	$ 178	$ 431
2017	653	1,802
2018	—	1,421
2019	—	45
Total	$ 831	$ 3,699
Less: Amount representing interest	(34)	
Present value of lease payments	797	
Less: Current portion	(679)	
Capital lease—net of current portion	$ 118	

Rent expense was $0.3 million and $0.3 million for the three months ended October 31, 2015 and 2014, respectively, and $0.9 million and $0.7 million for the nine months ended October 31, 2015 and 2014, respectively.

As of October 31, 2015, non-cancelable purchase commitments were $0.8 million.

Legal Matters—The Company is party to actions and proceedings incident to the Company's business in the ordinary course of business, including litigation regarding its intellectual property, challenges to the enforceability or validity of its intellectual property, and claims that the Company's products or services infringe on the intellectual property rights of others. The Company accrues a liability for such matters when it is probable that future expenditures will be made and such expenditures can be reasonably estimated. In management's opinion, there are no contingent liabilities requiring accrual as of October 31, 2015.

In November 2015, a lawsuit was filed by the State of Alabama related to 9-1-1 charges. At this point in the proceedings, losses, if any, that are reasonably possible to result from this litigation are not reasonably estimable. Accordingly, no reserves have been recorded in the Company's condensed consolidated financial statements with respect to the action.

Indemnification—The Company enters into standard indemnification arrangements in the ordinary course of business. Pursuant to these arrangements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified parties for losses suffered or incurred by the indemnified party, in connection with any trade secret, copyright, patent or other intellectual property infringement claim by any third party with respect to the Company’s technology. The term of these indemnification agreements is generally perpetual. The maximum potential amount of future payments the Company could be required to make under these agreements is not determinable because it involves claims that may be made against the Company in the future, but have not yet been made.

The Company has entered into indemnification agreements with its directors and officers that may require the Company to indemnify its directors and officers against liabilities that may arise by reason of their status or service as directors or officers, other than liabilities arising from willful misconduct of the individual. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has director and officer insurance coverage that reduces the Company’s exposure and enables the Company to recover a portion of any future amounts paid.

To date the Company has not incurred costs to defend lawsuits or settle claims related to these indemnification agreements. No liability associated with such indemnifications has been recorded to date.

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

8. Stockholders’ Equity

Reverse Stock Split

On July 6, 2015, the Company effected a one-for-two reverse stock split of its outstanding common stock, convertible preferred stock, stock options, warrants to purchase preferred stock and warrants to purchase common stock as approved by its Board of Directors. All information in this Quarterly Report on Form 10-Q relating to the number of shares, price per share and per share amounts have been adjusted to give effect to the one-for-two reverse stock split.

Convertible Preferred Stock

Upon the closing of the IPO on July 22, 2015, all of the Company's outstanding Series Alpha and Series Alpha-1 convertible preferred stock converted into 8,353,748 shares of common stock on a 1:1 basis and 241,469 shares of Series Beta preferred stock converted into 525,109 shares of common stock.

Common Stock and Preferred Stock

On July 6, 2015, the Company filed an amended and restated certificate of incorporation to increase the amount of common stock authorized for issuance to 100,000,000 shares with a par value of $0.0001 per share and 10,000,000 shares with a $0.0001 par value per share of preferred stock.

As of October 31, 2015 the Company had 16,791,033 shares of common stock outstanding which includes the 5,000,000 shares issued in the IPO. The Company did not have any shares of preferred stock issued and outstanding.

Equity Award Plans

2005 Stock Plan

The Board of Directors adopted, and the stockholders approved, the Company’s 2005 Stock Plan (the “2005 Plan”), in April 2005. The 2005 Plan provides for the grant of incentive stock options to its employees (and employees of its subsidiaries), and for the grant of non-statutory stock options and stock purchase rights to its employees, directors and consultants (and employees and consultants of its subsidiaries). In June 2015, the 2005 Plan was amended and restated in the form of the 2015 Equity Incentive Plan described below. The terms of the 2005 Plan as described in the Prospectus will continue to govern the terms and conditions of the outstanding awards previously granted thereunder.

2015 Equity Incentive Plan

In June 2015, the Company amended and restated its 2005 Plan in the form of 2015 Equity Incentive Plan (the “2015 Plan”) which became effective immediately upon the effectiveness of the Company’s IPO. The 2015 Plan provides for the grant of incentive stock options to its employees and any of its subsidiary corporations’ employees, and for the grant of non-statutory stock options, stock appreciation rights, restricted stock, restricted stock units, performance units and performance shares to its employees, directors and consultants and its subsidiary corporations’ employees and consultants. The maximum aggregate number of shares that may be issued under the 2015 Plan is 4,433,102 shares (which is the number of shares previously reserved for issuance under the 2005 Plan) plus 2,205,828 shares which is the number of shares equal to 10% of its outstanding shares of common stock measured at the time of completion of its IPO (as determined on a fully diluted basis, including the shares reserved under its equity plans). In addition, the number of shares available for issuance under the 2015 Plan will be annually increased on the first day of each of its fiscal years beginning with fiscal 2017, by an amount equal to the lessor of (i) 5% of the outstanding shares of its common stock as of the last day of its immediately preceding fiscal year; and (ii) such other amount as the Company's board of directors may determine.

As of October 31, 2015, the Company had 1,299,718 shares available for future issuance.

Employee Stock Purchase Plan

In conjunction with the completion of its IPO, the Company adopted the 2015 Employee Stock Purchase Plan ("ESPP"). The ESPP has 441,165 shares authorized for future issuance. The number of authorized shares under the ESPP is subject to increase on an annual basis. The ESPP allows eligible employees to purchase shares of common stock at a discount through payroll deductions of up to 15% of their eligible compensation subject to plan limitations. The ESPP provides for a 24-month offering period comprised of four purchase periods of approximately six months. Employees are able to purchase shares at 85% of the lower of the fair market value of the Company's common stock (i) at the date of commencement of the offering period or (ii) at the last day of the purchase period. The offering periods are scheduled to start on the first trading day on or after March 15 and September 15 of each year, except for the first offering period, which commenced on the first trading day upon the completion of the Company's IPO, or July 17, 2015, and ends on September 15, 2017. During the three months ended October 31, 2015, there was a purchase of 15,569 shares at a purchase price of $7.12 per share.

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

On September 15, 2015 the Company started a new offering period at a new offering price based on the closing price of the Company's common stock on the same date. The Company concluded that starting a new offering period prior to the completion of the existing offering period resulted in an accounting modification and accordingly, recorded $0.6 million of incremental compensation charge to be recognized over the remaining life of the ESPP offering period. During the three and nine months ended October 31, 2015, the Company recorded stock-based compensation expense of $0.2 million and $0.2 million, respectively, related to the ESPP.

Stock Options

Options to purchase shares of common stock may be granted to employees, directors, and consultants. These options vest from date of grant to up to five years and expire 10 years from the date of grant. Options may be exercised anytime during their term in accordance with the vesting/exercise schedule specified in the recipient's stock option agreement and in accordance with the plan provisions. Shares issued upon exercise prior to vesting, are subject to a right of repurchase, which lapses according to the original option vesting schedule.

Summary of option activity under the Company's 2005 Plan and 2015 Plan for the nine months ended October 31, 2015 is set forth below:

	Options Outstanding Number of Shares Underlying Outstanding Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Balance, January 31, 2015	1,893,239	$ 3.85	8.40	$ 10,109
Options granted	443,517	12.36		
Options exercised	(60,127)	0.43		
Options canceled	(87,328)	5.61		
Balance, October 31, 2015	2,189,301	5.60	8.05	$ 7,240
Vested and exercisable, October 31, 2015	636,197	$ 1.31	5.25	$ 4,419
Vested and expected to vest, October 31, 2015	1,990,744	$ 5.52	7.96	$ 6,743

Aggregate intrinsic value represents the difference between the exercise price of the options to purchase common stock and the fair market value of the Company's common stock. The aggregate intrinsic value of options exercised for the three months ended October 31, 2015 and 2014 was $0.2 million and $7,000, respectively, and $0.8 million and $0.4 million for the nine months ended October 31, 2015 and 2014, respectively.

Restricted Stock Units

Restricted Stock Units (RSUs) were granted to employees, non-employee board members and consultants. These RSUs are subject to a time-based vesting condition, which ranges from one to four years.

A summary of the Company's RSU activity and related information for the nine months ended October 31, 2015 is as follows:

	Number of Shares		Weighted−Average Grant-Date Fair Value Per Share	Weighted−Average Remaining Contractual Life (Years)		Aggregate Intrinsic Value (in thousands)
Balance as of January 31, 2015	—	$	—	—	$	—
RSUs granted	987,355		10.04			
RSUs vested	—		—			
RSUs canceled	(38,700)		10.91			
Balance as of October 31, 2015	948,655	$	10.00	2.32	$	7,646
Vested and expected to vest - October 31, 2015	901,222	$	9.04	2.17	$	7,396

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Common Stock Warrants

A summary of the Company's warrants to purchase common stock activity and related information for the nine months ended October 31, 2015 is as follows:

	Common Warrants Outstanding
Balance, January 31, 2015	87,828
Add: Conversion of Preferred Series Alpha warrants to common warrants on IPO	87,325
Less: Common warrants exercised to common stock	(9,152)
Less: Common warrants terminated	(2,046)
Balance, October 31, 2015	163,955

These warrants have exercise prices ranging from $4.70 to $6.04 per share and have expiration dates through January 2025.

9. Stock-Based Compensation

The total stock-based compensation the Company recognized for stock-based awards in the condensed consolidated statements of operations is as follows (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Cost of revenue	$138	$5	$261	$14
Sales and marketing	194	5	323	17
Research and development	487	35	943	73
General and administrative	617	31	1,198	67
Total stock-based compensation expense	$1,436	$76	$2,725	$171

The following table presents stock-based compensation expense by award-type (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Stock Options	$656	$ 76	$1,898	$171
Restricted Stock Units	575	—	604	—
Employee Stock Purchase Plan	205	—	223	—
Total stock-based compensation expense	$1,436	$ 76	$2,725	$171

As of October 31, 2015, there was $6.2 million, $7.6 million and $1.5 million of unrecognized share-based compensation expense, net of estimated forfeitures, related to non-vested stock option grants, unvested RSUs and ESPP, respectively, which will be recognized on a straight-line basis over the remaining weighted-average vesting periods of approximately 1.8 years, 2.8 years and 1.1 years, respectively.

Total outstanding non-employee stock options were 88,699 and 29,134 at October 31, 2015 and 2014, respectively. The total outstanding non-employee RSUs were 70,500 and 0 at October 31, 2015 and 2014, respectively. The non-employee stock-based compensation expense for the stock options and RSUs was not material for any of the periods presented.

Prior to the Company's IPO, the fair value of the shares of common stock underlying stock options was historically established by the Company's Board of Directors, and was based in part upon a valuation provided by an independent third-party valuation firm. Subsequent to the completion of the IPO, the Company uses the closing price of common stock as reported on the New York Stock Exchange on the grant date. The Company has consistently used peer company volatilities for calculating the expected volatilities for employee stock options and the ESPP. The expected term of options granted to employees is based on the simplified method as the Company does not have sufficient historical exercise data, and the expected term of the ESPP is based on the contractual term. The risk-free interest rate for the expected term of the options and the ESPP is based on the U.S. Treasury yield curve in effect at the time of grant. The Company recognizes its stock-based compensation related to options and RSUs using a straight-line method over the vesting term. The Company recognizes its stock-based compensation related to ESPP using a straight-line method over the offering period.

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

For the three and nine months ended October 31, 2015 and 2014 the fair value of employee stock options grants was estimated using the Black – Scholes model with the following assumptions:

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2015	2014	2015	2014
Stock Options:				
Expected volatility	54%-57%	73%-79%	54% - 62%	73%-81%
Expected term (in years)	5.8-6.1	5.5-6.1	5.3-6.1	5.5-6.1
Risk-free interest rate	1.6%-1.7%	1.9%-2.0%	1.6%-1.9%	1.8%-2.0%
Dividend yield	— %	— %	— %	— %

For the three and nine months ended October 31, 2015 and 2014 the fair value of employee stock purchase plan was estimated using the Black – Scholes model with the following assumptions:

For the three and nine months ended October 31, 2015 and 2014 the fair value of ESPP was estimated using the following assumptions:

	Three Months Ended		Nine Months Ended	
	October 31,		October 31,	
	2015	2014	2015	2014
ESPP:				
Expected volatility	38%-44%	— %	35%-44%	— %
Expected term (in years)	0.4-1.9	—	0.7-2.2	—
Risk-free interest rate	0.3%-0.8%	— %	0.1%-0.8%	— %
Dividend yield	— %	— %	— %	— %

Early Exercise of Common Stock

During the three and nine months ended October 31, 2014, the Company issued 61,667 and 125,560 shares, respectively, of common stock following the exercise of common stock options prior to their vesting dates, or early exercises. The Company did not issue any shares during the three and nine months ended October 31, 2015 that were early exercised. The amounts received from all such early exercises is recorded in accrued expenses and other long-term liabilities on the consolidated balance sheets and reclassified to stockholders' equity (deficit) as the options vest. The unvested shares are subject to the Company's repurchase right at the original purchase price, which lapses over the vesting term of the original option grant. As of October 31, 2015 and January 31, 2015, the aggregate price of shares subject to repurchase recorded in accrued expenses and other long-term liabilities totaled $0.2 million and $0.3 million, respectively.

Note 10. Income Taxes

The Company did not record a provision or benefit for income taxes during the three and nine months ended October 31, 2015, primarily due to unbenefited domestic losses. The Company recorded a $0.5 million benefit in the three and nine months ended October 31, 2014 arising from the acquisition of Talkatone, Inc. The Company continues to maintain a full valuation allowance against its net deferred tax assets.

At October 31, 2015, the Company had unrecognized tax benefits of $1.1 million, none of which would currently affect the Company's effective tax rate, if recognized due to the Company's net deferred tax assets being offset by a valuation allowance. The Company does not anticipate that the amount of unrecognized tax benefits relating to tax positions existing at October 31, 2015 will significantly increase or decrease within the next 12 months. There was no interest expense or penalties related to unrecognized tax benefits recorded through October 31, 2015.

A number of years may elapse before an uncertain tax position is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, the Company believes that its reserves for income taxes reflect the most likely outcome. The Company adjusts these reserves, as well as the related interest, in light of changing facts and circumstances. Settlement of any particular position could require the use of cash.

Ooma, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 11. Basic and Diluted Net Loss Per Share

Basic and diluted net loss per share of common stock allocable to common stockholders is calculated by dividing the net loss allocable to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share of common stock is the same as basic net loss per share of common stock, since the effects of potentially dilutive securities are antidilutive. Upon completion of the IPO on July 22, 2015, all outstanding convertible preferred stock was converted to common stock and are included in the weighted average number of common shares used to compute net loss per share from the conversion date.

The following table sets forth the computation of the Company’s basic and diluted net loss per share of common stock (in thousands, except share and per share data):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Numerator				
Net loss	$(3,531)	$(1,719)	$(10,869)	$(2,321)
Denominator				
Weighted-average common shares for basic and diluted net loss per share	16,703,852	2,379,125	7,875,761	2,221,414
Basic and diluted net loss per share	$(0.21)	$(0.72)	$(1.38)	$(1.04)

The following table sets forth the potential shares of common stock that were excluded from diluted weighted-average common shares outstanding:

	Three and Nine Months Ended October 31,	
	2015	2014
Options to purchase common stock	2,189,301	872,713
Employee stock purchase plan	400,487	—
Convertible preferred stock	—	8,353,748
Restricted stock units	948,655	—
Warrants to purchase convertible preferred stock	—	192,009
Warrants to purchase common stock	163,955	34,908
Common stock subject to repurchase	255,706	590,528
Potential shares excluded from diluted net loss per share	3,958,104	10,043,906

12. Defined Contribution Plans

The Company’s contributions to the 401(k) defined contribution plan, which are expensed immediately as compensation costs, were $0.1 million and $0.1 million or the three months ended October 31, 2015 and October 31, 2014, respectively, and $0.4 million and $0.2 million for the nine months ended October, 31, 2015 and October 31, 2014, respectively.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and with our audited financial statements included in our prospectus filed pursuant to Rule 424(b) under the Securities Act of 1933, as amended (the "Securities Act") with the SEC on July 17, 2015. In addition to historical condensed consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates, and beliefs. Our actual results could differ materially from those expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included under Part II, Item 1A below.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995 and other legal authority. These forward-looking statements concern our operations, economic performance, financial condition, goals, beliefs, future growth strategies, objectives, plans and current expectations.

Forward-looking statements appear throughout this Quarterly Report on Form 10-Q including in this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Forward-looking statements can generally be identified by words such as "will," "enables," "expects," "allows," "continues," "believes," "anticipates," "est or similar expressions. Examples of forward-looking statements include, among others, statements we make regarding (i) expected operating results, such as revenue growth, operating and other expenses, margins and earnings; (ii) expectations of the effect on our financial condition of claims, litigation, contingent liabilities, and governmental and regulatory investigations and proceedings; (iii) strategies for customer retention, growth, product development, market position, financial results and reserves; and (iv) strategies for risk management.

Forward-looking statements are neither historical facts nor assurances of future performance. They are based only on our current beliefs, expectations and assumptions regarding the future of our business, anticipated events and trends, the economy and other future conditions. As such, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and in many cases outside our control. Our expected results may not be achieved, and actual results may differ materially from our expectations. Therefore, you should not rely on any of these forward-looking statements.

Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as the section titled "Risk Factors" included under Part II, Item 1 A below, including but not limited to (i) the extent to which we are successful in gaining new customers and retaining existing ones; (ii) the incidence of service outages that could harm our reputation and impair our ability to sell our services; (iii) developments and changes in laws and regulations, including increased regulation of the internet telecommunications industry through legislative action and revised rules and standards applied by the Federal Communications Commission; and (iv) disruptions to our technology network including computer systems and software, as well as natural events such as severe weather, fires, floods and earthquakes or man-made or other disruptions of our operating systems, structures or equipment. Furthermore, such forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We are a leading provider of innovative communications solutions and other connected services to small business, home, and mobile users. Our unique hybrid SaaS platform, consisting of our proprietary cloud, on-premise appliances, mobile applications, and end-point devices, provides the connectivity and functionality that power our solutions. Our communications solutions deliver our proprietary HD voice quality, advanced features, and integration with mobile devices, at extremely competitive pricing and value. Our platform helps create smart workplaces and homes by providing value-added communications and other connected services and by integrating end-point devices to enable the Internet of Things. Our platform and solutions have the power to provide communications, productivity, automation, monitoring, safety, security, and networking infrastructure applications to our users.

We drive the adoption of our platform by providing communications solutions to the large and growing markets for small business, home, and mobile users and then accelerate growth by offering new and innovative connected services to our user base. Our small business and home customers adopt our platform by making a one-time purchase of one of our on-premise appliances, connecting the appliance to the internet and activating services, for which they primarily pay on a monthly basis. Our communications solutions are distinguished by the combination of our proprietary HD voice quality, exceptional value, an advanced feature set enhanced by a number of end-point devices and integration with mobile devices. We believe we have achieved high levels of customer retention and loyalty by delivering exceptional quality and customer satisfaction.

We generate our subscription and services revenue by selling subscriptions and other services for our communications solutions, as well as other connected services.

We generate our product and other revenue from the sale of our on-premise appliances and our end-point devices, as well as from porting fees to enable customers to transfer their existing phone numbers to the Ooma service.

Our total revenue increased from $18.3 million in the three months ended October 31, 2014 to $23.5 million in the three months ended October 31, 2015, representing 28% growth in total revenue. In the nine months ended October 31, 2015 our total revenue increased to $64.5 million compared to $51.3 million in the nine months ended October 31, 2014, representing 26% growth in total revenue. We have continued to make investments in research and development, brand marketing and channel development, incurring net losses of $(3.5) million and $(1.7) million during the three months ended October 31, 2015 and 2014, respectively, and $(10.9) million and $(2.3) million during the nine months ended October 31, 2015 and 2014, respectively.

Key Business Metrics

We review the following key metrics, to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions.

Core Users

We believe that the number of our core users is an indicator of our market penetration, the growth of our business and our anticipated future subscription and services revenue. We define our core users as the number of home user accounts, office user extensions and standalone Business Promoter accounts, which means Business Promoter users who do not subscribe to any other services from us. Talkatone users are excluded from the total number of core users.

Our core users as of October 31, 2015 and 2014 are approximately as follows:

	As of October 31,	
	2015	2014
Core Users	761,000	604,000

The increase in our core users was primarily due to the increases in our Ooma Telo customers and small business customers.

Annualized Exit Recurring Revenue

We believe that our annualized exit recurring revenue, or AERR, for our core users is an indicator of recurring subscription and services revenue for near-term future periods. Our AERR as of October 31, 2015 and 2014 is approximately as follows:

	As of October 31,	
	2015	2014
	(In thousands)	
Annualized Exit Recurring Revenue	$74,369	$57,158

We have experienced a year-over-year increase in AERR primarily due to an increase in our core users and also due to increase in our average recurring revenue per user.

Annual Net Dollar Subscription Retention Rate

We believe that our annual net dollar subscription retention rate for our core users provides insight into our ability to retain and grow our subscription and services revenue, and is an indicator of the long-term value of our customer relationships and the stability of our revenue base.

The Annual Net Dollar Subscription Retention Rate as of October 31, 2015 and 2014 is as follows:

	As of October 31,	
	2015	2014
Annual Net Dollar Subscription Retention Rate	97 %	102 %

Net Dollar Subscription Retention Rate decreased year-over-year primarily due to lower growth in average revenue per user on a year-over-year basis.

Adjusted EBITDA

We use Adjusted EBITDA to manage our business, evaluate our performance and make planning decisions. Adjusted EBITDA represents net loss before interest expense, net, other (expense) income, income taxes, depreciation and amortization, write-off of non-cash deferred debt issuance costs, stock-based compensation, change in the fair value of our convertible preferred stock warrants and change in fair value of our acquisition-related contingent consideration. A reconciliation of our net loss to Adjusted EBITDA for the three and nine months ended October 31, 2015 and 2014 is described below (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Reconciliation of net loss to Adjusted EBITDA:				
Net loss	$(3,531)	$(1,719)	$(10,869)	$(2,321)
Reconciling items:				
Interest expense, net	10	61	570	165
Write-off of non-cash deferred debt issuance costs	—	—	332	—
Other income and expense, net	19	11	31	20
Depreciation and amortization	376	232	1,046	644
Amortization of intangibles	98	111	295	207
Stock - based compensation	1,436	76	2,725	171
Benefit from Income tax	—	—	—	(502)
Change in fair value of convertible preferred stock warrants	—	151	442	366
Change in fair value of acquisition-related contingent consideration	43	241	167	334
Adjusted EBITDA	$(1,549)	$(836)	$(5,261)	$(916)

Components of Results of Operations

Revenue

We generate revenue primarily through the sale of subscriptions to our communications solutions and other connected services. We also generate revenue from the sale of our on-premise appliances and end-point devices that enable our solutions, as well as from porting fees to enable our customers to transfer their existing phone numbers to the Ooma service.

Subscription and services revenue. Our subscription and services revenue consists primarily of fees we bill to our customers in connection with their subscriptions to our communications solutions. Our revenue varies based upon the services and features utilized by our core users. We derive subscription and services revenue primarily from recurring monthly payments related to service plans, such as Ooma Premier, Ooma Office, international calling plans, and other subscriptions, which we refer to as service subscription plans. Subscription and services revenue also includes revenue generated from payments for qualified lead generation, prepaid international and directory assistance calling and mobile advertising from customers who have subscribed for these services, which we refer to as usage-based subscriptions. We recognize revenue under service subscription plans on a straight-line basis over their contractual service term. We recognize revenue under usage-based subscriptions based on actual usage. We also earn revenue from the display of advertisements through our Talkatone mobile application, primarily based on advertisement impressions displayed. We generally recognize revenue from mobile advertising on a net basis, because we are not the primary obligor to advertisers. We expect our subscription and services revenue to increase in absolute dollars, as we continue to grow our user base.

Product and other revenue. Our product and other revenue consists primarily of the sale of our on-premise appliances and end-point devices used in connection with our services and includes shipping and handling fees. We also generate other revenue from porting fees we charge our customers to enable them to transfer their existing phone numbers to Ooma Office or Telo. We recognize product and other revenue when the product has been delivered to the customer. We expect our product and other revenue to remain relatively flat or decrease slightly as we continue to sell our on-premise appliances at an attractive price point to facilitate the adoption of our platform, as well as selling fewer on-premise appliances per core user as we continue to emphasize growth in Ooma Office.

Cost of Revenue

Cost of subscription and services revenue. Our cost of subscription and services revenue primarily consists of payments we make for third-party network operations and telecommunications services, credit card processing fees, costs to maintain data centers, including co-location fees for the right to place our servers in data centers owned by third parties, depreciation of servers and equipment, along with related utilities and maintenance costs, personnel costs associated with customer care and network operations support, and allocated costs of facilities and information technology.

Cost of product and other revenue. Cost of product and other revenue is comprised primarily of the costs associated with the manufacturing of our on-premise appliances and end-point devices, as well as personnel costs for employees and contractors, costs related to porting our customers' phone numbers to our service, shipment of on-premise appliances and end-point devices, and allocated costs of facilities and information technology.

Gross Margin

Subscription and services gross margin. Subscription and services gross margin, can fluctuate based on a number of factors, including the costs we pay to third-party telecommunications providers, the timing of capital expenditures and related depreciation charges and changes in headcount. We expect our subscription and services gross margin to increase over the long term as users adopt additional connected services that we introduce in the future, although our subscription and services gross margin may fluctuate in the short term depending on the interplay of all of the factors identified above.

Product and other gross margin. Product and other gross margin, can fluctuate based on a number of factors, including the number of our on-premise appliances and end-point devices we sell during a period, as compared to the cost to produce those units and the relatively fixed personnel costs for employees and contractors incurred during the period. We sell our on-premise appliances at an attractive price point to facilitate the adoption of our platform. We therefore expect our product and other gross margin to fluctuate on a quarterly basis from small gross margin to breakeven in the foreseeable future.

Our subscription and services gross margin is significantly higher than our product and other gross margin. As a result, any significant change in the mix between subscription and services revenue and product and other revenue will cause our total gross margin to change. For example, in periods where we sell significantly more on-premise appliances than we forecasted, we would expect our total gross margin to decline.

However, we do expect our total gross margin to improve in the longer term as we continue to add more core users.

Operating Expenses

We classify our operating expenses as sales and marketing expenses, research and development expenses, and general and administrative expenses.

Sales and marketing expenses. Our sales and marketing expenses are the largest component of our operating expenses and consist primarily of personnel costs for employees and contractors directly associated with our sales and marketing activities, internet, television, radio and billboard advertising fees, public relations expenses, commissions we pay to resellers and other third parties, trade show expenses, travel expenses, marketing and promotional activities and allocated costs of facilities and information technology. We expect our sales and marketing expenses to increase in absolute dollars as we continue to actively grow our core users.

Research and development expenses. Our research and development efforts are focused on developing new and expanded features for our services and improvements to our platform and backend architecture. Our research and development expenses consist primarily of personnel costs for employees and contractors and allocated costs of facilities and information technology, software tools, and product certification. We expense research and development costs as incurred. We expect our research and development expenses to grow modestly going forward.

General and administrative expenses. Our general and administrative expenses consist primarily of personnel costs for employees engaged in administrative activities to support the day-to-day operations of our business. Other significant components of our general and administrative expenses include professional service fees, legal fees and allocated costs of facilities and information technology. We expect general and administrative expenses to modestly grow going forward.

Results of Operations

The following tables set forth selected condensed consolidated statement of operations data and such data as a percentage of total revenues. The historical results presented below are not necessarily indicative of the results that may be expected for any future period (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2015	2014	2015	2014
Revenues:				
Subscription and services	$19,470	$14,316	$52,495	$37,904
Product and other	4,006	3,971	11,969	13,383
Total revenues	23,476	18,287	64,464	51,287
Cost of revenues:				
Subscription and services	6,715	4,830	18,649	13,052
Product and other	4,277	4,065	12,067	12,610
Total cost of revenues	10,992	8,895	30,716	25,662
Gross profit	12,484	9,392	33,748	25,625
Operating expenses:				
Sales and marketing	7,539	5,958	20,247	15,518
Research and development	4,948	3,365	13,329	8,596
General and administrative	3,499	1,565	9,666	3,783
Total operating expenses	15,986	10,888	43,242	27,897
Loss from operations	(3,502)	(1,496)	(9,494)	(2,272)
Other (expense) income:				
Interest expense, net	(10)	(61)	(902)	(165)
Change in fair value of warrants	—	(151)	(442)	(366)
Other (expense) income, net	(19)	(11)	(31)	(20)
Other (expense) income	(29)	(223)	(1,375)	(551)
Loss before provision for income taxes	(3,531)	(1,719)	(10,869)	(2,823)
Income tax benefit	—	—	—	502
Net loss	$(3,531)	$(1,719)	$(10,869)	$(2,321)
Stock-based compensation:				
Cost of revenues	$138	$5	$261	$14
Sales and marketing	194	5	323	17
Research and development	487	35	943	73
General and administrative	617	31	1,198	67
Total stock-based compensation	$1,436	$76	$2,725	$171

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Percentage of Total Revenues:

	Three Months Ended October 31, 2015	Three Months Ended October 31, 2014	Nine Months Ended October 31, 2015	Nine Months Ended October 31, 2014
Revenues:				
Subscription and services	83 %	78 %	81 %	74 %
Product and other	17	22	19	26
Total revenues	100	100	100	100
Cost of revenues:				
Subscription and services	29	26	29	25
Product and other	18	22	19	25
Total cost of revenues	47	48	48	50
Gross profit	53	52	52	50
Operating expenses:				
Sales and marketing	32	33	31	30
Research and development	21	18	21	17
General and administrative	15	9	15	7
Total operating expenses	68	60	67	54
Loss from operations	(15)	(8)	(15)	(4)
Other (expense) income:				
Interest expense, net	—	—	(1)	—
Change in fair value of warrants	—	—	(1)	(1)
Other (expense) income, net	—	—	—	—
Other (expense) income	—	—	(2)	(1)
Loss before provision for income taxes	(15)	(8)	(17)	(5)
Income tax benefit	—	—	—	1
Net loss	(15 %)	(8 %)	(17 %)	(4 %)

Comparison of the three and nine months ended October 31, 2015 and 2014 (in thousands):

Revenues

	Three Months Ended October 31, 2015	Three Months Ended October 31, 2014	$ Change	% Change	Nine Months Ended October 31, 2015	Nine Months Ended October 31, 2014	$ Change	% Change
Revenues:								
Subscription and services	$19,470	$14,316	$ 5,154	36 %	$52,495	$37,904	$14,591	38 %
Product and other	4,006	3,971	35	1 %	11,969	13,383	(1,414)	(11 %)

Total revenues	$23,476	$18,287	$5,189	28	%	$64,464	$51,287	$13,177	26	%

Three Months Ended October 31, 2015 Compared to Three Months Ended October 31, 2014

Our total revenue increased by $5.2 million primarily due to an increase in subscription and services revenue.

Our subscription and services revenue increased by $5.2 million, primarily due to a 26% growth in our core users, which increased to approximately 761,000 as of October 31, 2015 from approximately 604,000 core users as of October 31, 2014. In addition to the increase in our core users, our average quarterly subscription and services revenue per core user, excluding Talkatone, increased to $24.45 for the three months ended October 31, 2015 from $23.67 for the three months ended October 31, 2014.

Our product and other revenue experienced a small increase, with an increase in the volume of on-premise appliances partly offset by a decrease in average selling price during the three months ended October 31, 2015 as compared to three months ended October 31, 2014.

Nine Months Ended October 31, 2015 Compared to Nine Months Ended October 31, 2014

Our total revenue increased by $13.2 million mainly due to an increase in subscription and services revenue of $14.6 million offset by a decrease in product and other revenue of approximately $1.4 million.

Our subscription and services revenue increased by $14.6 million, primarily due to an increase in our core users. In addition, our average quarterly subscription and services revenue per core user, excluding Talkatone, increased to $23.40 for the nine months ended October 31, 2015 from $22.68 for the nine months ended October 31, 2014. Additionally, Talkatone monthly active users, grew to over 1.5 million from approximately one million users at the end of third quarter of fiscal 2015.

Our product and other revenue decreased by $1.4 million due to a decrease in average selling price and in part because of reduction in sales to one of our reseller partners.

Cost of Revenues and Gross Margin

	Three Months Ended October 31, 2015	2014	$ Change	% Change	Nine Months Ended October 31, 2015	2014	$ Change	% Change
Cost of revenues:								
Subscription and services	$6,715	$4,830	$ 1,885	39 %	$18,649	$13,052	$ 5,597	43 %
Product and other	4,277	4,065	212	5 %	12,067	12,610	(543)	(4 %)
Total cost of revenue	$10,992	$8,895	2,097	24 %	$30,716	$25,662	5,054	20 %
Gross profit:								
Subscription and services	$12,755	$9,486	3,269	34 %	$33,846	$24,852	8,994	36 %
Product and other	(271)	(94)	(177)	188 %	(98)	773	(871)	(113 %)
Total gross profit	$12,484	$9,392	3,092	33 %	$33,748	$25,625	8,123	32 %
Gross margin:								
Subscription and services	66 %	66 %			64 %	66 %		
Product and other	(7 %)	(2 %)			(1 %)	6 %		
Total gross margin	53 %	51 %			52 %	50 %		

Three Months Ended October 31, 2015 Compared to Three Months Ended October 31, 2014

Total gross margin increased to 53% for the three months ended October 31, 2015 from 51% for the three months ended October 31, 2014 primarily due to higher proportionate growth of subscription and other services revenue as compared to product and other revenue, as subscription and services revenue carries higher gross margin.

The total gross profit increased by $3.1 million for the three months ended October 31, 2015, as compared to three months ended October 31, 2014, due to an increase in subscription and services gross profit of $3.3 million, which was offset in part by a decrease in product and other gross profit of $0.2 million.

The increase in cost of subscription and services revenue of $1.9 million was primarily due to an increase in personnel and consultant costs of $0.8 million, an increase in depreciation and facilities related costs of $0.3 million due to increase in headcount, an increase of $0.3 million increase in data storage and telecom costs and an increase in credit processing fees of $0.2 million.

The increase of $0.2 million in cost of product and other revenue was primarily driven by an increase in the number of on-premise appliances and end-point devices sold for the three months ended October 31, 2015 as compared to the three months ended October 31, 2014. The increase was in part offset by a decrease in the cost to manufacture our on-premise appliance with our contract manufacturers.

Nine Months Ended October 31, 2015 Compared to Nine Months Ended October 31, 2014

Total gross margin increased to 52% for the nine months ended October 31, 2015 from 50% for the nine months ended October 31, 2014 due to a higher proportionate growth of subscription and other services revenue as compared to product and other revenue, as subscription and services revenue carries higher gross margin. The increase in subscription and services revenue was driven by an increase in core users, the increase was offset in part due to ramp up of our investments in small business services.

The total gross profit increased by $8.1 million for the nine months ended October 31, 2015, as compared to nine months ended October 31, 2014, due to an increase in subscription and services gross profit of $9.0 million, which was offset in part by a decrease in product and other gross profit of $0.9 million.

The increase in cost of subscription and services revenue of $5.6 million was primarily due to an increase in personnel and consultant costs of $2.1 million, an increase of $1.0 million in telecom costs, an increase depreciation and facilities costs of $0.8 million, an increase in data storage costs of $0.7 million, an increase in credit card processing fees of $0.5 million, and an increase in stock-based compensation expense of $0.2 million.

The decrease of $0.5 million in cost of product and other revenue for the nine months ended October 31, 2015 as compared to the nine months ended October 31, 2014 was primarily due to a decrease in manufacturing costs of our on-premise appliances with our contract manufacturers, offset in part by a change in product mix and units sold, resulting from an increase in sale of products in small business segments of Ooma Office bundles and end-point devices.

Operating Expenses

	Three Months Ended October 31,				Nine Months Ended October 31,			
	2015	2014	$ Change	% Change	2015	2014	$ Change	% Change
Operating expenses:								
Sales and marketing	$7,539	$5,958	$ 1,581	27 %	$20,247	$15,518	$ 4,729	30 %
Research and development	4,948	3,365	1,583	47 %	13,329	8,596	4,733	55 %
General and administrative	3,499	1,565	1,934	124 %	9,666	3,783	5,883	156 %
Total operating expenses	$15,986	$10,888	$ 5,098	47 %	$43,242	$27,897	$ 15,345	55 %

Sales and Marketing

Three Months Ended October 31, 2015 Compared to Three Months Ended October 31, 2014

Sales and marketing expenses increased $1.6 million in the three months ended October 31, 2015 as compared to the three months ended October 31, 2014. The increase was due to $0.9 million increase in personnel and consultant expenses primarily driven by increased headcount and growth in business, $0.3 million increase in marketing activities and $0.2 million increase in stock based compensation expense.

Nine Months Ended October 31, 2015 Compared to Nine Months Ended October 31, 2014

Sales and marketing expenses increased $4.7 million in the nine months ended October 31, 2015 as compared to the nine months ended October 31, 2014. The increase was due to $2.4 million increase in personnel and consultant expenses primarily driven by increased headcount and growth in business, $1.5 million increase in marketing activities as we sought to increase product awareness, $0.4 million increase in facilities and related costs as we increased headcount in 2015 and $0.3 million increase in stock based compensation expense.

Research and Development

Three Months Ended October 31, 2015 Compared to Three Months Ended October 31, 2014

Research and development expenses increased $1.6 million in the three months ended October 31, 2015 as compared to the three months ended October 31, 2014. The increase was due to $1.1 million increase in personnel and consultant expenses primarily due to increased headcount and $0.5 million increase in stock-based compensation expense.

Nine Months Ended October 31, 2015 Compared to Nine Months Ended October 31, 2014

Research and development expenses increased $4.7 million in the nine months ended October 31, 2015 as compared to the nine months ended October 31, 2014. The increase was due to $3.5 million increase in personnel and consultant expenses primarily due to increased headcount, $0.9 million increase in stock-based compensation expense and $0.2 million increase in facilities costs.

General and Administrative

Three Months Ended October 31, 2015 Compared to Three Months Ended October 31, 2014

General and administrative expenses increased $1.9 million in the three months ended October 31, 2015 as compared to the three months ended October 31, 2014. The increase was due to an increase of $0.7 million primarily due to professional services and other expenses related to operating as a public company, $0.6 million increase in stock-based compensation, and $0.5 million increase in personnel expenses due to increased headcount.

Nine Months Ended October 31, 2015 Compared to Nine Months Ended October 31, 2014

General and administrative expenses increased $5.9 million in the nine months ended October 31, 2015 as compared to the nine months ended October 31, 2014. The increase was due to $2.6 million increase in personnel and consultant expenses primarily due to the increased headcount, $2.0 million increase primarily due to professional services and other expenses related to operating as a public company, and $1.1 million increase in stock-based compensation.

Other Income and Expense, net

	Three Months Ended October 31,				Nine Months Ended October 31,			
	2015	2014	$ Change	% Change	2015	2014	$ Change	% Change
Other (expense) income:								
Interest (expense), net	$(10)	$(61)	$ 51	*NM	$(902)	$(165)	$ (737)	*NM
Change in fair value of warrants	—	(151)	151	*NM	(442)	(366)	(76)	*NM
Other (expense) income, net	(19)	(11)	(8)	*NM	(31)	(20)	(11)	*NM
Total other (expense) income	$(29)	$(223)	$ 194	*NM	$(1,375)	$(551)	$ (824)	*NM

*Percentage is not meaningful

Three Months Ended October 31, 2015 Compared to Three Months Ended October 31, 2014

Other (expense) income is comprised mainly of interest expense related to the outstanding debt and the change in the fair value of warrants. For the three months ended October 31, 2015, the total other (expense) income decreased $0.2 million as compared to three months ended October 31, 2014 due to the payoff of outstanding debt in July 2015. The decrease was also attributed to the conversion and payout of preferred stock warrants into common stock during the second quarter of fiscal 2016, these warrants were fair valued during the three months ended October 31, 2014 which resulted in $0.2 million expense.

Nine Months Ended October 31, 2015 Compared to Nine Months Ended October 31, 2014

Other (expense) income is comprised mainly of interest expense related to the outstanding debt and the change in the fair value of warrants. For the nine months ended October 31, 2015, the interest expense increased by $0.7 million due to the increase in the outstanding debt in fiscal 2015. Also, included in interest expense was $0.3 million of non-cash deferred issuance costs that was written off due to the repayment of all outstanding debt in July 2015. In addition to the interest expense was $0.2 million of expense which resulted from a greater proportional increase in the fair value of the warrants period to period.

Income Tax Benefit

	Three Months Ended October 31,				Nine Months Ended October 31,			
	2015	2014	$ Change	% Change	2015	2014	$ Change	% Change
Income tax benefit	$ —	$ —	$ —	*NM	$ —	$ 502	$ (502)	*NM

*Percentage is not meaningful

We recorded a tax benefit of $0.5 million arising from the release of deferred tax valuation allowances as a result of acquisition of Talkatone, Inc. in May 2014. The release of valuation allowances was triggered by the recognition of $0.5 million of long term net deferred tax liabilities that were primarily related to the acquired intangible assets and R&D credits recorded upon the acquisition of Talkatone, Inc.

Liquidity and Capital Resources

As of October 31, 2015 we had $57.3 million of cash and cash equivalents. To date we have funded our operations through our sales to our customers, proceeds from issuance of common stock in the initial public offering and issuance of convertible preferred stock. In April 2015, we raised $5.0 million in proceeds from sale of our Series Beta convertible preferred stock. In July 2015, we completed our IPO in which we sold 5.0 million shares at $13.00 per share which resulted in net proceeds of $57.0 million, after deducting $4.5 million in underwriters' discounts and commissions and $3.5 million in offering costs, of which $3.3 million was paid and $0.2 million remained unpaid as of October 31, 2015. We used approximately $10.3 million of the IPO proceeds to repay our outstanding debt.

We believe that our existing cash and cash equivalents and $12.0 million funds available under our existing Revolver agreement will be sufficient to meet our cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including our growth rate, our needs for increased data center capacity to support our expanding customer base, the timing and extent of our sales and marketing and research and development expenditures, and the continuing market acceptance of our solutions.

The table below provides selected cash flow information, for the periods indicated (in thousands):

	Nine Months Ended October 31,	
	2015	2014
Net cash used in operating activities	$(696)	$(3,392)
Net cash used in investing activities	(1,117)	(1,633)
Net cash provided by financing activities	49,965	4,288
Net increase (decrease) in cash and cash equivalents	$48,152	$(737)

Net Cash Used in Operating Activities

We have historically used cash in operating activities due to our net losses, which include non-cash expense items such as depreciation and amortization, stock based compensation, write off of deferred issuance costs related to debt, change in the fair value of warrant liability and acquisition-related contingent consideration offset by changes in our operating assets and liabilities, particularly from accounts receivable, accounts payable and accrued expenses.

The key line items that resulted in net cash used in operating activities were as follows (in thousands):

	Nine Months Ended October 31,	
	2015	2014
Net Loss	$(10,869)	$(2,321)
Add back non-cash charges	5,071	1,260
Net loss before non-cash charges	(5,798)	(1,061)
Decrease (increase) in inventories	2,292	(6,038)
Increase in deferred inventory costs	(426)	(1,080)
Increase in accounts payable and accrued expenses	4,509	2,932
Increase in accounts receivable	(1,853)	(1,801)
Increase in deferred revenue	1,199	4,035
Others	(619)	(379)
Net cash used in operating activities	$(696)	$(3,392)

For the nine months ended October 31, 2015, our net loss of $10.9 million included non-cash charges of $5.1 million primarily related to $2.7 million of stock-based compensation; $1.3 million of depreciation and amortization expense, $0.3 million of write-off of non-cash deferred debt issuance costs due to the repayment of debt and $0.6 million of expense due to change in fair value of preferred warrant liability and acquisition-related contingent consideration. Operating asset and liability changes for the nine months ended October 31, 2015 included:

- a decrease of $2.3 million in inventory primarily due to usage of raw material and finished goods
- an increase of $0.4 million of deferred inventory costs due to higher inventory levels at channel partners
- an increase of $4.5 million of accounts payable and accrued liabilities due to the timing of payments and invoices primarily in advertising expenses
- an increase of $1.8 million in accounts receivable primarily due to the timing of billings to our channel partners and also due to increase in receivables related to services
- an increase of $1.2 million in deferred revenue resulting from an increase in core users primarily in part driven by the growth in the premium users offset in part by decrease in sales by our channel partners.

For the nine months ended October 31, 2014, our net loss of $2.3 million included non-cash charges of $1.3 million primarily related to $0.9 million of depreciation and amortization expense, $0.7 million of expense due to change in fair value of preferred warrant liability and acquisition-related earn out, $0.2 million of stock-based compensation offset by $0.5 million in .0 income tax benefit due to the acquisition of Talkatone, Inc. Operating asset and liability changes for the nine months ended October 31, 2014 included:

- an increase of $6.0 million in our raw material and finished goods inventory to scale our business
- an increase of $1.1 million in deferred inventory costs due to shipments to our channel partners net of product costs sold through to our end-users
- an increase of $2.9 million of accounts payable and accrued liabilities due to the timing of payments
- an increase of $1.8 million in accounts receivable due to the timing of shipments and billings to our channel partners
- an increase of $4.0 million in deferred revenue primarily due to an increase of $2.3 million of product revenue due to shipments to our channel partners net of product sold through to end-users and $1.7 million increase in deferred revenue from subscription and other services due to an increase in our core users primarily driven by growth in our premium users

Net Cash Used in Investing Activities

Our investing activities include business acquisitions and capital expenditures for property and equipment purchases. Our capital expenditures have primarily been for general business purposes, including leasehold improvements as we have expanded our office space to accommodate our growth in headcount, computer equipment used internally, and expansion of our network operations centers.

For the nine months ended October 31, 2015 we used $1.1 million in investing activities primarily for the purchase of property and equipment.

For the nine months ended October 31, 2014 we used $1.6 million in investing activities, which included $1.0 million in connection with a business acquisition and $0.7 million for the purchase of property and equipment.

Net Cash Provided by Financing Activities

Cash generated from financing activities includes proceeds from borrowings under our credit facilities, proceeds from our issuance of common stock following employee stock option exercises, issuance of preferred stock and proceeds from the sale of common stock in our IPO in July 2015. Cash used in financing activities includes repayment of debt, payment of preferred warrant liability and payment of acquisition related earn-out.

During the nine months ended October 31, 2015, financing activities provided $50.0 million of cash. During the nine months ended October 31, 2015, we generated net cash proceeds of $57.0 million from the issuance of common stock from our IPO, after adjusting for underwriting discounts and commissions of $4.5 million and offering costs of $3.5 million, of which $3.3 million was paid and $0.2 million remained unpaid as of October 31, 2015. Cash provided from financing activities also included $5.0 million from issuance of Series Beta preferred stock and $0.2 million in proceeds from the exercise of options and warrants and issuance of common stock under employee stock purchase offset by repayment of $11.5 million of outstanding debt, payment of $0.6 million of preferred warrant liability and payment of $0.5 million of acquisition-related earn-out.

During the nine months ended October 31, 2014, we had net proceeds of $4.3 million from financing activities, primarily due to $5.0 million from borrowings under our credit facility and $0.4 million from exercise of options and warrants offset by $1.1 million used to repay outstanding debt and capital leases.

Contractual Obligations and Commitments

Set forth below is information concerning our contractual commitments and obligations as of October 31, 2015 (in thousands):

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Capital lease obligations	$832	$179	$653	$ —	$ —
Operating lease obligations	3,699	431	3,223	45	
Total	$4,531	$610	$3,876	$ 45	$ —

The contractual commitment amounts in the table above are associated with enforceable and legally binding agreements. Capital lease obligations represent our obligation to make payments for equipment that we have leased and operating lease obligations represent our obligations to make payments under the lease agreements for our facilities.

As of October 31, 2015, non-cancelable purchase commitments with our contract manufacturers were $0.8 million.

As of October 31, 2015, we had no tax liabilities related to uncertainty in income tax positions.

Off-balance Sheet Arrangements

During the three and nine months ended October 31, 2015 and 2014, we did not have any arrangements with unconsolidated entities or financial partnerships, including entities such as structured finance or special purpose entities that were established for the purpose of facilitating off-balance sheet arrangements.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk in the ordinary course of our business. Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in foreign currency exchange rates and interest rates. We do not hold or issue financial instruments for trading purposes.

Interest Rate Sensitivity

We had cash and cash equivalents of $57.3 million and $9.1 million as of October 31, 2015 and January 31, 2015, respectively. Our cash and cash equivalents are held in cash and money market funds. Due to the short-term nature of these instruments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. In addition, as of January 31, 2015, we had approximately $10.7 million in short and long-term debt including accrued interest with variable interest rate components. A hypothetical 10% increase or decrease in interest rates would not have had a material impact on our interest expense. As of October 31, 2015, we did not have any outstanding debt with variable interest rates.

Foreign Currency Risk

To date, all of our revenue has been denominated in U.S. and Canadian dollars. Some of our revenue is subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Canadian dollar. Additionally, fluctuations in foreign currency exchange rates may cause us to recognize transaction gains and losses in our statements of operations. To date, foreign currency transaction realized gains and losses have not been material to our consolidated financial statements. A hypothetical 10% increase or decrease in foreign currency exchange rates would not have had a material impact on our condensed consolidated financial statements.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining adequate disclosure controls and procedures. Management, with the participation of our chief executive officer and our chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of October 31, 2015. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of October 31, 2015, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

On August 13, 2015, Michelle Hernandez, Ashley Salina, John Ramirez and Andre Rufus, on behalf of themselves and others similarly situated, filed a class action lawsuit in the United States District Court for the Northern District of California against the Company and its wholly-owned subsidiary, Talkatone, LLC (the "TCPA Litigation"). The lawsuit alleges that the Company and Talkatone, LLC sent unauthorized text messages to consumers on behalf of the Company in violation of the Telephone Consumer Protection Act. The complaint seeks class certification, statutory damages of $500-$1,500 per violation, an injunction against "wireless spam activities," and attorneys' fees and costs. The Company believes that the plaintiff's claims in the complaint are without merit, responded by filing a motion to dismiss the complaint on October 23, 2015, and will continue to vigorously defend this lawsuit. However, litigation is unpredictable and there can be no assurances that we will obtain a favorable final outcome or that we will be able to avoid unfavorable preliminary or interim rulings in the course of litigation that may significantly add to the expense of our defense and could result in substantial costs and diversion of resources. Based on our current knowledge, we have determined that the amount of any material loss or range of any losses that are reasonably possible to result from the TCPA Litigation are not reasonably estimable.

On November 12, 2015 the Alabama Statewide 9-1-1 Board filed a lawsuit in the Circuit Court of Montgomery, Alabama against the Company (the "Alabama Litigation"). The lawsuit alleges that the Company has failed to collect from its subscribers and remit certain fees pursuant to the Alabama Emergency Telephone Services Act (the "AETS Act"). The Company believes that the Commerce Clause of the United States Constitution bars the application of the AETS Act to the Company, since the Company has no employees, property or other indicia of a "substantial nexus" with the State of Alabama, and therefore the plaintiff's claims are without merit. The Company intends to vigorously defend this lawsuit. However, litigation is unpredictable and there can be no assurances that we will obtain a favorable final outcome or that we will be able to avoid unfavorable preliminary or interim rulings in the course of litigation that may significantly add to the expense of our defense and could result in substantial costs and diversion of resources. Based on our current knowledge, we have determined that the amount of any material loss or range of material losses that are reasonably possible to result from the Alabama Litigation are not reasonably estimable.

In addition to the TCPA Litigation and the Alabama Litigation, from time to time, we may be involved in a variety of other claims, lawsuits, investigations, and proceedings relating to contractual disputes, intellectual property rights, employment matters, regulatory compliance matters, and other litigation matters relating to various claims that arise in the normal course of business. Defending such proceedings is costly and can impose a significant burden on management and employees, we may receive unfavorable preliminary or interim rulings in the course of litigation, and there can be no assurances that favorable final outcomes will be obtained.

We determine whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. We assess our potential liability by analyzing specific litigation and regulatory matters using reasonably available information. We develop our views on estimated losses in consultation with inside and outside counsel, which involves a subjective analysis of potential results and outcomes, assuming various combinations of appropriate litigation and settlement strategies. Legal fees are expensed in the period in which they are incurred. Other than the TCPA Litigation and the Alabama Litigation, we currently are not a party to any material litigation or other legal proceedings, and as of October 31, 2015, we did not have any accrued liabilities recorded for loss contingencies.

Item 1A. Risk Factors

Our current and prospective investors should carefully consider the risks and uncertainties described below, together with all of the other information in this Quarterly Report on Form 10-Q, including our condensed consolidated financial statements and the related notes, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the “Cautionary Note Regarding Forward-Looking Statements,” before making investment decisions regarding our common stock. The risks and uncertainties described below may not be the only ones we face, but include the most significant factors currently known by us. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, also may become important factors that affect us. If any of the risks actually occur, our business, financial condition, results of operations could be materially and adversely affected. In that event, the trading price of our common stock could decline, and you could lose part or all of your investment.

Risks Related to Our Business and Our Industry

If we are unable to attract new users of our services on a cost-effective basis, our business will be materially and adversely affected.

In order to grow our business, we must continue to attract new users on a cost-effective basis. We use and periodically adjust the mix of advertising and marketing programs to promote our services. Significant increases in the pricing of one or more of our advertising channels could increase our advertising costs or may cause us to choose less expensive and perhaps less effective channels to promote our services. As we add to or change the mix of our advertising and marketing strategies, we may need to expand into channels with significantly higher costs than our current programs, which could materially and adversely affect our results of operations. We will incur advertising and marketing expenses in advance of when we anticipate recognizing any revenue generated by such expenses, and we may fail to experience an increase in revenue or brand awareness as a result of such expenditures. We have made in the past, and may make in the future, significant expenditures and investments in new advertising campaigns, and we cannot assure you that any such investments will lead to the cost-effective acquisition of additional customers. New users are drawn to our products and services by rankings circulated by organizations such as Amazon.com, Apple and Google app stores and highly regarded publications such as PC Magazine. If we are unable to maintain effective advertising programs and garner favorable rankings, our ability to attract new customers could be materially and adversely affected, our advertising and marketing expenses could increase substantially, and our results of operations may suffer.

We market our products and services principally to small businesses and households. Many of these consumers tend to be less technically knowledgeable and may be resistant to new technologies such as our cloud-based communications solutions and our connected services. Because our potential customers need to connect additional hardware at their location and take other technical steps not required for the use of traditional communications services such as telephone, fax and e-mail, these consumers may be reluctant to use our service. These customers may also lack sufficient resources, financial or otherwise, to invest in learning about our services, and therefore may be unwilling to adopt them. If these consumers choose not to adopt our services, our ability to grow our business will be limited.

Our customers may terminate their subscriptions for our service at any time without penalty, and increased customer turnover, or costs we incur to retain our customers and encourage them to add users and, in the future, to purchase additional functionalities and premium service editions, could materially and adversely affect our financial performance.

Our customers generally do not have long-term contracts with us, and they may terminate their subscription for our service at any time without penalty or early termination charges. We cannot accurately predict the rate of customer terminations or average monthly service cancellations or failures to renew, which we refer to as churn. Our Ooma Office customers may choose to reduce the number of lines or remove some of the solutions to which they subscribe. Additionally, our Ooma Telo customers subscribing to Premium Services have no obligation to renew their subscriptions for such services and may elect to terminate their subscription for any number of reasons, including changes in financial or employment status, perceived reduction in quality or value, and other unique and personal reasons.

We may not be able to predict the renewal rates for our customers. In addition, small business customers generally pay more for their subscriptions than home or mobile customers, so any increased churn in small business customers could materially and adversely affect our financial performance and user churn, resulting in a significant impact on our results of operations, and an increase in the cost we incur in our efforts to retain our customers and encourage them to upgrade their services and increase their number of users. Our core user churn rate could increase in the future if customers are not satisfied with our service, the value proposition of our services or our ability to otherwise meet their needs and expectations. Churn and reductions in the number of users for whom a small business customer subscribes may also increase due to factors beyond our control. Because of churn and reductions in the number of users for whom a customer subscribes, we have to acquire new customers, or acquire new users within our existing customer base, on an ongoing basis simply to maintain our existing level of customers and revenue. If a significant number of customers terminate, reduce or fail to renew their subscriptions, we may need to incur significantly higher marketing expenditures than we currently anticipate in order to increase the number of new customers or to sell existing customers additional services, and such additional marketing expenditures could harm our business and results of operations. Different factors may affect the churn of business, home, and mobile customers, and Talkatone customers differently. As a result, our business is susceptible to a broad array of market forces, and any of our efforts to mitigate risk of customer churn due to one factor may divert management’s time and focus away from efforts to mitigate risk of customer churn due to other factors. This broad-based susceptibility to churn could materially and adversely affect our financial performance.

Our future success also depends in part on our ability to sell additional subscriptions and additional functionalities to our current customers. This may require increasingly sophisticated and more costly sales efforts and a longer sales cycle. Any increase in the costs necessary to upgrade, expand and retain existing customers could materially and adversely affect our financial performance. If our efforts to convince customers to add users and, in the future, to purchase additional functionalities are not successful, our business may suffer. In addition, such increased costs could cause us to increase our subscription rates, which could increase our turnover rate.

We face competition in our markets by our competitors and may lack sufficient financial or other resources to compete successfully.

The cloud-based communications and connected services industries are highly competitive. We face continued competition from (i) established communications providers, such as AT&T Inc., Comcast Corporation and Verizon Communications Inc. in the U.S., and Rogers Communications Inc. and others in Canada; (ii) other communications companies such as 8x8, Inc., magicJack VocalTec Ltd., RingCentral, Inc. and Vonage Holdings Corp.; (iii) companies such as Broadsoft, Inc. and Microsoft Corporation (that generally license their software) and their resellers; (iv) traditional on-premise, hardware communications providers, such as Avaya Inc., Cisco Systems, Inc., ShoreTel, Inc. and their resellers; (v) mobile communications app companies providing “over-the-top” solutions, such as LINE Corporation, Pinger, Inc., Viber Media S.à.r.l. and WhatsApp Inc.; and (vi) other large internet companies, such as Google Inc. All of these companies currently or may in the future host their solutions through the cloud. In addition, as we expand our connected services, we face competition from lead-generation and internet search engine optimization companies and home automation companies.

Aggressive business tactics by our competitors may reduce our revenue.

Increased competition may result in aggressive business tactics by our competitors, including:

- selling at a discount or loss;
- offering products similar to our platform and solutions on a bundled basis at no charge;
- announcing competing products combined with extensive marketing efforts;
- providing financial incentives to consumers; and
- asserting intellectual property rights irrespective of the validity of the claims.

Our retail partners may offer the products and services of competing companies, which would adversely affect our business. Competition from other companies may also adversely affect our negotiations with service providers and suppliers, including, in some cases, requiring us to lower our prices. We may not be able to compete successfully with the offerings and sales tactics of other companies, which could result in the loss of customers and, as a result, our revenue and profitability could be adversely affected.

Mergers or other strategic transactions involving our competitors could weaken our competitive position, which could adversely affect our ability to compete effectively and harm our results of operations; additionally, mergers or other strategic transactions we engage in may not be successful.

We believe that some of our existing competitors may consolidate or be acquired. In addition, some of our competitors may enter into new alliances with each other or may establish or strengthen cooperative relationships with systems integrators, third-party consulting firms or other parties. Any such consolidation, acquisition, alliance or cooperative relationship could adversely affect our ability to compete effectively and lead to pricing pressure and our loss of market share, and could result in a competitor with greater financial, technical, marketing, service and other resources, all of which could harm our business, results of operations and financial condition.

In the past we have decided, and in the future may decide, to enter into mergers or other strategic transactions in which we acquire other companies. We cannot guarantee we will be able to successfully integrate the teams, assets, or business of these target companies into our business, that we will be able to fully recover the costs of such transactions or that we will be successful in leveraging such strategic transactions into increased business for our products.

We rely significantly on retailers and reseller partnerships to sell our products; our failure to effectively develop, manage, and maintain our retail sales and reseller partnership channels could materially and adversely affect our revenue.

We currently sell our Ooma Telo and Ooma Office products through a combination of direct sales, leading retailers such as Amazon.com, Costco.com, Best Buy, Fry's Electronics, Future Shop and Walmart, and our reseller partnership with Vivint Inc., and a significant portion of our product sales are made through our retail and reseller partnership channels. Similarly, to date, the vast majority of our Business Promoter accounts are obtained through a limited number of reseller partnerships. In addition, our Talkatone application relies significantly on the Apple and Google app stores for distribution. Our future success depends on our continued ability to establish and maintain a network of productive retailers, to maintain and expand our reseller partnership arrangements, and to maintain the ability of Talkatone to be distributed through the app stores and increase Talkatone's visibility therein. We expect that we will need to maintain and expand our retail channel and reseller partnership sales and Talkatone's distribution and visibility in the app stores as we seek to expand our customer base. We generally do not have long-term contracts with our retailers, distributors and reseller partners, and we have in the past and may in the future experience a loss of or reduction in sales through any of these third parties, which could materially reduce our revenue. In addition, if Apple or Google determine that Talkatone is non-compliant with their app store vendor policies, they may revoke our rights to sell Talkatone through their app store at any time. Our competitors may in some cases be effective in causing our current and potential retailers, and reseller partners to favor their services or prevent or reduce sales of our services. If we fail to maintain relationships with current retailers and reseller partners, fail to develop relationships with new retailers and reseller partners in new markets or expand the number of retailers and reseller partners in existing markets, or if we fail to manage, train, or provide appropriate incentives to our existing retailers and reseller partners, or if they are not successful in their sales efforts, sales of our products and services may decrease and our results of operations would suffer.

We depend on four vendors to manufacture the on-premise appliances and end-point devices we sell, and any delay or interruption in manufacturing, configuring and delivering by these third parties would result in delayed or reduced shipments to our customers and may harm our business.

We primarily rely on Mitac Computing Technology Corporation and Kentec Technology (SUZHOU) Co., Ltd. for production of our on-premise appliances and primarily on Hualin Precision Technology Co., Ltd and VTech Telecommunication Ltd. for production of our end-point devices we sell to our customers. We currently do not have long-term contracts with these vendors. As a result, these third parties are not obligated to provide products to or perform services for us for any specific period, in any specific quantities or at any specific price, except as may be provided in a particular purchase order. If these third parties are unable to deliver on-premise appliances or end-point devices of acceptable quality or in a timely manner, our ability to bring services to market, the reliability of our services and our reputation could suffer. We expect that it could take several months to effectively transition to new third-party manufacturers or fulfillment agents. Additionally, several components used in our on-premise appliances and end point devices are "single sourced" and any interruption in the suppliers of such components could cause our business to suffer as we identify alternative sources of components. In the past, labor strikes in West Coast ports have delayed shipments of our products from our manufacturers. Future repetition of such delays could negatively affect our ability to deliver product to our customers in a timely manner and may harm our business and hinder our growth.

To deliver our services, we rely on third parties for our network connectivity and co-location facilities for certain features in our services and for certain elements of providing our services.

We currently use the infrastructure of third-party service providers for hosting, internet access and other services that are vital to our service offering. Equinix, Inc. provides data center facilities; Internap, Zao, Comcast and NTT Inc. provide backbone internet access; and Bandwidth.com, Onvoy, Level 3, Broadvox and EarthLink provide origination services. We also rely on third-party services for our SMS and speech-to-text services which are sole-sourced. Intrado is our sole provider of 911 services. We expect that we will continue to rely heavily on third-party network service providers to provide these services for the foreseeable future. If any of these network service providers stop providing us with access to their infrastructure, fail to provide these services to us on a cost-effective basis, cease operations, or otherwise terminate these services, the delay caused by qualifying and switching to another third-party network service provider, if one is available, could have a material adverse effect on our business and results of operations.

We may be required to transfer our servers to new data center facilities if we are unable to renew our leases on acceptable terms, if at all, or the owners of the facilities decide to close their facilities, and we may incur significant costs and possible service interruption in connection with doing so. In addition, any financial difficulties, such as bankruptcy or foreclosure, faced by our third-party data center operators or any of the service providers with which we or they contract, may have negative effects on our business, the nature and extent of which are difficult to predict. Additionally, if our data centers are unable to keep up with our increasing needs for capacity, our ability to grow our business could be materially and adversely impacted.

If problems occur with any of these third-party network or service providers, it may cause errors or reduced quality in our services, and we could encounter difficulty identifying the source of the problem. The occurrence of errors or reduced quality in our service, whether caused by our systems or a third-party network or service provider, may result in the loss of our existing customers, delay or loss of market acceptance of our services, termination of our relationships and agreements with our resellers or liability for failure to meet service level agreements, and may seriously harm our business and results of operations.

We rely on purchased or leased hardware and software licensed from third parties in order to offer our service. In some cases, we integrate third-party licensed software components into our platform. This hardware and software may not continue to be available at reasonable prices or on commercially reasonable terms, or at all. Any loss of the right to use any of this hardware or software could significantly increase our expenses and otherwise result in delays in the provisioning of our service until equivalent technology is either developed by us, or, if available, is identified, obtained and integrated. Any errors or defects in third-party hardware or software could result in errors or a failure of our service which could harm our business.

We also contract with third parties to provide enhanced 911, or E-911, services, including assistance in routing emergency calls and terminating E-911 calls. Our providers operate a national call center that is available 24 hours a day, seven days a week, to receive certain emergency calls and maintain public service answering point, or PSAP, databases for the purpose of deploying and operating E-911 services. On mobile devices, we generally rely on the underlying cellular or wireless carrier to provide E-911 services. Any failure to perform, including interruptions in service, by our vendors, could cause failures in our customers' access to E-911 services and expose us to significant liability and damage our reputation.

Interruptions in our services could harm our reputation, result in significant costs to us and impair our ability to sell our services.

Because our technology platform is complex, incorporates a variety of new computer hardware, and the platform continues to evolve, our services may have errors or defects that are identified after customers begin using such services, which could result in unanticipated service interruptions. Although we test our services to detect and correct errors and defects before their initial release and before we make updates or other changes to such services, we have occasionally experienced significant service interruptions as a result of undetected errors or defects and may experience future interruptions of service if we fail to detect and correct errors and defects. For example, in April and May 2015 while working to upgrade our network, we encountered unexpected problems with the communications between our data centers, as well as certain server capacity issues, which led to multiple intermittent service outages, some of which lasted for up to approximately eight hours for some of our customers. While we have identified root causes of these service outages, and in each case were able to restore service to all of the affected customers, we continue to take corrective actions to address these root causes. We were able to correct such root causes without incurring material expenses, and we do not expect the outages in April and May to materially affect our results of operations. However, the costs incurred in correcting root causes for future service outages may be substantial and these and other related consequences could negatively impact our results of operations.

We currently serve our customers from two data center hosting facilities located in Northern California, where we lease space from Equinix, Inc. The second data center in Northern California was added in early 2015, and while we believe that such second data center and certain new procedures we have adopted will enable us to restore services quickly in the event of a service outage, these new procedures and our second data center, by themselves, will not prevent future outages. Any damage to, or failure of, these facilities, the communications network providers with whom we or they contract or with the systems by which our communications providers allocate capacity among their customers, including us, could result in interruptions in our service. Additionally, in connection with the expansion or consolidation of our existing data center facilities, we may move or transfer our data and our customers' data to other data centers. Despite precautions we take during this process, any unsuccessful data transfers may impair or cause disruptions in the delivery of our service.

Despite precautions taken at our hosting facilities, the occurrence of a natural disaster or an act of terrorism or other unanticipated problems at these facilities could result in lengthy interruptions in our service. Even with the disaster recovery arrangements that we have in place, our service could be interrupted.

Any defects in, or unavailability of, the components of our platform that cause interruptions of our services could, among other things:

- cause a reduction in revenue or a delay in market acceptance of our services;
- require us to issue refunds to our customers or expose us to claims for damages;
- cause us to lose existing customers and make it more difficult to attract new customers;
- divert our development resources or require us to make extensive changes to our software, which would increase our expenses and slow innovation;
- increase our technical support costs; and
- harm our reputation and brand.

We rely on third parties for some of our software development, quality assurance and operations.

We currently depend on various third parties for some of our software development efforts, quality assurance and operations. Specifically, we outsource some of our software development and design, quality assurance and operations activities to third-party contractors that have employees and consultants located in Canada, India, China, New Zealand, Russia and Ukraine. Our dependence on third-party contractors creates a number of risks, in particular, the risk that we may not maintain control or effective management with respect to these business operations.

Our agreements with these third-party contractors are either not terminable by them (other than at the end of the term or upon an uncured breach by us) or require at least 30 days' prior written notice of termination. If we experience problems with our third-party contractors, the costs charged by our third-party contractors increase or our agreements with our third-party contractors are terminated, we may not be able to develop new solutions, enhance or operate existing solutions or provide customer support in an alternate manner that is equally or more efficient and cost-effective.

We anticipate we will continue to depend on these and other third-party relationships in order to grow our business for the foreseeable future. If we are unsuccessful in maintaining existing and, if needed, establishing new relationships with third parties, our ability to efficiently operate existing services or develop new services and provide adequate customer support could be impaired, and as a result, our competitive position or our results of operations could suffer.

We rely on third parties to provide the majority of our customer service and support representatives. If these third parties do not provide our customers with reliable, high-quality service, our reputation will be harmed, and we may lose customers.

We offer customer support through both our online account management website and our toll-free customer support number. Our customer support is currently provided via a third-party provider located in the Philippines, as well as our employees in the U.S. We currently offer support almost exclusively in English. Our third-party providers generally provide customer service and support to our customers without identifying themselves as independent parties. The ability to support our customers may be disrupted by natural disasters, inclement weather conditions, civil unrest, strikes, acts of terrorism and other adverse events in the Philippines. Furthermore, as we expand our operations internationally, we may need to make significant expenditures and investments in our customer service and support to adequately address the complex needs of international customers, such as support in multiple foreign languages.

If any of these third parties do not provide reliable, high-quality service, our reputation and our business will be harmed and we may be exposed to significant liability. In addition, a significant service outage may cause a high volume of customer support inquiries, and our third-party customer service call center might be unable to respond to a significant spike in customer support inquiries in a timely manner. In addition, industry consolidation among providers of services to us may impact our ability to obtain these services or increase our costs for these services.

Our limited operating history makes it difficult to evaluate our current business and future prospects, which may increase the risk of investing in our stock.

Although we were incorporated in 2003, we did not formally introduce Ooma Telo until 2009 or Ooma Office until 2013. In addition, we acquired our Business Promoter business in 2012 and our Talkatone business in 2014. Our limited operating history limits our ability to plan for and model future growth. We have encountered and expect to continue encountering risks and uncertainties frequently experienced by growing companies in rapidly changing markets. If our assumptions regarding these uncertainties are incorrect or change in reaction to changes in our markets, or if we do not manage or address these risks successfully, our results of operations could differ materially from our expectations, and our business could suffer. Any success we may experience in the future will depend, in large part, on our ability to, among other things:

- retain and expand our customer base;
- increase revenue from existing customers as they add users and, in the future, purchase additional functionalities and premium service subscriptions;
- successfully acquire customers on a cost-effective basis;
- improve the performance and capabilities of our services, applications, and hardware through research and development;
- successfully expand our business domestically and internationally;
- successfully compete in our markets;
- continue to innovate and expand our service offerings;
- continue our relationships with strategic partners like Nest Labs, Inc. and reseller partners like Vivint, Inc.;
- continue our relationships with our current retail partners and develop relationships with additional retail partners;
- continue our relationships with our digital marketing agency partners, advertising agencies and digital advertising networks;

- continue our relationships with third-party vendors that enable our solutions;
- successfully protect our intellectual property and defend against intellectual property infringement claims;
- generate leads and convert potential customers into paying customers;
- maintain and enhance our third-party data center hosting facilities to minimize interruptions in the use of our services;
- determine appropriate prices for the marketplace; and
- hire, integrate and retain professional and technical talent.

We have incurred significant losses and negative cash flows in the past and anticipate continuing to incur losses and negative cash flows for the foreseeable future, and we may therefore not be able to achieve or sustain profitability in the future.

We have incurred substantial net losses since our inception, including net losses of approximately $(3.5) million and $(1.7) million for the three months ended October 31, 2015 and 2014, respectively, and $(10.9) million and $(2.3) million for the nine months ended October 31, 2015, respectively. We had an accumulated deficit of $(61.6) million as of October 31, 2015. We have spent considerable amounts of time and money since inception to develop new communications solutions and connected services. Additionally, we have incurred substantial losses and expended significant resources to market, promote, develop and sell our products and solutions. We also expect to continue investing for future growth, including for advertising, customer acquisition, technology infrastructure, storage capacity, services development and international expansion. In addition, as a public company, we will incur significant additional accounting, legal and other expenses.

As a result of our increased expenditures, we will have negative operating cash flows for the foreseeable future and will have to generate and sustain increased revenue to achieve future profitability. Achieving profitability will require us to increase revenue, manage our cost structure and avoid significant liabilities. Revenue growth may slow, revenue may decline or we may incur significant losses in the future for a number of possible reasons, including general macroeconomic conditions, increasing competition (including competitive pricing pressures), a decrease in the growth of the markets in which we compete or failure for any reason to continue capitalizing on growth opportunities. Additionally, we may encounter unforeseen operating expenses, difficulties, complications, delays, service delivery and quality problems and other unknown factors that may result in losses in future periods. If these losses exceed our expectations or our revenue growth expectations are not met in future periods, our financial performance will be harmed and our stock price could be volatile or decline.

Our business could suffer if we cannot obtain or retain direct inward dialing numbers, or DIDs, are prohibited from obtaining local or toll-free numbers, or are limited to distributing local or toll-free numbers to only certain customers.

Our future success depends on our ability to procure large quantities of local and toll-free DIDs in the U.S. and foreign countries in desirable locations at a reasonable cost and without restrictions. Our ability to procure and distribute DIDs depends on factors outside of our control, such as applicable regulations, the practices of the communications carriers that provide DIDs, the cost of these DIDs, and the level of demand for new DIDs. Due to their limited availability, there are certain popular area code prefixes we generally cannot obtain. Our inability to acquire DIDs for our operations would make our services less attractive to potential customers in the affected local geographic areas. In addition, future growth in our customer base, together with growth in the customer bases of other providers of internet-based business communications, has increased, which increases our dependence on needing sufficiently large quantities of DIDs.

If we are unable to effectively process local number and toll-free number portability provisioning in a timely manner, our growth may be negatively affected.

We support local number and toll-free number portability, which allows our customers to transfer to us and thereby retain their existing phone numbers when subscribing to our small business, home, and mobile services. Transferring numbers can be a manual process that can take up to 15 business days or longer to complete. A new customer of our services must maintain both our service and the customer's existing phone service during the number transferring process. Any delay we experience in transferring these numbers typically results from the fact that we depend on third-party carriers to transfer these numbers, a process we do not control, and these third-party carriers may refuse or substantially delay the transfer of these numbers to us. Local number portability is considered an important feature by many potential customers, and if we fail to reduce any related delays, we may experience increased difficulty in acquiring new customers. Moreover, the FCC requires us to comply with specified number porting timeframes when customers leave our service for the services of another provider. In Canada, the Canadian Radio-television and Telecommunications Commission, or CRTC, has imposed a similar number portability requirement on service providers like us. If we, or our third-party carriers, are unable to process number portability requests within the requisite timeframes, we could be subject to fines and penalties. Additionally, in the U.S., both customers and carriers may seek relief from the relevant state public utility commission, the FCC, or in state or federal court for violation of local number portability requirements.

If small businesses opt to perform advertising tasks on their own, demand for our lead-generation services would decrease, thereby negatively affecting our revenue.

Large internet marketing providers such as Google, Yahoo! and Microsoft offer online advertising products to small businesses through self-service platforms. As small businesses become more familiar with such platforms, they may increasingly choose to actively manage their own internet presence and their demand for the lead-generation services may decrease. We cannot predict the evolving experiences and preferences of small businesses and cannot assure you that we can develop our lead generation business, or develop similar new services, in a manner that will suit their needs and expectations faster or more effectively than our competitors, or at all. If we are not able to do so, our results of operations would suffer.

Our access to the majority of our lead-generation customers is currently through a limited number of digital agencies, which creates a significant risk that we could lose a majority of our lead generation service customers due to factors beyond our control.

We currently contract with several digital agencies to provide our lead-generation services as a component of their service to third parties who we include as our core users. If our relationship with these digital agencies degrades, they could elect not to use our lead-generation service, which would lead to the loss of a portion of our lead generation business revenue as well as a number of our core users. Also, for reasons beyond our control, the digital agencies we work with may lose their business relationships with third parties who purchase lead generation services for their customers, causing the digital agency to terminate its business relationship with us and the loss of such lead generation business revenue. Prior to February 2015, we contracted with three digital agencies to provide our lead generation service to third parties. In February 2015, one of them unexpectedly lost a key business relationship, which led that digital agency to terminate its business relationship with us, which in turn caused us to lose a few thousand of our core users. This concentration of our access to lead generation customers creates volatility in the churn of our core users, which risk will remain unless and until we significantly grow the number of digital agencies we contract with, and/or increase the number of small businesses that obtain lead generation services directly from us.

If we fail to continue developing our brand or our reputation is harmed, our business may suffer.

We believe that continuing to strengthen our current brand will be critical to achieving widespread acceptance of our services and will require continued focus on active marketing efforts. The demand for and cost of online and traditional advertising have been increasing and may continue to increase. Accordingly, we may need to increase our investment in, and devote greater resources to, advertising, marketing, and other efforts to create and maintain brand loyalty among users. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses incurred in building our brands. If we fail to promote and maintain our brand, or if we incur substantial expense in an unsuccessful attempt to promote and maintain our brands, our business could be materially and adversely affected.

Our services, as well as those of our competitors, are regularly reviewed and commented upon by online and social media sources, as well as computer and other business publications. Negative reviews, or reviews in which our competitors' products and services are rated more highly than our solutions, could negatively affect our brand and reputation. From time to time, our customers have expressed dissatisfaction with our services, including dissatisfaction with our customer support, our billing policies and the way our services operate. If we do not handle customer complaints effectively, our brand and reputation may suffer, we may lose our customers' confidence, and they may choose to terminate, reduce or not to renew their subscriptions. In addition, many of our customers participate in social media and online blogs about internet-based services, including our services, and our success depends in part on our ability to minimize negative and generate positive customer feedback through such online channels where existing and potential customers seek and share information. If actions we take or changes we make to our services upset these customers, their blogging could negatively affect our brand and reputation. Complaints or negative publicity about our services or customer service could materially and adversely impact our ability to attract and retain customers and our business, financial condition and results of operations.

A security breach could delay or interrupt service to our customers, compromise the integrity of our systems or data that we collect, result in the loss of our intellectual property or confidential information, harm our reputation, or subject us to significant liability.

Our operations depend on our ability to protect our network from interruption or damage resulting from unauthorized access or entry, computer viruses or malware or other events beyond our control. In the past, we may have been subject to undetected distributed denial-of-service, or DDOS, cyberattacks by hackers intent on bringing down our services, and we may be subject to DDOS and other forms of cyberattacks in the future. We cannot assure you that our backup systems, regular data backups, physical, technological and organizational security protocols and measures and other procedures that are currently in place, or that may be in place in the future, will be adequate to prevent unauthorized access to our systems, significant damage, system interruption, degradation or failure, or data loss or to respond to a cyberattack once launched. Additionally, hackers may attempt to directly gain access to a customer's on-premise appliance, which may delay or interrupt services, or may subject our customers to further security risks, including in relation to any connected household devices a customer might have now or in the future, such as Nest devices or other household sensors, or to our network more generally. Also, our services are web-based, and the amount of data we store for our users on our servers has been increasing as our business has grown. Despite the implementation of security measures, our infrastructure may be vulnerable to hackers, computer viruses, worms, other malicious software programs or similar disruptive problems caused by our customers, employees, consultants or other internet users who attempt to invade public and private data networks. In some cases we do not have in place disaster recovery facilities for certain ancillary services, such as email delivery of messages. Currently, nearly all of our customers authorize us to bill their credit or debit card accounts directly for all transaction fees that we charge. We rely on encryption and authentication technology to ensure secure transmission of confidential information, including customer credit and debit card numbers. Despite our efforts to encrypt and secure customer payment card information, hackers with sufficiently sophisticated technology or methods may still be able to infiltrate our systems to gain unauthorized access to payment card information. Further, advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or breach of the technology we use to protect transaction data.

Additionally, third parties may attempt to fraudulently induce domestic and international employees, consultants or customers into disclosing sensitive information, such as user names, passwords or customer proprietary network information, or CPNI, or other information in order to gain access to our customers' data or to our data. CPNI includes information such as the phone numbers called by a customer, the frequency, duration, and timing of such calls, and any services purchased by the customer, such as call waiting, call forwarding and caller ID, in addition to other information that may appear on a customer's bill. Third parties may also attempt to fraudulently induce employees, consultants or customers into disclosing sensitive information regarding our intellectual property and other confidential business information, or our information technology systems. In addition, because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any system failure or security breach that causes interruptions or data loss in our operations or in the computer systems of our customers or leads to the misappropriation of our or our customers' confidential or personal information, or CPNI, could result in significant liability to us. Such failure or breach could cause our service to be perceived as not being secure, subject us to regulatory requirements such as FCC notification, result in significant monetary costs, such as fines, legal fees and expenditures to improve and enhance our security measures, cause considerable harm to us and our reputation (including requiring notification to customers, regulators or the media) and deter current and potential customers from using our services. Additionally, we could incur significant costs, both monetary and with respect to management's time and attention, to investigate and remediate a data security breach. Because our onboarding and billing functions are conducted through a single data center, any security breach in that data center may cause an interruption in our business operations. Any of these events could have a material adverse effect on our business, results of operations and financial condition.

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Failures in internet infrastructure or interference with broadband access could cause current or potential customers to believe that our systems are unreliable, leading our current customers to switch to our competitors or potential customers to avoid using our services.

Many of our services depend on our customers' broadband access to the internet, usually provided through a cable or digital subscriber line, or DSL, connection. In addition, users who access our services and applications through mobile devices, such as smartphones and tablets, must have a high-speed connection, such as Wi-Fi, 3G, 4G or LTE, to use our services and applications. Currently, this access is provided by companies that have significant and increasing market power in the broadband and internet access marketplace, including incumbent phone companies, cable companies and wireless companies. Increasing numbers of users and increasing bandwidth requirements may degrade the performance of internet and mobile infrastructure, resulting in outages or deteriorations in connectivity and negatively impacting the quality with which we can deliver our solutions. As our customer base grows and their usage of communications capacity increases, we will be required to make additional investments in network capacity to maintain adequate data transmission speeds, the availability of which may be limited, or the cost of which may be on terms unacceptable to us. If adequate capacity is not available to us as our customers' usage increases, our network may be unable to achieve or maintain sufficiently high data transmission capacity, reliability or performance. Furthermore, as the rate of adopting new technologies increases, the networks on which our services and applications rely may not be able to sufficiently adapt to the increased demand for these services, including ours. In the past, we have experienced disruptions to our service. For example, in August 2011, we experienced an outage for approximately three hours, and in April and May 2015, we experienced multiple intermittent service outages that lasted for up to eight hours for some of our customers. Frequent or persistent interruptions could cause current or potential users to believe that our systems or services are unreliable, leading them to switch to our competitors or to avoid our services, and could permanently harm our reputation and brands. Because some of our services rely on integration between features that use both wired and wireless infrastructures, any of the aforementioned problems with either wired or wireless infrastructure may result in the inability of customers to take advantage of our integrated services and therefore may decrease the attractiveness of our collective services to current and potential customers.

The success of our business relies on customers' continued and unimpeded access to broadband service. Providers of broadband services may be able to block our services or charge their customers more for using our services, which could adversely affect our revenue and growth.

Some of the providers of broadband internet access and high-speed mobile access, such as AT&T and Verizon, offer products and services that directly compete with our own offerings, which can potentially give such providers a competitive advantage. For example, these providers may market and sell a bundle of services to our current and potential customers that includes services directly competitive to ours, and our current and potential customers may prefer these bundled offerings. Some providers of broadband access, including providers outside of the U.S., may take measures that affect their customers' ability to use our service, such as degrading the quality of the data packets we transmit over their lines, giving those packets low priority, giving other packets higher priority than ours, blocking our packets entirely or attempting to charge their customers more for also using our services. While actions like these by U.S. providers would violate the net neutrality rules recently adopted by the FCC and described below, most foreign countries have not adopted formal net neutrality or open internet rules, and there continues to be some uncertainty regarding whether the net neutrality rules will be upheld by courts or modified by legislative action.

On March 12, 2015 the FCC released new network neutrality and open internet rules that it had adopted on February 26, 2015. In that order, the FCC reclassified broadband Internet access services as a telecommunications service subject to some elements of common carrier regulation, including the obligation to provide service on just and reasonable terms, requirements related to customer privacy and requirements for accessibility for people with disabilities. The order also prohibits blocking or discriminating against lawful services and applications and prohibits "paid prioritization," or providing faster speeds or other benefits in return for compensation. The order went into effect on June 12, 2015 and is the subject of pending appeals by several parties. The net neutrality rules could affect the market for broadband internet access service in a way that impacts our business, for example by increasing the cost of broadband internet service and thereby depressing demand for our services or by increasing the costs of services we purchase.

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

Our quarterly and annual results of operations have varied historically from period to period, and we expect that they will continue to fluctuate due to a variety of factors, many of which are outside of our control, including:

- our ability to retain existing customers and attract new customers;
- our ability to sell premium solutions to our existing customers;
- our ability to introduce new solutions;
- the actions of our competitors, including pricing changes or the introduction of new solutions;
- our ability to effectively manage our growth;

- our ability to successfully penetrate the communications and connected services markets for small businesses, home, and mobile;
- the number of monthly and annual subscriptions at any given time;
- the timing, cost and effectiveness of our advertising and marketing efforts;
- the timing, operating cost and capital expenditures related to the operation, maintenance, and expansion of our business;
- the timing of our decisions with regard to product resource allocation;
- seasonality of consumers' purchasing patterns;
- service outages or security breaches and any related impact on our reputation;
- our ability to accurately forecast revenue and appropriately plan our expenses;
- costs associated with defending and resolving intellectual property infringement and other claims;
- changes in tax laws, regulations, or accounting rules;
- the timing and cost of developing or acquiring technologies, services or businesses and our ability to successfully manage any such acquisitions; and
- the impact of worldwide economic, industry, and market conditions.

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

We may require additional capital to pursue our business objectives and to respond to business opportunities, challenges or unforeseen circumstances. If capital is not available to us or only under unfavorable terms, our business, results of operations and financial condition may be adversely affected.

We intend to continue making expenditures and investments to support the growth of our business and may require additional capital to pursue our business objectives and respond to business opportunities, challenges or unforeseen circumstances, including the need to develop new solutions or enhance our existing solutions, enhance our operating infrastructure, and acquire complementary businesses and technologies. Accordingly, we may need to engage in equity or debt financings to secure additional funds. However, additional funds may not be available when we need them on terms acceptable to us, or at all. Our credit agreements include restrictive covenants and any debt financing we secure in the future could involve further restrictive covenants, which may make it more difficult for us to obtain additional capital and to pursue business opportunities.

In addition, volatility in the credit markets may have an adverse effect on our ability to obtain debt financing. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences, and privileges superior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, our ability to continue pursuing our business objectives and to respond to business opportunities, challenges or unforeseen circumstances could be significantly limited, and our business, results of operations, financial condition and prospects could be materially and adversely affected.

Growth may place significant demands on our management and our infrastructure.

We have recently experienced substantial growth in our business, including an increase in the number of customers we consider to be our core users. This growth has placed and may continue to place significant demands on our management and our operational and financial infrastructure. As our operations grow in size, scope and complexity, we will need to increase our sales and marketing efforts and add additional sales and marketing personnel worldwide and to improve and upgrade our systems and infrastructure to attract, service, and retain an increasing number of users. For example, we expect the volume of simultaneous calls to increase significantly as our user base grows. Our network hardware and software may not be able to accommodate this additional simultaneous call volume. The expansion of our systems and infrastructure will require us to commit substantial financial, operational and technical resources in advance of an increase in the volume of business, with no assurance that the volume of business will increase. Any such additional capital investments will increase our cost base. Continued growth could also strain our ability to maintain reliable service levels for our users, develop and improve our operational, financial and management controls, enhance our reporting systems and procedures and recruit, train, and retain highly skilled personnel. If we fail to achieve the necessary level of efficiency in our organization as we grow, our business, results of operations, and financial condition could be materially and adversely affected.

Shifts in trends or the emergence of new technologies may render our solutions obsolete or require us to expend significant resources to develop, license, or acquire new services or applications on a timely and cost-effective basis in order to remain competitive.

The cloud-based communications and connected services industries are emerging markets characterized by rapid changes in customer requirements, frequent introductions of new and enhanced services, and continuing and rapid technological advancement. We cannot predict the effect of technological changes on our business. To compete successfully in these emerging markets, we must anticipate and adapt to technological changes and evolving industry standards and continue to design, develop, manufacture and sell new and enhanced services that provide increasingly higher levels of performance and reliability at lower cost. For the three months ended October, 2015 and 2014, we derived approximately 75% and 81%, respectively, of our revenue from Ooma Telo. For the nine months ended October 31, 2015 and 2014, we derived 77% and 86%, respectively, of our revenue from Ooma Telo. We expect Ooma Telo will continue to account for a majority of our revenue for the foreseeable future. However, our future success will also depend on our ability to introduce and sell new services, features and functionality that enhance or are beyond the voice, fax, text and connected services we currently offer, as well as to improve usability and support and increase customer satisfaction. Our failure to develop solutions that satisfy customer preferences in a timely and cost-effective manner may harm our ability to renew our subscriptions with existing customers and to create or increase demand for our services and may materially and adversely impact our results of operations.

The introduction of new services by competitors or the development of entirely new technologies to replace existing offerings could make our solutions obsolete or adversely affect our business and results of operations. Announcements of future releases and new services and technologies by our competitors or by us could cause customers to defer purchases of our existing services, which also could have a material adverse effect on our business, financial condition or results of operations. We may experience difficulties with software development, operations, design or marketing that could delay or prevent our development, introduction or implementation of new or enhanced services and applications. We have in the past experienced delays in the planned release dates of new features and upgrades, and have discovered defects in new services and applications after their introduction. We cannot assure you that new features or upgrades will be released according to schedule, or that, when released, they will not contain defects. Either of these situations could result in adverse publicity, loss of revenue, delay in market acceptance or claims by customers brought against us, all of which could harm our reputation, business, results of operations, and financial condition. Moreover, the development of new or enhanced services or applications may require substantial investment, and we must continue to invest a significant amount of resources in our research and development efforts to develop these services and applications to remain competitive. We do not know whether these investments will be successful. If customers do not widely adopt any new or enhanced services and applications, we may not be able to realize a return on our investment. If we are unable to develop, license or acquire new or enhanced services and applications on a timely and cost-effective basis, or if such new or enhanced services and applications do not achieve market acceptance, our business, financial condition and results of operations may be materially and adversely affected.

Our success depends on the public acceptance of our connected services and applications.

Our future growth depends on our ability to significantly increase revenue generated from our communications solutions and other connected services that integrate voice communications technology with other functions, such as business promotion, automation, security and others. The markets for cloud-based communications and connected services are evolving rapidly and are characterized by an increasing number of market entrants. As is typical of a rapidly evolving industry, the demand for, and market acceptance of, these applications is uncertain. If the markets for cloud-based communications solutions or for other connected services fail to develop, develop more slowly than we anticipate or develop in a manner different than we expect, our services could fail to achieve market acceptance, which in turn could materially and adversely affect our business.

Our future growth in the small business market depends on the continued use of voice communications by businesses, as compared to e-mail and other data-based methods. A decline in the overall rate of voice communications by businesses would harm our business. Furthermore, our continued growth depends on future demand for and adoption of internet voice communications systems and services and on future demand for connected communications services. Although the number of broadband subscribers worldwide has grown significantly in recent years, only a small percentage of businesses have adopted internet voice communications services to date. For demand and adoption of internet voice communications services by businesses to increase, internet voice communications networks must improve the quality of their service for real-time communications by managing the effects of and reducing packet loss, packet delay, and packet jitter, as well as unreliable bandwidth, so that high-quality service can be consistently provided. Additionally, the cost and feature benefits of internet voice communications must be sufficient to cause customers to switch from traditional phone service providers. We must devote substantial resources to educate potential customers about the benefits of internet voice communications solutions, in general, and of our services in particular. If any or all of these factors fail to occur, our business may be materially and adversely affected.

Our Ooma Telo product and services are being sold to individuals and families. With the growth in cellular and other mobile technologies, many consumers have chosen to eliminate altogether their home telephone service. Our ability to continue growing our user base depends on our ability to convince our customers and potential customers that our service is sufficiently useful and cost-effective, such that it makes sense to maintain or reestablish home telephone services with us. Our growth could slow and our financial condition could be adversely affected if the trend of eliminating home telephone service continues or accelerates.

Our mobile platform, available to any consumer with a Wi-Fi or cellular data connected mobile device, operates in a market that is fragmented and difficult to get noticed by consumers. Many of our competitors in this market have been able to establish a significant user base and reputation in the market, which may make it more difficult for our products to be adopted. Furthermore, as new mobile devices are released, we may encounter difficulties supporting these devices and services, and we may need to devote significant resources to the creation, support, and maintenance of our mobile applications. Additionally, our competitors may allocate additional resources to marketing and promotion of their products, making it even more difficult to be noticed. It is also unclear how the adoption of “over-the-top” based communications will continue to grow. If the number of consumers using “over-the-top” based communications stagnates or declines, such movement may result in an intensified competition for consumers in this space.

Accusations of infringement of third-party intellectual property rights could materially and adversely affect our business.

There has been substantial litigation in the areas in which we operate regarding intellectual property rights. In the past, we have been sued by third parties claiming infringement of their intellectual property rights and we may be sued for infringement from time to time in the future. In the past, we have settled infringement litigation brought against us; however, we cannot assure you that we will be able to settle any future claims or, if we are able to settle any such claims, that the settlement will be on terms favorable to us. Our broad range of technology may increase the likelihood that third parties will claim that we infringe their intellectual property rights.

We have in the past received, and may in the future receive, notices of claims of infringement, misappropriation or misuse of other parties’ proprietary rights. For example, on April 17, 2015, plaintiff UrgenSync, LLC filed a complaint in the U.S. District Court for the Eastern District of Texas against us and other companies in the business of providing internet-based communications services, alleging infringement of U.S. Patent No. 8,295,802. The complaint sought unspecified monetary damages, costs, attorneys’ fees and other appropriate relief. Based upon our preliminary investigation, we believe the UrgenSync complaint was entirely without merit and that our products and services do not infringe any valid or enforceable claim of the aforementioned patent. On June 17, 2015, all of UrgenSync’s claims against us were dismissed with prejudice, effectively ending the litigation without us incurring significant legal or other expenses. Notwithstanding their merits, accusations and lawsuits like these often require significant time and expense to defend, may negatively affect customer relationships, may divert management's attention away from other aspects of our operations and, upon resolution, may have a material adverse effect on our business, results of operations, financial condition and cash flows.

Certain technology necessary for us to provide our services may, in fact, be patented by other parties either now or in the future. If such technology were validly patented by another person, we would have to negotiate a license for the use of that technology. We may not be able to negotiate such a license at a price that is acceptable to us or at all. The existence of such a patent, or our inability to negotiate a license for any such technology on acceptable terms, could force us to cease using the technology and cease offering products and services incorporating the technology, which could materially and adversely affect our business and results of operations.

If we were found to be infringing on the intellectual property rights of any third party, we could be subject to liability for such infringement, which could be material. We could also be prohibited from using or selling certain products or services, prohibited from using certain processes, or required to redesign certain products or services, each of which could have a material adverse effect on our business and results of operations.

These and other outcomes may:

- result in the loss of a substantial number of existing customers or prohibit the acquisition of new customers;
- cause us to pay license fees for intellectual property we are deemed to have infringed;
- cause us to incur costs and devote valuable technical resources to redesigning our services;

- cause our cost of goods sold to increase;
- cause us to accelerate expenditures to preserve existing revenue;
- cause existing or new vendors to require prepayments or letters of credit;
- materially and adversely affect our brand in the marketplace and cause a substantial loss of goodwill;
- cause us to change our business methods or services;
- require us to cease certain business operations or offering certain products, services or features; and
- lead to our bankruptcy or liquidation.

Our limited ability to protect our intellectual property rights could materially and adversely affect our business.

We rely, in part, on patent, trademark, copyright and trade secret law to protect our intellectual property in the U.S. and abroad. We cannot assure you that the particular forms of intellectual property protection we seek, including business decisions about when to file patents and when to maintain trade secrets, will be adequate to protect our business. We seek to protect our technology, software, documentation and other information under trade secret and copyright law, which afford only limited protection. For example, we typically enter into confidentiality agreements with our employees, consultants, third-party contractors, customers and vendors in an effort to control access to use and distribution of our technology, software, documentation and other information. These agreements may not effectively prevent unauthorized use or disclosure of confidential information and may not provide an adequate remedy in the event of such unauthorized use or disclosure, and it may be possible for a third party to legally reverse engineer, copy or otherwise obtain and use our technology without authorization. In addition, improper disclosure of trade secret information by our current or former employees, consultants, third-party contractors, customers or vendors to the public or others who could make use of the trade secret information would likely preclude that information from being protected as a trade secret.

We also rely, in part, on patent law to protect our intellectual property in the U.S. and internationally. Our intellectual property portfolio includes four issued U.S. patents, which we expect to expire between December 2028 and February 2032. We also have 14 patent applications pending for examination in the U.S. and four patent applications pending for examination in foreign jurisdictions, all of which are related to U.S. applications. We cannot predict whether such pending patent applications will result in issued patents or whether any issued patents will effectively protect our intellectual property. Even if a pending patent application results in an issued patent, the patent may be circumvented or its validity may be challenged in various proceedings in U.S. District Court, before the U.S. Patent and Trademark Office or before their foreign equivalents, such as reexamination, which may require legal representation and involve substantial costs and diversion of management time and resources. In addition, we cannot assure you that every significant feature of our solutions is protected by our patents, or that we will mark our products with any or all patents they embody. As a result, we may be prevented from seeking damages in whole or in part for infringement of our patents.

The unlicensed use of our brand, including domain names, by third parties could harm our reputation, cause confusion among our customers and impair our ability to market our products and services. To that end, we have registered numerous trademarks and service marks, have applied for registration of additional trademarks and service marks and have acquired a number of domain names in and outside the U.S. to establish and protect our brand names as part of our intellectual property strategy. If our applications receive objections or are successfully opposed by third parties, it will be difficult for us to prevent third parties from using our brand without our permission. Moreover, successful opposition to our applications might encourage third parties to make additional oppositions or commence trademark infringement proceedings against us, which could be costly and time consuming to defend against. There have been in the past, and may be in the future, instances where third parties have used our trade names, or have adopted confusingly similar trade names to ours. We have been successful in asserting our rights in our trade names and causing such third parties to cease such use, but we may not be successful in the future. If we are not successful in protecting our trademarks, our trademark rights may be diluted and subject to challenge or invalidation, which could materially and adversely affect our brand.

Despite our efforts to implement our intellectual property strategy, we may not be able to protect or enforce our proprietary rights in the U.S. or internationally (where effective intellectual property protection may be unavailable or limited). For example, we have entered into agreements containing confidentiality and invention assignment provisions in connection with the outsourcing of certain software development, quality assurance and development activities to third-party contractors located in Canada, India, New Zealand, Russia and Ukraine. We have also entered into an agreement containing a confidentiality provision with a third-party contractor located in the Philippines, where we have outsourced a significant portion of our customer support function. We cannot assure you that agreements with these third-party contractors or their agreements with their employees and contractors will adequately protect our proprietary rights in the applicable jurisdictions and foreign countries, as their respective laws may not protect proprietary rights to the same extent as the laws of the U.S. In addition, our competitors may independently develop technologies similar or superior to our technology, duplicate our technology in a manner that does not infringe our intellectual property rights or design around any of our patents. Furthermore, detecting and policing unauthorized use of our intellectual property is difficult and resource-intensive. Moreover, litigation may be necessary in the future to enforce our intellectual property rights, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation, whether successful or not, could result in substantial costs and diversion of management time and resources and could have a material adverse effect on our business, financial condition and results of operations.

We license technology from third parties we do not control and cannot be assured of retaining such licenses.

We rely upon certain technology, including hardware and software, licensed from third parties. There can be no assurance that the technology licensed by us will continue to provide competitive features and functionality or that the licenses for technology currently utilized by us or other technology which we may seek to license in the future, will be available to us on commercially reasonable terms or at all. The loss of, or inability to maintain, existing licenses could result in shipment delays or reductions until equivalent technology or suitable alternative products are developed, identified, licensed and integrated, and could harm our business. These licenses are typically offered on standard commercial terms made generally available by the companies providing the licenses. The cost and terms of these licenses individually are not material to our business.

If we experience excessive fraudulent activity or cannot meet evolving credit card association merchant standards, we could incur substantial costs and lose the right to accept credit cards for payment, which could cause our customer base to decline significantly.

Nearly all of our customers authorize us to bill their credit card accounts directly for service fees that we charge. If people pay for our services with stolen credit cards, we could incur substantial third-party vendor costs for which we may not be reimbursed. Further, our customers provide us with credit card billing information online or over the phone, and we do not review the physical credit cards used in these transactions, which increases our risk of exposure to fraudulent activity. We also incur charges, which we refer to as chargebacks, from the credit card companies' claims that the customer did not authorize the credit card transaction to purchase our service, something we have experienced in the past. If the number of unauthorized credit card transactions becomes excessive, we could be assessed substantial fines for excess chargebacks and we could lose the right to accept credit cards for payment. We have also been affected by the credit card breaches at various retail stores, which have caused millions of consumers to cancel credit cards as a result of the breach. We have found that some consumers do not renew their services after a card cancellation, which can have a material negative impact on our revenue. In addition, credit card issuers may change merchant standards, including data protection and documentation standards, required to utilize their services from time to time. If we fail to maintain compliance with current merchant standards, such as Payment Card Industry Data Security Standard, or PCI, or fail to meet new standards, the credit card associations could fine us or terminate their agreements with us, and we would be unable to accept credit cards as payment for our services. Our services may also be subject to fraudulent usage, including but not limited to revenue share fraud, domestic traffic pumping, subscription fraud, premium text message scams, and other fraudulent schemes. Although our customers are required to set passwords and Personal Identification Numbers, or PINs, to protect their accounts and may configure in which destinations international calling is enabled from their extensions, third parties may be able to access and use their accounts through fraudulent means. In addition, third parties may have attempted in the past, and may attempt in the future, to fraudulently induce domestic and international employees or consultants into disclosing customer credentials and other account information. Communications fraud can result in unauthorized access to customer accounts and customer data, unauthorized use of customers’ services, and charges to customers for fraudulent usage and expenses we must pay to carriers. We may be required to pay for these charges and expenses with no reimbursement from the customer, and our reputation may be harmed if our services are subject to fraudulent usage. Although we implement multiple fraud prevention and detection controls, we cannot assure you that these controls will be adequate to protect against fraud. Substantial losses due to fraud or our inability to accept credit card payments, which could cause our paid customer base to significantly decrease, could have a material adverse effect on our results of operations, financial condition and ability to grow our business.

Potential problems with our information systems could interfere with our business and operations.

We rely on our information systems and those of third parties for processing customer orders, distribution of our services, billing our customers, processing credit card transactions, customer relationship management, supporting financial planning and analysis, accounting functions and financial statement preparation and otherwise running our business. Information systems may experience interruptions, including interruptions of related services from third-party providers, which may be beyond our control. Such business interruptions could cause us to fail to meet customer requirements. All information systems, both internal and external, are potentially vulnerable to damage or interruption from a variety of sources, including without limitation, computer viruses, security breaches, energy blackouts, natural disasters, terrorism, war, telecommunication failures and employee or other theft, as well as third-party provider failures. Any disruption in our information systems and those of the third parties upon which we rely could have a significant impact on our business.

We may implement enhanced information systems in the future to meet the demands resulting from our growth and to provide additional capabilities and functionality. The implementation of new systems and enhancements is frequently disruptive to the underlying business of an enterprise, and can be time-consuming and expensive, increase management responsibilities and divert management attention. Any disruptions relating to our systems enhancements or any problems with the implementation, particularly any disruptions impacting our operations or our ability to accurately report our financial performance on a timely basis during the implementation period, could materially and adversely affect our business. Even if we do not encounter these material and adverse effects, the implementation of these enhancements may be much more costly than we anticipated. If we are unable to successfully implement the information systems enhancements as planned, our financial position, results of operations and cash flows could be negatively impacted.

Our use of open source technology could impose limitations on our ability to commercialize our services.

We use open source software in our platform on which our services operate. There is a risk that the owners of the copyrights in such software may claim that such licenses impose unanticipated conditions or restrictions on our ability to market or provide our services. If such owners prevail in such claim, we could be required to make the source code for our proprietary software (which contains our valuable trade secrets) generally available to third parties, including competitors, at no cost, to seek licenses from third parties in order to continue offering our services, to re-engineer our technology, or to discontinue offering our services in the event re-engineering cannot be accomplished on a timely basis or at all, any of which could cause us to discontinue our services, harm our reputation, result in customer losses or claims, increase our costs or otherwise materially and adversely affect our business and results of operations. If a copyright holder of such open source software were to allege we had not complied with the conditions of one or more of these licenses, we could be required to incur significant legal expenses defending against such allegations and could be subject to significant damages, enjoined from the sale of our solutions that contained the open source software and required to comply with the foregoing conditions, which could disrupt the distribution and sale of some of our solutions.

We depend largely on the continued services of our senior management and other key employees, the loss of any of whom could adversely affect our business, results of operations and financial condition.

Our future performance depends on the continued services and contributions of our senior management and other key employees to execute on our business plan, and to identify and pursue opportunities and services innovations. The loss of services of senior management or other key employees could significantly delay or prevent the achievement of our development and strategic objectives. In particular, we depend to a considerable degree on the vision, skills, experience and effort of our Chief Executive Officer, Eric B. Stang. All of our executive officers and senior management may terminate employment with us at any time with no advance notice. The replacement of any of these senior management personnel would likely involve significant time and costs, and such loss could significantly delay or prevent the achievement of our business objectives. Many members of our senior management have been our employees for many years and therefore have significant experience and understanding of our business that would be difficult to replace. In addition, certain members of our senior management team, including our general counsel, who joined us in December of 2013, and our chief financial officer, who joined us in December of 2014, have worked together for only a relatively short period of time and it may be difficult to evaluate their effectiveness, on an individual or collective basis, and ability to address future challenges to our business. Our inability to attract and retain the necessary personnel could adversely affect our business, financial condition or results of business. We do not maintain key person insurance for any of our personnel.

If we are unable to hire, retain and motivate qualified personnel, our business will suffer.

Our future success depends, in part, on our continued ability to attract and retain highly skilled personnel. We believe there is, and will continue to be, intense competition for highly skilled technical and other personnel with experience in our industry in the San Francisco Bay Area, where our headquarters is located, and in other locations where we may maintain offices in the future. We must provide competitive compensation packages and a high-quality work environment to hire, retain and motivate employees. If we are unable to retain and motivate our existing employees or attract qualified personnel to fill key positions, we may be unable to manage our business effectively, including the development, marketing and sale of existing and new services, which could have a material adverse effect on our business, financial condition, and results of operations. To the extent we hire personnel from competitors, we may be subject to allegations such personnel have been improperly solicited or divulged proprietary or other confidential information.

We may expand through acquisitions of, or investments in, other companies, each of which may divert our management's attention, result in additional dilution to our stockholders, increase expenses, disrupt our operations and harm our results of operations.

Our business strategy may, from time to time, include acquiring or investing in complementary services, technologies or businesses. We cannot assure you we will successfully identify suitable acquisition candidates, integrate or manage disparate technologies, lines of business, personnel and corporate cultures, realize our business strategy or the expected return on our investment, or manage a geographically dispersed company. Any such acquisition or investment could materially and adversely affect our results of operations. Acquisitions and other strategic investments involve significant risks and uncertainties, including:

- the potential failure to achieve the expected benefits of the combination or acquisition;
- unanticipated costs and liabilities;
- difficulties in integrating new products and services, software, businesses, operations and technology infrastructure in an efficient and effective manner;
- difficulties in maintaining customer relations;
- the potential loss of key employees of the acquired businesses;
- the diversion of the attention of our senior management from the operation of our daily business;
- the potential adverse effect on our cash position to the extent that we use cash for the purchase price;
- the potential significant increase of our interest expense, leverage, and debt service requirements if we incur additional debt to pay for an acquisition;
- the potential issuance of securities that would dilute our stockholders' percentage ownership;
- the potential to incur large and immediate write-offs and restructuring and other related expenses; and
- the inability to maintain uniform standards, controls, policies and procedures.

Any acquisition or investment could expose us to unknown liabilities. Moreover, we cannot assure you that we will realize the anticipated benefits of any acquisition or investment. In addition, our inability to successfully operate and integrate newly acquired businesses appropriately, effectively, and in a timely manner could impair our ability to take advantage of future growth opportunities and other advances in technology, as well as on our revenue, gross margins and expenses.

Additionally, we have recently acquired companies which form the basis for our Business Promoter and Talkatone solutions. We are still going through the process of integrating the employee bases and technologies acquired from those companies, and cannot assure you we will be able to effectively integrate those assets with our resources; we may not be able to realize the potential growth and gain we anticipated at the time of acquisition.

We may expand our international operations, which may expose us to significant risks.

To date, we have not generated significant revenue from outside of the U.S. and Canada, but we expect to grow our international revenue in the future. The future success of our business will depend, in part, on our ability to expand our operations and customer base worldwide. Operating in international markets requires significant resources and management attention and will subject us to regulatory, economic and political risks different from those in the U.S. Because of our limited experience with international operations and developing and managing sales and distribution channels in international markets, our international expansion efforts may not be successful. In addition, we will face risks in doing business internationally that could materially and adversely affect our business, including:

- our ability to comply with differing technical and environmental standards, data privacy and telecommunications regulations, and certification requirements outside the U.S.;

- difficulties and costs associated with staffing and managing foreign operations;
- potentially greater difficulty collecting accounts receivable and longer payment cycles;
- the need to adapt and localize our services for specific countries;
- the need to offer customer care in various native languages;
- reliance on third parties over which we have limited control, including international resellers, for marketing and reselling our services;
- availability of reliable broadband connectivity and wide area networks in targeted areas for expansion;

- lower levels of adoption of credit or debit card usage for internet related purchases by foreign customers and compliance with various foreign regulations related to credit or debit card processing and data privacy requirements;
- difficulties in understanding and complying with local laws, regulations, and customs in foreign jurisdictions;
- export controls and trade and economic sanctions administered by the Department of Commerce Bureau of Industry and Security and the Treasury Department's Office of Foreign Assets Control;
- tariffs and other non-tariff barriers, such as quotas and local content rules;
- compliance with various anti-bribery and anti-corruption laws such as the U.S. Foreign Corrupt Practices Act of 1977, as amended, or the FCPA;
- limited protection for intellectual property rights in some countries;
- adverse tax consequences;