

# SECURITIES & EXCHANGE COMMISSION EDGAR FILING

**Zedge, Inc.**

**Form: 10-Q**

**Date Filed: 2017-12-14**

Corporate Issuer CIK: 1667313

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED OCTOBER 31, 2017**

or

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

Commission File Number: 1-37782

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**ZEDGE, INC.**

(Exact Name of Registrant as Specified in its Charter)

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Delaware

(State or other jurisdiction of  
incorporation or organization)

22 Cortlandt Street, 14<sup>th</sup> Floor, New York, NY

(Address of principal executive offices)

26-3199071

(I.R.S. Employer  
Identification Number)

10007

(Zip Code)

(330) 577-3424

(Registrant's telephone number, including area code)

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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  No

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input checked="" type="checkbox"/>
Emerging growth company	<input checked="" type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of December 12, 2017, the registrant had the following shares outstanding:

Class A common stock, \$.01 par value:	524,775 shares outstanding
Class B common stock, \$.01 par value:	9,441,572 shares outstanding

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

ZEDGE, INC.  
CONSOLIDATED BALANCE SHEETS

	October 31, 2017	July 31, 2017
	(in thousands, except par value)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,163	\$ 4,580
Trade accounts receivable, net of allowance for doubtful accounts of \$0 at October 31, 2017 and July 31, 2017	1,898	1,712
Prepaid expenses	300	315
Other current assets	272	427
Total current assets	<u>6,633</u>	<u>7,034</u>
Property and equipment, net	3,005	2,678
Goodwill	2,437	2,518
Other assets	296	301
Total assets	<u>\$ 12,371</u>	<u>\$ 12,531</u>
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Trade accounts payable	\$ 155	\$ 33
Accrued expenses	2,173	1,840
Due to IDT Corporation	63	36
Total current liabilities	<u>2,391</u>	<u>1,909</u>
Total liabilities	<u>2,391</u>	<u>1,909</u>
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, \$.01 par value; authorized shares—2,400; no shares issued	-	-
Class A common stock, \$.01 par value; authorized shares—2,600; 525 shares issued and outstanding at October 31, 2017 and July 31, 2017	5	5
Class B common stock, \$.01 par value; authorized shares—40,000; 9,442 and 9,123 shares issued and outstanding at October 31, 2017 and July 31, 2017, respectively	92	91
Additional paid-in capital	21,760	21,446
Accumulated other comprehensive loss	(721)	(584)
Accumulated deficit	(11,156)	(10,336)
Total stockholders' equity	<u>9,980</u>	<u>10,622</u>
Total liabilities and stockholders' equity	<u>\$ 12,371</u>	<u>\$ 12,531</u>

See accompanying notes to consolidated financial statements.

ZEDGE, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>October 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(in thousands, except per share data)</b>	
Revenues	\$ 2,659	\$ 2,383
Costs and expenses:		
Direct cost of revenues (exclusive of amortization of capitalized software and technology development costs included below)	372	367
Selling, general and administrative	2,972	1,756
Depreciation and amortization	157	138
Write-off of capitalized software and technology development costs	-	9
(Loss) income from operations	(842)	113
Interest and other income	9	1
Net (loss) gain resulting from foreign exchange transactions	(1)	50
(Loss) income before income taxes	(834)	164
Benefit from (provision for) for income taxes	14	(1)
Net (loss) income	(820)	163
Other comprehensive (loss) income:		
Changes in foreign currency translation adjustment	(137)	73
Total other comprehensive (loss) income	(137)	73
Total comprehensive (loss) income	<u>\$ (957)</u>	<u>\$ 236</u>
(Loss) earnings per share attributable to Zedge, Inc. common stockholders:		
Basic	<u>\$ (0.08)</u>	<u>\$ 0.02</u>
Diluted	<u>\$ (0.08)</u>	<u>\$ 0.02</u>
Weighted-average number of shares used in calculation of (loss) earnings per share:		
Basic	<u>9,658</u>	<u>9,261</u>
Diluted	<u>9,658</u>	<u>10,458</u>

See accompanying notes to consolidated financial statements.

ZEDGE, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	<b>Three Months Ended</b>	
	<b>October 31,</b>	
	<b>2017</b>	<b>2016</b>
	<b>(in thousands)</b>	
<b>Operating activities</b>		
Net (loss) income	\$ (820)	\$ 163
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	157	138
Deferred income taxes	1	5
Stock-based compensation	73	27
Stock issued to FreeForm noteholders	242	-
Change in assets and liabilities:		
Trade accounts receivable	(186)	(11)
Prepaid expenses and other current assets	170	(264)
Other assets	4	(2)
Trade accounts payable and accrued expenses	438	392
Due to IDT Corporation	27	(226)
Deferred revenue	-	(7)
Net cash provided by operating activities	106	215
<b>Investing activities</b>		
Capitalized software and technology development costs and purchase of equipment	(488)	(349)
Net cash used in investing activities	(488)	(349)
<b>Financing activities</b>		
Proceeds from exercise of stock options	-	124
Net cash provided by financing activities	-	124
Effect of exchange rate changes on cash and cash equivalents	(35)	15
Net (decrease) increase in cash and cash equivalents	(417)	5
Cash and cash equivalents at beginning of period	4,580	5,978
Cash and cash equivalents at end of period	\$ 4,163	\$ 5,983

See accompanying notes to consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

**Note 1—Basis of Presentation**

The accompanying unaudited consolidated financial statements of Zedge, Inc. and its subsidiaries, Zedge Europe AS and Zedge Canada, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended October 31, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending July 31, 2018. The balance sheet at July 31, 2017 has been derived from the Company's audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. For further information, please refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended July 31, 2017, as filed with the U.S. Securities and Exchange Commission ("SEC").

The Company was formerly a majority-owned subsidiary of IDT Corporation ("IDT"). On June 1, 2016, IDT's interest in the Company was spun-off by IDT to IDT's stockholders and the Company became an independent public company through a pro rata distribution of the Company's common stock held by IDT to IDT's stockholders (the "Spin-Off").

The Company's fiscal year ends on July 31 of each calendar year. Each reference below to a fiscal year refers to the fiscal year ending in the calendar year indicated (e.g., fiscal 2018 refers to the fiscal year ending July 31, 2018).

**Note 2—Fair Value Measurements**

The following tables present the balance of assets and liabilities measured at fair value on a recurring basis:

	Level 1 (1)	Level 2 (2)	Level 3 (3)	Total
	(in thousands)			
31-Oct-17				
Assets:				
Foreign exchange forward contracts	\$ -	\$ -	\$ -	\$ -
Liabilities:				
Foreign exchange forward contracts	\$ -	\$ -	\$ -	\$ -
31-Jul-17				
Assets:				
Foreign exchange forward contracts	\$ -	\$ 137	\$ -	\$ 137
Liabilities:				
Foreign exchange forward contracts	\$ -	\$ -	\$ -	\$ -

(1) – quoted prices in active markets for identical assets or liabilities

(2) – observable inputs other than quoted prices in active markets for identical assets and liabilities

(3) – no observable pricing inputs in the market

*Fair Value of Other Financial Instruments*

The Company's other financial instruments at October 31, 2017 and July 31, 2017 included trade accounts receivable, trade accounts payable and due to IDT Corporation. The carrying amounts of the trade accounts receivable, trade accounts payable and due to IDT Corporation balances approximated fair value due to their short-term nature. This fair value estimate was classified as Level 2 of the fair value hierarchy.

### Note 3—Derivative Instruments

The primary risk managed by the Company using derivative instruments is foreign exchange risk. Foreign exchange forward contracts are entered into as hedges against unfavorable fluctuations in the U.S. Dollar - NOK exchange rate. Subsequent to the Spin-Off and until November 2016, IDT provided hedging services to the Company pursuant to the Transition Services Agreement (see Note 7). As of November 16, 2016, the Company entered into a Foreign Exchange Agreement with Western Alliance Bank allowing the Company to enter into foreign exchange contracts under its revolving credit facility with the bank (see Note 8). The Company does not apply hedge accounting to these contracts; therefore the changes in fair value are recorded in earnings. By using derivative instruments to mitigate exposures to changes in foreign exchange rates, the Company is exposed to credit risk from the failure of the counterparty to perform under the terms of the contract. The credit or repayment risk is minimized by entering into transactions with high-quality counterparties.

The fair value of outstanding derivative instruments recorded as assets in the accompanying consolidated balance sheets were as follows:

<u>Asset Derivatives</u>	<u>Balance Sheet Location</u>	<u>October 31,</u> <u>2017</u>	<u>July 31,</u> <u>2017</u>
(in thousands)			
Derivatives not designated or not qualifying as hedging instruments:			
Foreign exchange forward contracts	Other current assets	\$ —	\$ 137

The effects of derivative instruments on the consolidated statements of comprehensive (loss) income were as follows:

		<u>Amount of (Loss) Gain</u> <u>Recognized on Derivatives</u>	
		<u>Three Months Ended</u>	
<u>Derivatives not designated or not qualifying as hedging</u> <u>instruments</u>	<u>Statement of Comprehensive (Loss) Income Location</u>	<u>October 31,</u> <u>2017</u>	<u>2016</u>
(in thousands)			
Foreign exchange forward contracts	Net gain (loss) resulting from foreign exchange transactions	\$ (1)	\$ 50

### Note 4—Accrued Expenses

Accrued expenses consist of the following:

	<u>October 31,</u> <u>2017</u>	<u>July 31,</u> <u>2017</u>
(in thousands)		
Accrued vacation	\$ 760	\$ 685
Accrued payroll taxes	375	277
Accrued payroll and bonuses	331	250
Accrued severance	163	-
Accrued direct cost of revenues	-	6
Accrued advertising	172	184
Accrued income taxes	-	36
Accrued professional fees	99	130
Other	273	272
<b>Total accrued expenses</b>	<b>\$ 2,173</b>	<b>\$ 1,840</b>



## Note 5—Equity

Changes in the components of equity were as follows:

	<b>Three Months Ended October 31, 2017</b>
	<b>(in thousands)</b>
Balance, July 31, 2017	\$ 10,622
Stock issued to FreeForm noteholders	242
Stock-based compensation	73
Comprehensive income:	
Net loss	(820)
Foreign currency translation adjustments	(137)
Total comprehensive loss	(957)
Balance, October 31, 2017	<u>\$ 9,980</u>

### *Stock Options*

In September 2016, the Compensation Committee of our Board of Directors approved an equity grant of options to purchase an aggregate of 231,327 shares of our Class B common stock to our executive officers, a non-executive employee and a consultant. The options vest over a three-year period from grant. Unrecognized compensation expense related to this grant was an aggregate of \$681,000 based on the estimated fair value of the options on the grant date. In November, 2017, the Company cancelled 53,026 shares of these options grant because they exceeded the annual limit of 60,000 shares per grantee as set forth in Article 5(c) of the Amended and Restated 2016 Stock Option and Incentive Plan dated October 18, 2017 (the "2016 Incentive Plan"). Simultaneously, the Compensation Committee of our Board of Directors approved an options grant of 53,026 with similar terms. Unrecognized compensation expense related to this option grant was an aggregate of \$85,000 based on the estimated fair value of the options on the grant date.

On October 18, 2017, the Compensation Committee of the Company's Board of Directors approved the grant of options to purchase an aggregate of 124,435 shares of the Company's Class B common stock to 55 of its non-executive employees. The options vest over a three-year period from December 8, 2017. Unrecognized compensation expense related to this grant was an aggregate of \$159,000 based on the estimated fair value of the options on the grant date. The unrecognized compensation expense is being recognized on a straight-line basis over the vesting period. At October 31, 2017, there were 483,000 shares of the Company's Class B common stock available for awards under the 2016 Incentive Plan, inclusive of the additional 350,000 shares discussed below.

### *2016 Stock Option and Incentive Plan*

On October 18, 2017, the Company's Board of Directors amended the 2016 Incentive Plan to increase the number of shares of the Company's Class B common stock available for the grant of awards thereunder by an additional 350,000 shares. This amendment is subject to ratification by the Company's stockholders during Annual Meeting which is scheduled to take place on January 17, 2018.

### *Freeform Transaction*

In September 2017, the Company entered into an Agreement and Release with Freeform Development, Inc. ("Freeform") and certain of its former employees, pursuant to which the Company obtained releases for certain employees from their Freeform employment agreements in exchange for the repayment of certain of Freeform's liabilities. The Company paid Freeform \$125,000 in cash to pay its operating liabilities (with any excess to be refunded to the Company), and the Company paid the holders of Freeform's convertible promissory notes cash of \$97,567 and issued the noteholders a total of 126,679 shares of Zedge Class B common stock with a fair value of \$242,000 on issuance, which are subject to a two-year lock-up agreement. The Company believes this transaction does not qualify as a business combination under Accounting Standard Update 2017-01, which the Company adopted early on August 1, 2017, and as such accounted for the payment of the Freeform liabilities that aggregated \$465,000, as selling, general and administrative expense in three months ended October 31, 2017.

Additionally, the Company also issued a total of 192,953 shares of the Company's Class B common stock to former Freeform employees, which shall vest over a four-year period subject to continued employment. These shares had an aggregate grant date fair value of \$369,000 and is being amortized on a straight-line basis over the vesting period.

## Note 6—Earnings Per Share

Basic earnings per share is computed by dividing net income attributable to all classes of common stockholders of the Company by the weighted average number of shares of all classes of common stock outstanding during the applicable period. Diluted earnings per share is computed in the same manner as basic earnings per share, except that the number of shares is increased to include restricted stock still subject to risk of forfeiture and to assume exercise of potentially dilutive stock options using the treasury stock method, unless the effect of such increase is anti-dilutive.

The weighted-average number of shares used in the calculation of basic and diluted earnings per share attributable to the Company's common stockholders consists of the following:

	Three Months Ended October 31,	
	2017	2016
	(in thousands)	
Basic weighted-average number of shares	9,658	9,261
Effect of dilutive securities:		
Stock options	-	1,079
Non-vested restricted Class B common stock	-	118
Diluted weighted-average number of shares	<u>9,658</u>	<u>10,458</u>

The following shares were excluded from the dilutive earnings per share computations because their inclusion would have been anti-dilutive:

	Three Months Ended October 31,	
	2017	2016
	(in thousands)	
Shares excluded from the calculation of diluted earnings per share	<u>1,797</u>	<u>247</u>

For the three months ended October 31, 2017, the diluted earnings per share equals basic earnings per share because the Company had a net loss and the impact of the assumed exercise of stock options and vesting of restricted stock would have been anti-dilutive. For the three months ended October 31, 2016, outstanding stock options were excluded from the calculation of diluted earnings per share because the exercise price of the stock option was greater than the average market price of the Company's stock during the period.

#### Note 7—Related Party Transactions

Prior to the Spin-Off, IDT charged the Company for certain transactions and allocated routine expenses based on company specific items covered under a Master Services Agreement. This agreement provided for, among other things: (1) the allocation between the Company and IDT of costs of employee benefits, taxes and other liabilities and obligations; (2) services provided by IDT relating to human resources and employee benefits administration; and (3) finance, accounting, tax, facilities and legal services provided by IDT to the Company. Following the Spin-Off, IDT charges the Company for services it provides pursuant to the Transition Services Agreement. The services provided pursuant to the Transition Services Agreement include human resources, payroll, investor relations, legal, accounting, tax, financial systems, management consulting and foreign exchange risk management. As of October 31, 2017, most of these services were discontinued and are being performed directly by Zedge. IDT's charges are included in "Selling, general and administrative expense" in the consolidated statements of comprehensive (loss) income.

	Three Months Ended October 31,	
	2017	2016
	(in thousands)	
Payments by IDT on behalf of the Company	\$ 229	\$ 477
Cash repayments, net of advances	\$ (201)	\$ (703)

## Note 8—Revolving Credit Facility

As of September 27, 2016, the Company entered into a loan and security agreement with Western Alliance Bank for a revolving credit facility of up to \$2.5 million. Advances under this facility may not exceed the lesser of \$2.5 million or 80% of the Company's eligible accounts receivable, subject to certain concentration limits. The revolving credit facility is secured by a lien on substantially all of the Company's assets. The outstanding principal amount bears interest per annum at the greater of 3.5% or the prime rate plus 1.25%. Interest is payable monthly and all outstanding principal and any accrued and unpaid interest is due on the maturity date of September 27, 2018. The Company is required to pay an annual facility fee of \$12,500 to Western Alliance Bank. The Company is also required to comply with various affirmative and negative covenants and to maintain certain financial ratios during the term of the revolving credit facility. The covenants include a prohibition on the Company paying any dividend on its capital stock. The Company may terminate this agreement at any time without penalty or premium provided that it pays down any outstanding principal, accrued interest and bank expenses. At October 31, 2017, there were no amounts outstanding under the revolving credit facility and the Company was in compliance with all of the covenants.

As of November 16, 2016, the Company entered into a Foreign Exchange Agreement with Western Alliance Bank to allow the Company to enter into foreign exchange contracts not to exceed \$5.0 million in the aggregate at any point in time under its revolving credit facility. The available borrowing under the revolving credit facility is reduced by an applicable foreign exchange reserve percentage as determined by Western Alliance Bank, in its reasonable discretion from time to time, which was initially set at 10% of the nominal amount of the foreign exchange contracts in effect at the relevant time. In December 2016, the applicable foreign exchange reserve percentage was changed so that the reduction of available borrowing for major currency forward contracts of less than six months tenor is set at 10% of the nominal amount of the foreign exchange contracts, and for contracts over six months tenor, 12.5% of the nominal amount of the foreign exchange contracts. As of October 31, 2017, there were no outstanding foreign exchange contracts Foreign Exchange Agreement.

## Note 9—Business Segment and Geographic Information

The Company provides a content platform, worldwide, centered on self-expression, attracting both creators looking to promote their content and consumers who utilize such content to express their identity, feelings, tastes and interests. The Company's platform enables consumers to personalize their mobile devices with free, high quality ringtones, wallpapers, home screen app icons and notification sounds. The Company conducts business as one operating segment.

Net long-lived assets and total assets held outside of the United States, which are located primarily in Norway, were as follows:

	United States	Foreign	Total
	(in thousands)		
Long-lived assets, net:			
31-Oct-17	\$ 2,880	\$ 251	\$ 3,131
31-Jul-17	\$ 2,537	\$ 271	\$ 2,808
Total assets:			
31-Oct-17	\$ 7,267	\$ 5,104	\$ 12,371
31-Jul-17	\$ 8,910	\$ 3,621	\$ 12,531

## Note 10—Commitments & Contingencies and Tax Matters

### Legal Proceedings

In March 2014, Saregama India, Limited filed a lawsuit against the Company before the Barasat District Court, seeking approximately \$1.6 million in damages and an injunction for copyright infringement. The main ground for the lawsuit was an allegation that the Company avails the plaintiff's sound recordings through the Company's platform with full knowledge that the sound recordings have been uploaded and are being communicated to the public without obtaining any license from the plaintiff. The Company believes that the possibility of it bearing material liability on the matter is remote.

The Company may from time to time be subject to other legal proceedings that arise in the ordinary course of business. Although there can be no assurance in this regard, the Company does not expect any of those legal proceedings to have a material adverse effect on the Company's results of operations, cash flows or financial condition.

### Tax Audits

In September 2016, the Company was notified that the Zedge Europe AS tax returns for 2012 through 2016 were going to be audited by the tax authorities in Norway. The initial audit meeting took place in October 2016 and the audit is progressing. No significant issues have been identified at this time. Amounts asserted by taxing authorities or the amount ultimately assessed against the Company could be greater than any accrued amount. Accordingly, provisions may be recorded in the future as estimates are revised or underlying matters are settled or resolved. Imposition of assessments as a result of tax audits could have an adverse effect on the Company's results of operations, cash flows and financial condition.

As of October 31, 2017, the balance of the Company's net receivable from Norway's SkatteFUNN government program designed to stimulate research and development in Norwegian trade and industry was \$202,700, which was included in "Other current assets" in the consolidated balance sheet and \$25,800 was recorded as a reduction of selling, general and administrative expense for the three months ended October 31, 2017, and \$222,700 was recorded as a reduction of selling, general and administrative expense for the three months ended October 31, 2016, of which \$204,000 was related to prior periods.

#### **Note 11—Recently Issued Accounting Standards Not Yet Adopted**

In August 2017, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update ("ASU") intended to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, the ASU includes certain targeted improvements to simplify the application of hedge accounting guidance in U.S. GAAP. The amendments in this ASU are effective for the Company on August 1, 2019. Early application is permitted. Entities will apply the amendments to cash flow and net investment hedge relationships that exist on the date of adoption using a modified retrospective approach. The presentation and disclosure requirements will be applied prospectively. The Company is evaluating the impact that this ASU will have on its consolidated financial statements.

In May 2017, the Financial Accounting Standards Board ("FASB") issued an ASU to provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. Pursuant to this ASU, an entity should account for the effects of a modification unless all the following are met: (1) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified (if the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification); (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The Company will adopt the amendments in this ASU prospectively to an award modified on or after on August 1, 2018. The Company is evaluating the impact that the new standard will have on its consolidated financial statements.

In June 2016, the FASB issued an ASU that changes the impairment model for most financial assets and certain other instruments. For receivables, loans and other instruments, entities will be required to use a new forward-looking "expected loss" model that generally will result in the earlier recognition of allowance for losses. For available-for-sale debt securities with unrealized losses, entities will measure credit losses in a manner similar to current practice, except the losses will be recognized as allowances instead of reductions in the amortized cost of the securities. In addition, an entity will have to disclose significantly more information about allowances, credit quality indicators and past due securities. The new provisions will be applied as a cumulative-effect adjustment to retained earnings. The Company will adopt the new standard on August 1, 2020. The Company is evaluating the impact that the new standard will have on its consolidated financial statements.

In February 2016, the FASB issued an ASU related to the accounting for leases. The new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The Company will adopt the new standard on August 1, 2019. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is evaluating the impact that the new standard will have on its consolidated financial statements.

In May 2014, the FASB and the International Accounting Standards Board jointly issued a comprehensive new revenue recognition standard that will supersede most of the current revenue recognition guidance under U.S. GAAP and International Financial Reporting Standards ("IFRS"). The goals of the revenue recognition project were to clarify and converge the revenue recognition principles under U.S. GAAP and IFRS and to develop guidance that would streamline and enhance revenue recognition requirements. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Entities have the option of using either a full retrospective or modified retrospective approach for the adoption of the standard. The Company expects to adopt this standard on August 1, 2018 using the modified retrospective approach. The Company has identified its main revenue streams, which are advertising revenue, app installs and advertising ops outsourcing. In addition, the Company substantially completed reviewing contracts and other relevant documents for most of its customers that comprises its main revenue streams. Based on this preliminary analysis to date of the adoption of the standard, the Company has not identified a significant impact on its consolidated financial statements, although this is subject to change as the Company completes the process.

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

The following information should be read in conjunction with the accompanying consolidated financial statements and the associated notes thereto of this Quarterly Report, and the audited consolidated financial statements and the notes thereto and our Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017, as filed with the U.S. Securities and Exchange Commission (or SEC).

As used below, unless the context otherwise requires, the terms "the Company," "Zedge," "we," "us," and "our" refer to Zedge, Inc., a Delaware corporation, and its subsidiaries, Zedge Europe AS and Zedge Canada, Inc., collectively.

### Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements that contain the words "believes," "anticipates," "expects," "plans," "intends," and similar words and phrases. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from the results projected in any forward-looking statement. In addition to the factors specifically noted in the forward-looking statements, other important factors, risks and uncertainties that could result in those differences include, but are not limited to, those discussed under Item 1A to Part I "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017. The forward-looking statements are made as of the date of this report and we assume no obligation to update the forward-looking statements, or to update the reasons why actual results could differ from those projected in the forward-looking statements. Investors should consult all of the information set forth in this report and the other information set forth from time to time in our reports filed with the SEC pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934, including our Annual Report on Form 10-K for the fiscal year ended July 31, 2017.

### Overview

We provide one of the most popular content platforms, worldwide, centered on self-expression, attracting both creators looking to promote their content and consumers who utilize such content to express their identity, feelings, tastes and interests. Today our platform enables consumers to personalize their mobile devices with free, high-quality ringtones, wallpapers, home screen app icons, widgets and notification sounds. Our smartphone app, called Zedge, available in Google Play and iTunes app stores, has been installed over 289 million times, has more than 33 million monthly active users, or MAUs, as of October 31, 2017. The Zedge app has averaged among the top 30 free applications in the Google Play store in the United States and in the iTunes Entertainment category for the past five years. MAU is a performance indicator that captures the number of unique users that opened our app in the previous 30-day period. To date, we have grown our user base without material investment in marketing, user acquisition or advertising.

We generate over 90% of our revenues from selling our advertising inventory to advertising networks, advertising exchanges, and direct arrangements with advertisers. Advertising networks and advertising exchanges are technology platforms that facilitate the buying and selling of media advertising inventory from multiple ad networks. The price of advertising inventory is fixed on an advertising network whereas the price for advertising inventory is determined through bidding on an advertising exchange. Advertisers are attracted to us because of our sizable user base and our focus on mobile phone personalization. The remainder of our revenue is primarily generated from our managing and optimizing the advertising inventory of a third-party mobile application publisher, as well as overseeing the billing, collections and reporting related to advertising for this publisher.

A key element in maintaining our position is our ability to meet user's expectations, which necessitates retaining employees with solid educational and professional credentials who are passionate about our mission to serve as a medium for self-expression.

Our ability to continue attracting advertisers depends on the growth and demographics of our user base, increased app usage and improved retention. These will require continued investment in product, technology and marketing. Our growth plan also relies on improved monetization techniques and selective strategic investments and acquisitions.

We believe that our business model is scalable and allows for significant portions of revenue growth to flow to our bottom line.

We were formerly a majority-owned subsidiary of IDT Corporation, or IDT. On June 1, 2016, IDT's interest in Zedge was spun-off by IDT to IDT's stockholders and we became an independent public company through a pro rata distribution of our common stock held by IDT to IDT's stockholders (the Spin-Off).

### Recent Developments

In September 2017, we entered into an Agreement and Release with Freeform Development, Inc. ("Freeform") and certain of its former employees, pursuant to which we obtained releases for the employees from their Freeform employment agreements in exchange for the repayment of Freeform's liabilities. We paid Freeform \$125,000 in cash to pay its operating liabilities (with any excess to be refunded to us), and we paid the holders of Freeform's convertible promissory notes cash of \$97,567 and issued the noteholders a total of 126,679 shares of our Class B common stock with a fair value of \$242,000 on issuance, which are subject to a two-year lock-up agreement. In addition, we issued a total of 192,953 restricted shares of our Class B common stock, with a fair value of \$369,000 on issuance, to former employees of Freeform and those employees entered into Employment Agreements with us.

The aggregate consideration paid by us was \$834,000, consisting of cash of \$223,000 and 319,632 shares of our Class B common stock with a fair market value of \$611,000 on the date of issue. The 192,953 shares that were issued to former employees of Freeform vest equally over four years, contingent upon them remaining employees of Zedge. We believe that the acquisition does not qualify as a business combination under Accounting Standard Update 2017-01, which the Company adopted early on August 1, 2017, and as such accounted for the payment of the Freeform liabilities, an aggregate of \$465,000, as selling, general and administrative expense in three months ended October 31, 2017. We will charge the fair market value of the employee shares of \$369,000 to expense over the four-year requisite service period.

In October 2017, we announced cost-cutting measures that included a modest headcount reduction plan in which we reduced our workforce by approximately 10%. In connection with this plan, we incurred estimated severance costs of \$191,000 that was charged to selling, general and administrative expense in the three months ended October 31, 2017.

### **Critical Accounting Policies**

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. Our significant accounting policies are described in Note 1 to the consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses as well as the disclosure of contingent assets and liabilities. Critical accounting policies are those that require application of management's most subjective or complex judgments, often as a result of matters that are inherently uncertain and may change in subsequent periods. Our critical accounting policies include those related to capitalized software and technology development costs, revenue recognition and goodwill. Management bases its estimates and judgments on historical experience and other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. For additional discussion of our critical accounting policies, see our Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017.

### **Recently Issued Accounting Standards Not Yet Adopted**

In August 2017, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update ("ASU") intended to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, the ASU includes certain targeted improvements to simplify the application of hedge accounting guidance in U.S. GAAP. The amendments in this ASU are effective for the Company on August 1, 2019. Early application is permitted. Entities will apply the amendments to cash flow and net investment hedge relationships that exist on the date of adoption using a modified retrospective approach. The presentation and disclosure requirements will be applied prospectively. The Company is evaluating the impact that this ASU will have on its consolidated financial statements.

In May 2017, the Financial Accounting Standards Board ("FASB") issued an ASU to provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. Pursuant to this ASU, an entity should account for the effects of a modification unless all the following are met: (1) the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified (if the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification); (2) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3) the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. The Company will adopt the amendments in this ASU prospectively to an award modified on or after on August 1, 2018. The Company is evaluating the impact that the new standard will have on its consolidated financial statements.

In June 2016, the FASB issued an ASU that changes the impairment model for most financial assets and certain other instruments. For receivables, loans and other instruments, entities will be required to use a new forward-looking "expected loss" model that generally will result in the earlier recognition of allowance for losses. For available-for-sale debt securities with unrealized losses, entities will measure credit losses in a manner similar to current practice, except the losses will be recognized as allowances instead of reductions in the amortized cost of the securities. In addition, an entity will have to disclose significantly more information about allowances, credit quality indicators and past due securities. The new provisions will be applied as a cumulative-effect adjustment to retained earnings. The Company will adopt the new standard on August 1, 2020. The Company is evaluating the impact that the new standard will have on its consolidated financial statements.

In February 2016, the FASB issued an ASU related to the accounting for leases. The new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The Company will adopt the new standard on August 1, 2019. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is evaluating the impact that the new standard will have on its consolidated financial statements.

In May 2014, the FASB and the International Accounting Standards Board jointly issued a comprehensive new revenue recognition standard that will supersede most of the current revenue recognition guidance under U.S. GAAP and International Financial Reporting Standards ("IFRS"). The goals of the revenue recognition project were to clarify and converge the revenue recognition principles under U.S. GAAP and IFRS and to develop guidance that would streamline and enhance revenue recognition requirements. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Entities have the option of using either a full retrospective or modified retrospective approach for the adoption of the standard. The Company expects to adopt this standard on August 1, 2018 using the modified retrospective approach. The Company has identified its main revenue streams, which are advertising revenue, app installs and advertising ops outsourcing. In addition, the Company substantially completed reviewing contracts and other relevant documents for most of its customers that comprises its main revenue streams. Based on this preliminary analysis to date of the adoption of the standard, the Company has not identified a significant impact on its consolidated financial statements, although this is subject to change as the Company completes the process.

## Results of Operations

### Three Months Ended October 31, 2017 Compared to Three Months Ended October 31, 2016.

	Three months ended		Change	
	October 31,			
	2017	2016	\$	%
	(in thousands)			
Revenues	\$ 2,659	\$ 2,383	\$ 276	11.6%
Direct cost of revenues	372	367	5	1.4%
Selling, general and administrative	2,972	1,756	1,216	69.2%
Depreciation and amortization	157	138	19	13.8%
Write-off of capitalized software and technology development costs	-	9	(9)	nm
(Loss) income from operations	(842)	113	(955)	-845.1%
Interest and other income	9	1	8	800.0%
Net (loss) gain resulting from foreign exchange transactions	(1)	50	(51)	-102.0%
Benefit from (provision for) for income taxes	14	(1)	15	-1500.0%
Net (loss) income	\$ (820)	\$ 163	\$ (983)	-603.1%

nm—not meaningful

*Revenues.* Revenues increased 11.6% in Q1 of fiscal 2018 compared to the same period in fiscal 2017 primarily attributable to initiatives that we have taken to improve our app's core user experience including the introduction of sideswipe and improved content recommendations which, amongst other things, contributed to improvements in MAU, engagement, frequency of use and retention. During the middle of Q1 of fiscal 2018 we also launched new Android ad units that increased revenue and the number of ad impressions viewed per user. These changes offset the revenue declines experienced across our desktop and mobile websites which became less relevant with the adoption of our smartphone apps as well as our decision to reduce our investment in the Game Channel in mid-April 2016.

MAU for the last 30 days of the quarter increased 5.7% to 33.4 million from 31.6 million in the comparable period of fiscal 2017, with growth across all regions, globally. MAU is a performance indicator that captures the number of unique users that opened our app in the previous 30-day period.

Average revenue per MAU derived from our apps (ARPMU) increased 9.9% to \$0.0256 from \$0.0233, the fourth consecutive quarterly improvement. This increase resulted primarily from the introduction of new Android ad placements that increased the number of ad impressions viewed by users resulting in higher ARPMU. We manage our business to ARPMU.

We experienced a 6.0% decrease in advertising effective cost per thousand impressions (eCPMs) in Q1 of fiscal 2018 when compared to the last year quarter. This decline was primarily a result of (i) our prioritizing viewed ad impressions per user ahead of eCPMs in order to maximize revenue; and (ii) the impact of the relative weighting of our user base to emerging markets on revenue contribution as eCPMs are lower in these markets when compared to well-developed economies.

In order to increase our revenues, we launched sideswipe and improved upon content recommendations making fresh and relevant content consistently available in order to encourage greater engagement and increase revenue. In July 2017, we began a limited test of rewarded video ads (i.e. full screen video ads that users are required to watch in exchange for access to content). The test results revealed an incremental increase in revenue without negatively impacting user retention. As such we are adding this placement into our app.

Our cumulative install count, that is the number of times the Zedge app has been installed on devices, increased to 288.8 million at October 31, 2017 from 230.5 million a year ago.

In February, 2016 our iOS app was removed from the iTunes store. In response we introduced a standalone wallpaper app in iTunes in March 2016 offering free wallpapers, a standalone ringtone app in iTunes in December 2016 offering free ringtones, and a premium ringtone app in April 2017 featuring for-purchase remixes of music from chart topping artists. The rollout of these individual apps was done in order to both fully comply with iTunes terms and conditions as well as mitigate risk. The premium ringtone app was also introduced in order to experiment with a paid content monetization capability and to offer tap-to-set ease of use and generate revenues from sources other than advertising. In mid-December 2016, we launched a new ad strategy with our Wallpaper and Ringtones apps, which improved the user experience. Even after these steps, we have not fully recovered from the removal from the iTunes store in February 2016 and, although certain initiatives are intended to grow our user base across all platforms, unless we are able to replicate the prior user experience and functionality, we may never achieve the penetration we saw prior to the removal. Revenue from our iOS app improved 29% when compared the revenue for the three months ended October 31, 2017 to the same period a year ago, but it represents a decline of 68% when compared to the same period two years ago.

*Direct cost of revenues.* The slight increase in direct cost of revenues in the three months ended October 31, 2017 compared to the same period in fiscal 2017 was attributable to the fees that we pay to third parties that provide us with internet hosting, content serving and filtering and marketing automation services. As a percentage of revenue, direct costs in Q1 of fiscal 2018 declined to 14.0% from 15.4% in the same period in fiscal 2017. This decrease resulted primarily from the redesign of our backend infrastructure. In addition, we renegotiated rates with one of our service providers which further contributed to lowering our direct cost of revenues as a percentage of revenues.

*Selling, general and administrative expenses.* Selling, general and administrative expense ("SG&A") consists mainly of payroll, benefits, facilities, marketing, content acquisition and consulting, professional fees, and public company operating costs. SG&A expenses increased 69.2% to \$2.97 million from \$1.76 million compared to the same period in fiscal 2017, primarily attributable to the costs incurred in connection with the Freeform acquire and the severance costs associated with the workforce reduction. For the three months ended October 31, 2017, we spent \$652,000 on developing Zedge's marketplace which launched on iOS as a beta on December 11, 2017. This amount includes the cost of \$465,000 of which \$242,000 was paid in stock for the Freeform acquire. The severance costs incurred in connection with the workforce reduction was \$191,000.

In October 2016, we recorded a \$204,000 receivable from Norway's SkatteFUNN (a government program designed to encourage research and development in Norwegian trade and industry) which related to previous periods. As a result of this tax credit, SG&A for the three months ended October 31, 2016 was lowered by \$204,000 which contributed in large part to the overall increase in compensation expenses for the three months ended October 31, 2017 when compared to the same period a year ago. Excluding former Freeform employees, our headcount was 66 as of October 31, 2017 compared to 59 as of October 31, 2016. This increase in headcount also contributed to the overall rise in compensation expenses after accounting for higher capitalized software and technology development costs.

SG&A included stock-based compensation expense of \$73,000 and \$27,000 in the three months ended October 31, 2017 and 2016, respectively. In September 2016, the Compensation Committee of our Board of Directors approved an equity grant of options to purchase an aggregate of 231,327 shares of our Class B common stock to our executive officers, a non-executive employee and a consultant. The options vest over a three-year period. Unrecognized compensation expense related to this grant was an aggregate of \$681,000 based on the estimated fair value of the options on the grant date. In November, 2017, the Company cancelled 53,026 shares of these options grant because they exceeded the annual limit of 60,000 shares per grantee as set forth in Article 5(c) of the Amended and Restated 2016 Stock Option and Incentive Plan dated October 18, 2017. Simultaneously, the Compensation Committee of our Board of Directors approved an options grant of 53,026 with similar terms. Unrecognized compensation expense related to this options grant was an aggregate of \$85,000 based on the estimated fair value of the options on the grant date.

In October 2017, our Compensation Committee approved an equity grant of options to purchase an aggregate of 124,435 shares of our Class B common stock to 55 non-executive employees. The options vest over a three-year period. Unrecognized compensation expense related to this grant was an aggregate of \$159,000 based on the estimated fair value of the options on the grant date. At October 31, 2017, unrecognized compensation expense related to unvested stock options was an aggregate of \$666,000. The unrecognized compensation expense will be recognized on a straight-line basis over the remaining vesting period of the relevant grant that ends in fiscal 2021.

We granted 192,953 restricted shares to the former Freeform employees that joined Zedge as a result of the acquire entered into in September 2017. These shares vest in four equal annual installments and are contingent upon ongoing employment with Zedge. Unrecognized compensation expense related to this grant was an aggregate of \$369,000 based on the estimated fair value of the shares on the grant date. The unrecognized compensation expense will be recorded on a straight-line basis over the remaining vesting period. At October 31, 2017, unrecognized compensation expense related to unvested restricted stock was an aggregate of \$361,000.

*Depreciation and amortization.* Depreciation and amortization consists mainly of amortization of capitalized software and technology development costs of our internal developers and one consultant on various projects that we invested in specific to the various platforms on which we operate our service offerings.

*Write-off of capitalized software and technology development costs.* In the three months ended October 31, 2016, we decided not to launch a project that was in development. Since this abandoned project did not have any future benefit, we charged the capitalized software and technology development costs for the project to expense.

*Net (loss) gain resulting from foreign exchange transactions.* Net (loss) gain resulting from foreign exchange transactions are comprised of losses and gains generated from movements in Norwegian Krone, or NOK, relative to the U.S. Dollar, including gains or losses from our NOK hedging activities. In the three months ended October 31, 2017 and 2016, we had losses of \$1,000 and gains of \$50,000, respectively, from NOK hedging activities.



*Benefit from (provision for) income taxes.* The change from a provision for income taxes to a benefit in the three months ended October 31, 2017 compared to the three months ended October 31, 2016 was due to the loss that was incurred plus a prior year adjustment in the three months ended October 31, 2017 compared to the income in the three months ended October 31, 2016.

## Liquidity and Capital Resources

### General

Historically, we have satisfied our cash requirements initially through funding by our stockholders, including IDT, including approximately \$3 million in equity financing provided prior to our Spin-Off, and from cash flows from our operations.

At October 31, 2017, we had cash and cash equivalents of \$4.2 million and working capital (current assets less current liabilities) of \$4.2 million. We currently expect that our cash and cash equivalents on hand, and our cash flow from operations will be sufficient to meet our anticipated cash requirements for the next twelve months. We also maintain a revolving line of credit of up to \$2.5 million and a foreign exchange contract facility of up to \$5.0 million with Western Alliance Bank, as discussed below in Financing Activities.

The following tables present selected financial information for the three months ended October 31, 2017 and 2016:

	Three months ended October 31,	
	2017	2016
	(in thousands)	
<b>Cash flows provided by (used in):</b>		
Operating activities	\$ 106	\$ 215
Investing activities	(488)	(349)
Financing activities	-	124
Effect of exchange rate changes on cash and cash equivalents	(35)	15
<b>(Decrease) increase in cash and cash equivalents</b>	<b>\$ (417)</b>	<b>\$ 5</b>

### Operating Activities

Our cash flow from operations varies significantly from quarter to quarter and from year to year, depending on our operating results and the timing of operating cash receipts and payments, specifically trade accounts receivable and trade accounts payable. Cash flow from operations are also impacted by the factors impacting revenue discussed above. Cash provided by operating activities in the three months ended October 31, 2017 and 2016 was primarily due to the revenues generated from our service offerings.

In September 2016, we were notified that the Zedge Europe AS tax returns for 2012 through 2016 were going to be audited by the tax authorities in Norway. The initial audit meeting took place in October 2016 and the audit is progressing. No significant issues have been identified at this time. Amounts asserted by taxing authorities or the amount ultimately assessed against us could be greater than the accrued amount. Accordingly, provisions may be recorded in the future as estimates are revised or underlying matters are settled or resolved. Imposition of assessments as a result of tax audits could have an adverse effect on our results of operations, cash flows and financial condition.

In September 2017, we entered into an Agreement and Release with Freeform Development, Inc. ("Freeform") and certain of its former employees, pursuant to which we obtained releases for the employees from their Freeform employment agreements in exchange for payments by us to satisfy certain of Freeform's liabilities. We paid Freeform \$125,000 in cash to pay its operating liabilities (with any excess to be refunded to us), and we paid the holders of Freeform's convertible promissory notes cash of \$97,567 and issued the noteholders a total of 126,679 shares of our Class B common stock. In addition, we issued a total of 192,953 shares of our Class B common stock to the employees and the employees entered into Employment Agreements with us. The aggregate consideration paid by us in connection with these matters was \$834,000 consisting of cash of \$223,000 and 319,632 shares of our Class B common stock with a fair market value of \$611,000 on the date of issue. We accounted for the payment of the Freeform liabilities, an aggregate of \$465,000, as selling, general and administrative expense in three months ended October 31, 2017, of which \$242,000 was paid in stock and \$223,000 was paid in cash. We will charge the fair market value of the restricted stock granted to these employees of \$369,000 to noncash compensation expense over the four-year requisite service period.

## Investing Activities

Cash used in investing activities in the three months ended October 31, 2017 and 2016 consisted mostly of capitalized software and technology development costs related to various projects that we invested in specific to the various platforms on which we operate our service offerings.

## Financing Activities

We received proceeds of \$67,579 from the exercise of stock options in the three months ended October 31, 2016 for which we issued 48,299 shares of our Class B common stock. In addition, in the three months ended October 31, 2016, we received proceeds of \$56,840 from the exercise of stock options in fiscal 2016 which was recorded as a receivable as of July 31, 2016. No stock options were exercised in the three months ended October 31, 2017.

As of September 27, 2016, we entered into a loan and security agreement with Western Alliance Bank for a revolving credit facility of up to \$2.5 million. Advances under this facility may not exceed the lesser of \$2.5 million or 80% of our eligible accounts receivable subject to certain concentration limits. The revolving credit facility is secured by a lien on substantially all of our assets. The outstanding principal amount bears interest per annum at the greater of 3.5% or the prime rate plus 1.25%. Interest is payable monthly and all outstanding principal and any accrued and unpaid interest is due on the maturity date of September 27, 2018. We are required to pay an annual facility fee of \$12,500 to Western Alliance Bank. We are also required to comply with various affirmative and negative covenants as well as maintain certain financial ratios during the term of the revolving credit facility. The covenants include a prohibition on us not paying any dividend on our capital stock. We may terminate this agreement at any time without penalty or premium provided that we pay down any outstanding principal, accrued interest and bank expenses. At October 31, 2017, there were no amounts outstanding under the revolving credit facility and we were in compliance with all of the covenants.

As of November 16, 2016, we entered into a Foreign Exchange Agreement with Western Alliance Bank to allow us to enter into foreign exchange contracts not to exceed \$5.0 million in the aggregate at any point in time under our revolving credit facility. The available borrowing under the revolving credit facility is reduced by an applicable foreign exchange reserve percentage as determined by Western Alliance Bank, in its reasonable discretion from time to time, which was initially set at 10% of the nominal amount of the foreign exchange contracts in effect at the relevant time. In December 2016, the applicable foreign exchange reserve percentage was changed so that the reduction of available borrowing for major currency forward contracts of less than six months tenor is set at 10% of the nominal amount of the foreign exchange contracts, and for contracts over six months tenor, 12.5% of the nominal amount of the foreign exchange contracts. As of October 31, 2017, there were no outstanding foreign exchange contracts.

We do not anticipate paying dividends on our common stock until we achieve sustainable profitability and retain certain minimum cash reserves. The payment of dividends in any specific period will be at the sole discretion of our Board of Directors.

### *Changes in Trade Accounts Receivable*

Gross trade accounts receivable were \$1.9 million at October 31, 2017 and \$1.7 million at July 31, 2017. Our cash collections during the three months ended October 31, 2017 and 2016 were \$2.6 million and \$2.6 million, respectively.

### *Concentration of Credit Risk and Significant Customers*

Historically, we have had very little or no bad debt, which is common with other platforms of our size that derive their revenue from digital advertising, as we aggressively manage our collections and perform due diligence on our customers. In addition, the majority of our revenue is derived from large, credit-worthy customers, e.g. MoPub (owned by Twitter) and Ogury, and we terminate our services with smaller customers immediately upon balances becoming past due. Since these smaller customers rely on us to derive their own revenue, they generally pay their outstanding balances on a timely basis.

In the three months ended October 31, 2017, four customers represented 33%, 19%, 12% and 11% of our revenue, and in the three months ended October 31, 2016, three customers represented 52%, 15% and 13% of our revenue. At October 31, 2017, three customers represented 44%, 17% and 11% of our accounts receivable balance, and at July 31, 2017, two customers represented 47% and 12% of our accounts receivable balance. All of these significant customers were advertising exchanges operated by leading companies, and the receivables represent many smaller amounts due from advertisers.

## Contractual Obligations and Other Commercial Commitments

Smaller reporting companies are not required to provide the information required by this item.

## Off-Balance Sheet Arrangements

At October 31, 2017, we did not have any "off-balance sheet arrangements," as defined in relevant SEC regulations that are reasonably likely to have a current or future effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources, other than the following.

In connection with our Spin-Off, we and IDT entered into various agreements prior to the Spin-Off including a Separation and Distribution Agreement to effect the separation and provide a framework for our relationship with IDT after the Spin-Off, and a Tax Separation Agreement, which sets forth the responsibilities of us and IDT with respect to, among other things, liabilities for federal, state, local and foreign taxes for periods before and including the Spin-Off, the preparation and filing of tax returns for such periods and disputes with taxing authorities regarding taxes for such periods. Pursuant to Separation and Distribution Agreement, among other things, we indemnify IDT and IDT indemnifies us for losses related to the failure of the other to pay, perform or otherwise discharge, any of the liabilities and obligations set forth in the agreement. Pursuant to the Tax Separation Agreement, among other things, IDT indemnifies us from all liability for taxes of ours and any of our subsidiaries or relating to our business with respect to taxable periods ending on or before the Spin-Off, and we indemnify IDT from all liability for taxes of ours and any of our subsidiaries or relating to our business accruing after the Spin-Off. Notwithstanding the foregoing, we are responsible for, and IDT has no obligation to indemnify us for, any tax liability of ours resulting from an audit, examination or other proceeding related to any tax returns that relate solely to us and our subsidiaries regardless of whether such tax return relates to a period prior to or following the Spin-Off.

**Item 3. Quantitative and Qualitative Disclosures About Market Risks**

Smaller reporting companies are not required to provide the information required by this item.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures.* Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of October 31, 2017.

*Changes in Internal Control over Financial Reporting.* During the quarter ended October 31, 2017, we made changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. To streamline our accounting and finance function while achieving cost cutting objectives, we and IDT mutually agreed to discontinue certain accounting and finance services that were provided by IDT under the Transition and Services Agreement and brought those functions in house. Also in a further effort to reduce costs we have decided to conduct the quarterly evaluation of our internal control over financial reporting ourselves rather than the previous outsourcing of the function to an outside accounting firm.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

Legal proceedings in which we are involved are more fully described in Note 10 to the Consolidated Financial Statements included in Item 1 to Part I of this Quarterly Report on Form 10-Q.

### Item 1A. Risk Factors

There are no material changes from the risk factors previously disclosed in Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended July 31, 2017.

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

None

### Item 3. Defaults Upon Senior Securities

None

### Item 4. Mine Safety Disclosures

Not applicable

### Item 5. Other Information

None

### Item 6. Exhibits

Exhibit Number	Description
31.1*	<a href="#">Certification of Chief Executive Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002.</a>
31.2*	<a href="#">Certification of Chief Financial Officer pursuant to 17 CFR 240.13a-14(a), as adopted pursuant to §302 of the Sarbanes-Oxley Act of 2002.</a>
32.1*	<a href="#">Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002.</a>
32.2*	<a href="#">Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002.</a>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed or furnished herewith.

**SIGNATURES**

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

**ZEDGE, INC.**

December 14, 2017

By: \_\_\_\_\_  
**Tom Arnoy**  
**Chief Executive Officer**

December 14, 2017

By: \_\_\_\_\_  
**Jonathan Reich**  
**Chief Financial Officer**

## CERTIFICATION OF CHIEF EXECUTIVE OFFICER

PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a)  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Tom Arnoy, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Zedge, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 14, 2017

/s/ Tom Arnoy  
**Tom Arnoy**  
Chief Executive Officer

## CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a)  
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Jonathan Reich, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Zedge, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: December 14, 2017

/s/ JONATHAN Reich  

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**Jonathan Reich**  
Chief Financial Officer

**Certification Pursuant to  
18 U.S.C. Section 1350  
(as Adopted Pursuant to Section 906 of  
the Sarbanes-Oxley Act Of 2002)**

In connection with the Quarterly Report of Zedge, Inc. (the "Company") on Form 10-Q for the quarter ended October 31, 2017 as filed with the Securities and Exchange Commission (the "Report"), I, Tom Arnoy, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: December 14, 2017

/s/ Tom Arnoy

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**Tom Arnoy**  
**Chief Executive Officer**

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Zedge, Inc. and will be retained by Zedge, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.



**Certification Pursuant to  
18 U.S.C. Section 1350  
(as Adopted Pursuant to Section 906 of  
the Sarbanes-Oxley Act Of 2002)**

In connection with the Quarterly Report of Zedge, Inc. (the "Company") on Form 10-Q for the quarter ended October 31, 2017 as filed with the Securities and Exchange Commission (the "Report"), I, Jonathan Reich, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: December 14, 2017

/s/ JONATHAN REICH

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**Jonathan Reich**  
**Chief Financial Officer**

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Zedge, Inc. and will be retained by Zedge, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.