CALLWAVE INC
Form 10-Q
February 14, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 December 31, 2007

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

Commission File Number: 000-50958

CallWave Inc.

(Exact name of registrant as specified in its charter)

Delaware	**77-0490995**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

136 West Canon Perdido Street, Suite A, Santa Barbara, California 93101

(Address of principal executive offices)

(Zip code)

(805) 690-4100

(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer x

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

At January 31, 2008, the number of shares outstanding of the registrant s common stock, no par value, was 20,997,175.

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CALLWAVE INC.

Form 10-Q

For the Quarter Ended December 31, 2007

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CALLWAVE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	As of December 31, 2007 (unaudited)	As of June 30, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 22,990	$ 20,299
Marketable securities	26,769	32,411
Accounts receivable; net of allowance for doubtful accounts of $354 and $436, respectively	2,060	2,396
Other current assets	669	563
Total current assets	52,488	55,669
Property and equipment, net	2,185	2,118
Intangible assets, net	4,230	4,405
Other assets	87	83
Total assets	$ 58,990	$ 62,275
Liabilities And Stockholders Equity		
Current liabilities:		
Accounts payable	$ 598	$ 677
Accrued payroll	728	910
Deferred revenue	831	855
Other current liabilities	1,661	1,309
Total current liabilities	3,818	3,751
Commitments and contingencies		
Stockholders equity:		
Common stock, no par value; 100,000 shares authorized at December 31, 2007 and June 30, 2007; 20,995 and 20,880 shares issued and outstanding at December 31, 2007 and June 30, 2007, respectively	74,452	73,346
Other comprehensive loss	(762)	(36)
Accumulated deficit	(18,518)	(14,786)
Total stockholders equity	55,172	58,524
Total liabilities and stockholders equity	$ 58,990	$ 62,275

See accompanying notes.

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CALLWAVE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	For the Three Months Ended December 31,		For the Six Months Ended December 31,	
	2007	2006	2007	2006
Revenue	$ 4,877	$ 6,908	$ 10,229	$ 13,443
Cost of sales	1,807	2,189	3,739	4,419
Gross profit	3,070	4,719	6,490	9,024
Operating expenses (1):				
Sales and marketing	1,951	1,493	3,521	3,033
Research and development	1,448	1,777	3,050	3,409
General and administrative	1,766	3,440	3,946	6,764
Restructuring charges			1,095	
Total operating expenses	5,165	6,710	11,612	13,206
Operating loss	(2,095)	(1,991)	(5,122)	(4,182)
Interest income	690	798	1,390	1,597
Loss before income taxes	(1,405)	(1,193)	(3,732)	(2,585)
Income tax expense				
Net loss	$ (1,405)	$ (1,193)	$ (3,732)	$ (2,585)
Net loss per share:				
Basic and diluted	$ (0.07)	$ (0.06)	$ (0.18)	$ (0.12)
Weighted average common shares outstanding:				
Basic and diluted	20,962	20,813	20,930	20,807
(1) Includes stock-based compensation as follows:				
Sales and marketing	$ 77	$ 48	$ 165	$ 93
Research and development	77	91	134	166
General and administrative	95	122	205	261
Restructuring charges			370	

See accompanying notes.

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CALLWAVE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended December 31,	
	2007	**2006**
Cash flows from operating activities:		
Net loss	$ (3,732)	$ (2,585)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	533	390
Stock based compensation	874	520
Bad debt expense	387	701
Loss (Gain) on sale of marketable securities	16	(12)
Changes in operating assets and liabilities:		
Accounts receivable, net of bad debt expense	(51)	(1,051)
Other assets	(110)	(279)
Accounts payable	(79)	687
Accrued payroll and other liabilities	167	777
Deferred revenue	(24)	870
Income taxes payable	3	9
Net cash provided by (used in) operating activities	(2,016)	27
Cash flows from investing activities:		
Purchases of marketable securities	(18,009)	(58,703)
Sales of marketable securities	22,909	54,226
Purchases of property and equipment	(425)	(528)
Net cash provided by (used in) investing activities	4,475	(5,005)
Cash flows from financing activities:		
Proceeds from exercises of stock options	232	72
Net cash provided by financing activities	232	72
Net increase (decrease) in cash and cash equivalents	2,691	(4,906)
Cash and cash equivalents at beginning of the period	20,299	24,040
Cash and cash equivalents at end of the period	$ 22,990	$ 19,134

See accompanying notes.

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CALLWAVE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company and Basis of Presentation

The accompanying condensed consolidated interim financial statements of CallWave, Inc., and its wholly owned subsidiaries (CallWave, or the Company) have been prepared in conformity with accounting principles generally accepted in the United States and are consistent in all material respects with those applied in the Company s annual report on Form 10-K for the year ended June 30, 2007. The preparation of condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and judgments that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Examples include the estimate of useful lives of property and equipment, the valuation of stock-based compensation, the allowance for doubtful accounts, and the recognition and measurement of income tax assets and liabilities. The actual results experienced by the Company may differ from management s estimates.

The interim financial information is unaudited, but reflects all normal recurring adjustments that are, in the opinion of management, necessary to fairly present the information set forth therein. The interim financial statements should be read in conjunction with the audited financial statements and related notes included in the Company s 2007 annual report on Form 10-K filed with the Securities and Exchange Commission on September 12, 2007. Interim results are not necessarily indicative of the results for a full year.

Principles of consolidation The Condensed Consolidated Financial Statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated.

Share-Based Compensation The Company adopted SFAS No. 123(R), *Share-Based Payment*, using the modified-prospective-transition-method as of July 1, 2005. Historically, the Company elected to account for employee stock compensation under the fair value method in accordance with SFAS No. 123*, Accounting for Stock-Based Compensation*, and had reflected compensation expense related to the fair value of options issued to employees in the condensed consolidated statement of operations. See further discussion in Note 3.

Revenue recognition The Company earns revenues primarily from paid subscriber services and to a lesser extent, fees earned from local exchange carrier call termination access charges and the offering of third-party products and services to subscribers.

The Company recognizes revenue in accordance with accounting principles generally accepted in the United States and with Securities and Exchange Commission Staff Accounting Bulletin 104 (SAB 104), *Revenue Recognition*, which clarifies certain existing accounting principles for the timing of revenue recognition and classification of revenues in the financial statements. Revenue is recognized beginning when there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the fees are fixed and determinable and collection is reasonably assured. Subscriber revenues consist mainly of monthly recurring subscription fees. Revenue is recognized ratably over the subscription period when the SAB 104 criteria are met. Revenues and associated expenses are deferred and recognized over the service period. Associated expenses are deferred only to the extent of such deferred revenue. During the quarter ended September 30, 2006, the Company refined the assumptions used for the amortization of deferred revenue and the associated costs. The effect on revenue of refining these assumptions, which was treated as a change in estimate in accordance with U.S. generally accepted accounting principles (GAAP), was a reduction in revenue of $594,000 for the three months ended September 30, 2006. These refined assumptions also reduced cost of sales by $214,000 and increased net loss by $380,000, or $0.02 per basic and diluted share. The change in estimate relates to more timely and accurate information made available by the Company s third party billing provider.

In addition to the direct relationship that the Company has with the majority of its paid subscribers, CallWave also has indirect relationship agreements with Internet Service Providers (ISPs) and other companies whereby those companies customers are offered a co-branded subscription service. When the agreement provides that CallWave is the party responsible for providing the service, has control over the fees charged to customers and bears the credit risk, CallWave records the gross amount billed as revenue in accordance with Emerging Issues Task Force 99-19 (EITF 99-19), *Reporting Revenues Gross as a Principal Versus Net as an Agent*. When the agreement provides that CallWave receives a net payment from the co-branding partners based upon the number of their customers registered for CallWave services, the Company records the net amount received as revenue in accordance with EITF 99-19.

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CALLWAVE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Deferred revenue Deferred revenue consists of customer prepayments of subscription fees, which will be earned in the future under agreements existing at the balance sheet date. Deferred revenue is amortized ratably over the period in which services are provided. In addition, install fees are recorded as deferred revenues and amortized to revenue over the expected period of performance, or the estimated average customer subscription life.

Cost of sales Cost of sales consists of billing and collection costs, long-distance telephone service expenses used to deliver the Company s services, and systems and telecommunications infrastructure.

Comprehensive loss Comprehensive loss was $4,458,000 and $2,483,000 for the six months ended December 30, 2007 and 2006, respectively. The comprehensive loss differs from the net loss by the net unrealized gain or loss on short-term investments.

Software development costs Costs of software developed to be sold or licensed to the external market are accounted for under Statement of Financial Accounting Standards (SFAS) No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed.* Under SFAS No. 86, the Company expenses the costs of research, including pre-development efforts prior to establishing technological feasibility, and costs incurred for training and maintenance. Software development costs are capitalized when technological feasibility has been established and anticipated future revenues assure recovery of the capitalized amounts. Because of the relatively short time period between technological feasibility and product release, and the insignificant amount of cost incurred during such period, the Company has not capitalized any software development costs to date.

Impairment of long-lived assets The Company accounts for the impairment and disposition of long-lived assets in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* In accordance with SFAS No. 144, long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Cash equivalents All highly liquid investments with original maturities of three months or less at date of purchase are considered to be cash equivalents.

Marketable securities Marketable securities consist of investment grade government agency and corporate debt securities. Investments with maturities beyond one year are classified as short-term based on their highly liquid nature and because such investments represent the investment of cash that is available for current operations. All investments are classified as available-for-sale and are recorded at market value. Unrealized gains and losses are reflected in other comprehensive loss.

During the quarter ended December 31, 2007, certain auction rate securities failed auction due to sell orders exceeding buy orders. Of the Company s $27 million marketable securities portfolio at December 31, 2007, $10 million (at cost) is currently associated with failed auctions, all of which have been in a loss position for less than 12 months. The funds associated with failed auctions will not be accessible until a successful auction occurs or a buyer is found outside of the auction process. These securities are rated AAA. Based on third party valuation models and an analysis of other-than-temporary impairment factors, the Company has determined that these securities are not permanently impaired. The Company recorded an unrealized loss within Other Comprehensive Loss of approximately $775,000 pre-tax at December 31, 2007, related to these auction rate securities. These securities are being analyzed each reporting period for other-than-temporary impairment factors.

Concentrations of credit risk The Company has a concentration of credit risk from an agreement with a vendor for billing and collection services provided for a portion of the Company s paid users. The Company would be subject to sustaining a loss relative to its current receivable balance if the vendor failed to perform under the terms of the agreement. The receivable from the vendor at December 31, 2007 and June 30, 2007 was $1,199,000 and $1,514,000, respectively.

Income taxes Income taxes are recorded in accordance with SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires the recognition of deferred tax assets and liabilities to reflect the future tax consequences of events that have been recognized in the Company s financial statements or tax returns. Measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and tax bases of the Company s assets and liabilities result in a deferred tax asset, SFAS No. 109 requires an evaluation of the probability of being able to realize the future benefits indicated by such assets. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or the entire deferred tax asset will not be realized.

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CALLWAVE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Effective at the beginning of Fiscal 2008, the Company adopted FIN 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. The adoption of FIN 48 did not have a material impact on the Company s financial statements.

Valuation of acquired intangible assets Intangible assets are accounted for under Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires the Company to record intangible assets at their fair value. Historically, the Company has used the cash purchase price at the time of acquisition as the best indicator of fair value. SFAS No. 142 also requires the Company to periodically evaluate the carrying value of intangible assets to determine if an impairment loss should be recorded under Statement of Financial Accounting Standards (SFAS) No. 144. In accordance with SFAS 144, an impairment loss shall be recognized if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value.

Net loss per share The Company computes net loss per share in accordance with SFAS No. 128, *Earnings per Share*. Under the provisions of SFAS No. 128, basic net loss per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net loss per share is computed using the weighted-average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of shares issuable upon exercise of stock options and warrants. The dilutive effect of outstanding stock options and warrants is reflected in diluted loss per share by application of the treasury stock method.

The following table sets forth the computation of basic and diluted net loss per share:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
	(unaudited, in thousands except per share data)			
Basic and diluted net loss per share:				
Net loss attributable to common stockholders	$ (1,405)	$ (1,193)	$ (3,732)	$ (2,585)
Weighted-average common shares outstanding	20,962	20,813	20,930	20,807
Effect of dilutive securities:				
Stock options and warrants				
Convertible preferred shares				
Weighted-average common shares outstanding for diluted calculation	20,962	20,813	20,930	20,807
Net loss per share:				
Basic and diluted	$ (0.07)	$ (0.06)	$ (0.18)	$ (0.12)

Options to purchase 3,929,000 and 3,433,000 shares were outstanding at December 31, 2007 and 2006, respectively, and warrants to purchase 24,000 and 120,000 shares were outstanding at December 31, 2007 and 2006, respectively. These options and warrants were excluded from the computation of diluted earnings per share because their effect would be anti-dilutive due to the net loss.

2. Stockholders Equity

Common Stock

As of December 31, 2007, the Company is authorized to issue 100,000,000 shares of common stock. As of December 31, 2007, 3,953,000 shares of common stock are reserved for 24,000 warrants and 3,929,000 for stock options issued and outstanding.

Warrants

As of December 31, 2007, the Company has issued and outstanding warrants to purchase up to 24,000 shares of common stock at an exercise price of $0.55. No warrants were exercised during the six months ended December 31, 2007. Warrants to purchase 96,000 shares expired during the six months ended December 31, 2007.

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CALLWAVE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

3. Share-Based Payments

As of December 31, 2007, the Company s stock option plans consist of the 2004 Option Plan, the 2000 Option Plan and the 1999 Option Plan. The maximum shares issuable under these plans at December 31, 2007, consist of 4,773,965 shares, 2,250,000 shares and 1,350,000 shares authorized of which 3,122,632, 573,182 and 233,390 options are outstanding under the 2004, 2000 and 1999 Option Plans, respectively.

The Company s Board of Directors grants options at an exercise price equal to the fair market value of the Company s common stock at the date on which the grant is approved by the Board. Stock option grants under the 2000 and 1999 Option Plans generally have a term of ten years from the date on which the grant is approved by the Board and option grants under the 2004 Plan generally have a term of five years from the date on which the grant is approved by the Board of Directors. Vesting terms for most options are one-eighth after six months, and one-forty-eighth per month thereafter, becoming fully vested in four years.

The Company accounts for stock-based compensation in accordance with the provisions of SFAS No. 123 (Revised 2004), *Share-Based Payment* (SFAS No. 123R). Under the fair value recognition provision of SFAS No. 123R, stock-based compensation cost is estimated at the grant date based on the fair value of the award. The fair value of stock options granted is estimated using the Black-Scholes-Merton option pricing model and a single option award approach. The fair value is amortized on a straight-line basis over the requisite service period of the awards, which is generally the vesting period.

Determining the appropriate fair value of stock-based awards at the grant date requires judgment, including estimating stock price volatility, forfeiture rates and expected term. The Company computes expected volatility based on a combination of both historical volatility and market-based implied volatility, as management believes that the combination provides a more accurate estimate of future volatility. The expected term represents the period of time that the stock-based awards are expected to be outstanding and is determined based on historical experience of similar awards. Expected forfeitures are based on historical experience per department. Due to the inherent uncertainty in valuing awards for publicly-traded stock as of the grant date, given that such awards will be exercised, purchased or sold at indeterminate future dates, the actual value realized by the recipients, if any, may vary significantly from the value of the awards estimated at the grant date.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	**2006**	**2007**	**2006**
Weighted average fair value of stock options granted	$ 1.34	$ 1.29	$ 1.34	$ 1.44
Risk free interest rate	3.45-4.01%	4.57%	3.45-4.26%	4.57-4.95%
Expected life (in years)	4.0	4.0	4.0	4.0
Expected volatility	54-55%	50-60%	54-55%	45-60%
Expected dividend yield	0.00%	0.00%	0.00%	0.00%
Expected forfeiture rate	11-53%	5-68%	9-53%	2-68%

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CALLWAVE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

A summary of option activity under the Option Plans as of December 31, 2007, and changes during the six months then ended is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at July 1, 2007	3,460,165	$ 3.48		
Granted	1,346,883	2.91		
Exercised	(60,455)	1.91		
Forfeited or expired	(306,336)	3.60		
Outstanding at September 30, 2007	4,440,257	3.32		
Granted	17,250	2.76		
Exercised	(54,156)	2.15		
Forfeited or expired	(474,147)	3.17		
Outstanding at December 31, 2007	3,929,204	$ 3.35	3.98	$ 1,149
Vested or expected to vest at December 31, 2007	3,408,458	$ 3.40	3.92	$ 1,063
Exercisable at December 31, 2007	1,958,583	$ 3.61	3.67	$ 833

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company s closing stock price on the last trading day of the quarter ended December 31, 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2007. This amount will change based on the fair market value of the Company s common stock. The total intrinsic value of options exercised during the six months ended December 31, 2007 and 2006, was $42,000 and $21,000, respectively.

As of December 31, 2007, there was $2.7 million of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the Option Plans. That cost is expected to be recognized over a weighted-average period of 2.97 years. Total share-based compensation expense recognized for the six months ended December 31, 2007 and 2006 was $874,000 and $520,000, respectively.

4. Commitments and Contingencies

Leases

The Company leases office space and certain office equipment under non-cancelable operating leases. Rental expense under operating lease agreements was $213,000 and $170,000 for the three months ended December 31, 2007 and 2006, respectively, and $397,000 and $338,000 for the six months ended December 31, 2007 and 2006, respectively.

Future minimum commitments remaining under these agreements as of December 31, 2007, are as follows:

Twelve Months Ending December 31:	Minimum Commitment (in thousands)
2008	$ 692
2009	593
2010	397
2011	148
2012 and thereafter	375

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CALLWAVE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Other Commitments and Contingencies

The Company has long-distance service agreements with certain carriers. As of December 31, 2007, minimum obligations under these agreements due within one year total $611,000. However, the Company expects to maintain some form of long-distance service agreements indefinitely, and will likely assume similar obligations following the expiration of these agreements. As of December 31, 2007, minimum obligations due within one year under agreements with providers of billing and collection services and outsourced customer support total $552,000.

5. Restructuring Charges

In August of 2007, the Company announced a reorganization and reduction in force and the termination of its Chief Executive Officer. As a result of the reorganization the Company incurred a one time charge of approximately $1.1 million associated primarily with severance, health insurance, and accelerated stock option compensation expense. The entire charge has been recognized in the first quarter of the fiscal year ending June 30, 2008.

In January of 2008, the Company announced an additional reduction in force and the termination of several Executive Officers. As a result of the reduction in force the Company incurred a one time charge of approximately $800,000 to $1.0 million associated primarily with severance, health insurance, and accelerated stock option compensation expense. The entire charge will be recognized in the third quarter (ending March 31, 2008) of the fiscal year ending June 30, 2008.

6. Income Taxes

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which temporary differences and net operating losses become deductible and tax credits become usable. Due to the uncertainty surrounding the timing of realizing the benefits of its favorable tax attributes in future tax returns, the Company has placed a valuation allowance against its otherwise recognizable deferred tax assets. The net increase in the valuation allowance for the six months ended December 31, 2007, was approximately $699,000 due to management s determination that it is more likely than not that the deferred tax asset will not be realized.

As of December 31, 2007, the Company has cumulative net operating loss carryforwards for federal and California income tax purposes of approximately $15.6 million and $24.8 million respectively. The losses begin to expire in fiscal year 2010. In addition, the Company has available tax credit carryforwards of approximately $2.0 million and $0.8 million for federal and California tax purposes, respectively. The federal tax credits begin to expire in 2009. California tax credits can be carried over indefinitely.

7. Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Management does not expect SFAS No. 157 to have a material impact on the Company s financial condition or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). This standard requires employers to recognize the underfunded or overfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in the funded status in the year in which the changes occur through accumulated other comprehensive income. Additionally, SFAS No. 158 requires employers to measure the funded status of a plan as of the date of its year-end

statement of financial position. The new reporting requirements and related new footnote disclosure rules of SFAS No. 158 are effective for fiscal years ending after December 15, 2006. The new disclosure rules did not impact the Company s financial statements because the Company does not currently sponsor a defined benefit pension plan. The new measurement date requirement applies for fiscal years ending after December 15, 2008. Management does not expect SFAS No. 158 to have a material impact on the Company s financial condition or results of operations.

CALLWAVE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of SFAS No. 115* . The new statement allows entities to choose, at specified election dates, to measure eligible financial assets and liabilities at fair value that are not otherwise required to be measured at fair value. If a company elects the fair value option for an eligible item, changes in that item s fair value in subsequent reporting periods must be recognized in current earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Management does not expect SFAS No. 159 to have a material impact on the Company s financial condition or results of operations.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R). The purpose of issuing the statement is to revise current guidance in SFAS No. 141 to better represent the economic value of business combination transactions. The revisions include, but are not limited to: (1) acquisition costs will be recognized separately from the acquisition; (2) known contractual contingencies at the time of the acquisition will be considered part of the liabilities acquired and will be measured at their fair value; all other contingencies will be measured at their fair value only if it is more likely than not that they meet the definition of a liability; (3) contingent consideration based on the outcome of future events will be recognized and measured at the time of the acquisition; (4) business combinations achieved in stages (step acquisitions) will need to recognize the identifiable assets and liabilities, as well as noncontrolling interests in the acquiree, at the full amounts of their fair values; and (5) a bargain purchase (defined as a business combination in which the total acquisition-date fair value of the identifiable net assets acquired exceeds the fair value of the consideration transferred plus any noncontrolling interest in the acquiree) will require that excess to be recognized as a gain attributable to the acquirer. Management does anticipate that the adoption of SFAS No. 141R will have a material impact on the Company s financial condition or results of operations. SFAS No. 141R will be effective for any business combinations that occur after December 15, 2008.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* . SFAS No. 160 was issued to improve the relevance, comparability, and transparency of financial information provided to investors by requiring all entities to report noncontrolling (minority) interests in subsidiaries in the same way, that is, as equity in the consolidated financial statements. Moreover, SFAS No. 160 eliminates the diversity that currently exists in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. SFAS No. 160 will be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Management does anticipate that the adoption of SFAS No. 160 will have a material impact on the Company s financial condition or results of operations.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This quarterly report contains forward-looking statements that include information relating to future events, future financial performance, strategies, expectations, competitive environment, regulation and availability of resources. These forward-looking statements include, without limitation, statements regarding: proposed new applications and services; development of additional strategic relationships; our market opportunity; our strategy; our expectations concerning litigation, regulatory developments or other matters; statements concerning projections, predictions, expectations, estimates or forecasts for our business, financial and operating results and future economic performance; statements of management s goals and objectives; and other similar expressions concerning matters that are not historical facts. Words such as may, will, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates, an well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by which, that performance or those results will be achieved. Forward-looking statements are based on information available at the time they are made and management s good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause these differences include, but are not limited to:

our ability to maintain and expand our user base;

industry competition;

our ability to continue to execute our growth strategies;

litigation, legislation, regulation or technological developments affecting our business;

general economic conditions; and

other factors discussed in the sections titled Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, and Overview.

Forward-looking statements speak only as of the date they are made. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information, except to the extent required by applicable securities law. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

Overview

Company Overview

CallWave is a telephony and speech application company that uses the power of software to streamline communications between mobile, landline and VOIP phone systems and make them interoperable on the desktop. Through our proprietary Phone Companion Software (PCS) we allow subscribers to manage their calls from their desktop without purchasing or installing additional hardware, changing service providers, or changing existing phone numbers.

Historically, our subscriber base consisted primarily of dial-up subscribers who, before subscribing to our service, had been missing calls while on the Internet via their dial up connection. The CallWave Services Platform allows customers to screen, transfer or intercept incoming calls while their dial-up service connection is in use.

As customers have migrated towards faster and more reliable broadband offerings, we have enhanced our service platform in the direct and indirect channels. With these enhancements CallWave is leading a new category of unified communication services focused on Phone Companion Software with features that include Web 2.0 widgets, voice to text recognition applications, wireless mobile voicemail, virtual fax, and desktop texting applications.

Our distribution strategy encompasses both a direct to consumer web channel and an indirect partner channel whereby we private-label our full suite of services.

We continue to support our traditional direct to consumer dial up business with our Internet Voicemail application that ensures subscribers won t miss calls while on line with their dial-up connection. While this base has been declining we continue to view it as a core asset as it allows us to test new products and feature sets and continues to provide significant free cash flow that can be invested in a unified communications portfolio of virtual software applications.

We also support a fax to e-mail direct to consumer application. Historically we had not focused on this product segment as we were involved in litigation with j2 Global Communications and Catch Curve. During March of 2007 we settled all outstanding litigation with j2 Global and Catch Curve and received a perpetual license to their intellectual property portfolio. With the litigation behind us we have added new capabilities to our virtual fax product and we re-launched our new service prior to December 31, 2007. With our enhanced product offering we launched new pricing packages to our subscriber base in the second quarter of fiscal 2008.

During our fiscal second quarter we launched a new premium mobile application. Our new mobile application allows users to portalize and archive their mobile phone communications experience. We have integrated the mobile, landline, and IP based phone systems along with SMS and virtual faxing capabilities with an easy to use desktop client and personalized messaging portal. End users will now have the ability to archive their voicemail, SMS, fax and contacts all within a web based portal which allows users to quickly search across calling and messaging content. Our new Vtxt service enables voice to text conversion of voicemail which gives consumers the ability to read their messages and extends the listening experience to the desktop.

With the launch of our new premium virtualized fax and mobile products we will continue to work with indirect channel and distribution partners who wish to private-label our full suite of applications and services. Our applications provide a necessary and critical layer to the unified communications strategy of our partners. These applications enable partners to deliver converged voice services ahead of converged networks that are rapidly deployed at a minimal cost.

The CallWave Solution

Our solutions enable a unified communications experience that will provide greater control and manageability of the most critical devices on which users rely the PC, the landline, and the mobile phone.

Leveraging our wholly-owned telephone subsidiary, years of experience and innovation in making mobile phones and PCs talk to each other, CallWave is in a unique position to provide a complete suite of secure, scalable, and cost-effective, user-friendly mobile applications. These include the industry s first summarized voice-to-text speech application which digitizes and portalizes voice messages and mobile visual voicemail that enables users to read voicemail and only listen to messages when convenient. The applications will provide for permanent storage and search of voice, text, and fax assets in a personal web-based PhonePage . In addition, our applications allow for real-time mobile call screening, free long-distance calling and roaming, and Virtual Fax receive and send services.

CallWave s services are interoperable across mobile and landline devices and work with a user s existing phone number and service provider.

Customers have the flexibility to pay us for their subscriptions using credit cards, mail-in checks or through their telephone bills. Subscribers register for our service either on our website or on our partners websites and download our client software onto their personal computers. Our Web 2.0 widgets and wireless mobile voicemail applications do not require a download of our client software.

Certain key aspects of our solutions are common, including:

Affordable application services. Our application-based services are customized to meet the requirements of cost-conscious mainstream subscribers, without requiring them to purchase additional hardware or telephone lines or change service providers. We offer flexible service levels, enabling our subscribers to pay for only those applications they need to manage their existing telecommunications services.

Ease of installation and use. We designed our application-based services to be easy to install on a personal computer and easy to use with minimal behavioral changes. During registration and installation, our software is automatically configured based on subscribers existing communications services. The registration and installation process typically take only a few minutes. In most cases we automatically provision the services without requiring subscribers to call their existing network service providers. Our call-bridging services are delivered over subscribers existing communication networks and require no additional hardware and no new telephone number. Our wireless mobile voicemail services do not require a software download.

Optimized use of existing telecommunications networks and devices. Our platform enables real-time connectivity among subscribers existing telecommunications services and devices by allowing them to choose where a call is delivered. Our application-based services also provide users with detailed caller identification information, giving subscribers the choice to take the call or direct it to their preferred and most convenient answering device. Our wireless mobile voicemail service offers many of the same benefits without having to download software.

Scalable, reliable and flexible software platform. Our platform has been designed to scale to support millions of simultaneous and concurrent users, to deliver carrier-class reliability and to be sufficiently flexible to address the changing market needs. Our infrastructure and open architecture enable us to efficiently and economically identify and develop new information services for our subscribers as they adopt new technologies and desire enhanced functionality from their communication services as well as support IMS and next generation network requirements of service providers.

Complementary to telecommunications service providers. Our software platform integrates with and enhances the existing offerings of the providers of telecommunications services and is interoperable with current generation landline, mobile and IP networks and devices that can seamlessly migrate and scale to an IMS enabled environment.

Our Strategy

Our objective is to establish ourselves as the leader in mobile and business communications and become an essential element in completing a business or partner unified communication strategy. We plan to achieve this objective through a combination of services available direct to consumers via our web channel and through CallWave branded and private label versions of these services to indirect partners, as follows:

Invest personnel and marketing resources in the wireless mobile services market. We believe that the market for mobile telephony services will continue to grow at a faster rate than the market for landline telephony services. We intend to focus our marketing efforts on acquiring new wireless mobile subscribers.

Extend our reach through indirect partnerships. Today, most of our sales come from direct acquisition of customers through our web marketing programs. We also have commercial relationships with Internet and telecommunications service providers through which we provide various call-bridging services for their subscribers. In addition, we also maintain online distribution relationships with a number of smaller companies. We intend to develop similar relationships with other partners to help us reach a wider range of subscribers.

Maintain our focus on the needs of the mainstream and wireless mobile market. We endeavor to provide services that the mainstream and wireless mobile market highly values and that we can provide to users at an affordable price. We believe that the market opportunity for addressing the communications needs of these cost-conscious and mobile users is large and growing. We intend to remain focused on these markets and provide a range of enhanced communications services that meet the needs of this market.

Continue to follow a subscriber-driven approach. We believe that our large subscriber base helps us gain a comprehensive and accurate understanding of the needs, desires and priorities of our subscribers, which is critical to the ongoing success of our business. The information and analysis enables us to better identify subscriber requirements and behavioral patterns and continue to develop new and enhanced communications services that current and potential subscribers in the mainstream market value.

Provide enhanced communications services for mainstream and wireless mobile users. Our platform bridges calls effectively across all mainstream forms of Internet access and across all landline, mobile and Internet service providers. This enables us to provide affordable, value-added communications services to mainstream and mobile users without the additional cost of changing service providers or purchasing new hardware or the inconvenience of changing phone numbers.

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Extend and enhance component applications and service levels. Our platform gives us the flexibility to design, deploy, test and enhance features and applications quickly and easily. We are able to bundle these component applications rapidly into new service levels. We intend to offer additional applications and service levels to meet the diverse and evolving needs of our existing and targeted subscribers and we intend to enhance existing applications and service levels to remain competitive.

Critical Accounting Policies and the Use of Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, allowances for doubtful accounts, accounting for income taxes, loss contingencies, stock-based compensation, and valuation of acquired intangible assets. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our Condensed Consolidated Financial Statements. Management has discussed the development and selection of the following critical accounting policies, estimates and assumptions with the Audit Committee of our Board of Directors and the Audit Committee has reviewed these disclosures.

Revenue recognition.

We earn revenues primarily from paid subscriber services and, to a lesser extent, from local exchange carrier call termination access charges and the offering of third-party products and services to our subscribers.

We recognize revenue in accordance with accounting principles generally accepted in the United States and with Securities and Exchange Commission Staff Accounting Bulletin 104 (SAB 104), *Revenue Recognition*, which clarifies certain existing accounting principles for the timing of revenue recognition and classification of revenues in the financial statements. We recognize revenue beginning when there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the fees are fixed and determinable and collection is reasonably assured. Our subscriber revenues consist mainly of monthly recurring subscription fees. We recognize revenue ratably over the subscription period when the SAB 104 criteria are met. Revenues and associated expenses are deferred and recognized over the associated service period. Associated expenses are deferred only to the extent of such deferred revenue.

In addition to the direct relationship that we have with the majority of our paid subscribers, we also have indirect relationship agreements with Internet service providers (ISPs) and other companies whereby those companies customers are offered a co-branded subscription service. When the agreement provides that we are the party responsible for providing the service, have control over the fees charged to customers and bear the credit risk, we record the gross amount billed as revenue in accordance with Emerging Issues Task Force 99-19 (EITF 99-19), *Reporting Revenues Gross as a Principal Versus Net as an Agent*. When the agreement provides that we receive a net payment from our co-branding partners based upon the number of their customers registered for our services, we record the net amount received as revenue in accordance with EITF 99-19.

Allowances for Doubtful Accounts

We record an allowance for doubtful accounts based on our historical experience with bad debts. We periodically review and evaluate bad debt reserves held by the local telephone companies and the third party that manages our billing relationship with the telephone companies. Judgment is required when we assess the realization of receivables, including assessing the probability of collection. Our allowance for doubtful accounts totaled $354,000 as of December 31, 2007 and $436,000 as of June 30, 2007. Our allowance for doubtful accounts is correlated with our aggregate billings through the local telephone companies.

Accounting for Income Taxes

We account for income taxes using the asset and liability method in accordance with SFAS No. 109, *Accounting for Income Taxes*, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and tax bases of the assets and liabilities. At December 31, 2007, we had net deferred tax assets of $9.5 million. Due to the uncertainty of realizing these net deferred tax assets, we have recorded a valuation allowance for the entire balance of the deferred tax assets. Such uncertainty primarily relates to the potential for net operating loss carryforwards and tax credits which begin to expire in 2010 and 2009, respectively, to be realized against future taxable income. We will continue to assess the likelihood of realization of these assets.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business. We consider the likelihood of loss or impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted and whether new accruals are required.

Stock-Based Compensation

We account for stock-based compensation in accordance with the provisions of SFAS No. 123 (Revised 2004), *Share-Based Payment* (SFAS No. 123R). Under the fair value recognition provision of SFAS No. 123R, stock-based compensation cost is estimated at the grant date based on the fair value of the award. We estimate the fair value of stock options granted using the Black-Scholes-Merton option pricing model and a single option award approach. The fair value is amortized on a straight-line basis over the requisite service period of the awards, which is generally the vesting period.

Determining the appropriate fair value of stock-based awards at the grant date requires judgment, including estimating stock price volatility, forfeiture rates and expected term. We compute expected volatility based on a combination of both historical volatility and market-based implied volatility, as we believe that the combination provides a more accurate estimate of future volatility. The expected term represents the period of time that our stock-based awards are expected to be outstanding and is determined based on historical experience of similar awards. Due to the inherent uncertainty in valuing awards for publicly-traded stock as of the grant date, given that such awards will be exercised, purchased or sold at indeterminate future dates, the actual value realized by the recipients, if any, may vary significantly from the value of the awards estimated by us at the grant date.

Valuation of acquired intangible assets

We have acquired intangible assets primarily via the acquisition of license agreements. These license agreements give us the right to practice and use certain technologies in the fax, voice and internet telephony space. These assets are accounted for under Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires us to record these assets at their fair value. Historically, we have used the cash purchase price at the time of acquisition as the best indicator of fair value. SFAS No. 142 also requires us to periodically evaluate the carrying value of intangible assets to determine if an impairment loss should be recorded under Statement of Financial Accounting Standards (SFAS) No. 144. In accordance with Statement 144, an impairment loss shall be recognized if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value. SFAS No. 144 outlines the factors which individually or in combination could trigger an impairment review as follows:

- A significant decrease in the market price of a long-lived asset (asset group)

- A significant adverse change in the extent or manner in which a long-lived asset (asset group) is being used or in its physical condition

- A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived asset (asset group), including an adverse action or assessment by a regulator

- An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset (asset group)

- A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset (asset group)

- A current expectation that, more likely than not, a long-lived asset (asset group) will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

If we determine that the carrying value of intangible assets may not be recoverable based upon the existence of one or more of the above indicators of impairment, we would measure any impairment based on a projected discounted cash flow method using a discount rate commensurate with the risk inherent in our business.

Recent Accounting Pronouncements

A discussion of recent accounting pronouncements is included in Note 7 of the Notes to the Unaudited Condensed Consolidated Financial Statements.

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Results of Operations

The following tables set forth our statement of operations data for each of the periods indicated (in thousands).

	Three Months Ended December 31,		Six Months Ended December 31,	
	2007	2006	2007	2006
Statement of Operations Data:				
Revenues	$ 4,877	$ 6,908	$ 10,229	$ 13,443
Cost of sales	1,807	2,189	3,739	4,419
Gross profit	3,070	4,719	6,490	9,024
Operating expenses:				
Sales and marketing	1,951	1,493	3,521	3,033
Research and development	1,448	1,777	3,050	3,409
General and administrative	1,766	3,440	3,946	6,764
Restructuring charges			1,095	
Total operating expenses	5,165	6,710	11,612	13,206
Operating loss	(2,095)	(1,991)	(5,122)	(4,182)
Interest income	690	798	1,390	1,597
Loss before income taxes	(1,405)	(1,193)	(3,732)	(2,585)
Income tax expense				
Net loss	$ (1,405)	$ (1,193)	$ (3,732)	$ (2,585)

Three Months Ended December 31, 2007 and December 31, 2006

Revenues. Revenues were $4,877,000 for the three months ended December 31, 2007, compared to $6,908,000 for the three months ended December 31, 2006, a decrease of $2,031,000, or 29%. Subscription revenues were $4,809,000 for the three months ended December 31, 2007, representing 99% of revenues, compared to $6,853,000 for the three months ended December 31, 2006, representing 99% of revenues, a decrease of $2,044,000, or 30%. The decrease in our revenues was attributable primarily to a decrease in the number of paying subscribers from approximately 642,000 at December 31, 2006 to approximately 536,000 at December 31, 2007. The decrease in subscribers is driven by the migration of dial up users to broad band which is a trend we expect to continue. In addition, our average revenue per user (ARPU) decreased as we have a higher percentage of our subscribers from our indirect channel distribution arrangements. We record revenue from our indirect channel distributors on a gross or net basis depending on the facts of the agreement. Revenues from our indirect channel distributors for the three months ended December 31, 2007, were $570,000 or 12% of revenues compared to $770,000 or 11% of revenues for the same period last year.

Cost of sales. Cost of sales was $1,807,000 for the three months ended December 31, 2007, compared to $2,189,000 for the three months ended December 31, 2006, a decrease of $382,000, or 17%. Cost of sales for the quarter ended December 31, 2006 was reduced by a credit of $574,000 from one of our telecommunications carriers. The carrier was charging us for more lines than we had contracted to rent over an eleven month period beginning in January, 2006. The carrier agreed to credit our account for the overcharges and apply the credit to future bills. Absent the credit, cost of sales for the quarter ended December 31, 2006, would have been $2,763,000 as compared to cost of sales of $1,807,000 for the three months ended December 31, 2007, a reduction of $956,000, or 35%. The decrease in cost of sales is primarily related to the decrease in the number of subscribers.

Sales and marketing. Sales and marketing expenses were $1,951,000, or 40% of revenues, for the three months ended December 31, 2007, compared to $1,493,000, or 22% of revenues, for the three months ended December 31, 2006, an increase of $458,000, or 31%. The increase is driven by higher advertising and marketing costs associated with the launch of our new products and the redesign of the CallWave brand. We are committed to investing in our Sales and Marketing functions as we migrate a greater percentage of our business toward indirect channel distributors while continuing to strategically invest in the direct-to-consumer channel.

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Research and development. Research and development expenses were $1,448,000, or 30% of revenues, for the three months ended December 31, 2007, compared to $1,777,000, or 26% of revenues, for the three months ended December 31, 2006. The 4% increase as a percentage of total revenue is driven by the quarter over quarter decline in revenue as our direct to consumer dial up subscribers migrate to broadband services and we transition our business toward indirect channel distributors. We believe it is essential to have a strong and efficient research and development team as we develop new products in the direct channel and migrate our business toward indirect channel distribution arrangements with landline, mobile carriers and web portals, while continuing to strategically invest in the direct-to-consumer channel. We will be investing in new technologies and shifting certain research and development functions offshore in an effort to gain greater efficiencies and streamline costs.

General and administrative. General and administrative expenses were $1,766,000, or 36% of revenues for the three months ended December 31, 2007, compared to $3,440,000, or 50% of revenues, for the three months ended December 31, 2006, a decrease of $1,674,000, or 49%. The decrease in general and administrative expenses was due primarily to reduced legal fees of $1,069,000 as a result of the settlement of the j2 Global Communications litigation. General and administrative expenses have also declined due to reductions in performance bonuses and bad debt expense.

Income tax provision. No tax benefit was derived from the net loss recognized during the three months ended December 31, 2007 and 2006 due to the valuation allowance established to offset our deferred tax assets. Total deferred tax assets amount to $9.5 million and have been fully offset by a valuation allowance reflecting the fact that we have not determined that it is more likely than not that we will be able to use our deferred tax assets to reduce income taxes. We will continue to assess the likelihood of realization of our net deferred tax assets and will adjust the balance accordingly.

Net loss. Net loss was $1,405,000 for the three months ended December 31, 2007, compared to net loss of $1,193,000 for the three months ended December 31, 2006. This increase in net loss was primarily the result of reduced revenues as we shift our focus toward indirect distributor arrangements.

Six Months Ended December 31, 2007 and December 31, 2006

Revenues. Revenues were $10,229,000 for the six months ended December 31, 2007, compared to $13,443,000 for the six months ended December 31, 2006, a decrease of $3,214,000, or 24%. Subscription revenues were $10,133,000 for the six months ended December 31, 2007, representing 99% of revenues, compared to $13,336,000 for the six months ended December 31, 2006, representing 99% of revenues, a decrease of $3,203,000, or 24%. The decrease in our revenues was attributable primarily to a decrease in the number of paying subscribers from approximately 642,000 at December 31, 2006 to approximately 536,000 at December 31, 2007. The decrease in subscribers is driven primarily from the migration of dial up users to broad band which is a trend we expect to continue. In addition, our average revenue per user (ARPU) decreased as we have a higher percentage of our subscribers from our indirect channel distribution arrangements. We record revenue from our indirect channel distributors on a gross or net basis depending on the facts of the agreement. Revenues from our indirect channel distributors for the six months ended December 31, 2007, were $1,190,000 or 12% of revenues compared to $1,583,000 or 12% of revenues for the same period last year. During the first quarter of the prior fiscal year we refined our assumptions for the amortization of deferred revenue and the associated costs. The effect on revenue of refining these assumptions, which was treated as a change in estimate under U.S. GAAP, was a reduction in revenue of $594,000. These refined assumptions also reduced cost of sales by $214,000 and increased net loss by $380,000, or $0.02 per share. The change in estimate relates to more timely and accurate information made available by our third party billing provider.

Cost of sales. Cost of sales was $3,739,000 for the six months ended December 31, 2007, compared to $4,419,000 for the six months ended December 31, 2006, a decrease of $680,000, or 15%. Cost of sales for the six months ended December 31, 2006 was reduced by a credit of $574,000 from one of our telecommunications carriers. The carrier was charging us for more lines than we had contracted to rent over an eleven month period beginning in January, 2006. The carrier agreed to credit our account for the overcharges and apply the credit to future bills. Absent the credit, cost of sales for the six months ended December 31, 2006, would have been $4,993,000 as compared to cost of sales of $3,739,000 for the three months ended December 31, 2007, a reduction of $1,254,000, or 25%. The decrease in cost of sales is primarily related to the decrease in the number of subscribers.

Sales and marketing. Sales and marketing expenses were $3,521,000, or 34% of revenues, for the six months ended December 31, 2007, compared to $3,033,000, or 23% of revenues, for the six months ended December 31, 2006. The increase is driven by higher advertising and marketing costs associated with the launch of our new products and the redesign of the CallWave brand. We are committed to investing in our Sales and Marketing functions as we migrate a greater percentage of our business toward indirect channel distributors while continuing to strategically invest in the direct-to-consumer channel.

Research and development. Research and development expenses were $3,050,000, or 30% of revenues, for the six months ended December 31, 2007, compared to $3,409,000, or 25% of revenues, for the six months ended December 31, 2006, a decrease of $359,000, or 11%. The 5%

increase as a percentage of total revenue is driven by the quarter over quarter decline in revenue as our direct to consumer dial up subscribers migrate to broadband services and we transition our business toward indirect channel distributors. We believe it is essential to have a strong research and development team as we develop new products in the direct channel and migrate our business toward indirect channel distribution arrangements with landline, mobile carriers and web portals, while continuing to strategically invest in the direct-to-consumer channel. We will be investing in new technologies and shifting certain research and development functions offshore in an effort to gain greater efficiencies and streamline costs.

General and administrative. General and administrative expenses were $3,946,000, or 39% of revenues for the six months ended December 31, 2007, compared to $6,764,000, or 50% of revenues, for the six months ended December 31, 2006, a decrease of $2,818,000, or 42%. The decrease in general and administrative expenses was due primarily to reduced legal fees of $2,022,000 as a result of the settlement of the j2 Global Communications litigation. General and administrative expenses have also declined due to reductions in performance bonuses and bad debt expense.

Restructuring charges. During the quarter ended September 30, 2007, we announced a reorganization and reduction in force and the termination of our Chief Executive Officer. As a result of the reorganization we incurred a one time charge of approximately $1.1 million associated primarily with severance, health insurance, and accelerated stock option compensation expense. The entire charge was recognized in the quarter ended September 30, 2007.

Income tax provision. No tax benefit was derived from the net loss recognized during the six months ended December 31, 2007 and 2006 due to the valuation allowance established to offset our deferred tax assets. Total deferred tax assets amount to $9.5 million and have been fully offset by a valuation allowance reflecting the fact that we have not determined that it is more likely than not that we will be able to use our deferred tax assets to reduce income taxes. We will continue to assess the likelihood of realization of our net deferred tax assets and will adjust the balance accordingly.

Net loss. Net loss was $3,732,000 for the six months ended December 31, 2007, compared to net loss of $2,585,000 for the six months ended December 31, 2006. This increase in net loss was primarily the result of reduced revenues as we shift our focus toward indirect distributor arrangements and the restructuring charges discussed above.

Liquidity and Capital Resources

At December 31, 2007, our principal sources of liquidity were cash and cash equivalents of $22,990,000, marketable securities of $26,769,000, and accounts receivable net of allowance for doubtful accounts of $2,060,000. We believe our current cash reserves are adequate to cover the anticipated losses over the next year as we migrate our business towards the indirect channel while continuing to strategically invest in our direct-to-consumer channel. We do not expect cash flow from operations to be positive in future periods until we return to profitability. Although we are anticipating significant losses in the near future we believe our cash on hand will be adequate to fund our operations for at least the next twelve months. However, we reexamine our cash requirements periodically in light of changes in our business.

Cash and cash equivalents and marketable securities declined from $52.7 million at June 30, 2007 to $49.8 million at December 31, 2007. This decrease is primarily due to cash used in operations of $2 million and net unrealized losses on marketable securities of $762,000.

During the quarter ended December 31, 2007, certain auction rate securities failed auction due to sell orders exceeding buy orders. Of our $27 million marketable securities portfolio at December 31, 2007, $10 million (at cost) is currently associated with failed auctions, all of which have been in a loss position for less than 12 months. The funds associated with failed auctions will not be accessible until a successful auction occurs or a buyer is found outside of the auction process. These securities are rated AAA. Based on third party valuation models and an analysis of other-than-temporary impairment factors, we have determined that these securities are not permanently impaired. We recorded an unrealized loss within Other Comprehensive Loss of approximately $775,000 pre-tax at December 31, 2007, related to these auction rate securities. These securities are being analyzed each reporting period for other-than-temporary impairment factors.

Off-Balance Sheet Arrangements

We have not entered into any off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign currency exchange risk. We do not currently do any business denominated in foreign currencies and, therefore, are not subject to any significant foreign currency exchange risk.

Interest rate sensitivity. We had cash and cash equivalents totaling $23 million and marketable securities totaling $26.8 million at December 31, 2007, and cash and cash equivalents totaling $20.3 million and marketable securities totaling $32.4 million at June 30, 2007. Cash and cash equivalents were held for working capital purposes in depository accounts at FDIC-regulated banking institutions. Marketable securities consist of investment grade securities including auction-rate securities, which carry interest or dividend rates that reset every seven to 28 days, corporate bonds, and government and agency securities. We do not enter into investments for trading or speculative purposes. Declines in interest rates,

however, will reduce our future interest income. If interest rates were to decline by 3.0% as compared to the rates at December 31, 2007, our interest income would decrease by approximately $380,000 on a quarterly basis based on the outstanding balance of our marketable securities and money market funds at December 31, 2007. A decline in market value of 3.0% would reduce the value of our cash equivalents and marketable securities by approximately $800,000.

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ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.*
As of the end of the period covered by this report, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, management evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2007.

(b) *Changes in internal controls over financial reporting.*

There have not been any changes in our internal control over financial reporting during the fiscal quarter ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

(c) *Inherent Limitations on Effectiveness of Controls.*

The Company s management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are effective at a reasonable assurance level. However, the Company s management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS
A determination that we have infringed the intellectual property rights of a third party could expose us to substantial damages, restrict our operations or require us to procure costly licenses to the intellectual property that is the subject of the infringement claims. Such a license may not be available to us on acceptable terms or at all. Any effort to defend ourselves from assertions of infringement or misappropriation of a third party s intellectual property rights, whether or not we are successful, would be expensive and time-consuming and would divert management resources. Any adverse determination that we have infringed the intellectual property rights of a third party, or the costs we incur to defend ourselves against such claims, whether or not we are successful, would have a material adverse impact on our business and results of operations.

Our customers or other companies with whom we have a commercial relationship could also become the target of litigation relating to the patent and other intellectual property rights of others. This could trigger support and indemnification obligations, which could result in substantial expenses, including the payment by us of costs and damages relating to patent infringement. In addition to the time and expense that could be required for us to meet our support and indemnification obligations, any such litigation could hurt our relations with our customers and other companies. Thus, the sale of our services could decrease. Claims for indemnification may be made by third parties with whom we do business and such claims may harm our business, prospects, financial condition and results of operations.

From time to time, we may be subject to litigation, such as class action lawsuits, that could negatively affect our business operations and financial position. Such disputes could cause us to incur unforeseen expenses, could occupy a significant amount of our management s time and attention, and could negatively affect our business operations and financial condition.

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ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors set forth under the caption Risk Factors in Part I, Item 1A, of our Annual Report on Form 10-K, for our fiscal year ended June 30, 2007. The risks discussed in our Annual Report on Form 10-K could materially affect our business, financial condition and future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or operating results. Other than those described below, there have been no material changes to the Risk Factors as previously disclosed in our Form 10-K for the fiscal year ended June 30, 2007.

We may be required to incur significant costs to modify our systems in order to meet the requirements of the Communications Assistance to Law Enforcement Act.

The Communications Assistance to Law Enforcement Act, or CALEA, sets forth the assistance capabilities that telecommunications carriers are legally required to have and maintain within their networks to assist law enforcement in conducting lawfully-authorized electronic surveillance. We currently believe that the circuit-switching facilities of our subsidiary, Liberty Telecom, are in compliance with CALEA-related requirements. As Liberty Telecom expands its service offerings, further modifications to its local switching equipment may be necessary to comply with applicable laws and regulations. In 2005, the FCC released an order concluding that CALEA applies to facilities-based broadband Internet access providers and providers of interconnected VoIP service. On May 12, 2006, the FCC issued an order that addressed, among other things, the assistance capabilities required for facilities-based broadband Internet access providers and providers of interconnected VoIP. Further implementation of CALEA could result in additional regulatory burdens for us and for Liberty Telecom. Complying with CALEA and rules implementing CALEA may require us to incur substantial costs, which could negatively impact our results of operations.

The underlying telecommunications and telecommunications services upon which we rely to provide our services may become subject to burdensome regulations that could increase our costs or hamper our ability to provide our service offerings.

We provide our services through data transmissions over public telephone lines and other facilities provided by telecommunications companies. The underlying transmissions are typically subject to regulation by the FCC, state public utility commissions and, in the future, could become subject to regulation by foreign governmental authorities to the extent subscribers use our services outside the territories of the United States. These regulations affect the prices that we pay for transmission services, the competition we face from communications service providers that may choose to offer enhanced services similar to ours and other aspects of our market. Changes in the federal and state regulatory rules governing the offerings of our underlying suppliers, or developments in the interpretation of existing regulations, could decrease our revenue, increase our costs or restrict our service offerings. The impact of federal or state legislative, regulatory, or adjudicatory actions or requirements may apply not only prospectively but conceivably retroactively and could result in an increase in our costs, adversely affect how we conduct our business, our financial condition and results of operations.

Our wholly-owned subsidiary, Liberty Telecom, is a telecommunications carrier subject to state and federal regulation as a Competitive Local Exchange Carrier and is required to have a certificate of public convenience and necessity in order to operate in the state of Nevada as a Competitive Local Exchange Carrier. If Liberty Telecom were to lose its certificate, we may not be able to obtain access to telecommunications services at rates or on other terms and conditions that are as favorable as those that we currently have.

On September 23, 2005, the FCC released an order reclassifying wireline broadband Internet access services as information services, thereby placing wireline broadband Internet access services within the same general regulatory framework as cable modem services. Similarly, on November 7, 2006, and March 23, 2007, the FCC released orders declaring Broadband over Power Line (BPL)-enabled Internet access service and wireless broadband Internet access service, respectively, to be information services. As information services, wireline, wireless, and BPL-enabled broadband Internet access, like cable modem service, no longer are subject to regulation under Title II of the Communications Act of 1934, as amended, or the FCC s Computer Inquiry rules, but are subject to specific obligations imposed under Title I of the Act. The Commission also permitted, in March 2006, a petition of Verizon for forbearance of federal Title II and Computer Inquiry regulation of its broadband services to be deemed granted by operation of statutory law. A federal court appeal of this action by operation of law was denied in December of 2007 on procedural grounds, as the appellate court found that the FCC had not taken a judicially reviewable action. Late in 2007, by order, the Commission granted in part petitions for forbearance filed in 2006 by AT&T, Embarq, and other ILECs that had sought relief similar to that afforded Verizon by operation of law. Judicial review of these more recent forbearance decisions remains pending. A comparable forbearance petition filed by Qwest is pending. These FCC actions, and the grant of the pending petitions for forbearance, could potentially enable ILECs to (1) raise barriers for subscribers to their broadband transmission services to use our enhanced services, (2) charge higher rates for underlying broadband transmission service to subscribers to our enhanced services, or (3) bundle enhanced services that are similar to our enhanced services with their broadband transmission services at such a rate that it becomes economically infeasible for us to compete with the ILEC. If one or more ILECs take any of those actions with explicit or tacit permission from the FCC, then it could have a material adverse impact upon our profitability and the results of our operations.

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Future legislation, regulation, or legal decisions affecting the Internet, Internet telephony or IP-enabled services could restrict our business, prevent us from offering our services or increase our cost of doing business.

We believe that, as a matter of regulatory classification, our offerings are unregulated enhanced services or information services rather than regulated telecommunications services as those terms are defined by the Communications Act of 1934, as amended, (the Act) and the FCC. We also believe that our offerings do not meet the FCC s definition of interconnected VoIP services, which are subject to certain common carrier-type regulations under the FCC s rules. As such, we believe that we are not currently subject to direct regulation by the FCC either as a common carrier or as a provider of interconnected VoIP services. Nor do we believe that we are subject to regulation under state statutes or rules that govern telecommunications utilities, telephone companies, local exchange carriers, telephone toll services, or other similar regulatory categories. However, there is a risk that (1) federal or state regulators could rule that some features of our services are subject to existing common carrier or common carrier-type regulations, (2) the FCC could expand the definition of interconnected VoIP services to cover some or all of the features of our services, in which case the features would be subject to the common carrier-type regulations the FCC has imposed on providers of interconnected VoIP services, or (3) state or federal regulators could otherwise increase the scope of services subject to their regulations to include one or more of our services or specific features of our services.

To date, the FCC has not adopted a comprehensive regulatory framework for IP-enabled services or even attempted to classify IP-enabled services generally under the Act. In 2004, the FCC released a notice of proposed rulemaking in Docket 04-36 that sought public comment regarding the regulatory classification of IP-based services and the regulatory framework for those services, including the rights and obligations of providers of IP-enabled services. However, the FCC has yet to address the majority of the issues raised in this proceeding. Instead, the FCC has issued several *ad hoc* decisions classifying particular offerings as telecommunications, telecommunications services, or information services, and clarifying the regulatory consequences of those classifications under the Act and the FCC s rules. With respect to a subset of IP-enabled voice services called interconnected VoIP services, the FCC also has begun imposing various common carrier-type regulatory obligations, including the obligation to contribute to the federal Universal Service Fund, to offer enhanced 911 service, to comply with the same CALEA requirements that apply to providers of telecommunications services, to comply with regulations regarding the use and protection of Customer Proprietary Network Information, to comply with the disability access requirements that currently apply to telecommunications service providers (including the obligation to contribute to the Interstate Telecommunications Relay Services fund), and to pay federal regulatory fees. Under the FCC s current definition, interconnected VoIP services include any service that: (i) enables real-time, two-way voice communications; (ii) requires a broadband connection from the user s location; (iii) requires IP-compatible customer premises equipment; and (iv) permits users generally to receive calls that originate on the Public Switched Telephone Network (PSTN) and to terminate calls to the PSTN.

Interconnected VoIP services generally are offered to the public as substitutes for, or as substantially equivalent to, existing telecommunications services. By contrast, our customers could not use our services unless they are also separately receiving telecommunications services from their own service providers. Moreover, our services do not require, although they are compatible with, a broadband connection from the user s location or IP-compatible customer premises equipment, and thus they do not meet the FCC s definition of interconnected VoIP services. Nonetheless, in light of the FCC s decisions imposing regulatory obligations upon interconnected VoIP services, certain states have indicated that they may be interested in regulating services that they perceive to be the functional equivalent of telecommunications services. We may be faced with substantially increased regulatory burdens and costs if (1) state regulators attempt to regulate the information services that we provide or rule that any of our services or features are subject to their current regulatory provisions (even if the FCC does not also regulate such services or features), or (2) if the FCC expands the definition of interconnected VoIP services to include, or otherwise determines that the scope of the services subject to its regulations does include, the types of services we provide.

Apart from the specific regulatory obligations that the FCC has imposed upon providers of interconnected VoIP services, there are few laws, regulations or rulings that specifically address access to, or commerce on, the Internet, including the provision of IP-based telephony and other IP-enabled services. However, the growth in the market for IP-based telephony and other IP-enabled communications, and the popularity of these services, along with other regulatory objectives, such as ensuring adequate funding levels for the federal Universal Service Fund create the risk that governments and agencies increasingly will seek to regulate services such as our current offerings, including the potential for rulings that such regulations have applied all along. Many legislative and regulatory actions are underway or are being contemplated by federal and state authorities and certain past decisions suggest that the FCC or state regulatory authorities could eventually rule that certain IP-enabled services are telecommunications services that are subject to common carrier regulations. For example, on April 21, 2004, the FCC released a narrow declaratory ruling finding that certain Internet protocol telephony services are telecommunications services upon which interstate access charges may be assessed. Prior to this decision, the FCC had never ruled that a specific service relying on Internet-protocol technology was a telecommunications service. More recently, on June 27, 2006, the FCC issued a decision finding that providers of interconnected VoIP services offer telecommunications as defined by the Communications Act and must therefore contribute to the federal Universal Service Fund. Similarly, on June 30, 2006, the FCC released an order holding that menu-driven prepaid calling cards, and prepaid calling cards that use IP transport to deliver all or a portion of the call embody telecommunications services, and these prepaid calling card providers qualify as telecommunications carriers that are subject to, among other things, Universal Service Fund contributions based on their interstate revenues as well as intrastate and interstate access charges. These rulings illustrate that certain Internet-protocol based services may become subject to costs and regulations that, previously, were not thought to be applicable. Moreover, two petitions for forbearance were filed at the FCC in October 2007 and January 2008,

respectively, that, in combination, appear to require the FCC, under Communications Act timetables, to ascertain by January 2009, at the latest, whether IP-based calls exchanged with the public

switched network are information services or telecommunications services, an issue which the Commission has to date declined to address directly. The outcome of these two petitions could have an impact on the regulatory treatment of some of our current and future services. We are unable to predict the impact, if any, that future legislation, regulations, or administrative and judicial decisions may have on our business.

In any event, as communications services increasingly are delivered over the Internet and as we expand the services and features that we offer, our business may become increasingly regulated at the federal, state, and/or foreign government levels, which may increase our operating costs and could also subject us to new regulatory fees or financial obligations. As we introduce new offerings, it is possible that some of them may fall within existing telecommunications or interconnected VoIP regulations, increasing our costs and reducing our operating margins.

Regulatory proceedings, legislative efforts and adjudications, including but not limited to some of those described above, have created a certain level of uncertainty regarding the regulatory classification of some of our services and features. Future regulatory actions may lead to the imposition of additional regulatory obligations and requirements on us in the provision of our services and features, including but not limited to certification requirements, interstate or intrastate access charges, regulatory fees, payments to support state and federal universal service-funds, taxes related to Internet or IP-enabled communications, requirements to provide free access to certain users, regulations based on encryption concerns, consumer protection requirements and certain minimum service levels. We could conceivably become subject to requirements and obligations not only at the federal level, but also in any of the states in which we have customers or from which third persons initiate communications to call our customers, as well as in any of those jurisdictions in which facilities exist or activities occur which support our offerings. Further, as we expand into additional lines of business or make new service offerings, we could become subject to existing or future regulation or other legal requirements, including but not limited to those which apply to telecommunications services and the providers of such services. The impact of federal or state legislative, regulatory, or adjudicatory actions or requirements may apply not only prospectively but conceivably retroactively and could result in an increase in our costs, possible penalties and forfeitures in the event determinations are made that certain features of our services have been subject to regulatory or legal obligations all along, adversely affect how we conduct our business, adversely affect our financial condition and results of operations, and restrict our growth potential.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Sales of Unregistered Securities

None.

Use of Proceeds

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At our 2007 Annual Meeting of Stockholders held on December 14, 2007 (the Annual Meeting), our stockholders: (i) elected seven directors to serve until the 2008 Annual Meeting (Proposal No. 1); and (ii) ratified the appointment of Mayer Hoffman McCann P.C. as independent auditors for the fiscal year ending June 30, 2008 (Proposal No. 2). The tabulation of votes for each of the proposals is set forth below:

Proposal No. 1

Election of seven directors to serve until the 2008 Annual Meeting:

FOR	AGAINST

16,743,328	527,136

Proposal No. 2

Ratification of the appointment of Mayer Hoffman McCann P.C. as independent auditors of the Company for the 2008 fiscal year:

FOR	**AGAINST**	**ABSTAIN**
17,193,477	16,081	60,906

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ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description
3.1[(1)]	Amended and Restated Certificate of Incorporation of the Registrant.
3.2[(2)]	Certificate of Amendment to Amended and Restated Certificate of Incorporation.
3.3[(3)]	Certificate of Amendment to Amended and Restated Certificate of Incorporation.
3.4[(4)]	Bylaws of the Registrant.
31.1	Certification of Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Previously filed in the Registrant s Registration Statement Amendment No. 5 on Form S-1 (File No. 333-115438) filed on September 27, 2004 and incorporated herein by reference.

(2) Previously filed in the Registrant s Quarterly Report on Form 10-Q filed on February 14, 2006 and incorporated herein by reference.

(3) Previously filed in the Registrant s Quarterly Report on Form 10-Q filed on February 13, 2007 and incorporated herein by reference.

(4) Previously filed in the Registrant s Registration Statement on Form S-1 (File No. 333-115438) on May 13, 2004 and incorporated herein by reference.

SIGNATURES

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

CALLWAVE, INC.,

Date: February 14, 2008

By: /s/ Jeffrey Cavins
Jeffrey Cavins,
President and Chief Executive Officer

Date: February 14, 2008

By: /s/ Mark Stubbs
Mark Stubbs
Chief Financial Officer

(principal financial and accounting officer)