UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended June 30, 2008

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 ¨ (Do not check if a smaller reporting company)	Smaller reporting company 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

The aggregate market value of common stock held by non-affiliates computed by reference to the price at which the common stock was last sold as of December 31, 2007 was $7,208,764. In determining who are affiliates of the Company for purposes of this computation, it is assumed that directors, officers, and any persons who held on December 31, 2007, more than 5% of the issued and outstanding common stock of the Company are affiliates of the Company. The characterization of such directors, officers, and other persons as affiliates is for purposes of this computation only and should not be construed as a determination or admission for any other purpose that any of such persons are, in fact, affiliates of the Company.

At September 1, 2008, the number of shares outstanding of the registrant s common stock, no par value, was 21,175,971.

Portions of the Proxy Statement to be filed with the Securities and Exchange Commission and to be used in connection with the Annual Meeting of Stockholders are incorporated by reference into Part III of this annual report on Form 10-K to the extent stated therein.

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PART I

Item 1. Business

BUSINESS

Industry Background

Historically, CallWave has been an Internet telephony company bridging the gap between the mobile telephone, desktop computer and traditional fax line. The primary revenue sources were from dial-up subscribers who used our services to screen, transfer and store messages on their landline and mobile phones and virtual fax users who were looking for a cheaper alternative to premise based fax machines. However, as these subscribers have migrated to broadband and VOIP services over the last few years we have seen a consistent decline in our revenue. Over the last twelve months we have been using the capital from our legacy business to invest in the growing unified communications space.

The term unified communications represents the power of software to deliver complete communication solutions by integrating voice, messaging and video across applications and devices that people use every day. These include landline and mobile telephone services such as voice mail, phone calls, messaging and conferencing, and computer-based services such as document creation, email, instant messaging (IM) and collaboration.

The convergence of available international bandwidth and Internet technology along with software solutions that bridge the gap between telephony and computing have created an opportunity for unified communications. Disintermediation of wireless and landline carrier operators via Internet technology, software applications and available bandwidth is breaking down the regional barriers that historically defined traditional telecommunications. Many pioneers of the telecommunications and software industries believe that software will ultimately control telephony. Industry experts believe the transition from traditional telecommunications to software-based telecommunications represents a global unified communications annual market revenue opportunity of $40 to $50 billion.

CallWave is addressing the global collaboration and conferencing segment of the unified communications market. Based on historical data and growth trends, research firms Gartner Inc. and IDC estimate the collaboration and conferencing market will reach $4.8 billion globally in annual revenue and $3.4 billion in the U.S. in 2009, with global growth to $5.8 billion annually by 2012.

A number of macro-economic forces are driving growth in the online collaboration and conferencing market. Work groups and corporate organizational structures are being redesigned and formed around telecommuting. The new work style is characterized by the need to share ideas and work together instantly and easily from anywhere, anytime. Companies are supporting this new work style in addressing these forces:

- Globalization requires competitive companies and their employees to speak and collaborate with partners and customers anywhere around the globe as effectively as they do with parties that are physically located in the building down the street.

- The stagnant global economic conditions have necessitated corporate expense reductions, including reductions in travel and telecommunication expenses. Mobile professionals and enterprises are moving away from airplanes as a means of attending routine meetings, and are increasing investments in collaboration and conferencing technologies to meet corporate communication objectives more efficiently and cost effectively.

- Environmentalism is on the rise and, increasingly, the public considers corporate responsibility as fundamental to enterprise success there by placing emphasis on alternative communication solutions to eliminate travel and commuting time.

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Young knowledge workers who are predisposed to evolving technologies are entering the workforce. This cohort of workers is typically equipped with mobile-centric backgrounds and is accustomed to using real-time messaging and communication solutions such as IM in lieu of email.

Expanding mobile workforces require the expansion of non-traditional work environments. Collaboration solutions make it easier to work effectively and collaborate from any location, reducing the need to be in the office.

State legislative initiatives are being introduced to reduce congested freeways and dependency on energy there by placing emphasis on alternative communication solutions to eliminate travel and commuting time.

Company Overview

Historically we have offered several on-demand web telephony services and virtual fax services. Starting in the first quarter of our fiscal year ending June 30, 2009 we will be offering a new web collaboration service as well as mobile federated IM and presence services which we acquired in August 2008 when we purchased the assets of WebMessenger.

Our legacy services add features and functionality to the telecommunications services used by mainstream consumers and small and home offices and are provided on a free trial or subscription basis. Our Phone Companion Software (PCS)-based services are delivered on our proprietary Enhanced Services Platform, which allows subscribers to manage calls across their existing landline, mobile and Internet networks. Our services enable subscribers to receive, respond and manage calls or faxes on most communications devices without requiring them to purchase or install additional hardware, purchase additional telecommunications services, change their phone number, or switch their service provider. Calls can be accessed on a subscriber s handset, in email, or on the Internet. Our Enhanced Services Platform intercepts inbound phone and fax calls to our subscribers and is able to redirect these calls to the devices or access points selected by the subscribers using their existing telecommunications lines. In addition, the Enhanced Services Platform enables us to provide virtual phone and fax numbers to our subscribers who then can publish multiple phone or fax numbers for use with a single phone line. As of June 30, 2008, we had approximately 485,000 paying subscribers for our services. We currently view these services as strategic only to the extent they provide capital resources to fund our new web collaboration software. Our intent is to maximize cash flow from the legacy business and only invest in systems maintenance to keep these services running.

Our new web collaboration and messaging platform, which was launched on September 17, 2008, is called FUZE. FUZE is a browser-based solution that leverages our telephony foundation and enables enterprise-class, cross-platform collaboration, presence, real-time messaging and conferencing with unique features including high-resolution visuals, high-definition audio and synchronized video and imagery between browsers anywhere in the world. FUZE works with desktops, laptops and most smart phones. The target customers for FUZE are enterprises, small- and medium-enterprises (SMEs) as well as mobile professionals.

We believe that mobility is the key to collaboration. According to Gartner, Inc., today there are more than 4 billion mobile subscribers worldwide. About 25% of these are business professionals and about 10% of the worldwide mobile workforce uses their mobile device to dial-in to conferences every day. According to a recent survey published by Gartner, Inc., the virtualization of the U.S. workforce has grown by more than 800% in the last five years. While mobile endpoint devices have become the default device in the enterprise, enterprise investments in mobile communications have been minimal creating a gulf between office and mobile devices. Our product development strategy is aimed at bridging this chasm.

WebMessenger s technology offers a presence engine for all of CallWave s products and the ability to extend FUZE to endpoint devices such as mobile phones. At the same time WebMessenger integrates those endpoint devices into Microsoft s Office Communications Server (OCS). WebMessenger includes

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RSA-encrypted, enterprise-class, real-time messaging that integrates the corporate environment with the mobile user and extends desktop collaboration across all networks and platforms BlackBerry, Windows Mobile, Symbian, Palm, smartphones and iPhones. Interoperability among platforms with a mobile extension represents one of the major development hurdles in creating collaboration and conferencing solutions. WebMessenger is sold as an independent product line and has also been integrated into our FUZE web collaboration platform.

CallWave plans to offer several pricing packages and tiers that are designed to drive recurring, predictable and scalable economics via subscription-based pricing and traditional software licensing and maintenance agreements. Subscription-based pricing is an accepted form of pricing for Software-as-a-Service (SaaS) solutions for small, medium and enterprise business, as well as the small office and home office (SoHo) markets. With larger enterprise customers, CallWave plans to offer both subscription-based pricing and software licensing to further align its product offerings with traditional software-based buying disciplines and budgets.

CallWave s products will be distributed through direct corporate sales via the Company s sales force; online, web marketing sales; and third party distribution partnerships including resellers. FUZE is designed to be a multi-year lifecycle product. As CallWave grows its user-base, the Company plans to continue to develop enhanced versions and features of this product and cross-sell other future complementary products that it adds to its portfolio.

Services and Technology Architecture

We have designed and developed our technology architecture for our new unified communications software to satisfy the interactive communications requirements of a broad range of customers. We provide a number of on-demand web-collaboration services that don t require the users to download any software. Our web-collaboration services are delivered through a hosted model built on top of Amazon s EC2 cloud computing technology that will allow us infinite scalability without the need to invest in or build out data centers. By leveraging Amazon s EC2 architecture we can scale our capacity up or down depending on our customer demand, leverage their investment in secure architecture and focus on enhancing our core web collaboration and mobile software products.

Many of the features, including federated IM, conferencing and some video content, are available on the majority of today s smart phones. The mobile extensibility architecture consists of two components: the WebMessenger Mobile Server and the WebMessenger Mobile Client that can be loaded on the mobile handset over the air (OTA). The Mobile Server sits in the data center and provides a communication interface between Microsoft Office Communications Server(OCS) and mobile handsets as illustrated below.

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For organizations supporting RIM Blackberry devices, the Web Messenger Mobile Server also interfaces with the Blackberry Enterprise Server (BES). Each mobile device must run the WebMessenger Mobile Client. The client communicates with the WebMessenger Mobile Server using a proprietary WebMessenger protocol (i.e. not SIP based). Information passed between the client and the server contains the IM and presence information available within OCS.

Our Legacy technology is delivered by our desktop based Phone Companion Software (PCS) through our proprietary Enhanced Services Platform. Our wholly owned subsidiary Liberty Telecom, a competitive local exchange carrier (CLEC), provides us with proprietary call routing and switching technology. We have designed our call-bridging software to be highly configurable and flexible, enabling us to deliver customized services to each of our subscribers through a common software platform, and to quickly add or enhance applications and features to meet the evolving needs of the mainstream market. Our Enhanced Services Platform intercepts inbound calls from traditional landline, wireless and IP-based networks, manages and filters calls and delivers calls to our subscribers on landline telephones, mobile phones and personal computers. Our platform contains a number of component applications, or communications applets, which we bundle into customized services to address the unique needs of our different target markets. For example, our software allows subscribers who are using their landline telephones for Internet access to screen and accept telephone calls on other devices such as a mobile or landline telephone.

CallWave FUZE

We launched our new enterprise-class collaboration, presence and real time communications product called FUZE on September 17, 2008 in New York at the Web 2.0 Expo New York and Interop New York 2008 tradeshows. FUZE allows customers to meet online and bridges the gulf between the office and mobile devices. With FUZE, customers are now able to collaborate with clients and their teams instantly from anywhere and on any device. Meetings can be conducted from your desktop or mobile phone with High Definition (HD) quality and leverages proprietary synching technology that ensures that content is always in-sync across multiple connections and countries. Our new FUZE platform incorporates high fidelity conferencing and enterprise-class security and reliability. FUZE also integrates federated IM across all popular IM platforms, is presence enabled and syncs with Microsoft Outlook so meetings are easy to schedule and coordinate.

We plan to offer several pricing packages and tiers for our FUZE product line that are designed to drive recurring, predictable and scalable economics via subscription-based pricing and traditional software licensing and maintenance agreements. Subscription-based pricing is an accepted form of pricing for SaaS solutions for small, medium and enterprise business, as well as the small office and home office (SoHo) markets. With larger enterprise customers, we plan to offer both subscription-based pricing and software licensing to further align our product offerings with traditional software-based buying disciplines and budgets.

CallWave WebMessenger

CallWave acquired the assets of WebMessenger in August 2008 of this year for $9 million. WebMessenger s presence engine and federated IM technology has been integrated into our FUZE web collaboration product line which was launched on September 17, 2008. The Web Messenger product line allows the FUZE platform to extend collaboration to the mobile phone. We believe that it will be critical for web meeting and content providers to have an enterprise class collaboration solution that can be extended to the mobile endpoint devices. WebMessenger will also be sold as a stand alone product line to small and medium sized companies as well as enterprise customers. We plan on offering the following WebMessenger product lines:

WebMessenger Alerts. WebMessenger Message Alerts allows end users and group administrators to define custom filters and alert rules that are automatically applied to all incoming email, SMS messages, and phone calls. Message Alerts manages and controls communications on mobile business devices. The WebMessenger Alerts product will be sold in a standard, enterprise and compliance package, at various pricing tiers depending upon the number of users and architecture requirements.

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WebMessenger Mobile Voice. WebMessenger Mobile Voice works in conjunction with WebMessenger Mobile Enterprise Collaboration solutions to unify mobile (instant messaging) IM and (internet protocol) IP telephony within the enterprise environment, significantly enhancing real-time collaboration for mobile professionals, while dramatically reducing mobile phone costs. WebMessenger Mobile Voice simplifies IT deployment of mobile collaboration and IP telephony solutions. Mobile professionals can communicate from their mobile device in the same way they do from their desk. By combining mobile IM and voice in a single solution, an enterprise can extend its investment in real-time collaboration platforms from Microsoft, IBM and others, as well as investments in VoIP and IP PBX solutions. WebMessenger Mobile Voice will be sold as a premise, hosted and stand-alone package with various pricing tiers depending upon the number of users and architecture requirements.

WebMessenger Mobile. WebMessenger Mobile extends presence and secure enterprise class IM to the mobile phone. The solution is federated across all enterprise collaboration platforms and public IM networks including Microsoft OCS/LCS, IBM Lotus Sametime, Jabber/XMPP, Reuters Messaging, MSN Messenger, AOL Im, Yahoo IM, Google Talk, Skype and ICQ. The platform is optimized for all major mobile platforms including BlackBerry, Windows Mobile, Apple iPhone, Symbian and Palm. WebMessenger Mobile will be sold as both consumer and fully integrated enterprise solution with various pricing packages depending on the number of users and the architecture requirements.

CallWave Internet Answering Machine

Our CallWave Internet Answering Machine services have historically generated most of our revenues. These services extend the functionality of our subscribers existing telecommunications services by adding easy-to-use enhancements such as real-time voicemail, which allows subscribers to screen a message being left on their landline number from their mobile phone or their Internet-connected personal computer. Our landline services also include virtual telephone numbers that enable our subscribers to receive the benefits of a personalized or dedicated phone number routed to their existing telephone lines, without requiring additional physical phone lines to be installed. We do not plan to invest additional resources in this business. However, we view this business as a core asset that allows the Company to test new products and feature sets and importantly provides significant free cash flow that can be invested in our unified communications products.

We offer three principal levels of CallWave service:

CallWave Alert ($1.50 per month or $17.95 per year). CallWave Alert is our lowest-priced subscription level. Our CallWave Alert service delivers notifications of calls placed to any of our subscribers telephone numbers, even when those lines are not answered or are in use by sending a message to a device of our subscribers choosing.

CallWave Messenger ($5.95 per month). CallWave Messenger is our mid-level subscription, providing all of the features of CallWave Alert, as well as caller identification and delivery of voice messages, even when subscribers lines are in use or are not answered.

CallWave Connect ($7.95 per month). CallWave Connect is our most feature-rich and high-end service level currently offered. CallWave Connect service enables customers to screen, transfer or receive calls in real-time, and if they choose, interrupt the message to take the call. In addition, subscribers to CallWave Connect receive the benefits of a system that automatically creates a contact book based on the calls received and allows them to use our enhanced features to reply or call back to persons listed in their address book and to initiate text or voice communications to other persons as well.

CallWave Internet Fax

CallWave Fax utilizes the same Enhanced Services Platform to offer customers personalized fax numbers that send and receive faxes to the user s e-mail account. This provides greater flexibility to customers by allowing them to receive and print faxes from any location where they are connected to a personal computer and allows customers to keep an unlimited digital history of all faxes. We provide various pricing packages ranging from $7.95-$12.95 per month.

Callwave HD Audio Conferencing

Callwave HD Audio Conferencing service provides audio conferencing and allows participants to call in any way they want mobile, Skype or a landline from anywhere in the world all at competitive prices. HD Audio Conferencing allows users to visually manage conferences from a computer or smartphone with no software required. We provide various pricing packages ranging from $9.95-$19.95 per month.

CallWave Voicemail-To-Text

CallWave Voicemail-To-Text, launched January 2007, enables users to manage calls from multiple sources (i.e. PCs, and mobile and home phones), making available unlimited, searchable, easily archived digital voicemail. Voicemail-to-Text sends a copy of mobile phone voicemail messages to users email, enabling them to sort and prioritize, listen and respond to messages all from their email inbox. When not at the computer, users are notified of mobile voicemail messages via detailed text message, with the ability to sort messages, listen, pause, replay, save, delete or reply to the caller (via text or callback), all from their desktop. In January 2008, CallWave also launched Voicemail-to-Text for Apple products that have the look and feel of Apple operating systems. We provide various pricing packages ranging from $14.95-$49.95 per month.

CallWave Web 2.0 Widgets

Widgets are mini web applications that are very simple to download and highly cost-effective channels for delivering software and services to consumers whom we may not reach through other marketing channels. During the year, CallWave introduced SMS text messaging widgets in addition to the wireless industry s first visual voicemail widget. The visual voicemail widget enables users to view their list of wireless mobile voice messages on their desktop and then prioritize and listen to these messages. The SMS text widget allows desktop sending of text messages domestically within the United States. All widgets have access to a PhonePage described below. We distribute our widgets on popular galleries including Google, Apple, Yahoo!, Microsoft, and social networks. The widgets are currently free and will be used as a lead generation channel for our FUZE and WebMessenger products.

Our Strategy

CallWave s business objective is to become a leading provider of software solutions to enterprises, SMEs and mobile professionals with differentiated technologies and products that address the high-growth collaboration and conferencing segment of the unified communications market. We plan to achieve this objective through the following strategies:

Leverage CallWave s first mover advantage with its unique WebMessenger and FUZE collaboration and conferencing platforms. The Company s product lines offer differentiated features and address major development hurdles in the collaboration and conferencing market including providing platform agnostic mobile collaboration capabilities across devices, high-def audio, video and document sharing. With this first mover advantage, CallWave believes it is well positioned to become a leader in the collaboration and conferencing market.

Extend FUZE to mobile devices smartphones and business users. Integrating WebMessenger s presence-based technology with FUZE allows CallWave to offer FUZE to Mobile endpoint devices. With this unique capability, FUZE collaboration applications can be extended globally, securely and across platforms to mobile devices without downloading any software. FUZE is designed to work through any mobile endpoint device or personal computer (PC) screen and an IP connection, which

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means FUZE will be able to operate on most end-point devices including set-top boxes, gaming consoles and other platforms that are being developed and will be brought to market. CallWave plans to leverage FUZE s unique mobile extensibility, technology independence and platform agnostic abilities.

Establish global footprint through FUZE and WebMessenger rollout. CallWave s FUZE and WebMessenger product lines address growing global trends in collaboration and conferencing. With collaboration and conferencing solutions that extend RSA-encrypted, enterprise class applications to the mobile phone regardless of the platform, CallWave s products are designed to meet global demand.

Make strategic acquisitions that accelerate, enhance and/or defend CallWave s leadership position. CallWave s acquisition strategy is opportunistic and based on three criteria. The Company evaluates acquisition opportunities that it believes will generate additional subscribers or customers, provide unique technologies or capabilities, and/or help accelerate the Company s revenues and earnings growth.

Invest in future growth and current trends while controlling operating expense. In conjunction with its new product launches and to remain at the forefront of evolving technology, the Company expects to continue to invest in sales, marketing, and research and development in fiscal 2009. CallWave operates software teams in Silicon Valley, California and Sofia, Bulgaria.

Scale technology using cloud computing and virtualization. CallWave plans to use cloud computing to scale its business without incurring traditional costs that are associated with growth of operations. Cloud computing and virtualization provide computer networking and storage services for business customers. It can also eliminate a company s need for its own data center and allows business to pay for bandwidth on an on-demand basis.

Our historical business has been a traditional direct-to-consumer dial-up business with an Internet voicemail application that ensures subscribers won t miss calls while on line with their dial-up connection. Our legacy business includes approximately 485,000 subscribers.

The customer base for our legacy products has been declining. At this time we do not plan to invest additional resources in our legacy business. However, we do expect to maintain the legacy infrastructure and limited advertising to drive profitable new subscribers to our legacy businesses. We view the legacy business as a core asset that allows us to test new products and feature sets and provide significant free cash flow that can be invested in our new line of unified communications products. We expect that over time sales of our new products will mitigate the impact of declining revenue from our legacy business.

Customer Support

Support is provided to customers at all stages of their experience with us through our client software, email and telephone. Email inquiries and help requests are generally responded to within 24 hours, while telephone inquiries are handled through a toll-free number during normal business hours. Our customer support representatives have direct access to customers account information and can change service configurations for customers in real-time.

Our customer care staff services the customer email and telephone support load. The customer care workforce is augmented with additional agents from third-party call center operations trained for, and dedicated to, supporting our product lines.

Sales and Marketing

Historically, we sold our services directly to consumers through our web channel or on a private label basis through our carrier channel. The majority of our legacy product sales to date have been through our web channel.

We will reach customers for our new FUZE and WebMessenger products through a variety of sales and marketing channels. We will continuously analyze and re-evaluate our sales and marketing strategies to ensure we are effectively reaching out to our target markets. Our primary sales and marketing channels will include:

Internet advertising. We use a number of different Internet advertising relationships and channels to reach our potential customers. We typically pay fees to our Internet advertising vendors, based principally on the number of website visitors. Internet advertising will be used to acquire paying customers for our FUZE and WebMessenger products as well as drive leads to an inside sales team.

Channel relationships. We have commercial relationships with Hawaiian Tel, Century Tel, and EarthLink under which they resell our legacy Internet Answering Machine services to their customers on a co-branded basis. We also maintain channel relationships with several smaller service providers who resell our Internet Answering Machine product line. Our goal will be to work with channel partners and systems integrators to distribute our new FUZE and WebMessenger product lines.

Direct Sales Force. We have started to build a direct and inside sales force. Our direct sales force will focus on building relationships with large enterprise accounts, channel partners and systems integrators. Our inside sales force will concentrate on leads provided to us through online marketing and our free product lines to generate sales into small-and medium-size business.

Customers and Channel Relationships

Customers

From April 2001, when we first introduced our paid services, through June 30, 2005, our subscriber base increased dramatically. Over the last two years we have experienced the expected churn in our traditional business as subscribers move away from dial-up services as an access medium for the Internet to faster more reliable broadband services. For our fiscal year ended June 30, 2006 we had 706,000 paying subscribers. During fiscal year 2007, as expected, our paid subscriber base decreased by 11% to 631,000 and in our fiscal year 2008 our customer base decreased by 22% to 485,000. As of June 30, 2008 we had not launched our new FUZE product line and therefore had no paying customers on this service.

Infrastructure and Operations

Infrastructure

We have developed a sophisticated subscription billing system that supports free trials, monthly and prepaid annual plans, installment payments and configurable packages and price points. We bill our subscribers directly, in which case they pay either by check or credit card, or indirectly through regional and national service providers.

All subscriber data is stored in SQL Server databases. We store and analyze aggregate subscriber data to understand trends and subscriber behavior. This data is not currently shared with any other party, except for the express purposes of service provisioning, billing and legal compliance, and is not sold to any other party.

Operations

Our operations group manages our system and service deployments and upgrades, facility build-outs, network architecture, physical and network security, data redundancy and availability, system health monitoring, data logging, capacity planning, disaster planning, interaction with telecommunications technical staff and general troubleshooting. These facilities are only associated with our legacy lines of business and the staff associated with maintaining these locations have been significantly reduced over the last 12 months.

Our wholly-owned subsidiary, Liberty Telecom, operates telecommunications switching equipment and other facilities in Reno, Nevada. Our Reno facility is built using a highly-redundant architecture to enhance the

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reliability and availability of our services. We have a backup co-location site in Las Vegas, Nevada which provides geographic redundancy. At this time all services are redundantly hosted in this facility.

Our web-collaboration services are delivered through a hosted model built on top of Amazon s EC2 cloud computing technology and require very little Network Operations Center support.

Liberty Telecom

Liberty Telecom, LLC, a Delaware limited liability company, is our wholly-owned subsidiary. Liberty Telecom is a competitive local exchange carrier (CLEC) and is subject to the jurisdiction of both the Nevada State Public Utilities Commission, or Nevada PUC, and the FCC. Liberty Telecom has received approval from the Nevada PUC to operate as a Local Exchange Carrier, or LEC. This LEC approval enables Liberty to provide local exchange and intrastate exchange access telecommunication services to end user customers and long distance carriers and other consumers of exchange access service. Under federal law, Liberty Telecom provides interstate exchange access services under blanket authority granted by the FCC in its rules. As a local exchange carrier, Liberty Telecom maintains a tariff for interstate access charges on file at the FCC, has obligations to make periodic payments to the federal and state universal service funds, file periodic reports on its utilization of numbers, and is subject to the general laws and regulations of both Nevada and the United States applicable to telecommunications carriers, including the obligation to provide services that are just, reasonable, and non-discriminatory.

Our legacy services were designed to allow customers, when they are connected to the Internet on a dial-up connection, to receive a notice that someone is calling them, as well as to give them the opportunity to take that call. In order to provide this capability, we need to have local circuits terminating at our center in Reno, Nevada that carry the calls, which have been redirected and forwarded to our center over toll-free lines. Liberty Telecom provides us with those local connections for receiving the call-forwarded traffic. In addition, if, after screening a call, a subscriber wishes to take the call, we need a carrier to carry the local portion of the traffic to the device on which the customer will receive the call. Liberty provides us with the telecommunications services that support that need.

In addition to using its own facilities to provide telecommunications services, Liberty Telecom also has Interconnection Agreements with SBC/Nevada Bell and Sprint in Nevada under which Liberty Telecom can exchange traffic with these carriers, obtain services, lease facilities, and collocate its own facilities, as necessary, in order to provide its own telecommunications services.

Our ownership of Liberty Telecom provides us with several benefits associated with our legacy Internet Answering Machine and Virtual Fax lines of business, including the following:

Liberty Telecom saves us money because it is able to connect calls directly with other telecommunications carriers as a peer, often at little or no charge from the other carriers. Because the wholesale rate given to a peer carrier is lower than the lowest rate given to a non-peer customer for certain types of purchased telecommunication services, our ownership of Liberty Telecom allows us to reduce substantially the access facilities charges we otherwise would pay.

Liberty Telecom provides us a reliable source of telephone numbers, which we need in order to provide services to our subscribers. Unrelated telecommunications service providers would not be as reliable a source of telephone numbers, as they have a limited supply of telephone numbers and may allocate their available numbers to other companies rather than to us.

Liberty Telecom increases the reliability of our services to our customers by providing us with interconnections to the carriers that host the inbound and outbound telecommunications services used by our subscribers. This allows us to identify and resolve service problems far more quickly and effectively than we would be able to achieve if we were to obtain these interconnections from unrelated service providers, and reduces the number and extent of service disruptions that our customers encounter.

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Research and Development

We believe it is essential to have a strong research and development team in order to respond rapidly to market needs with a high degree of quality, reliability and scalability. Our research and development team follows a formal development process that has been refined to meet our objectives and minimize post-deployment maintenance. We have leveraged the acquisition of WebMessenger and consolidated most of our research and development resources to Sofia, Bulgaria.

Our research and development expenditures were $5,125,000, $7,178,000, and $6,805,000 for the fiscal years ended June 30, 2008, 2007 and 2006, respectively.

Competition

The market for our products and services is increasingly competitive, evolving rapidly and is subject to shifting customer needs and introductions of new products and services. Our current and potential competitors approach the market from different areas of expertise and vary in size and scope with respect to the products and services that they offer or may offer in the future.

Within our legacy product set we face competition from providers of enhanced services and products, such as answering machines, voicemail, Internet call waiting, and virtual telephone numbers for fax or voice communications. The companies that compete in these areas include Avaya, AOL, Protus IP Solutions, Ring Central, and j2 Global Communications, or j2. For example, Avaya enables telecommunications service providers to offer voice messaging enhanced services to their customers. j2 offers fax services that provide users local fax and voicemail numbers, and the ability to send faxes from the user s computer desktop as well as to receive faxes as email attachments, optical character recognition of incoming faxes, and the ability to listen to voicemail. Those services compete with our enhanced services and fax service offerings. Protus IP Solutions enables online fax by email, using existing email accounts and the Internet to send and receive faxes without a fax machine. Some of those services compete with our fax service offerings.

Within our legacy product lines we face competition from Internet service providers such as AOL, Google, MSN, AT&T WorldNet, and United Online, which are increasingly integrating enhanced functionalities with their basic services. AOL offers an enhanced communication application that includes such services as caller ID, caller name and location, incoming call management technology, telemarketer blocking, ability to listen to messages while online, call log of missed calls while online, ability to answer calls while user is online and voicemail for unanswered incoming phone calls. AOL markets its service offerings primarily to customers that already subscribe to AOL s Internet access services, though its service offerings also are available to non-AOL users.

Within our legacy product lines we face competition from telephone service providers such as the regional Bell operating companies and cable access providers. These competitors are increasingly integrating enhanced functionalities with their basic services. For example, BellSouth offers an Internet call waiting service that competes with our service offerings. The product includes caller ID, caller name, incoming call management technology and voicemail for unanswered incoming phone calls. BellSouth markets its product primarily to its residential telephone user base, though its service is not presently available in all BellSouth service areas.

Further, within our legacy base we face competition from primary line displacement vendors which are competing with telephone service providers. These competitors include Vonage, AT&T CallVantage, 8X8, and Net2Phone, and are offering enhanced services with their basic telephone services. For example, Vonage offers local and long-distance telephone services for consumers and small businesses. Each of these plans includes features such as voice mail, caller ID, caller name, call waiting, call forwarding, and three-way calling. Vonage also offers other options at an additional cost, including a dedicated fax line and additional phone numbers. These services are marketed to users with high-speed Internet access and compete directly with our service offerings to those same users.

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We compete with all of the above companies for a share of the monthly telecommunications and information services spending of our target market. Historically, we have differentiated ourselves by offering services that are independent of the underlying network infrastructure and, hence, enabling subscribers access to enhanced communication services without changing their service providers, phone number, or purchasing new equipment. However, as we have indicated in our strategy section, the customer base for our legacy products has been declining. At this time we do not plan to invest additional resources in our legacy business. However, we do expect to maintain the legacy infrastructure and limited advertising to drive profitable new subscribers to our legacy businesses. We view the legacy business as a core asset that allows the Company to test new products and feature sets and importantly provide significant free cash flow that can be invested in our new line of unified communications products. We expect that over time sales of our new products will mitigate the impact of declining revenue from our legacy business.

Although we had not entered the web collaboration, conferencing and messaging market at year end we had signaled our intent to enter these markets. As of the filing of this document we have launched our new FUZE and WebMessenger platforms at the Web 2.0 and Interop conferences in New York that were held on September 17, 2008. This market is intensely competitive, subject to rapid change and is significantly affected by new product and service introductions and other market activities of industry participants. This market is also currently dominated by companies that are significantly larger than us and have greater capital resources. Although we believe we are launching new and innovative technologies there is no guarantee that we will be successful with the launch of our new platforms within the web conferencing, collaboration and messaging space. Although we have significant resources, if we are not successful with our new product launches we might not have enough time to launch a new strategy and might be forced to sell the company for its technology and remaining capital. Although our new products do not currently compete against any one entity with respect to all aspects of our services, we do compete with various companies with respect to specific elements of our collaboration and mobile services. For example, we compete with providers of traditional communications technologies such as teleconferencing and videoconferencing, application software and tools companies including online application services providers, and web conferencing products and services such as Adobe Systems, Cisco Systems, Citrix Systems, Genesys S.A., IBM, Microsoft, Netviewer, NTR Global, and Saba. While there are established players in this market there are new entrants coming into this space at a rapid pace. Some of the recent new companies that offer some of the same functionality as we do include Yugma, DimDim and Jabber.

Competition from Microsoft for the collaboration software and services markets may adversely affect us as we launch our new product set and try to gain market share in this space. Microsoft has a product offering which is competitive with ours and which is called Microsoft Office Live Meeting. Microsoft also has an offering called Office Live, which consists of a set of Internet-based software services. Microsoft s new operating system, Windows Vista, includes a real-time web meeting feature, for up to ten persons, and related collaboration functionalities such as document sharing. Microsoft s investment of development and marketing resources in products or services that compete directly with us and Microsoft s integration of competitive technologies acquired from other companies may have an adverse impact on our business. More generally, Microsoft may attempt to leverage its dominant market position in the operating system, productivity application or browser markets, through technical integration or bundled offerings, to expand further its presence in these web collaboration markets. This expanded Microsoft presence in web collaboration markets could make it difficult for other vendors of web collaboration products and services, such as CallWave, to compete.

In addition, some competitors offer web collaboration products and services targeted at customers who are more price-conscious and are less concerned about functionality, scalability, mobile phone applications, integration and security features. Such offerings may make it difficult for us to compete in this segment of the market. Finally, some of our competitors such as IBM and Cisco offer software products or products that are a combination of software and hardware that include web collaboration functionality. This type of web collaboration offering, sometimes called a customer premise or on-premise solution, allows customers to purchase such products, install them at their own facilities, and manage the products by themselves. If significant numbers of existing or potential customers determine that they would prefer to have their web conferencing or

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more advanced web collaboration needs met with these types of products, the perceived potential demand for CallWave services would decrease.

We believe that the principal competitive factors in our market include:

- service functionality, quality and performance;
- ease of use, reliability, scalability and security of services;
- the ability to support and synchronize high definition video and content over multiple locations
- extensibility to the mobile phone with integration into Microsoft s OCS platform and the ability to support multiple handset operating systems
- ability to introduce new services to the market in a timely manner;
- ability to integrate with third-party offerings and services; and
- pricing.

Although we believe our services will compete favorably with respect to many of these factors, the market for our services is relatively new and rapidly evolving. We may not be able to achieve a competitive position against current and potential competitors, especially those with greater resources such as IBM, Microsoft, Cisco Systems, Citrix Systems and Adobe Systems.

Intellectual Property

Our success is dependent in part upon our ability to develop and preserve our technology and to operate our business without infringing on the proprietary rights of others. We rely on a combination of patents, trademarks, domain name registrations, trade secret laws and contractual restrictions to enforce our rights in our intellectual property. We seek to limit disclosure of our intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements. While the protection of our intellectual property is important to our business, because of the rapid pace of innovation within the web collaboration, instant messaging, presence and telecommunications and information services industries, we believe that factors such as the technological and creative skills of our personnel, our focus on our subscribers needs and timely and effective customer support are more important to the success of our business.

We currently have 11 issued patents. Our patents are in several areas including internet call waiting systems, call screening, caller availability, mobile payment systems and caller identification. We currently have over 54 patent applications pending in the United States Patent Office. We may seek additional patents in the future. We cannot guarantee that patents will be issued from pending or future applications or that, if patents are issued, they will not be challenged, invalidated or circumvented, or that any rights granted there under will provide meaningful protection or other commercial advantage to us. Moreover, we cannot guarantee that any patent rights will be upheld in the future or that we will be able to preserve any of our other intellectual property rights.

Third parties may infringe or misappropriate our patents or other proprietary intellectual property rights such as copyrights and trademarks. When we become aware of such infringement, we may take action including bringing legal action against such parties. Conversely, we may be subject to claims of alleged infringement of patents and other intellectual property rights of third parties. In addition, we may be unaware of filed patent applications which have not yet been made public and which relate to our services. From time to time, we have received notices alleging that we infringe intellectual property rights of third parties. In such cases, we investigate the relevant facts, respond to the allegations and, where case facts and other conditions warrant, consider settlement options. Also, while we have a significant amount of intellectual property around internet telephony we currently have no issued patents in the web collaboration and conferencing space. We currently have pending patents around video collaboration and syncing and instant messaging protocols, however, these applications will not be useful in defending us against infringement claims in the internet collaboration and conferencing space.

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We hold several registered trademarks in the United States, including a registered mark on the phrase Internet Answering Machine , the name CallWave, and on a stylized service mark for CW. After the end of the year ending June 30, 2008 we also applied for the trademark FUZE and acquired the rights to the trademarks for WebMessenger and Syncview.

We license intellectual property from third parties and incorporate such intellectual property into our services. These relationships are generally non-exclusive and have a limited duration. Moreover, we have certain obligations with respect to non-use and non-disclosure of such intellectual property. We cannot guarantee that the steps we have taken to prevent infringement or misappropriation of our intellectual property or the intellectual property of third parties will be successful.

See the sections titled Risk Factors We may not be able to protect and enforce our intellectual property rights, which could impair our ability to compete and reduce the value of our services, and Other persons may assert claims that our business operations or technology infringe or misappropriate their intellectual property rights, which could increase our costs of operation and distract management and could result in expensive settlement costs.

Employees

As of June 30, 2008, we had 49 full-time employees: 16 are in research and development, 15 are in operations and customer care, 8 are in sales and marketing and 10 are in general and administrative functions. None of our employees are covered by collective bargaining agreements.

Item 1A. Risk Factors

We are moving into markets that are intensely competitive, subject to rapid change and are significantly affected by new product and service introductions and other market activities of industry participants.

The web collaboration, conferencing and messaging markets are currently dominated by companies that are significantly larger than us and have greater access to capital resources and new technologies. Although we believe we are launching new and innovative technologies there is no guarantee that we will be successful with the launch of our new platforms within the web conferencing, collaboration and messaging space. Although we have significant resources, if we are not successful with our new product launches we might not have enough time or resources to launch a new strategy and might be forced to sell the company s technology and remaining capital. Although our new products do not currently compete against any one entity with respect to all aspects of our services, we do compete with various companies with respect to specific elements of our collaboration and mobile services. For example, we compete with providers of traditional communications technologies such as teleconferencing and videoconferencing, application software and tools companies including online application services providers, and web conferencing products and services such as Adobe Systems, Cisco Systems, Citrix Systems, Genesys S.A., IBM, Microsoft, Netviewer, NTR Global, and Saba. While there are established participants in this market there are also new entrants coming into this space at a rapid pace. Some of the recent new companies that offer some of the same functionality we offer include Yugma, DimDim and Jabber.

Competition from Microsoft for the collaboration software and services markets may adversely affect us as we launch our new product set and try to gain market share in this space. Microsoft has a product offering which is competitive with ours and which is called Microsoft Office Live Meeting. Microsoft also has an offering called Office Live, which consists of a set of Internet-based software services. In January 2007, Microsoft began selling its new Windows Vista operating system which includes a real-time web meeting feature for up to ten persons and related collaboration functionalities such as document sharing. Microsoft has also announced plans to offer web collaboration functionality in its Office Communications Server product scheduled for release later in 2007. Microsoft s investment of development and marketing resources in products or services that compete directly with us and Microsoft s integration of competitive technologies acquired from other companies may have an

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adverse impact on our business. More generally, Microsoft may attempt to leverage its dominant market position in the operating system, productivity application or browser markets through technical integration or bundled offerings to expand further its presence in these web collaboration markets. This expanded Microsoft presence in web collaboration markets could make it difficult for other vendors of web collaboration products and services, such as CallWave, to compete.

In addition, some competitors offer web collaboration products and services targeted at customers who are more price-conscious and are less concerned about functionality, scalability, mobile phone applications, integration and security features. Such offerings may make it difficult for us to compete in this segment of the market. Finally, some of our competitors such as IBM and Cisco offer software products or products that are a combination of software and hardware that include web collaboration functionality. This type of web collaboration offering, sometimes called a customer premise or on-premise solution, allows customers to purchase such products, install them at their own facilities, and manage the products by themselves. If significant numbers of existing or potential customers determine that they would prefer to have their web conferencing or more advanced web collaboration needs met with these types of products, the perceived potential demand for CallWave services would decrease.

Our ability to successfully market and distribute our new WebMessenger and Fuze services is dependent upon our ability to market and sell these services to enterprise customers rather than consumers.

We built our business around the marketing and distribution of our legacy IVM service to consumers, using the marketing and sales outlets that are effective in reaching those customers. In order to successfully market and sell our newer WebMessenger and Fuze services, we must employ the personnel and skills required for marketing and selling those services to business enterprises, which will be the primary purchasers of those services. The skills required in order to successfully market and sell to such enterprise customers is different from the expertise that we developed in selling to consumers. Therefore, we must attract and retain qualified personnel who have those skills, and learn to manage the marketing and sales process for such enterprise customers. If we are not able to find appropriately skilled personnel, or to manage their efforts effectively, then we may not be able to successfully deploy these new services. In that event, we would not realize the full sales potential from these new services, and our results of operations and stock value likely would be adversely affected.

We have limited intellectual property protection for our newer service offerings.

We have limited intellectual property protection for our new WebMessenger and FUZE service offerings. As a result, we may not be able to foreclose other service providers from offering services that mimic and compete directly with these new service offerings. Consequently, we may not be able to create a revenue stream that we could protect by asserting infringement claims against third parties that mimic our service offerings. While we plan to pursue appropriate intellectual property protections for our services, there can be no assurance that we will obtain such protections or that we can assert any such intellectual property rights in a manner that impedes competitors from capturing a portion of the market demand that we may create with our new services. If that occurs, then we may have limited success in capturing market share, we may not be able to generate significant recurring revenue from our new service offerings, and the value of our company will be negatively affected.

We may suffer losses from operations and reduce our accumulated cash reserves as we shift resources from our profitable direct distribution business and focus our business and investments on indirect distribution of our services.

We have elected to reduce the amount of resources that we are devoting to our traditional business in which we had marketed and distributed our services directly to users, and instead to expand the resources that we are

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investing in the development and marketing of our services through indirect distribution arrangements. As a result, we expect to realize lower revenues from our traditional business. However, we do not expect to begin generating substantial revenues from indirect distribution arrangements for at least several quarters. That delay in generating substantial revenues is attributable to a number of factors, including the time period required to develop indirect distribution relationships, the time required to implement technological changes to our services in order to make them compatible with the communications infrastructure of service providers with which we enter into indirect distribution relationships, and the time required to successfully market our services to their customers and persuade those customers to subscribe for our services. As we undergo this transition from a business based upon our traditional landline services sold directly to the consumer, to one based primarily upon the delivery of services through indirect distribution relationships, we are likely to realize losses from operations and reduce our accumulated cash reserves.

Our ability to successfully implement indirect distribution arrangements is dependent upon our ability to integrate our technology with that of the companies that distribute our services.

In order for our indirect distribution arrangements to be successful, the companies with whom we enter into indirect distribution arrangements must be able to integrate our services with their own service offerings. That integration process requires that our technology operate effectively with the service platforms from which those companies deliver services to their customers and meet the technical specifications and operating parameters imposed by companies with which we are seeking indirect distribution relationships. The integration of our services with the service platform of those other companies is a complex process that requires not only that our respective technology platforms operate together, but also that our engineering departments work effectively together at a technical level in integrating our respective services. Those tasks require time, and we may encounter technical difficulties that occasion delay. We also may encounter some technical difficulties that adversely affect the customer s ability to fully utilize our services or even our ability to integrate our services at all. If we are unable to overcome those challenges, then our indirect distribution strategy may be adversely affected, and we may not be able to achieve the revenue and profitability gains that we are seeking to achieve.

The use of indirect distribution arrangements may cause us to realize lower revenues and profitability than we traditionally have realized from direct web distribution of our services.

We expect that the principal growth in subscribers will come primarily from the implementation of indirect distribution arrangements. While these arrangements typically deliver subscribers to us at a lower subscriber acquisition cost than our traditional sources of subscribers, they also tend to generate a lower average revenue per user, or ARPU, than the traditional direct web channel sources of subscribers. In order to achieve substantial future revenue growth from these indirect distribution arrangements, we will need to implement indirect distribution arrangements that afford us broad exposure to significant numbers of potential subscribers, and we will need the other parties to those arrangements to cooperate with us in distributing our services to their customers. If we are unable to accomplish those objectives, then we may not achieve future revenue growth, and our results of operations will be adversely affected.

Our ability to successfully implement indirect distribution arrangements and custom integrate our technology with that of the service providers that distribute our services may cause us to reduce our ability to innovate in our direct web channel.

In order for our indirect distribution arrangements to be successful, the companies with whom we enter into indirect distribution arrangements require custom features, unique network integrations and branding. That integration process requires development from our engineering team. Given limited engineering resources, our ability to rapidly innovate and deliver competitive new services in the direct web channel may be reduced.

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Because we are unable to predict with precision the rate at which we will acquire paying subscribers for our services through the indirect distribution relationships that we will be emphasizing, our results of operations may be correspondingly less predictable, our stock price therefore may be more volatile, and our stockholders may suffer losses.

From our traditional business, which involved the direct marketing and distribution of our services to customers in the web channel, we have assembled a substantial amount of data that allowed us to predict our subscriber counts, revenues, and profits in that legacy business with some reliability. As our business increasingly emphasizes the delivery of our services through indirect distribution relationships, however, we will be operating without historical data that would allow us to predict with any precision the rate at which our services will be accepted by consumers or the prices at which consumers may be willing to subscribe for those services. Consequently, we may experience significantly greater swings in our revenues and profitability than in the past, our stock price may become increasingly volatile, and our stockholders may realize losses in the value of their shares.

If service providers elect to bundle services similar to ours that they obtain from other providers or to develop such services themselves as part of their product offering, we could lose many of our paid subscribers.

The market for communications and information services is competitive, and many service providers attempt to attract and retain subscribers by offering a variety of services. While service providers that provide Internet call waiting and call management services generally impose a separate charge, those service providers may in the future bundle such services with their other service offerings, thereby effectively offering these services for no incremental fee. If we lose subscribers to those network service providers that bundle services that are competitive with ours and we are unable to find replacement subscribers willing to pay for our services, our business, revenues and profitability would be adversely affected.

Increased marketing costs for Internet advertising may cause further erosion in our traditional landline business.

Our subscriber acquisition costs for our traditional land-line customers are dependent largely upon our ability to purchase multiple types of advertising at a reasonable cost. Our advertising costs vary over time, depending upon a number of factors, some of which are beyond our control, such as seasonality, the particular mix of advertising we use and the rate at which we convert potential subscribers into paid subscribers, and consolidation among companies that control advertising channels. We have experienced an increase in subscriber acquisition costs in the recent periods. Given our belief that our revenues from our traditional landline business will decline over time, we have decided not to increase the amount of money that we spend on Internet advertising for our landline services. As a result, we are realizing both reduced marketing expenditures and a higher unit cost for the advertising services that we purchase. We expect that those two factors will occasion an acceleration in the decline of our landline business over time.

New Internet-based distribution channels are emerging for the types of services we offer direct to the consumer which may cause an increase in our marketing costs.

Widgets and Gadgets have introduced a new, low cost distribution channel for direct-to-consumer web services such as voicemail and other call management services. If we fail to establish a position in this new channel it may impact our ability to acquire customers for our services unless we increase our marketing costs.

We are dependent upon billing arrangements with regional telephone companies for collecting fees from many of our subscribers.

We currently collect the majority of our revenues through billing arrangements in which our subscribers local telephone companies bill and collect our service fees from our subscribers on our behalf and forward those

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fees to us. We collect the remainder of our revenues through our subscribers credit cards and checks. If the telephone companies terminated those billing arrangements, or if the cost of those arrangements increased significantly, we may be unable to continue to collect a significant portion of our revenues in this manner, and instead would have to collect those revenues through use of subscribers credit cards, by having subscribers mail checks to us, or by other means. Because many subscribers prefer to pay for our services through their telephone bills, any need to rely upon alternative means to collect a significant portion of our revenues may lead to a loss of a substantial portion of the subscribers who currently pay for our services as part of their monthly bill from their telephone company, a decline in the rate at which we increase the number of our paid subscribers, or significant delinquencies in payments by our subscribers. If we are not able to successfully manage and maintain these billing relationships, our bad debt reserves may increase and we may lose subscribers that prefer paying for our services on their local telephone bill.

Customer billing is a highly complex process, and our billing system must efficiently interface with third party systems. Our ability to accurately and efficiently bill our subscribers is dependent on the successful operation of the third party systems upon which we rely and our ability to provide these third parties the information required to process transactions. Any failures or error in our current billing systems or procedures or resulting from any upgrades to our billing systems or procedures could materially and adversely affect our business and financial results.

If we fail to maintain effective internal financial and managerial systems and procedures, our results of operations may be adversely affected.

As we expand our operations and offer new services, there is a risk that our systems and procedures may not be adequate to support our operations or ensure proper identification of and proper accounting treatment for our activities. Our failure to maintain and implement such adequate systems and procedures could adversely affect the information on which we base our decisions, thereby causing us to make inappropriate business decisions. Those incorrect decisions in turn, could adversely affect our business, financial condition, and results of operation.

We face competition in our legacy business from well-capitalized hardware vendors, software vendors and service providers against whom we may not be able to successfully compete.

Competition in the communications and information services industries is intense. We face competition for our offerings from Internet service providers, such as AOL, landline and wireless telephone companies, such as AT&T, cable companies and other communications hardware, software and services vendors. These companies are better capitalized, have greater name recognition and significantly larger existing subscriber bases than we do. We may also face competition in the future from communications hardware and software companies that are currently focused on other markets. If these or other companies provide services similar to ours, we may not be able to compete effectively, which would harm our results of operations and financial condition.

There are limited barriers to entry for other companies to provide services that compete with ours.

Telecommunications services were historically provided by companies that made substantial capital investments in their networks. The size of those investments and the time required to deploy those networks served as significant barriers to entry into such markets. In contrast, we provide software-based enhanced services that do not require substantial capital expenditures to deploy and maintain. As a result, other companies with strong technical staffs and knowledge of the communications and information services industries could compete with us without facing significant capital expenditures or other barriers to entry. As a result, we may face increasing competition from companies with significantly greater resources than we have, which may force us to reduce our prices and increase our operating expenses to remain competitive. If we are not able to compete successfully with these companies, we may lose customers or fail to grow our business as we anticipate, either of which could harm our financial condition, results of operations and future growth prospects.

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We rely upon the networks of numerous long-distance and local carriers to provide services to our subscribers. If the cost of these services were to increase, we may not be able to profitably provide our services to our subscribers.

In providing services to our subscribers, we incur a number of underlying telecommunications costs which are beyond our control. Our services rely in part upon the toll-free long-distance and local services that we purchase from network service providers. In order to deliver our services to our subscribers, our customers also must subscribe to certain ancillary services from their telecommunications providers that re-route certain telephone calls from our subscribers telephone lines to toll-free numbers that we have leased at our software-based switching facility, which facilitates the receipt of the call by the number that the subscribers designate. The cost of services, which we integrate into our service offerings, or which subscribers assume directly, in order to receive our services is beyond our control and may increase for a number of reasons, including:

a general increase in wholesale long-distance rates or charges for call forwarding services;

an election by service providers to implement a new pricing structure on the services that we currently purchase;

an election by third-party service providers to impose charges for services which are currently toll-free; and

an increase in subscriber usage patterns that increases the cost of the services that we purchase.

Our ability to offer services to our subscribers at competitive rates is partially dependent upon our ability to use that toll-free telephone network and our subsidiary s ability to procure telephone network access and services on a reliable basis and at reasonable prices. If we are unable to effectively manage the cost of our underlying network services, then our pricing structure with a significant number of our subscribers would increase, which could make it difficult to conduct business at attractive margins**.** Similarly, if the costs of the ancillary services which our subscribers must purchase from their telecommunications providers in order to receive our services were to increase, then our services may become less attractive to our existing and prospective customers, and we may lose subscribers which would adversely affect our revenues, our prospects for growth, our operating results, and our financial condition.

There are a limited number of long-distance and interconnection service providers that are able to provide the services on which we rely.

We currently have contracts with four service providers for long-distance services, and our wholly-owned subsidiary, Liberty Telecom, LLC also has interconnection agreements with other telecommunications companies, which together provide us with services that we integrate into our enhanced offerings. Each of those contracts may be terminated without cause by the service provider upon advance written notice. The required notice period, in each instance, is less than the amount of time that we would likely need to negotiate a contract with a successor provider and modify our system to re-route our subscribers inbound calls to that successor s network. In addition, there are only a limited number of service providers with which we can contract to provide these services. As a result, if one or more of the service providers from which we currently procure long-distance or interconnection services were to terminate our existing contractual relationships, we may not be able to locate a substitute provider on a timely basis and upon reasonable terms, if at all, in order to avoid a disruption or loss of service to our subscribers. If we are not able to purchase access to sufficient long-distance and interconnection services at reasonable prices, we may not be able to profitably provide our services to our subscribers and our operating results and financial condition would be harmed.

We rely upon the Internet and other networks controlled by third parties to provide our services and if we are not able to maintain access to these networks at reasonable rates, we may not be able to profitably provide our services.

We provide our services by integrating and enhancing underlying services on other companies networks that rely on the public switched telephone network, across the private networks constructed and owned by other

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companies such as those in the cable industry, and across the Internet. If the owners of any one or more of those networks were either to refuse to transport calls to our subscribers, or were to impose significantly higher charges for those calls, or if applicable regulations were to impose significantly higher charges for those calls, we would likely face increased operating costs, our profitability could suffer and our business could be harmed.

Because a significant portion of our subscribers to our legacy business are price sensitive, we may not be able to increase the charges for our services without adversely affecting our ability to attract and retain paid subscribers.

Our subscribers are generally price sensitive. In response to that sensitivity, we have attempted to control our costs in order to be able to charge low subscription rates for our landline services, which generally range from $1.50 to $7.95 per month, and are as high as $12.95 per month in limited circumstances. We expect that recruiting new subscribers may become more expensive on average if we increase our marketing efforts. If we experience significant cost increases or otherwise want to increase our margins, we may be unable to increase our monthly charges by an amount sufficient to allow us to maintain margins or our profitability, and our business and operating results could be adversely affected.

We are dependent upon the availability of reasonably priced call-forwarding services to provide our services to the majority of our subscribers in a cost-effective manner.

Customers who subscribe to certain of our services typically subscribe to call-forwarding services from their local telephone service provider. Generally, these call-forwarding services are available to our subscribers at a reasonable price. If the service providers do not provide these services at a reasonable price, the overall price of obtaining our services may exceed the amount that our current and potential subscribers are willing to pay. If the prices for these services increase, a significant number of our subscribers may terminate their subscriptions for our services, which would have an adverse effect on our revenues, operating results, financial condition, and prospects for growth.

Customers who subscribe to certain of our services typically configure call-forwarding services from their wireless provider. Generally, these call-forwarding services are available to our subscribers at no additional charge. If the wireless service providers do not provide these services at a reasonable price, at all, or exclusively to another enhanced service provider, our ability to provide some of our services may not be practical. If the prices for these services increase or are no longer available, a significant number of our subscribers may terminate their subscription for our services, which would have an adverse effect on our growth potential.

We are dependent upon the availability of reasonably priced text messaging services to provide some of our services.

Customers who subscribe to certain of our services rely on our ability to send text messages on their behalf to other cell phone users or from us directly to our subscribers. Generally, these text messaging capabilities are available to us and are available at a reasonable price. If the wireless service providers terminate our ability to send text messages, a significant number of our subscribers may terminate their subscriptions for our services, which would have an adverse effect on our growth potential. Service providers might choose to terminate our ability to send text messages if they view our services as a competitive threat to their own or if our infrastructure is hacked and mass spam messages are sent to cell phone users.

A catastrophic event at Liberty Telecom s telephone switching facilities would cause the disruption of our legacy services to subscribers.

Our enhanced services currently depend on telecommunications services from our subsidiary, Liberty Telecom, which are provided using call-switching facilities in Las Vegas and Reno, Nevada. A catastrophic event, such as an earthquake or a fire, that destroys part or all of the facilities would disrupt our business and prevent us from providing services to our subscribers for an extended period of time. Because our subscribers expect our services to match the high reliability that characterizes services in the communications and information services industries generally, any failure in our ability to service our subscribers could cause us to lose significant numbers of subscribers, and make it more difficult to obtain new paid subscribers.

A system failure or a breach of our network security could delay or interrupt service to our subscribers or lead to a misappropriation of our confidential information.

Our operations are dependent upon our ability to protect our computer network from interruption, unauthorized entry, computer viruses and other similar events. Our existing and planned precautions may not be adequate to prevent a significant interruption in the operation of our network. Despite the implementation of security measures, our infrastructure also may be vulnerable to computer viruses, hackers or similar disruptive problems caused by our subscribers, employees or other Internet users who attempt to invade public and private data networks. A system failure or a breach of our security measures may lead to a disruption in service, or the misappropriation of confidential information, which may result in significant liability to us and also may deter current and potential subscribers from using our services. Any system failure or security breach that causes interruptions or data loss in our operations or in the computer systems of our subscribers could cause us to lose paid subscribers and harm our business, prospects, financial condition and results of operations.

Our security measures may not prevent security breaches that could harm our business. Currently, a significant number of our users authorize us to bill their credit card accounts directly for all transaction fees charged by us. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication technology to effect secure transmission of confidential information, including customer credit card numbers. Advances in computer capabilities, new discoveries in the field of cryptography or other developments may result in a compromise or breach of the technology used by us to protect transaction data. Any compromise of our security could harm our reputation and, therefore, our business, and also subject us to significant liability. In addition, a party who is able to circumvent our security measures could misappropriate proprietary information, or cause interruptions in our operations, damage our computers or those of our users, or otherwise damage our reputation and business.

If we experience excessive fraudulent credit card charges, we could lose the right to accept credit cards for payment and our subscriber base could decrease significantly.

A significant number of our paid subscribers authorize us to bill their credit card accounts directly for all service fees charged by us. We incur losses from claims that the customer did not authorize the credit card transaction to purchase our service. If the numbers of unauthorized credit card transactions becomes excessive, we could be assessed substantial fines for excess charge backs, or we could lose the right to accept credit cards for payment. If we were unable to accept credit cards, our paid subscriber base could significantly decrease, which could have a material adverse effect on our business, prospects, financial condition, operating results and cash flows.

If we do not successfully anticipate the service demands of our subscribers, we may be unable to successfully attract and retain subscribers.

We must accurately forecast the features and functionality required by our current and potential subscribers. In addition, we must design and implement service enhancements that meet subscriber requirements in a timely and efficient manner. We may not successfully determine subscriber requirements and, therefore, may not be able to satisfy subscriber demands. Furthermore, as our current subscribers needs change, we may not be able to identify, design and implement in a timely and efficient manner services incorporating the type and level of features desired by our subscribers. If we fail to accurately determine or effectively market subscriber feature requirements or service enhancements, we may lose current subscribers or fail to attract new subscribers, and may be unable to grow our revenues.

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Other persons may assert claims that our business operations or technology infringe or misappropriate their intellectual property rights, which could increase our costs of operation and distract management and could result in expensive settlement costs.

Other companies or individuals, including our competitors, may claim that we infringe or misappropriate their intellectual property rights. From time to time, third parties have contacted us, asserting that we may infringe their intellectual property rights. While we have been able to handle successfully such challenges to our legacy services, we are transitioning the Company s focus into the new Webmessenger and FUZE service offerings that focus on the collaboration and conferencing markets. While we have some issued patents and at least one pending patent application that may provide us some proprietary protection for these new services, we may encounter in this new market space issued patents with claims that describe part or all of our new service offerings.

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 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.

We may be engaged in legal proceedings that could cause us to incur unforeseen expenses and could occupy a significant amount of our management s time and attention.

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.

We may not be able to protect and enforce our intellectual property rights, which could impair our ability to compete and reduce the value of our services.

We rely primarily upon a combination of trademark, trade secret, copyright and patent law protections, and contractual restrictions to protect our proprietary technology. Those measures may not provide meaningful protection. For example, any rights granted under any of our existing or future patents may not provide meaningful protection or any commercial advantage to us. Such patents could be challenged or circumvented by our competitors or declared invalid or unenforceable in judicial or administrative proceedings. The failure of any patents to adequately protect our technology would make it easier for our competitors to offer similar services. With respect to our proprietary rights, it may be possible for third parties to copy or otherwise obtain and use our proprietary technology or marks without authorization or to develop similar technology independently. Monitoring unauthorized use of our proprietary technology or marks is difficult and costly. We may not be able to detect unauthorized use of, or to take appropriate steps to enforce, our intellectual property rights, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If we commence an action to terminate a third party s authorized use of our intellectual property rights, we may face challenges to the validity and enforceability of our proprietary rights and may not prevail in any litigation regarding those rights. Any efforts to enforce or determine the scope of our intellectual property rights, whether initiated by us or a third party, would be expensive and time-consuming, would divert management resources and could adversely affect our business, whether or not such litigation results in a determination favorable to us.

If we are unable to obtain additional telephone numbers, we may not be able to grow our subscriber base.

Our future success will depend in part upon our ability to procure and maintain sufficient quantities of telephone numbers in area codes where our subscribers are located at costs we can afford. The ability of telecommunications carriers to provide us with telephone numbers to be used in conjunction with our services depends on applicable regulations, the practices of telecommunications carriers that provide telephone numbers, and the level of demand for new telephone numbers. In addition, the Federal Communications Commission, or FCC, has regulations concerning numbering resource utilization. If CallWave does not sufficiently utilize the numbers assigned to it, it may have to relinquish control of those unused numbers. Furthermore, the FCC and state public utility commissions periodically review numbering utilization, and may in the future propose additional changes to regulations or interpret existing regulations that affect number assignment and the availability of numbers for, or the applicability of number portability requirements to, our services. Failure to have access to sufficient telephone numbers in a timely and cost-effective manner, or the loss of use of numbers we have previously accessed or may access, could prevent us from entering some markets or slow our growth in the markets in which we currently sell our services.

Our Enhanced Services Platform is a complex hardware and software system that could fail and cause service interruptions to our subscribers.

Our hardware and software systems are complex and are critical to our business. If our systems fail, our subscribers or our indirect distribution partners subscribers might experience reduced levels of service or service interruptions. Software-based services, such as ours, may contain undetected errors or failures when introduced or when new versions are released. Errors may be found in our software before or after commercial release, and, as a result, we may experience development delays or a disruption of our services. Failures in our system or interruptions to our service could cause us or our indirect distribution partners to lose paid subscribers and harm our business, prospects, financial condition and results of operations.

If we are unable to maintain access to national IP-protocol based networks, then our business and results of operations may be adversely affected.

Historically, to obtain our services, our subscribers had their calls routed on long-distance circuits through the public switched telephone network to our software switching facilities in Nevada. That structure requires that we often pay for long-distance telephone service. We expect to increasingly rely upon the public Internet or third-party managed Internet protocol networks, which would not change how we provision services to our subscribers, but would allow us to reduce our cost of sales by using more of the less expensive Internet and local telephone network minutes and fewer of the more expensive long-distance telephone network minutes. We recently entered into a contract with a provider of these Internet and managed Internet protocol network services, which is a privately managed Internet where access is controlled to ensure quality of service. If we are unable to establish and effectively manage such relationships on a cost-effective basis, or if the costs associated with Internet and local telephone network minutes increase, then our ability to manage our costs may be adversely affected and our results of operations may suffer.

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Our success depends in large part upon our retention of our executive officers and our ability to hire and retain additional key personnel.

Our future performance depends in large part upon the continued services of our executive officers and other key technical, operations and management personnel. Our future success also depends on our continuing ability to attract and retain highly qualified technical, operations and managerial personnel. Competition for such personnel is intense, and we may not be able to retain our key employees or attract or retain other highly qualified technical, operations and management personnel in the future. The loss of the services of one or more of our executive officers or other key employees or our inability to attract and retain additional qualified personnel could harm our business and prospects.

We may need to raise additional capital to support the growth of our operations, but such additional funds may not be available.

Our future capital needs are difficult to predict. We may require additional capital in order to take advantage of opportunities, including strategic alliances and potential acquisitions, or to respond to changing business conditions and unanticipated competitive pressures. Additionally, funds generated from our operations may be less than anticipated. As of June 30, 2008, we had total working capital of $36.3 million, $29.8 million of cash and cash equivalents, and $8.8 million of marketable securities. While we believe that our current capital resources will be sufficient to fund our operations through the end of June 30, 2009, we may need to raise additional funds either by borrowing money or issuing additional equity in order to handle unforeseen contingencies or take advantage of new opportunities. We may not be able to raise such funds on favorable terms, if at all. If we are unable to obtain additional funds, then we may be unable to take advantage of new opportunities or take other actions that otherwise might be important to our business or prospects.

If we acquire other businesses or license technologies, they could prove difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results.

Our business strategy in the future may include the acquisition of other businesses or licensing of technologies. We may not be able to identify, negotiate, integrate or finance any such future acquisition or license successfully. We have not acquired any companies to date and have no arrangements or agreements with respect to any potential acquisition and, therefore, have no experience with integrating other business operations or technologies with ours. If we engage in any such strategic transaction, then we may encounter unforeseen operating challenges and expenses that may require a significant amount of management time that otherwise would be devoted to running our operations. If we undertake acquisitions or other strategic transactions, then we may issue shares of stock that dilute the interests of existing stockholders; and we may incur debt, assume contingent liabilities, or create additional expenses related to amortizing intangible assets, any one or more of which may harm our business and results of operations.

We are exposed to risks and increased expense from recent legislation requiring companies to evaluate internal controls.

Section 404 of the Sarbanes-Oxley Act of 2002 (the Act) requires our management to report on the effectiveness of our internal controls over financial reporting beginning with the fiscal year ended June 30, 2008. In addition, the Act requires our independent registered public accounting firm to attest to the effectiveness of our internal controls over financial reporting beginning with the fiscal year ended June 30, 2010. In the event that we or our independent registered public accounting firm determine that our internal controls over financial reporting are not effective as defined under Section 404 for fiscal year 2009 or any subsequent period, or we are unable to remediate any potential material weaknesses is our internal controls, investor perceptions of our company may be adversely affected and could cause a decline in the market price of our stock, and we could experience further increases in expenses and redirection of management resources in order to remedy any such weakness in internal controls.

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Risks Related To Our Industry

We may not be able to respond to the rapid technological change of the communications and information services industries and, as a result, our business may be adversely affected.

The communications and information services industries are undergoing rapid and significant technological change. We cannot predict the effect of technological changes on our business. We expect that new services and technologies will emerge in the markets in which we compete. Those new services and technologies may be superior to the services and technologies that we provide or those new services may render our services and technologies obsolete. In addition, those services and technologies may not be compatible with ours. If we are not able to effectively respond to technological changes, the services we provide may no longer be attractive to our current and potential subscribers and our business, prospects, financial condition and results of operations may be harmed.

We are exposed to risks that our subscribers could attempt to use some of our features to reach emergency services by dialing 911, which could result in liability since we do not provide access to emergency services to subscribers who dial 911.

Some features of our services allow our subscribers to initiate calls to other end users served by the public switched network, mobile service providers, or interconnected VoIP providers. These features do not support 911 services, and thus our subscribers cannot access emergency services by dialing 911. Although we provide subscribers with numerous warnings that they cannot use our service features to dial 911 and include conspicuous limitations on liability clauses within our service agreements, there remains the risk that a subscriber will attempt to use the features we provide to place a call to an emergency services provider, which could result in the loss of or damage to property or injury or death to one or more persons. If a court or other body with competent jurisdiction concludes that we are at least partially liable for such loss, damage, or injury, we could incur the obligation to pay substantial monetary damages that adversely affect our operating results and cause us financial harm.

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

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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.

Our business and users may be subject to sales tax and other taxes.

The application of indirect taxes, such as sales and use tax, to e-commerce businesses such as CallWave and our users is a complex and evolving issue. Many of the fundamental statutes and regulations that impose these taxes were established before the growth of the Internet and e-commerce. In many cases, it is not clear how existing statutes apply to the Internet or e-commerce. In addition, some jurisdictions have implemented laws specifically addressing the Internet or some aspect of e-commerce and several other proposals have been made at the U.S. federal, state and local level that would impose additional taxes on the sale of goods and services through the Internet. These proposals, if adopted, could substantially impair the growth of e-commerce, hamper our ability to retain and attract new customers and diminish our ability to derive financial benefit from our activities. In December 2004, the U.S. federal government enacted legislation extending the moratorium on states and other local authorities imposing access or discriminatory taxes on the Internet through November 2007. This moratorium does not prohibit federal, state, or local authorities from collecting taxes on our income or from collecting taxes that are due under existing tax rules. The application of existing, new, or future laws could have adverse effects on our business, prospects, and operating results. There have been, and will continue to be, substantial ongoing costs associated with complying with the various indirect tax requirements in the numerous markets in which we conduct or will conduct business.

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.

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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.

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Risks Related To Our Common Stock

Our executive officers, directors and 5% stockholders own a significant percentage of our stock and will be able to exercise significant influence over stockholder votes.

Our executive officers, directors and 5% stockholders together beneficially own approximately 66% of our common stock, including shares subject to options and warrants that confer beneficial ownership of the underlying shares. Accordingly, these stockholders, for the foreseeable future will continue to have significant influence over our affairs including the election of directors and significant corporate transactions, such as a merger or other sale of our company or its assets. This concentrated control will limit the ability of shareholders to influence corporate matters and, as a result, we may take actions that our stockholders do not view as beneficial. For example, this concentration of ownership could have the effect of delaying or preventing a change in control or otherwise discouraging a potential acquirer from attempting to obtain control of us, which in turn could cause the market price of our common stock to decline or prevent our stockholders from realizing a premium over the market price for their shares of our common stock.

Provisions in Delaware law and our charter documents may make it difficult for a third party to acquire us and could depress the price of our common stock.

Provisions of Delaware law, our certificate of incorporation and our bylaws could make it more difficult for a third party to acquire control of us. For example:

- we are subject to Section 203 of the Delaware General Corporation Law, which would make it difficult for another party to acquire us without the approval of our board of directors;
- our certificate of incorporation authorizes our board of directors to issue preferred stock without requiring stockholder approval, and preferred stock could be issued as a defensive measure in response to a takeover proposal; and
- our certificate of incorporation or bylaws:
  - prohibits cumulative voting in the election of directors;
  - limits the persons who may call special meetings of our stockholders; and
  - imposes advance notice requirements for nominations for election to our board of directors and for proposing matters to be acted upon by our stockholders.

These and other provisions of Delaware law, our certificate of incorporation and our bylaws may make it more difficult for a third party to acquire us even if an acquisition might be in the best interests of our stockholders, and the price at which shares of our common stock are purchased and sold therefore may be depressed.

We are incurring increased costs as a result of being a public company.

As a public company, we are incurring significant additional legal, accounting and other expenses. The Sarbanes-Oxley Act of 2002, as well as new rules subsequently implemented by the Securities and Exchange Commission and the NASDAQ National Market, require changes in corporate governance practices of public companies. These new rules and regulations have resulted in increased legal and financial compliance costs and management efforts and we expect those costs and efforts to continue to increase. It has become more expensive for us to obtain director and officer liability insurance, and it may become more difficult to obtain such insurance in the future, which may cause us to accept reduced policy limits and reduced coverage or to incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors or as executive officers. We cannot predict or estimate the amount of additional costs we may incur, but these additional costs and demands on management time and attention may harm our business and results of operations.

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We do not intend to pay cash dividends.

We have never declared or paid cash dividends on our capital stock. We currently intend to retain all available funds and any future earnings for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. As a result, capital appreciation, if any, of our common stock will be the sole source of potential gain for our stockholders for the foreseeable future.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our corporate headquarters are located at 140 Second Street, San Fracisco, California, where we lease approximately 5,000 square feet. We conduct sales and marketing and research and development at these facilities. The lease expires in July of 2011.

Our finance department is at 136 West Canon Perdido Street, Santa Barbara, California, where we lease approximately 16,000 square feet. The lease expires on July 31, 2010. We have an option to extend the term of this lease for an additional five years. As of June 30, 2008, we have entered into negotiations to terminate a portion of the lease that covers approximately half of the space.

Subsequent to year end, CallWave also acquired a lease of approximately 400 square meters in Sophia, Bulgaria. We conduct research and development at this facility. The lease expires in September of 2009.

Liberty Telecom leases approximately 5,900 square feet of space in Reno, Nevada, under three separate lease agreements. This space houses its telecommunications switching equipment. The leases expire between July 2009 and December 2013. Two of the leases have options to extend the term of the lease.

Liberty Telecom also has a co-location agreement to house and operate certain telecom switching equipment in approximately 150 square feet in Las Vegas, Nevada. The co-location agreement expires in August 2009. Liberty Telecom has three options to renew the term of the Agreement for an additional 24 months each.

We believe our properties are suitable and adequate for our present needs, and we periodically evaluate whether additional facilities are necessary.

Item 3. 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

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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.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the Company s 2008 fiscal year.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Holders

Our common stock is listed on the NASDAQ Stock Market, LLC, under the symbol CALL . Trading of our common stock commenced September 30, 2004 following completion of our initial public offering.

The following table sets forth, for the periods indicated, the high and low sales prices for our common stock as reported by the NASDAQ Stock Market, LLC:

Fiscal 2008	**High**	**Low**
First Quarter	$ 3.74	2.18
Second Quarter	3.15	1.77
Third Quarter	3.13	1.70
Fourth Quarter	2.85	2.31

Fiscal 2007	**High**	**Low**
First Quarter	$ 3.77	$ 2.56
Second Quarter	2.92	2.51
Third Quarter	3.35	2.50
Fourth Quarter	3.96	2.84

There were approximately 60 stockholders of record of our common stock as of August 31, 2008, although there are a significantly larger number of beneficial owners of our common stock.

Dividends

We have not paid any cash dividends on our capital stock and do not anticipate paying any cash dividends in the foreseeable future.

Securities Authorized for Issuance under Equity Compensation Plans

Equity Compensation Plan Information

As of June 30, 2008

Plan Category	**Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights (a)**	**Weighted-Average Exercise Price of Outstanding Options Warrants and Rights (b)**	**Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)**
Equity compensation plans approved by security holders	3,033,048	$ 3.31	3,453,589

Recent Sales of Unregistered Securities

None

Item 6. Selected Financial Data

SELECTED CONSOLIDATED FINANCIAL DATA

(in thousands, except per share data)

The following selected consolidated financial data should be read in conjunction with, and are qualified by reference to, our consolidated financial statements and related notes and the section titled Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this annual report. We have prepared this information using our audited consolidated financial statements for the years ended June 30, 2008, 2007, 2006, 2005 and 2004. Our Consolidated Financial Statements for the years ended June 30, 2008 and 2007, are included in Item 15 of this Annual Report on Form 10-K.

	Fiscal Year Ended June 30,				
	2008	**2007**	**2006**	**2005**	**2004**
Statements of Operations Data:					
Revenues	$ 20,008	$ 25,201	$ 36,594	$ 45,518	$ 38,886
Cost of sales	7,191	8,746	13,088	13,026	11,673
Gross Profit	12,817	16,455	23,506	32,492	27,213
Operating expenses					
Sales and marketing	6,057	7,652	6,293	9,533	5,987
Research and development	5,125	7,178	6,805	6,868	5,294
General and administrative	7,480	12,021	11,508	7,622	4,985
Restructuring charges	2,138				
Loss on disposal of property and equipment	8	114	23	4	30
Impairment of long-lived assets			253		
Total operating expenses	20,808	26,965	24,882	24,027	16,296
Operating income (loss)	(7,991)	(10,510)	(1,376)	8,465	10,917
Interest income, net of expense	2,309	3,044	2,479	1,032	93
Income (loss) before income taxes	(5,682)	(7,466)	1,103	9,497	11,010
Income tax expense (benefit)		6	3,086	(2,105)	(505)
Net income (loss)	$ (5,682)	$ (7,472)	$ (1,983)	$ 11,602	$ 11,515
Net income (loss) per share:					
Basic	$ (0.27)	$ (0.36)	$ (0.10)	$ 0.72	$ 1.96
Diluted	$ (0.27)	$ (0.36)	$ (0.10)	$ 0.57	$ 0.73
Shares used in net income (loss) per share:					
Basic	21,010	20,827	20,615	16,171	5,886
Diluted	21,010	20,827	20,615	20,295	15,674

	As of June 30,				
	2008	**2007**	**2006**	**2005**	**2004**
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 29,839	$ 20,299	$ 24,040	$ 16,828	$ 6,187
Marketable securities	8,768	32,411	36,907	39,996	7,003
Restricted cash				335	335
Working capital	36,315	51,918	62,049	59,029	11,263
Total assets	56,590	62,275	67,455	69,245	21,628
Convertible preferred stock					28,761
Accumulated deficit	(20,468)	(14,786)	(7,314)	(5,331)	(16,933)

Total stockholders equity	51,943	58,524	64,662	64,396	15,523

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This annual 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 Business.

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 laws. 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

Historically we have worked to realign our business focus to take advantage of two important trends in the telecommunication industry:

- the convergence of landline, mobile, and Internet communications.
- the acceleration in the adoption of the on-demand delivery model.

These trends continued to drive the need among service providers for flexible, faster-to-market, network independent software applications to compete against competitive threats. In response, we moved to complement our direct-to-consumer business model with an on-demand application model to provide communication solutions that require minimal allocation of capital and allow service providers to quickly react to customer needs and adapt to the dynamically shifting competitive landscape.

The customer base for our legacy products has been declining. At this time we do not plan to invest additional resources in our legacy business. However, we do expect to maintain the legacy infrastructure and limited advertising to drive profitable new subscribers to our legacy businesses. We view the legacy business as a core asset that allows us to test new products and feature sets and provide significant free cash flow that can be invested in our new line of unified communications products. We expect that over time sales of our new products will mitigate the impact of declining revenue from our legacy business.

We launched our new enterprise-class collaboration, presence and real time communications product called FUZE on September 17, 2008 in New York at the Web 2.0 Expo New York and Interop New York 2008 tradeshows. FUZE allows customers to meet online and bridges the gulf between the office and mobile devices. With FUZE, customers are now able to collaborate with clients and their teams instantly from anywhere and on any device. Meetings can be conducted from your desktop or mobile phone with High Definition (HD) quality and leverages proprietary synching technology that ensures that content is always in-sync across multiple connections and countries. Our new FUZE platform incorporates high fidelity conferencing and enterprise-class security and reliability. FUZE also integrates federated IM across all popular IM platforms, is presence enabled and syncs with Microsoft Outlook so meetings are easy to schedule and coordinate.

We plan to offer several pricing packages and tiers for our FUZE product line that are designed to drive recurring, predictable and scalable economics via subscription-based pricing and traditional software licensing and maintenance agreements. Subscription-based pricing is an accepted form of pricing for Software-as-a-Service (SaaS) solutions for small, medium and enterprise business, as well as the small office and home office (SoHo) markets. With larger enterprise customers, we plan to offer both subscription-based pricing and software licensing to further align our product offerings with traditional software-based buying disciplines and budgets.

Critical Accounting Policies and the Use of Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our 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 under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our 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, fees earned 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

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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.

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 $285,000 as of June 30, 2008 and $436,000 as of June 30, 2007. Our allowance for doubtful accounts is correlated with our aggregate billings.

Accounting for Income Taxes

We account for income taxes using the asset and liability method in accordance with SFAS 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 June 30, 2008, we had net deferred tax assets of $10.9 million. Due to the uncertainty of realizing these net deferred tax assets, we have recorded a valuation allowance of $10.9 million against these net 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.

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.

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.

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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.

Stock-Based Compensation

We account for stock-based compensation in accordance with the provision 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 SFAS No. 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.

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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

For additional information regarding recently issued accounting pronouncements, see Note 2 to our Consolidated Financial Statements in Item 15 of this Annual Report on Form 10-K.

Results of Operations

Comparison of Fiscal Years Ended June 30, 2008 and 2007

Revenues. Revenues were $20 million in the fiscal year ended June 30, 2008, compared to $25.2 million in the fiscal year ended June 30, 2007, a decrease of $5.2 million, or 21%. Subscription revenues were $19.9 million in fiscal 2008, representing 99% of revenues, compared to $25 million in fiscal 2007, representing 99% of revenues, a decrease of $5.1 million, or 20%. The decrease in our revenues in fiscal 2008 was attributable primarily to a decrease in the number of paying subscribers from approximately 631,000 at June 30, 2007 to approximately 485,000 at June 30, 2008. The decrease in subscribers is driven primarily from the migration of dial up users to broad band. Revenues from our indirect channel partners in fiscal year 2008 were $2.2 million or 11% of revenues compared to $3.0 million or 12% of revenues for the same period last year. During the first quarter of the year ended June 30, 2007, 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 diluted 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 $7.2 million in fiscal 2008, compared to $8.7 million in fiscal 2007, a decrease of $1.5 million, or 17%. The decrease in cost of sales is primarily related to the decrease in the number of subscribers. In addition, we received a federal telecommunications excise tax refund of $412,000 related to our telecommunications cost that reduced cost of sales during the year ended June 30, 2008. In the prior year, we received a credit of $574,000 from one of our telecommunications carriers in the 2nd quarter of fiscal 2007. 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. As of June 30, 2007, the credit was entirely utilized.

Sales and marketing. Sales and marketing expenses were $6.1 million, or 30% of revenues, in fiscal 2008, compared to $7.7 million, or 31% of revenues, in fiscal 2007, a decrease of $1.6 million. We have reduced our advertising expense on old services as we focus on bringing our new service offerings to market. In addition, headcount associated with the marketing and sales of our legacy products has been reduced.

Research and development. Research and development expenses were $5.1 million, or 26% of revenues, in fiscal 2008, compared to $7.2 million, or 28% of revenues, in fiscal 2007, a decrease of $2.1 million. The reduction was driven by a reduction in force associated with our legacy products. We believe it is essential to have a strong and efficient research and development team as we launch our new unified communications product lines. We continue to invest in new technologies and we have shifted certain research and development functions offshore in an effort to gain greater efficiencies and streamline costs. After year end we shifted the majority of our research and development team to Sofia, Bulgaria.

General and administrative. General and administrative expenses were $7.5 million or 38% of revenues in fiscal 2008, compared to $12 million, or 48% of revenues, in fiscal 2007, a decrease of $4.5 million. The decrease in general and administrative expenses was due to reduced legal fees as a result of the settlement of the

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j2 Global Communications litigation in 2007, reductions in headcount related to our restructuring and business realignment, reductions in performance bonuses and lower bad debt expense.

Restructuring charges. During the quarter ended September 30, 2007, we announced a reorganization and reduction in workforce and the termination of our Chief Executive Officer. As a result of the reorganization we incurred a 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. In addition, during the quarter ended March 31, 2008, we announced a second reduction in workforce and the termination of several Executive Officers. As a result of the second reduction in workforce, we incurred a charge of approximately $1 million associated primarily with severance, health insurance, accelerated stock option compensation expense, and facilities closures. The entire charge has been recognized in the third quarter ended March 31, 2008.

On August 28, 2008, the Company announced a third reorganization and reduction in workforce. As a result of the reorganization the Company will incur a charge of approximately $600,000 to $800,000 associated primarily with severance, health insurance, facilities consolidation, and accelerated stock option compensation expense. The entire charge will be recognized in the quarter ended September 30, 2008. We do not expect further restructuring charges during our fiscal year ending June 30, 2009.

Income tax provision. No tax benefit was derived from the net losses recognized during the years ended June 30, 2008 and 2007 due to the valuation allowance established to offset our deferred tax assets. Total deferred tax assets amount to $11.4 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 may adjust the balance in the future accordingly.

Net loss. The net loss was $5.7 million for the year ended June 30, 2008, compared to net loss of $7.5 million for the same period last year. This net loss was primarily the result of reduced revenues as we shift our focus toward indirect distributor arrangements and our preparation for shifting our company into the indirect channel.

Comparison of Fiscal Years Ended June 30, 2007 and 2006

Revenues. Revenues were $25.2 million in fiscal 2007 compared to $36.6 million in fiscal 2006, a decrease of $11.4 million, or 31%. Subscription revenues were $25 million in fiscal 2007, representing 99% of revenues, compared to $36.2 million in fiscal 2006, representing 99% of revenues, a decrease of $11.2 million, or 31%. The decrease in our revenues in fiscal 2006 was attributable primarily to a decrease in the number of paying subscribers from approximately 706,000 at June 30, 2006 to approximately 631,000 at June 30, 2007. The decrease in subscribers is driven primarily from the migration of dial up users to broad band. In addition, our average revenue per user (ARPU) decreased during fiscal 2006 as we have a higher percentage of our subscribers from our indirect channel distribution agreements. We record revenue from our indirect channel partners on a gross or net basis depending on the facts of the agreement. Revenues from our indirect channel partners in fiscal year 2007 were $3.0 million or 12% of revenues compared to $2.7 million or 7% of revenues for the same period last year. During the first quarter of the year ended June 30, 2007, 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 $8.7 million in fiscal 2007, compared to $13.1 million in fiscal 2006, a decrease of $4.4 million, or 34%. Gross margins increased to 65.3% for the year ended June 30, 2007 from

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64.2% for the year ended June 30, 2006. The decrease in cost of sales is primarily related to the decrease in the number of subscribers and a credit of $574,000 from one of our telecommunications carriers which we received in the 2nd quarter of fiscal 2007. 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. As of June 30, 2007, the credit has been entirely utilized.

Sales and marketing. Sales and marketing expenses were $7.7 million, or 31% of revenues, in fiscal 2007, compared to $6.3 million, or 17% of revenues, in fiscal 2006, an increase of $1.4 million. The 14% 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 also had increased marketing expenses as we promoted our direct to consumer free beta products through various ad based services. We expect to incur higher marketing expenses in coming quarters as we continue to promote new products and new product features and enhancements in the direct to consumer and carrier channels. We are committed to investing in our Sales and Marketing functions as we migrate a greater percentage of our business toward indirect channel distributors with landline and mobile operators while continuing to build product usage and add new subscribers in the direct-to-consumer channel.

Research and development. Research and development expenses were $7.2 million, or 28% of revenues, in fiscal 2007, compared to $6.8 million, or 19% of revenues, in fiscal 2006, an increase of $0.4 million. The 9% increase in research and development as a percentage of total revenue was 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. Over the last six months we have launched seven new products and believe it is essential to have a strong research and development team as we continue to develop new products and add additional features and functionality 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.

General and administrative. General and administrative expenses were $12 million or 48% of revenues in fiscal 2007, compared to $11.5 million, or 31% of revenues, in fiscal 2006, an increase of $0.5 million, or 4%. The increase in general and administrative expenses was due primarily to increased legal fees, payroll and related expenses, and stock based compensation charges. Legal fees related to the litigation with j2 Global and Catch Curve were approximately $3,300,000 for the twelve months ended June 30, 2007. As a result of the settlement, these fees will not be recurring in future quarters.

Impairment loss. During the fiscal year ended June 30, 2006, we determined, based on an analysis of future cash flows, that our investment in and receivable from a company in which we had a minority interest was other than temporarily impaired. Accordingly, we recorded an impairment loss in the amount of $253,000.

Income tax provision. We recognized an income tax provision for the twelve months ended June 30, 2006 of $3,086,000. No tax benefit was derived from the net loss recognized during the twelve months ended June 30, 2007 due to the valuation allowance established to offset our deferred tax assets. Total deferred tax assets amount to $8.8 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 may adjust the balance in the future accordingly.

Net loss. The net loss was $7.5 million for the year ended June 30, 2007, compared to net loss of $2.0 million for the same period last year. This net loss was primarily the result of reduced revenues as we shift our focus toward indirect distributor arrangements and our preparation for shifting our company into the indirect channel. Other contributing factors consisted of increased payroll and related costs, litigation fees, stock based compensation charges, and a change in estimate described under Revenues above. The net loss was reduced by the credit described in the Cost of sales section above.

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Liquidity and Capital Resources

At June 30, 2008, our principal sources of liquidity were cash and cash equivalents of $30 million, marketable securities of $8.8 million, and accounts receivable net of allowance for doubtful accounts of $1.8 million. We do not expect cash flow from operations to be positive in future periods until we return to profitability. Subsequent to year end we acquired Web Messenger for $9 million in cash. Although our available cash balance was reduced by the acquisition and we are anticipating 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 (including auction rate securities) decreased from $52.7 million at June 30, 2007 to $46.1 million at June 30, 2008. This decrease is primarily due to cash used in operations of $3.0 million, net unrealized losses on marketable securities of $2.5 million, and purchases of property and intangible assets of $1.6 million, partially offset by cash received from exercises of employee stock options of $496,000.

During the quarter ended December 31, 2007, certain auction rate securities began to fail auction due to sell orders exceeding buy orders. Of the Company s $16.3 million marketable securities portfolio at June 30, 2008, $7.5 million 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. All of the auction rate securities were AAA rated and were in compliance with our investment policy at the time of acquisition. We currently have the ability and intent to hold these investments until a recovery of the auction process or until maturity. 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 $2.5 million pre-tax at June 30, 2008, related to these auction rate securities. Securities that have been subject to the highest risk of decline in value have generally been securities that are not tax exempt (e.g. non-municipal securities). We do not invest in tax exempt securities because of our large net operating loss carry forwards. Of the $10 million (at cost) in auction rate securities we hold, $7.5 million remains rated as investment grade.

These securities are being analyzed each reporting period for impairment, including other-than-temporary impairment factors. We will continue to closely monitor developments, particularly in regard to the $2.5 million of securities that have been down graded, and will record a permanent impairment if circumstances lead us to believe that the value of these securities will not recover. Recently some banks announced settlements with the New York Attorney General to restore liquidity to certain clients holdings of auction rate securities. Our securities are held with Lehman Brothers. For a time, we believed that Lehman Brothers would also reach a settlement; however, Lehman Brothers has subsequently declared bankruptcy and it is now uncertain whether liquidity will be restored to our auction rate securities in the near future. Accordingly, we have reclassified our auction rate securities to non-current assets at June 30, 2008. We now believe that the liquidity of these securities is unlikely to be restored in a period less than twelve months from such date. These auction failures are symptomatic of current conditions in the broader debt markets and are not unique to CallWave.

Off-Balance Sheet Arrangements

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

Contractual Payment Obligations

A summary of our contractual commitments and obligations as of June 30, 2008 is as follows:

		Payments Due by Period			
Contractual Obligations	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
		(in thousands)			
Operating lease obligations	$ 2,261	$ 811	$ 1,105	$ 291	$ 54
Purchase obligations	365	352	13		
Total	$ 2,626	$ 1,163	$ 1,118	$ 291	$ 54

Purchase obligations consist primarily of contracts with communications services providers totaling $341,000 and contractual obligations to pay $11,000 to providers of billing and collection services and outsourced customer support due in less than one year.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Foreign currency exchange risk. Historically, we have not conducted any business denominated in foreign currencies and, therefore, were not subject to any significant foreign currency exchange risk. On August 4, 2008, the Company entered into an Asset Purchase Agreement with WebMessenger, Inc. As part of the purchase, CallWave acquired an office in Sofia, Bulgaria, which may subject the Company to foreign currency exchange risk in future periods.

Interest rate sensitivity. We had cash and cash equivalents totaling $29.8 million and marketable securities totaling $8.8 million at June 30, 2008, 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 June 30, 2008, our interest income would decrease by approximately $214,000 on a quarterly basis based on the outstanding balance of our marketable securities and money market funds at June 30, 2008. A decline in market value of 3.0% would reduce the value of our marketable securities by approximately $263,000.

Item 8. Financial Statements and Supplementary Data

The financial statements required pursuant to this item are included in Item 15 of this report and are presented beginning on page F-1.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. 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 June 30, 2008.

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

There have not been any changes in our internal control over financial reporting during the quarter ended June 30, 2008 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.

Item 9B. Other Information

None.

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PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this Item concerning our directors is incorporated by reference from the information set forth in the section entitled Section 16(a) Beneficial Ownership Reporting Compliance in the Company s definitive Proxy Statement for the 2008 Annual Meeting of Stockholders to be filed with the Commission within 120 days after the end of our fiscal year ended June 30, 2008, or the Proxy Statement. The information required by this Item concerning our executive officers is incorporated by reference from the information set forth in the section of the Proxy Statement entitled Executive Officers, Directors and Key Employees. The information required by this Item concerning our code of ethics is set forth in Exhibit 14 of this Annual Report on Form 10-K. The information required by this Item concerning our equity compensation plan is set forth under Item 5 of this Annual Report on Form 10-K.

Item 11. Executive Compensation

The information required by this item is incorporated by reference to the section entitled Executive Compensation of the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is incorporated by reference to the sections entitled Security Ownership of Certain Beneficial Owners and Management and Section 16(a) Beneficial Ownership Reporting Compliance, of the Proxy Statement.

Item 13. Certain Relationships and Related Transactions

The information required by this item is incorporated by reference to the section entitled Certain Transactions of the Proxy Statement.

Item 14. Principal Accountant Fees and Services

The information required by this item is incorporated by reference to the section entitled Independent Accountants of the Proxy Statement.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are being filed as part of this report:

(1) *Consolidated Financial Statements*

Reference is made to the Index to Consolidated Financial Statements of CallWave, Inc. appearing on page F-1 of this report.

(2) *Consolidated Financial Statement Schedules*

The following consolidated financial statement schedule of the Company for each of the fiscal years ended June 30, 2008 and 2007, is filed as part of this Annual Report on Form 10-K and should be read in conjunction with the Consolidated Financial Statements, and the related notes thereto, of the Company.

Schedule II Valuation and Qualifying Accounts for the fiscal years ended June 30, 2008 and 2007.

(3) *Exhibits*

The following exhibits are included in this Annual Report on Form 10-K:

3.1(1)	Amended and Restated Certificate of Incorporation of Registrant.
3.2(2)	Amended and Restated Certificate of Incorporation of the Registrant.
3.3(3)	Bylaws of the Registrant.
3.4(4)	Certificate of Amendment to Amended and Restated Certificate of Incorporation
10.1(4)	2004 Stock Incentive Plan.
10.2(5)	First Amendment to 2004 Stock Incentive Plan.
10.3(6)	Employment Agreement dated June 1, 2006, by and between Mark Stubbs and the Registrant.
10.4(7)	Second Amendment to 2004 Stock Incentive Plan.
10.5(8)	Third Amendment to 2004 Stock Incentive Plan.
10.6(9)	Employment Agreement dated September 5, 2007, by and between Jeffrey Cavins and the Registrant.
10.7(10)	Employment Agreement dated February 19, 2008, by and between Rich Roberts and the Registrant.
10.8	Asset Purchase Agreement by and among WebMessenger, Inc. and CallWave, Inc.
14	Code of Ethics
21	List of Subsidiaries
23	Consent of Mayer Hoffman McCann P.C., Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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(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) filed on May 13, 2004 and incorporated herein by reference.
(5) Previously filed in the Registrant s Quarterly Report on Form 10-Q filed on November 15, 2005 and incorporated herein by reference.
(6) Previously filed in the Registrant s Current Report on Form 8-K filed on November 27, 2006 and incorporated herein by reference.
(7) Previously filed in the Registrant s Quarterly Report on Form 10-Q filed on November 13, 2006 and incorporated herein by reference.
(8) Previously filed in the Registrant s Quarterly Report on Form 10-Q filed on November 13, 2007 and incorporated herein by reference.
(9) Previously filed in the Registrant s Current Report on Form 8-K filed on September 5, 2007 and incorporated herein by reference.
(10) Previously filed in the Registrant s Quarterly Report on Form 10-Q filed on May 14, 2008 and incorporated herein by reference.

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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: September 26, 2008	By:	/s/ JEFFREY CAVINS **Jeffrey Cavins,** **President and Chief Executive Officer**
Date: September 26, 2008	By:	/s/ MARK STUBBS **Mark Stubbs,** **Chief Financial Officer** **(principal financial and accounting officer)**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on September 6, 2008 by the following persons on behalf of the registrant and in the capacities indicated.

Signature	Title	Date
/s/ JEFFREY CAVINS **Jeffrey Cavins**	President and Chief Executive Officer	September 26, 2008
/s/ MARK STUBBS **Mark Stubbs**	Chief Financial Officer (Principal Financial and Accounting Officer)	September 26, 2008
/s/ PETER V. SPERLING **Peter V. Sperling**	Chairman and Director	September 26, 2008
/s/ MANUEL RIVELO **Manuel Rivelo**	Director	September 26, 2008
/s/ JEFFREY O. HENLEY **Jeffrey O. Henley**	Director	September 26, 2008
/s/ JERRY MURDOCK **Jerry Murdock**	Director	September 26, 2008
/s/ OSMO HAUTANEN **Osmo Hautanen**	Director	September 26, 2008

/s/ RAJ RAITHATHA	Director	September 26, 2008
Raj Raithatha		

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

CallWave, Inc.

We have audited the accompanying consolidated balance sheets of CallWave, Inc., as of June 30, 2008 and 2007, and the related consolidated statements of operations, stockholders equity and cash flows for each of the two years in the period ended June 30, 2008. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CallWave, Inc. as of June 30, 2008 and 2007, and the results of their operations and their cash flows for each of the two years in the period ended June 30, 2008, in conformity with U.S. generally accepted accounting principles.

/s/ MAYER HOFFMAN MCCANN P.C.

MAYER HOFFMAN MCCANN P.C.

Los Angeles, California

September 26, 2008

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CALLWAVE, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

	June 30, 2008	June 30, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 29,839	$ 20,299
Marketable securities, available for sale, at fair value	8,768	32,411
Accounts receivable; net of allowance for doubtful accounts of $285 and $436 at June 30, 2008 and 2007, respectively	1,774	2,396
Other current assets	581	563
Total current assets	40,962	55,669
Property and equipment, net	2,355	2,118
Intangible assets, net	5,652	4,405
Auction rate securities	7,492	
Other assets	129	83
Total assets	$ 56,590	$ 62,275
Liabilities And Stockholders Equity		
Current liabilities:		
Accounts payable	$ 710	$ 677
Accrued payroll	583	910
Deferred revenue	600	855
Other current liabilities	1,754	1,309
Short term debt	1,000	
Total current liabilities	4,647	3,751
Commitments and contingencies		
Stockholders equity:		
Common stock, $0 par value; 100,000 shares authorized; 21,176 and 20,880 shares issued and outstanding at June 30, 2008 and 2007, respectively	74,948	73,346
Other accumulated comprehensive loss	(2,537)	(36)
Accumulated deficit	(20,468)	(14,786)
Total stockholders equity	51,943	58,524
Total liabilities and stockholders equity	$ 56,590	$ 62,275

See accompanying notes.

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CALLWAVE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Years ended June 30, 2008	2007
Revenues	$ 20,008	$ 25,201
Cost of sales	7,191	8,746
Gross profit	12,817	16,455
Operating expenses (1):		
Sales and marketing	6,057	7,652
Research and development	5,125	7,178
General and administrative	7,480	12,021
Restructuring charges	2,138	
Loss on disposal of property and equipment	8	114
Total operating expenses	20,808	26,965
Operating loss	(7,991)	(10,510)
Interest income, net of expense	2,309	3,044
Loss before income taxes	(5,682)	(7,466)
Income tax expense		6
Net loss	$ (5,682)	$ (7,472)
Net loss per share:		
Basic and diluted	$ (0.27)	$ (0.36)
Weighted-average common shares outstanding:		
Basic and diluted	21,010	20,827
(1) Includes stock-based compensation as follows:		
Sales and marketing	$ 104	$ 171
Research and development	118	345
General and administrative	434	559
Restructuring charges	450	

See accompanying notes.

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CALLWAVE, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Common Stock		Other Accumulated Comprehensive Loss	Accumulated Deficit	Total Stockholders Equity
	Shares	Amount			
Balance at July 1, 2006	**20,800**	**$ 72,119**	**$ (143)**	**$ (7,314)**	**$ 64,662**
Exercise of stock options	65	112			112
Stock based compensation expense		1,075			1,075
Stock issued for purchase of property	15	40			40
Unrealized gain on available for sale securities			107		107
Net loss				(7,472)	(7,472)
Comprehensive loss					(7,365)
Balance at June 30, 2007	**20,880**	**73,346**	**(36)**	**(14,786)**	**58,524**
Exercise of stock options and warrants	296	496			496
Stock based compensation expense		1,106			1,106
Unrealized gain on available for sale securities			7		7
Unrealized loss on auction rate securities			(2,508)		(2,508)
Net loss				(5,682)	(5,682)
Comprehensive loss					(8,183)
Balance at June 30, 2008	**21,176**	**$ 74,948**	**$ (2,537)**	**$ (20,468)**	**$ 51,943**

See accompanying notes.

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CALLWAVE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Years ended June 30, 2008	2007
Cash flows from operating activities:		
Net loss	$ (5,682)	$ (7,472)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,094	884
Loss on disposal of property and equipment	38	114
Stock based compensation expense	1,106	1,075
Bad debt expense	668	1,408
Net realized loss (gain) on sale of marketable securities	7	(30)
Changes in operating assets and liabilities:		
Accounts receivable, net of bad debt expense	(46)	(970)
Prepaid income tax		88
Other assets	(64)	341
Accounts payable	33	226
Accrued payroll and other liabilities	118	(21)
Deferred revenues	(255)	763
Income taxes payable		(10)
Net cash used in operating activities	(2,983)	(3,604)
Cash flows from investing activities:		
Purchase of intangible assets	(597)	(4,000)
Purchases of marketable securities	(18,000)	(83,006)
Sales of marketable securities	31,643	87,639
Purchases of property and equipment	(1,030)	(939)
Proceeds from the sale of property and equipment	11	6
Net cash provided by (used in) investing activities	12,027	(300)
Cash flows from financing activities:		
Exercises of stock options	496	163
Net cash provided by financing activities	496	163
Net increase (decrease) in cash and cash equivalents	9,540	(3,741)
Cash and cash equivalents at beginning of the period	20,299	24,040
Cash and cash equivalents at end of the period	$ 29,839	$ 20,299
Supplemental disclosures of cash flow information		
Cash paid for:		
Income taxes	$	$ 6
Non-cash investing activities:		
Stock issued for purchase of property	$	$ 40
Non-cash financing activities:		
Purchase of intangible assets with short term debt	$ 1,000	$

See accompanying notes.

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and Basis of Presentation

Description of business CallWave, Inc. (CallWave, or the Company), was incorporated in August 1998, first marketed its free services in February 1999 and began marketing paid subscription services in April 2001. CallWave provides software-based communications application services that bridge calls across existing landline, mobile and Internet networks.

Principles of consolidation The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated.

Use of estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States necessarily requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The primary accounts that are particularly sensitive to changes in estimates are the allowance for doubtful accounts, net realizable value of investments, and the valuation allowance for deferred taxes. Actual results could differ from those estimates.

Cash equivalents All highly liquid investments with original maturities of three months or less at the 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 estimated fair value. Unrealized gains and losses are reflected in other comprehensive loss.

During the quarter ended December 31, 2007, certain auction rate securities began to fail auction due to sell orders exceeding buy orders. Of the Company s $16.3 million marketable securities portfolio at June 30, 2008, $7.5 million 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. All of the auction rate securities were AAA rated and were in compliance with the Company s investment policy at the time of acquisition. The Company currently has the ability and intent to hold these investments until a recovery of the auction process or until maturity. 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. However, the Company recorded an unrealized loss within Other Comprehensive Loss of approximately $2.5 million pre-tax at June 30, 2008, related to these auction rate securities.

In addition, the Company s auction rate securities were being held with a bank that declared bankruptcy subsequent to June 30, 2008. It is now uncertain whether liquidity will be restored to these securities in the near future. Accordingly, the auction rate securities were reclassified to non-current assets. These securities are being analyzed each reporting period for impairment, including other-than-temporary impairment factors. Recent auction failures relating to this type of security are symptomatic of current conditions in the broader debt markets and are not unique to CallWave.

Accounts Receivable Accounts receivable consists of trade receivables arising in the normal course of business. The Company does not charge interest on its trade receivables. The allowance for doubtful accounts is

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the Company s best estimate of the amount of probable non-paying customer accounts in the Company s existing accounts receivable. The Company reviews its allowance for doubtful accounts monthly and determines the allowance based upon historical bad debt experience and payment history. If estimated allowances for uncollectible accounts subsequently prove insufficient, an additional allowance may be required.

Fixed assets Fixed assets are stated at cost less accumulated depreciation. Fixed assets are depreciated using the straight-line method over their estimated useful lives.

Fair value of financial instruments Financial instruments consist of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities. The carrying values of these instruments approximate fair value due to their short-term nature.

Concentrations of credit risk Financial instruments that subject the Company to credit risk consist primarily of trade accounts receivable. Concentration of credit risk is generally diversified due to the large number of customers composing the Company s customer base. 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 net receivable from the vendor at June 30, 2008 and 2007 was $984,000 and $1,514,000, respectively.

The Company maintains its cash balances in financial institutions located in California and Nevada. The balances are insured by the Federal Deposit Insurance Corporation up to $100,000. The Company s cash balances exceed the maximum amount insured.

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 associated 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. 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

CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

customers and bears the credit risk, CallWave records the gross amount billed as revenue in accordance with Emerging Issues Task Force Issue No. 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.

Deferred revenue Deferred revenue consists of customer prepayments, 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. Associated costs, such as billing fees, are deferred and recognized over the same period. In addition, install fees and up front non-recurring engineering 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. During the year ended June 30, 2008, the Company applied for and received a refund of federal communications excise taxes is the amount of $412,000. The refund was credited to cost of sales in the year ended June 30, 2008. During the year ended June 30, 2007, the Company received a credit of $574,000 from a telecommunication carrier. The credit resulted in a reduction in cost of sales during the year ended June 30, 2007.

Research and development Research and development expenses consist principally of payroll and related expenses for research and development personnel and consultants. Research and development costs are expensed as incurred.

Advertising Advertising costs are expensed as incurred. Advertising expense was $2,300,000 and $3,402,000 for the years ended June 30, 2008 and 2007, respectively.

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.

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

CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

Effective at the beginning of the Fiscal year ended June 30, 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 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 SFAS No. 142. In accordance with SFAS No. 142, 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.

Share-Based Compensation 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 Company estimates 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. See Note 8 for further discussion.

Comprehensive loss Comprehensive loss was $8,183,000 and $7,365,000 for the years ended June 30, 2008 and 2007, respectively. The comprehensive loss differs from the net loss by the change in net unrealized gain or loss on short-term investments.

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 and conversion of convertible preferred stock. The dilutive effect of outstanding stock options and warrants is reflected in diluted loss per share by application of the treasury stock method. Convertible preferred stock is reflected on an if-converted basis.

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Fiscal Year ended June 30, 2008	2007
	(in thousands, except per share data)	
Basic and diluted net income per share:		
Net loss attributable to common stockholders	$ (5,682)	$ (7,472)
Weighted-average common shares outstanding	21,010	20,827
Effect of dilutive securities:		
Add: Stock options and warrants		
Add: Convertible preferred shares		
Weighted-average common shares outstanding for diluted calculation	21,010	20,827
Net loss per share:		
Basic and diluted	$ (0.27)	$ (0.36)

Options and warrants to purchase approximately 3,033,000 and 3,580,000 shares were outstanding at June 30, 2008 and 2007, respectively. These options and warrants were excluded from the computation of diluted loss per share because their effect would be anti-dilutive.

2. 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. In February 2008, the FASB issued FSP 157-2, Effective Date of FASB Statement No. 157 which permits a one-year deferral for the implementation of SFAS 157 with regard to non-financial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). 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.

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

CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 not anticipate that the adoption of SFAS No. 160 will have a material impact on the Company s financial condition or results of operations.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* . This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity s derivative instruments and hedging activities and their effects on the entity s financial position, financial performance, and cash flows. SFAS 161 applies to all derivative instruments within the scope of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* as well as related hedged items, bifurcated derivatives, and nonderivative instruments that are designated and qualify as hedging instruments. Entities with instruments subject to SFAS 161 must provide more robust qualitative disclosures and expanded quantitative disclosures. SFAS 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. Management does not anticipate that the adoption of SFAS No. 161 will have a material impact on the Company s financial condition or results of operations.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). SFAS 162 is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with GAAP for nongovernmental entities. SFAS 162 is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. Management does not expect the adoption of this statement will have a material impact on the Company s results of operations, financial position or cash flows.

CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In May 2008, the FASB issued SFAS No. 163, *Accounting for Financial Guarantee Insurance Contracts an Interpretation of FASB Statement No. 60* (SFAS 163). SFAS 163 requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. This statement also clarifies how SFAS 60 applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. Those clarifications will increase comparability in financial reporting of financial guarantee insurance contracts by insurance enterprises. This statement requires expanded disclosures about financial guarantee insurance contracts. The accounting and disclosure requirements of SFAS 163 will be effective for financial statements issued for fiscal years beginning after December 15, 2008. Management does not expect the adoption of this statement will have a material impact on the Company s results of operations, financial position or cash flows.

3. Marketable Securities

The Company considers its investment portfolio and marketable equity investments to be available-for-sale as defined by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Accordingly, these investments are recorded at fair value, which is based on quoted market prices. Realized gains totaled $10,000 and $44,000 for the fiscal years ended June 30, 2008 and 2007, respectively. Realized losses totaled $17,000 and $14,000 for the fiscal years ended June 30, 2008 and 2007, respectively. The cost of securities sold is based on the specific identification method. The fair values of available-for-sale investments by type of security, contractual maturity, and classification in the balance sheets are as follows (in thousands):

June 30, 2008	**Amortized Cost**	**Gross unrealized gains**	**Gross unrealized losses**	**Estimated fair value**
Type of security:				
Corporate debt securities	$ 6,797	$	$ 29	$ 6,768
Auction rate securities	10,000		2,508	7,492
U.S. Treasury securities and obligations of U.S. government agencies	24,528			24,528
Money market funds	5,244			5,244
Other interest bearing securities				
Total debt securities	$ 46,569	$	$ 2,537	$ 44,032

June 30, 2007	**Amortized Cost**	**Gross unrealized gains**	**Gross unrealized losses**	**Estimated fair value**
Type of security:				
Corporate debt securities	$ 33,428	$ 1	$ 35	$ 33,394
U.S. Treasury securities and obligations of U.S. government agencies	1,989		2	1,987
Money market funds	15,797			15,797
Other interest bearing securities				
Total debt securities	$ 51,214	$ 1	$ 37	$ 51,178

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	As of June 30, 2008	2007
Contractual maturity:		
Maturing in one year or less	$ 30,775	$ 47,232
Maturing after one year through three years	3,349	2,926
Maturing after three years	9,908	1,020
Total debt securities	$ 44,032	$ 51,178

	As of June 30, 2008	2007
Classification in balance sheets:		
Cash and cash equivalents	$ 27,772	$ 18,767
Marketable securities	8,768	32,411
Auction rate securities	7,492	
Total debt securities	$ 44,032	$ 51,178

The primary objectives for the Company s fixed income investment portfolio are liquidity and safety of principal. Investments are made with the objective of achieving the highest rate of return consistent with these two objectives. The Company s investment policy limits investments to certain types of instruments issued by institutions primarily with investment grade credit ratings and places restrictions on maturities and concentration by type and issuer.

4. Property and Equipment

Property and equipment, at cost, consists of the following:

		As of June 30, (in thousands)	
	Useful Life	2008	2007
Software	3 years	$ 522	$ 424
Office equipment	5 years	14	14
Furniture & fixtures	5 years	240	183
Computers, machinery and equipment	5 years	5,043	4,283
Leasehold improvements	Shorter of lease term or 5 years	359	352
		6,178	5,256
Less accumulated depreciation		(3,823)	(3,138)
Property and equipment, net		$ 2,355	$ 2,118

Depreciation expense on fixed assets was $743,000 and $756,000 for the years ended June 30, 2008 and 2007, respectively.

5. Intangible Assets

In January, 2006, the Company entered into a license agreement with an independent software company to use certain software programs and related intellectual property in CallWave s products. In March, 2006, the Company entered into a license agreement with Web Telephony, Inc., to use certain patent rights. In March,

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2007, the Company entered into a license agreement with j2 Global Communications and Catch Curve for a fully paid-up nonexclusive license to use certain licensed patents for non-fax services. These up front license payments were classified as intangible assets. The Company is amortizing the cost of the intangible assets on a straight-line basis over the life of the underlying patents. In addition, the Company purchased intellectual property for $1.6 million in June 2008 (see Note 6). This intellectual property is being amortized over its useful life of five years. The weighted average amortizable life of the intangible assets is 10 years. Amortization expense for the years ended June 30, 2008 and 2007, was $350,000 and $128,000, respectively.

Intangible assets consist of the following:

	As of June 30, 2008	As of June 30, 2007
	(in thousands)	
Amortized intangible assets:		
Purchased licenses, at cost	$ 6,147	$ 4,550
Less: accumulated amortization	(495)	(145)
Intangible assets, net	$ 5,652	$ 4,405

Estimated future amortization expense is as follows:

Years ending June 30, (in thousands)	
2009	$ 662
2010	654
2011	654
2012	654
2013	654
Thereafter	2,374

6. Related Party Transactions

During the quarter ended March 31, 2008, the Company entered into an agreement with a company controlled by an employee to license certain patented technology that is being used in the development of an integrated product. The agreement called for a license fee of up to $500,000, payable in installments upon the completion of certain milestones. During fiscal 2008, the Company had paid $275,000 under this agreement. The Company had capitalized the payments as intangible assets and was amortizing them over the term of the agreement. During the quarter ended June 30, 2008, the Company entered into an agreement to purchase the licensed technology for $1.6 million, less amounts already paid under the license agreement. The assets purchased included primarily source code, software binaries, software libraries, and software applications. The total amount of the purchase price was capitalized as an intangible asset and is being amortized over its useful life (see Note 5).

7. Stockholders Equity

Common Stock

As of June 30, 2008, the Company is authorized to issue 100,000,000 shares of common stock. As of June 30, 2008, 3,033,348 shares of common stock are reserved for stock options issued and outstanding.

The Company s board of directors has the authority without further action by the stockholders, to issue up to 10,000,000 shares of preferred stock in one or more series, to establish from time to time the number of shares to be included in each such series, to fix the rights, preferences and privileges of the shares of each wholly unissued

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

series and any qualifications, limitations or restrictions thereon, and to increase or decrease the number of shares of any such series (but not below the number of shares of such series then outstanding).

Warrants

At June 30, 2007, the Company had outstanding warrants to purchase up to 120,000 shares of common stock at an exercise price of $0.55. Warrants to purchase 24,000 shares were exercised and warrants to purchase 96,000 shares expired during the twelve months ended June 30, 2008. As of June 30, 2008, there were no warrants outstanding.

8. Stock Option Plans

As of June 30, 2008, the Company s stock option plans consist of the 2004 Option Plan, the 2000 Option Plan and the 1999 Option Plan. Shares reserved under these plans at June 30, 2008, consist of 4,773,965 shares, 2,250,000 shares and 1,350,000 shares authorized of which 2,579,113, 301,805 and 152,430 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 outstanding options is one-eighth after six months, and one-forty-eighth per month thereafter, becoming fully vested in four years. During the year ended June 30, 2008, the Company changed the vesting terms for all new options issued under the 2004 Plan. The new vesting terms are one-fourth after twelve 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 provision 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 determined 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.

	Fiscal Year Ended June 30,	
	2008	**2007**
Weighted average fair value of stock options granted	$1.32	$1.44
Risk free interest rate	2.87% 4.26%	4.57% 4.95%
Expected life (in years)	4.0	4.0
Expected volatility	53.95% 54.72%	52.72% 57.61%
Expected dividend yield	0%	0%
Expected forfeiture rate	9% 63%	2% 68%

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A summary of option activity under the Option Plans as of June 30, 2008, and changes during the two years in the period then ended is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at July 1, 2006	2,427,318	3.88		
Granted	1,409,258	3.08		
Exercised	(65,187)	1.71		
Forfeited or expired	(311,224)	4.93		
Outstanding at June 30, 2007	3,460,165	3.50		
Granted	1,997,383	2.88		
Exercised	(272,147)	1.77		
Forfeited or expired	(2,152,053)	3.37		
Outstanding at June 30, 2008	3,033,348	$ 3.31	3.51	$ 254
Vested or expected to vest at June 30, 2008	2,560,033	$ 3.39	3.35	$ 254
Exercisable at June 30, 2008	1,459,485	$ 3.72	2.79	$ 254

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 fiscal years ended June 30, 2008 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 June 30, 2008. This amount changes based on fluctuations in the fair market value of the Company s common stock. The total intrinsic value of options exercised during the years ended June 30, 2008 and 2007 was $224,000 and $92,000, respectively.

As of June 30, 2008, there was $2.1 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 3.04 years.

Total share-based compensation expense recognized for the years ended June 30, 2008 and 2007 was $1,106,000 and $1,075,000, respectively. For stock option awards subject to graded vesting we recognize compensation cost on a straight-line basis over the service period for the entire award.

9. Restructuring Charges

During the quarter ended September 30, 2007, the Company announced a reorganization and reduction in workforce and the termination of the Chief Executive Officer. As a result of the reorganization the Company incurred a 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. In addition, during the quarter ended March 31, 2008, the Company announced a second reduction in workforce and the termination of several Executive Officers. As a result of the second reduction in workforce, the Company incurred a charge of approximately $1 million associated primarily with severance, health insurance, accelerated stock option compensation expense, and facilities closures. The entire charge was recognized in the quarter ended March 31, 2008.

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. 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 $907,000 and $657,000 for the years ended June 30, 2008 and 2007, respectively.

Future minimum commitments remaining under these agreements as of June 30, 2008, are as follows:

Fiscal Year Ending June 30:	Minimum Commitment (in thousands)
2008	$ 811
2009	749
2010	356
2011	160
2012	131
Thereafter	54

Other Commitments and Contingencies

The Company has long-distance service agreements with five carriers. As of June 30, 2008, minimum obligations under these agreements due within one year total $341,000. 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 June 30, 2008, minimum obligations due within one year under agreements with providers of billing and collection services and outsourced customer support total $11,000.

Employment Continuation Obligations

The Company entered into employment continuation agreements with certain Company officers requiring the Company to provide post employment benefits if the Company terminates officers employment without good reason. Benefits include salary continuation, severance benefits, continuation of health care benefits, and accelerated vesting of granted stock options for terminated officers. The Company recognizes the costs of post employment benefits when actually paid.

Legal Proceedings

From time to time, the Company has been subject to legal proceedings and claims in the ordinary course of business. These claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. In addition, the result of an unfavorable outcome on certain of these matters could have a material adverse effect on the Company s financial position and results of operations.

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Income Taxes

The provision for income taxes consists of the following for each of the periods ended:

	June 30, 2008	June 30, 2007
Current federal provision	$	$
Current state		6
Deferred tax provision		
	$	$ 6

The difference between the effective tax rates and the statutory tax rates are reconciled as follows:

	June 30, 2008	June 30, 2007
Statutory rate applied to income before income tax provision (benefit)	$ (1,932)	$ (2,538)
State taxes, net of Federal and other tax benefits	(252)	(388)
Non deductible expenses	343	339
Alternative minimum tax		6
Utilization of net operating loss and other tax benefit carryforwards		
Change in valuation allowance	2,059	3,146
Other	(218)	(559)
	$	$ 6

The tax effect of temporary differences that give rise to a significant portion of the deferred tax assets and liabilities is presented below:

	June 30, 2008 (in thousands)	June 30, 2007 (in thousands)
Deferred tax assets:		
Net operating loss carryforwards	$ 5,992	$ 4,829
Tax credits	3,867	3,109
Equity compensation	437	302
Other	683	679
Total deferred tax assets	10,979	8,919
Deferred tax liabilities:		
Depreciation	(122)	(121)
Valuation allowance	(10,857)	(8,798)
Net deferred 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. Use of net operating loss and other carryforwards are limited by the change of ownership rules described below. 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

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CALLWAVE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

valuation allowance against its otherwise recognizable deferred tax assets. The net increase in the valuation allowance for the fiscal years ended June 30, 2008 and 2007, was approximately $2.1 million and $3.2 million due to management s determination that it is more likely than not that the deferred tax asset will not be realized.

As of June 30, 2008, the Company has cumulative net operating loss carryforwards for federal and California income tax purposes of approximately $17.1 million and $25.7 million respectively. The losses begin to expire in fiscal year 2010. In addition, the Company has available tax credit carryforwards of approximately $2.4 million and $1.3 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.

12. Employee Benefit Plan

The Company has a 401(k) savings plan covering substantially all of its employees. Eligible employees may contribute through payroll deductions. In 2005, the Company began to match 50% of employees contributions up to a maximum of $1,000 per year per employee. Through June 30, 2008 and 2007, the Company has matched employee contributions to the 401(k) savings plan totaling approximately $76,000 and $83,000, respectively.

13. Subsequent Events

On August 4, 2008, the Company entered into an Asset Purchase Agreement with WebMessenger, Inc. Under the terms of the agreement, the Company purchased certain software and all the copyrights and pending patent applications with respect to the software for $9 million in cash. Of the total purchase price, $1.8 million was deposited in escrow to secure the performance of the seller s obligations under the agreement. As part of the agreement, the Company opened an office in Sophia Bulgaria to house a research and development team.

On August 28, 2008, the Company announced a reorganization and reduction in workforce. As a result of the reorganization the Company will incur a charge of approximately $600,000 to $800,000 associated primarily with severance, health insurance, facilities consolidation and accelerated stock option compensation expense. The entire charge will be recognized in the quarter ended September 30, 2008.

14. Quarterly Information (Unaudited)

	September 30, 2007	December 31, 2007	March 31, 2008	June 30, 2008
	(in thousands, except per share data)			
Revenues	$ 5,352	$ 4,877	$ 5,153	$ 4,627
Gross profit	3,420	3,070	3,454	2,873
Operating loss	(3,027)	(2,095)	(1,829)	(1,040)
Income tax expense				
Net loss	(2,327)	(1,405)	(1,239)	(711)
Net loss per share basic and diluted	$ (0.11)	$ (0.07)	$ (0.06)	$ (0.03)

	September 30, 2006	December 31, 2006	March 31, 2007	June 30, 2007
Revenues	$ 6,535	$ 6,908	$ 6,230	$ 5,528
Gross profit	4,305	4,719	3,973	3,458
Operating income (loss)	(2,192)	(1,991)	(3,367)	(2,961)
Income tax expense				6
Net income (loss)	(1,392)	(1,193)	(2,601)	(2,286)
Net income (loss) per share basic	$ (0.07)	$ (0.06)	$ (0.12)	$ (0.11)

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Item 15. Exhibits and Financial Statement Schedules

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON SCHEDULE

To the Board of Directors and Stockholders

CallWave, Inc.:

We have audited the consolidated financial statements of CallWave, Inc. and Subsidiaries as of June 30, 2008 and 2007 and for each of the two years in the period ended June 30, 2008, and have issued our report thereon dated September 26, 2008. Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The information included in the accompanying Schedule II Valuation and Qualifying Accounts is presented for purposes of complying with the Securities and Exchange Commission s rules and is not a required part of the basic consolidated financial statements. Such information for each of the two years in the period ended June 30, 2008, has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

/s/ MAYER HOFFMAN MCCANN P.C.

MAYER HOFFMAN MCCANN P.C.

Los Angeles, California

September 26, 2008

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SCHEDULE II

Valuation And Qualifying Accounts

For the Fiscal Years Ended June 30, 2008 and 2007

Years Ended June 30,	Balance at Beginning of Period	Additions Charged to Expense	Deductions	Balance at End of Period
		(in thousands)		
2008				
Allowance for doubtful accounts	$ 436	$ 668	$ (819)	$ 285
2007				
Allowance for doubtful accounts	$ 574	$ 1,408	$ (1,546)	$ 436

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