

June 26, 2017

## INVESTMENT HIGHLIGHTS

- Crexendo offers state of the art services, having won the **Internet Telephony Excellence Award for Innovation** in IP communication *four years in a row*, as well as the **2016 Communications Solutions Product of the Year Award** and the **2016 TMC Labs Innovation Award**.
- Crexendo predicts that it will break even on both a cash flow and GAAP net income basis by the fourth quarter of 2017.
- Management is growing Crexendo organically while cutting operating expenses. In the most recent quarter, cloud telecommunications revenue rose 16%, while overall expenses fell 6% year-over-year.
- The VoIP market is predicted to grow 10.7% per year over the next five years, reaching \$20 billion by 2022, representing a large opportunity for Crexendo.<sup>1</sup>
- Unlike many of its competitors, Crexendo develops all its products and firmware in-house. This allows the company to send out firmware updates every 6-8 weeks, improving the customer experience and providing it with a **key competitive advantage**.

## COMPANY DATA

Date:	06/26/2017
52-Week Range (\$)	1.35-1.60
Shares Outstanding (mn)	13.8
Market Cap (\$mn)	20.02
3-Mo. Average Volume (k)	1.27
Total Cash (\$mn)	0.968
Total Debt (\$mn)	1.021
Dividend Yield (%)	0
Short Interest (%)	4.88
Insider Ownership (%)	76.20
Institutional Ownership (%)	6.78
Institution Holding Shares	2

## KEY FINANCIALS

	FY14A	FY15A	FY16A
Revenue (\$ mn)	7.59	7.82	9.12
EPS (\$)	-0.57	-0.35	-0.21
Net Income (\$ mn)	-6.38	-4.54	-2.79
EBIT (\$ mn)	-6.60	-4.83	-2.76
EBITDA (\$ mn)	-5.93	-4.56	-2.62

## SHARE PRICE PERFORMANCE



<sup>1</sup> IBISWo2 IBISWorld, "VoIP in the US," April 2017

## COMPANY DESCRIPTION

**Crexendo is a cloud communications company that provides important cloud telecommunication services and other hosted services to businesses.** The company's goal is to play a critical role in helping businesses communicate with customers, suppliers and other businesses. Crexendo offers numerous services and phone systems to help achieve this goal. The company is focused on the US and Canadian markets.



(4 years running)



Source: Crexendo Sales Presentation

Crexendo provides a full-fledged unified cloud communications ecosystem. Its offerings include cloud communication services, mobile applications, network services, and telecom devices. Some of the features Crexendo offers includes advanced call center reports, call recording, find-me/follow-me, mobile applications, customizable outbound Caller ID, Unified Communications, collaboration, and much more. Fundamentally, Crexendo brings Fortune 500 communication features to small businesses at affordable costs. The company prepares businesses for the future, offering a unified business communications solution, with an intuitive web-based interface and an easy-to-use mobile app.



Source: Crexendo Sales Presentation

**Crexendo hosts and stores these applications in its own data centers, which allows customers to use and pay for the features that they need.** Unlike many of its competitors, the company develops both the hardware and software associated with its phone system. This allows Crexendo to constantly innovate and add more features, further increasing the value added for business owners.

**Crexendo provides multiple devices with different price points and capabilities.** Crexendo’s desktop devices are state-of-the-art, feature rich telephone devices offering up to 5 VoIP (voice over internet protocol) accounts, 5-way conferencing, color displays, High Definition audio, and a plethora of additional features. Crexendo also has the ability for customers to BYOD (Bring Your Own Device) for Polycom, Yealink and Cisco VoIP phone users which is a very attractive option for customers already using VoIP phones.

**Crexendo Product Offering**

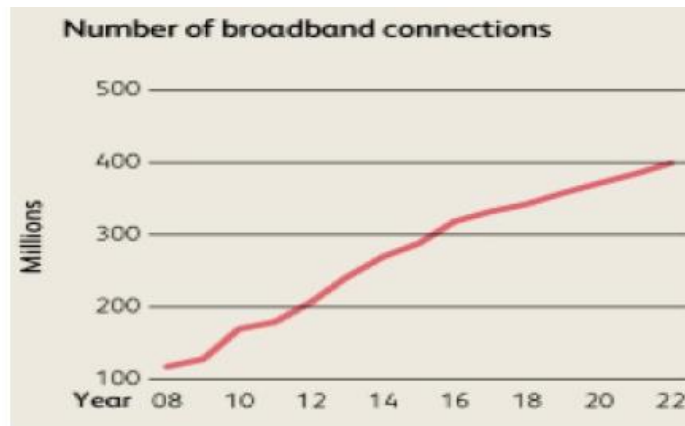


Source: Crexendo webpage

**Crexendo provides high-speed internet and web hosting services to businesses as well.** This comes in the form of a wide range of network service solutions including Cable, T1, Fiber Optic, Multi-Protocol Label Switching (MPLS), Metro Ethernet (EOC) and DSL options. The company also generates revenue from managing websites, but this segment was only 14% of Crexendo’s total revenue in 2016 and is declining. Management is winding this segment down intentionally to focus on the more attractive hosted Cloud Telecom market.

## RAPID GROWTH OF CLOUD TELECOMMUNICATION

**Crexendo primarily competes in the VoIP market, which is possible for rapid success.** The U.S. market for VoIP is projected to reach \$20 billion by 2022.<sup>2</sup> A key external driver for this market is the number of broadband connections in the U.S. From 2008, this number shot up, from 100 million broadband connections to 300 million broadband connections. It is further projected to grow to 400 million by 2022. This is a major trend and will allow Crexendo to continue adding new customers.



Source: IBISWorld VoIP Report

The Telecommunications Act of 1996 paved the way for CLECs to provide their own network and switching and compete with traditional and established local exchange carriers. This move was intended to promote competition among local as well as long-distance phone service providers. While the CLEC space is highly competitive with many well-established players, stringent government regulations pose a barrier to entry into this field. North America is expected to be the dominant market due to established industry standards and strict controls already in place. The recent shift from residential end users to SMBs (small and medium sized businesses) is expected to amplify demand for CLEC products. Crexendo is an authorized CLEC provider in 44 states and authorized to sell telecommunication services in every U.S. state, Puerto Rico and Canada.

## ORGANIC GROWTH AND STRONG COST DISCIPLINE

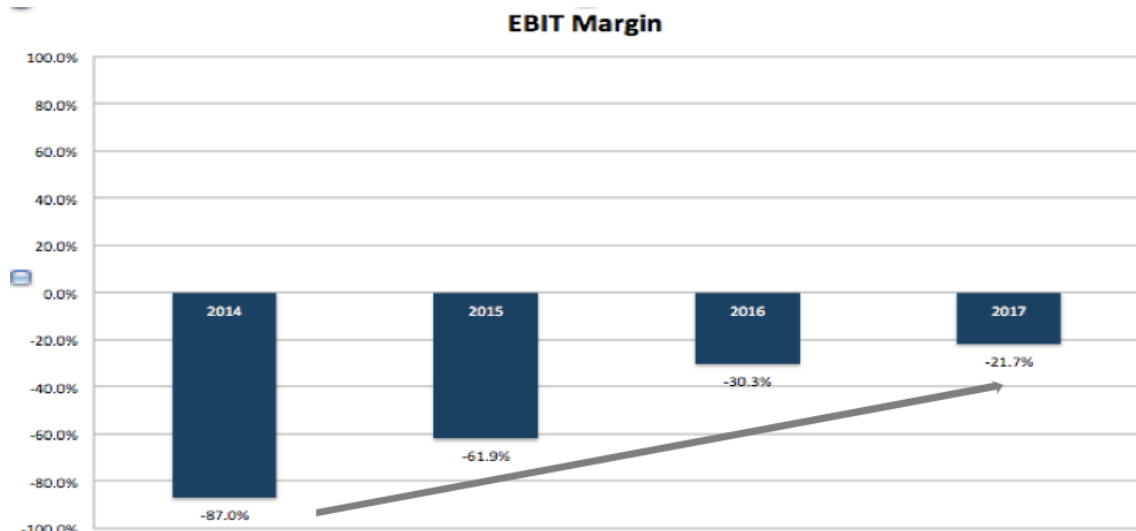
A new injectable. **Crexendo's management is sharply focused on cost control.** This is critical for achieving break-even cash flow/GAAP net income, a key goal for management. While the company has been unprofitable over the past few years, we have seen margins improve dramatically in this time frame. This has been a broad-based improvement, with both gross and operating margins rising.

<sup>2</sup> IBISWorld, "VoIP in the US," April 2017

Since 2014, Crexendo's gross margin has increased rapidly, shooting up from 52.8% to 60.2%. In the most recent quarter, the first quarter of 2017, the gross margin further improved to 63%. This gross margin improvement has been possible because Crexendo owns both its hardware and software. The company can control the entirety of its expenses through the lifecycle of its product. This ability, combined with management's sharp focus on reducing expenses, means that the gross margin expansion is likely to continue. The company's EBIT margin, which is inclusive of operating expenses, has also seen major improvement. Within the same 2014 to 2016 time period, the EBIT margin improved from -87% to an astonishing -30.3%.

While the gross margin improvement did help increase EBIT, the majority of this rise is due to operating expenses decreasing sharply. The company has dramatically improved its sales process, causing selling, general and administrative (SG&A) expenses to come down. Most revenue is also recurring, which means the SG&A expense associated with that revenue has decreased because the initial sale has already been made. In 2013, the cloud communications operating expenses alone were 238% of revenue, but in 2016, this has come down to 97%, a large decrease.

Once again, Crexendo further improved the EBIT margin to -21.7% in the first quarter of 2017. This was driven by 8% revenue growth and a 6% decline in operating expenses. We expect to see further improvement, especially because Crexendo has made a few key sales hires in the most recent quarter, including a new VP of Sales and a new Director of Sales. We have attached a chart of the historical EBIT margin below. For 2017, we used data from the first quarter.



Source: JGR Capital Partners' Analysis

This cost cutting is especially impressive given that Crexendo's management has also grown revenue since 2014. In 2016, revenue grew by 17% year over year. This represents an acceleration from 2015, where revenue only grew 3%. It's important to remember that Crexendo's revenue growth rate is also negatively affected by the decline in its web services segment. Revenue growth for the cloud telecommunications segment has been much stronger, clocking in at 81% in 2014, 39% in 2015, and 30% in 2016. As revenue goes up, and costs come down, Crexendo looks likely to achieve profitability soon, removing a key risk for investors. On the Q1 2017 earnings call, management commented that they are still on the right track towards achieving profitability in the fourth quarter of 2017.

## MAJOR CREXENDO POISED TO SUCCEED IN COMPETITIVE MARKET

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**Crexendo has maintained key advantages over its large competitors that we believe will allow it to grow faster.** Some of the ways Crexendo differs from its competitors are discussed below.

### **RingCentral (NYSE: RNG)**

RingCentral offers their own custom cloud platform to businesses and enterprises of all sizes and is one of the biggest players in the small business market. RingCentral's small business platform closely resembles Crexendo's and offers many easy-to-use features as well as strong integration with many leading business applications such as Outlook, Salesforce, and Google Docs. However, unlike Crexendo, RingCentral offers three tiers of fixed pricing for SMBs, with each increasing level of service offering more features. This may result in a business having to pay extra for a desired feature that only the second tier of RingCentral contains, despite not needing any of the other features from the second tier. On the other hand, Crexendo offers a custom pricing plan with features tailored precisely to the needs of a customer. If the desired feature is not available, Crexendo can also develop it in-house and subsequently make it available to other businesses.

### **Broadsoft, Inc. (NASDAQ: BSFT)**

As a pioneer in unified cloud communications, Broadsoft offers more than 425 features that are packaged together in its cloud communications solution. Its business segment, Broadsoft Business, provides a comprehensive, mobile-integrated communication suite similar to Crexendo's. However, Broadsoft lacks name recognition to the public and even to its customers, as its business strategy involves selling its service through its extensive, worldwide partnerships of more than 700 telecom carriers (such as AT&T, Verizon, Comcast, and Vonage) across 80 countries.<sup>3</sup> While this strategy has improved global coverage and annual sales, it also creates risks and strong dependence on the telecom carriers themselves—a service provider's poor network could create the impression that Broadsoft offers poor services. In addition, telecom carriers today experience significant competition from cloud communications providers such as RingCentral and Crexendo. Crexendo develops the platform, software, and hardware in-house, eliminating any major risks from third-party dependence, unlike Broadsoft.

### **8x8, Inc. (NASDAQ: EGHT)**

8x8 is a global cloud communications solutions provider for both SMBs and large enterprises. Known for being the first company to develop the communications cloud, it competes directly with Crexendo through a segment that combines VoIP communications, team collaboration, call center, and analytics into a single platform. 8x8 is actively expanding its operations globally, unlike Crexendo, which focuses on the North American market. In May 2017, 8x8 partnered with Regus, a shared workspace provider, to expand its cloud communications service to another 13 countries.

However, Crexendo maintains certain advantages that 8x8 does not. For example, 8x8 relies on third party vendors such as Polycom for its hardware, while Crexendo owns and provides its own telecom devices tailored specifically to their platform and their customer's need. In addition, Crexendo's small business focus allows it to offer its customers frequent upgrades and 24x7 customer support that 8x8 cannot match. This is significant, as small businesses have grown rapidly, creating 64% of the new jobs in the U.S. over the past 15 years.<sup>4</sup> With the current political and economic atmosphere, Crexendo's focus on small businesses will likely increase growth with minimal costs.

<sup>3</sup>Network World, "BroadSoft: The most important UC vendor you probably haven't heard of," November 22 2016

**Vonage (NYSE: VG)**

A longtime leader in residential cloud communication solutions, Vonage has recently built out its business division with new cloud-based services through a series of acquisitions. These M&A activities, which include the acquisitions of Nexmo, iCore Networks, Telesphere and Vocalocity, have pushed Vonage to the top of the North American unified cloud communications market. The service Vonage provides to businesses is similar to Crexendo's. However, while the M&A strategy has shown immense success, resulting in a 51% year-over-year increase in revenue in the first quarter 2017, Vonage is still new to the business VoIP market, and is vulnerable to risks from potential incompatibility and stability issues with its acquired systems, as the Vonage platform is essentially built on top of various existing cloud solutions, including Broadsoft. As a result, it also depends on an array of third-party vendors and providers to fix potential problems. Crexendo, on the other hand, is free from this vulnerability because it develops its custom platform.

**Overall, Crexendo provides one of the best solutions for small businesses on the market with not only unified cloud communications service, but also networking and hardware services.** It offers a complete and customizable package tailored to the specific needs of its customers. This is unique in the cloud communications market, which is set to grow significantly.

**IN HOUSE INNOVATION IS A MAJOR ADVANTAGE**

By innovating its technology and cloud infrastructure in-house, Crexendo is able to provide a more flexible and up-to-date interface, with advanced features at a lower price. The company creates most of its products and services entirely on its own, including the hardware and software. This feature sets it apart from its competitors and provides the company the advantages of delivering cloud services on demand, without being dependent on third parties and their software development time frames. This also ensures Crexendo is quickly able to adapt to the ever-changing industry requirements and provide quick turnarounds to its customers at affordable prices. As an example, Crexendo uses innovation, price, and ease of use to design solutions for call centers by taking the most common functionalities and making them highly accessible to small businesses, allowing any business to become competitive with much larger companies. An entire range of built-in functionality, including skills-based routing, dashboards, real-time statistics, tiered management, collaboration, and CRM integration is provided at no additional charge. Crexendo is also able to provide customers the flexibility to turn their smartphones/tablets into a fully functional mobile business extension.

<sup>4</sup> Gretchen Schmid, "17 Statistics Every Business Owner Needs to Be Well Aware Of," May 15 2017



## Collaboration

- 📺 Real-Time Video
- 📺 Screen Sharing and Messaging
- 📺 Rich Document Sharing and Collaboration
- 📺 Organize Meetings and Manage Tasks
- 📺 Works on Any Device and Any Platform

Source: Crexendo Sales Presentation

## DISCOUNTED CASH FLOW VALUATION

**We constructed a discounted cash flow using a bottom-up methodology.** We have projected company cloud telecommunications revenues based on the industry average growth rate of 26%.<sup>5</sup> We projected Crexendo's revenue under two different potential scenarios: a bull and a base case. The key difference between the two scenarios is the revenue growth rate we used.

**For both our bull and base cases we used a Weighted Average Cost of Capital ("WACC") of 19.4%.** This was based on a risk premium of 7%, a beta of 2.54x, and a risk-free rate of 2.3%. These inputs resulted in a cost of equity of 20.1% and a cost of debt (post tax) of 4.8%. The company's capital structure is primarily equity, which resulted in the cost of equity having a much heavier weight in our ultimate WACC calculation. We used a terminal growth rate of 3%.

Debt and Equity in thousands	
Risk-free rate	2.3%
Beta	2.54
Risk premium	7.0%
Extra risk	0.0%
<b>Cost of equity</b>	<b>20.1%</b>
Cost of Debt	8.0%
<b>Cost of Debt (post tax)</b>	<b>4.8%</b>
Equity	20,705
Debt	1,021
<b>WACC</b>	<b>19.4%</b>

Weighted Average Cost of Capital, Source: JGR Capital Partners' Analysis

<sup>5</sup> Markets and Markets Research, "Cloud Communication Platform Market worth 4.45 Billion USD by 2021", 2017



To project out the gross margin, we looked at the historical trend in each business segment's cost of goods sold as a percentage of revenue. Historically, Crexendo has seen its cloud telecommunication gross margin improve by 11.5% each year. Because management is working on increasing its gross margin, we assumed that this trend would continue. In order to keep our assumptions conservative, we also assumed that by 2019, Crexendo would no longer see gross margins improvements. Currently, the gross margin for cloud telecommunications is 56%; by 2019, we believe it will be 77%.

We used a similar process for each segment's operating expenses, looking at the trend for the line items as a percentage of revenue. For both cloud telecommunications and web services, we noticed that each of these operating expenses tended to decrease by 25% from 2014 to 2016 when expressed in this way. We projected this trend to 2019, assuming that operating expenses would stay constant as a percentage of revenue for 2020 and 2021. For taxes, we assumed a 35% tax rate each year, based on historical data. This tax rate may prove to be too high if corporate tax reform occurs. The company also has substantial net operating loss carry-forwards, which it can use to offset taxable income generated. We projected that depreciation & amortization, along with capital expenditures constant, would stay at around 2% of sales, matching historical trends.

#### Bull Case:

(\$Thousands)	FY17E	FY18E	FY19E	FY20E	FY21E
EBIT	(347.6)	2,685.1	6,588.9	8,243.3	10,569.1
Less: Tax	0.0	0.0	0.0	0.0	0.0
<b>NOPLAT</b>	<b>(347.6)</b>	<b>2,685.1</b>	<b>6,588.9</b>	<b>8,243.3</b>	<b>10,569.1</b>
Changes in working capital	(307.3)	(606.8)	(653.3)	(792.1)	(1,006.5)
Depreciation & Amortization	222.1	277.5	352.3	451.7	582.5
Capex	231.7	279.1	353.5	452.5	583.0
<b>FCFF</b>	<b>(49.8)</b>	<b>3,290.3</b>	<b>7,241.0</b>	<b>9,034.7</b>	<b>11,575.0</b>
Discount factor	0.91	0.76	0.64	0.53	0.45
PV of FCFE	(45.2)	2,501.8	4,612.7	4,821.7	5,175.4
Sum of PV of FCFE					17,066.2
Terminal cash flow					47,362.9
PV of terminal cash flow					21,176.7
<b>Enterprise value</b>					<b>38,242.9</b>
Less: Debt					1,021.0
Add: Cash					968.0
<b>Equity value</b>					<b>38,189.9</b>
Outstanding shares (MN)					13.8
<b>Fair value per share (\$)</b>					<b>2.8</b>

Source: JGR Capital Partners

The industry average growth rate for the cloud communications platform market is 26%.<sup>6</sup> The cloud communications platform market is analogous to Crexendo's cloud telecommunications segment. In a bull case scenario, we believe that Crexendo can beat these projections, growing at 30% instead, given strong execution and attractive positioning.

Compared to its competitors, Crexendo owns their entire technology platform, and is smaller, leaving it more room to grow. Historical trends lend credence to the idea that Crexendo will outperform the market. In the 2014-2016 time period, Crexendo's cloud telecommunications revenue has grown by 81%, 39%, and 30% respectively due to Crexendo's execution. In the first quarter of 2017, the company made several important sales hires as well, which may help boost sales. In a bull case, we believe that Crexendo's current fair value should be approximately \$2.8 per share.

<sup>6</sup> Markets and Markets Research, "Cloud Communication Platform Market worth 4.45 Billion USD by 2021", 2017

**Base Case:**

(\$Thousands)	FY17E	FY18E	FY19E	FY20E	FY21E
EBIT	(323.1)	2,547.6	6,031.0	7,306.1	9,069.2
Less: Tax	0.0	0.0	0.0	0.0	0.0
<b>NOPLAT</b>	<b>(323.1)</b>	<b>2,547.6</b>	<b>6,031.0</b>	<b>7,306.1</b>	<b>9,069.2</b>
Changes in working capital	(275.5)	(538.0)	(548.5)	(636.7)	(780.1)
Depreciation & Amortization	215.9	261.6	321.8	399.6	499.2
Capex	227.3	262.3	322.4	400.1	499.5
<b>FCFF</b>	<b>(59.0)</b>	<b>3,084.8</b>	<b>6,579.0</b>	<b>7,942.3</b>	<b>9,848.9</b>
Discount factor	0.91	0.76	0.64	0.53	0.45
PV of FCFE	(53.5)	2,345.6	4,190.9	4,238.7	4,403.6
Sum of PV of FCFE					15,125.2
Terminal cash flow					40,300.0
PV of terminal cash flow					18,018.7
<b>Enterprise value</b>					<b>33,143.9</b>
Less: Debt					1,021.0
Add: Cash					968.0
<b>Equity value</b>					<b>33,090.9</b>
Outstanding shares (MN)					13.8
Fair value per share (\$)					2.4

Source: JGR Capital Partners

In a base case scenario, we assume that Crexendo's revenue growth matches the industry growth rate of 26%. Crexendo's cloud telecommunications growth rate has been declining, even if it historically outperformed the competition. In 2016, this segment only increased 30%, vs. 39% in 2015. Given the decline, we see it as likely that Crexendo's growth rate will decline to 26%. EBIT for 2017 is a bit lower in the base case because we projected gross costs and operating expenses as a percentage of revenue. Depreciation and amortization, as well as capital expenditures, changed in the base/bull case because we projected these two-line items as a percentage of revenue.

Given Crexendo's positioning in the market and smaller size, we believe it is unlikely the company will ever grow slower than the industry growth rate. We assume that Crexendo will continue to execute in line with historical trends, and its sales hire and unique product offering will no longer allow it to outperform the industry. Even under this scenario, we believe that Crexendo's fair value would be approximately \$2.4 per share. This would represent 50% upside from current levels.

## QUARTERLY FINANCIAL SUMMARY

Compared to the first quarter 2016, Crexendo's revenue increased by 8%, while its cloud telecommunications revenue increased 16%. This is due to management's emphasis on strengthening its sales by acquiring new clients and renewing existing contracts. Web services revenue declined 29%, as the company has decided to move away from this area strategically.

The company significantly improved its net income, losing only \$0.01 this quarter, an improvement over the \$0.04 loss a year ago, on a non-GAAP basis. Revenue growth helped

improve the bottom line, but another big factor was the decrease in operating expenses. Overall, operating expenses decreased by 6% year-over-year. This was driven by 9% decline in general & administrative expenses. Unsurprisingly, EBITDA improved as well. EBITDA increased by over 41% to -\$0.5 million as compared to -\$0.8 million in the same period in 2016. Adjusted EBITDA shot up by over 68% from -\$0.6 million to -\$0.2 million in Q1 2017. We are encouraged by the company's ability to control expenses while growing their top line revenue.

(In thousands, except per share and share data)	Three Months Ended March 31,	
	2017	2016
Revenue	\$ 2,344	\$ 2,174
Operating Expenses		
Cost of Revenue	802	913
Selling and marketing	690	610
General and Administrative	1171	1291
Research and Development	190	229
Total Operating Expenses	2853	3043
Loss from Operations	(509)	(869)
Other Income/(Expense)		
Interest Income	3	4
Interest Expense	(35)	(35)
Other Income, net	2	35
Total Other Income/(Expense), net	(30)	4
Loss before Income Tax	(539)	(865)
Income tax Provision	(4)	(3)
Net Loss	\$ (543)	\$ (868)
Net Loss per common share, basic and diluted	\$ (0.04)	\$ (0.07)
Weighted average number of common shares outstanding, basic and diluted	13,699,389	13,243,883

Source: Crexendo 10-Q, 2017

## RISK FACTORS

The company operates in the highly competitive and fast changing technology sector. Crexendo needs to retain its key employees to ensure consistent upgrades of existing products and new product releases. In addition, Crexendo may face competition as a result of price cuts from competitors or new entrants, which may impact its revenue stream.

Changes in rules and regulations related to telecommunication service providers, including net neutrality laws, may increase Crexendo's costs and/or ability to effectively compete. For a more detailed list of risks please see the company's SEC filings.

## EXPERIENCED MANAGEMENT

**The company has a management team that has over 100+ years of combined industry knowledge, leaving it well-positioned to become a leader in the cloud technology space**

### Steve G. Mihaylo (Chairman of the Board & CEO)

- Former Founder & CEO of Inter-Tel, Inc. one of the largest telephone system manufacturers and managed telecom service providers in the US competing against industry giants such as AT&T, Cisco, Avaya and Nortel.
- Grew Inter-Tel to nearly \$500 million in annual sales before the company was sold for
- \$720 million in 2007 to Mitel via Francisco Partners.

**Doug Gaylor (President & Chief Operating Officer)**

- Joined as VP of Sales in 2009
- Over 29 years of experience in the telecom industry; Formerly Sr. Vice President at Inter-Tel/Mitel; sales in his region reached \$175Million
- Subject matter expert in hosted telecom, network services, PBX and key systems, call centers and managed services
- Strong experience in all areas of cloud and hosted services

**Ron Vincent, CPA (Chief Financial Officer)**

- Joined as VP of Finance in April of 2012, appointed CFO in May 2012
- Formerly Audit Senior Manager for Ernst & Young, LLP from 2005-2012
- CPA with a total of 13 years of experience as an auditor- provided assurance services to public and private companies in various industries including; telecommunication and network service providers.
- Subject matter expert in hosted telecom, network services, PBX and key systems, call centers and managed services

**Jeffrey Korn (General Counsel)**

- Previously served as the company's Chief Legal Officer
- Formerly advisor to private venture firms, partner at a law firm and private consultant

## COMPANY INFORMATION

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## DISCLOSURE

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